

ASX Announcement: 18 August 2011

CEO & CFO on FY Results & Outlook

Open Briefing interview with CEO Richard Allely & CFO Geoff Stephenson



In this Open Briefing[®], Richard & Geoff discuss:

- Cost reductions, efficiency improvements generate profit growth
- New Zealand Transformation Plan to contribute in 2012
- Promising longer term growth opportunities in digital

Record of interview:

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PMP Limited (ASX: PMP) reported a net loss of \$11.3 million for the year ended 30 June 2011, compared with net profit of \$20.6 million in the previous year. EBIT before significant items was \$56.7 million, up 8.5 percent, on revenue of \$1,194.3 million, down 1.5 percent. Given first half EBIT of \$32.2 million, this implies second half EBIT of \$24.5 million, a 9.4 percent increase from the previous corresponding period. Is second half growth indicative of prospective performance in the current year ending June 2012?

CEO Richard Allely

We're very pleased with the 2011 result given some of the disruptions we faced, particularly in the second half, due to natural disasters. The floods in Queensland knocked out one of our paper warehouses, the Christchurch earthquake closed down our plant there for four days, and the tsunami in Japan disrupted production at a major paper supplier, forcing us to turn to European suppliers at a higher cost.

Those impacts aside, we see the second half profit growth as indicative of the year ahead. We're running the business on a lower cost base: notwithstanding the fact we've seen volumes decline in our markets and notwithstanding our revenue was down by 2 percent, our operating earnings were up nearly 9 percent.

We saw some of the impact of the lower cost base flow through in the second half of fiscal 2011 and expect a further flow-on effect in 2012. We also expect to start to see the full year run rate benefits of the New Zealand Transformation Plan from around quarter three 2012. As a result, we expect to have a better 2012 than 2011.

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Significant items for 2011 totalled \$52.2 million pre-tax, with \$25.7 million relating to Scribo impairment and closure costs and \$26.5 million to costs associated with your ongoing

Transformation Plan. Given the closure of Scribo seemed a relatively sudden decision, are there other areas of the business that might be subject to review and/or write-down? When do you expect PMP to return to bottom-line profitability?

CEO Richard Allely

Our balance sheet is clean: we don't have a lot of intangibles and each of our cash generating units has a fair value in excess of its carrying value. Therefore, we don't expect any further write-downs in the short to medium term.

We'd disagree that the closure of Scribo was sudden. We communicated very clearly to the market at the time of our first half result announcement that we were reviewing Scribo because of what we were seeing post the GFC, and we took an initial write-down at that point. Then the book distribution space was severely shaken by major player the Red Group going into administration. Post the Scribo review we took the view that the business wasn't going to recover any time soon and we weren't prepared to run it at a loss.

We expect positive bottom-line profitability in fiscal 2012.

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Print Australia volumes decreased by 2.8 percent to 253,000 tonnes and revenue fell 4.0 percent to \$472.4 million but EBIT before significant items rose 16.0 percent to \$55.4 million. To what extent was the EBIT improvement attributable to improved product mix and to what extent to cost reductions? What scope is there for further Print profit growth in an environment of weak consumer spending?

CEO Richard Allely

The EBIT increase was primarily due to cost reductions resulting from running the business a lot better. Our paper wastage levels were down, our inventory levels were better managed and our throughput speeds and productivity improved dramatically. We were also able to manage freight and logistics and our back-end processes more effectively in terms of on-time delivery and production efficiency. So all aspects of production control and management came together to deliver what we think is a great result in our core business given the lack of top line growth.

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Revenue in the Distribution Australia business was \$90.9 million, up 7.5 percent from the previous year, driven by new contract volumes and increasing market share. EBIT before significant items was \$1.1 million, compared with a loss of \$2.2 million. What has been the basis of your market share gains and what is the ability of the business to grow revenue without significantly increasing its cost base?

CEO Richard Allely

The cost base of this business is relatively fixed in that we have a network that delivers to circa 98 percent of letterboxes across Australia. There are incremental costs for delivering additional items through the network, but the fixed costs don't substantially change: it's a volume-profit business. So, given this is a two-player market and we have a share of around 35 percent, our aspiration is to get closer to a 50 percent share to benefit from those volume advantages.

Over the last couple of years we've invested in and worked tirelessly to create the best letterbox distribution service this country has seen. Our major competitor has also had to lift its game, and today our clients get the best service they've ever received in this segment. Nevertheless, much of the revenue growth we've enjoyed has been because we've priced the service at a level to bring volume to the business. Until our market share reaches a level we're happy with, we'll continue to compete largely on price.

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Gordon & Gotch booked EBIT before significant items of \$3.7 million, down from \$7.5 million in the previous year due to higher freight costs as well as a loss of \$3.7 million by the discontinued Scribo business. With rising competition from international online wholesalers, how can a relatively high-cost business like Gordon & Gotch improve its profitability and remain relevant?

CEO Richard Allely

We don't have huge expectations for growth in this segment largely because we're the only independent distributor of magazines – both domestic and international – in the country, and we're seeing magazine circulation levels decreasing.

Competition from online delivery is increasing but we don't see that as a complete substitute for the printed product: online alternatives can provide content in a different way for some readers but it's not going to replace the printed product overnight.

In this environment the business will need to manage costs really well, recognising that volumes are likely to continue to decline.

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PMP Digital booked EBIT of \$0.1 million, down 96.0 percent, on revenue of \$28.6 million, down 8.0 percent. You've attributed the decline to product mix and reduced volumes. How do you see earnings trending in the current year and how much will new revenue from Dmarketer contribute?

CEO Richard Allely

The review of our growth options we've been conducting over the last weeks brings this division into focus. The PMP Digital business has a number of the products and services we believe are necessary in the digital space and that can be leveraged into a digital marketing services business that could generate substantial growth.

The order book for Dmarketer is filling and we're encouraged by the take-up of the product. We expect to see a positive contribution from Dmarketer in fiscal 2012.

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EBIT from PMP's New Zealand operations was down 13.1 percent to \$4.8 million on revenue \$189.1 million, down 3.3 percent. The EBIT reduction reflected an unfavourable New Zealand dollar exchange rate and weaker local trading conditions at Gordon & Gotch. Can the New Zealand Transformation make a positive contribution to earnings if trading conditions remain subdued?

CEO Richard Allely

Yes. We believe our New Zealand business will be our star performer in 2012. And that's because we're making truly transformational changes to the business. We've largely consolidated our Print sites into one-state-of-the-art, purpose-built site, and that's expected to substantially improve the efficiency and profitability of our New Zealand operations.

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PMP's free cash flow was \$27.1 million in 2011, down from \$40.2 million in the previous year, primarily reflecting a \$4.6 million deterioration in working capital and capex of \$14.7 million for the Transformation Plan. With further Transformation Plan capex of \$13.3 million flagged, as well as spending on a growth program, what is the outlook for free cash flow in the current year?

CFO Geoff Stephenson

The outlook for operating cash flow is positive. There will be some further Transformation Plan capex spend in 2012 as we finish the process, but our operating cash flow position provides a sound base to meet those requirements. In addition, we've completed our debt refinancing, which has extended our debt maturity profile through to September 2014.

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As at June 2011, PMP had net debt of \$141.0 million, down from \$168.1 million a year earlier. Gearing (debt/equity) was 40 percent, down from 45 percent and interest cover for the year was 6.7 times, up from 5.3 times. Given reduced gearing levels, does debt reduction remain a priority? What is your gearing target for the business?

CFO Geoff Stephenson

Our gearing target remains unchanged at between 50 percent to 75 percent debt to equity over the cycle. While we're currently well below that target, we believe this is appropriate given the current volatility in financial markets. In addition, strong cash management is always a priority for us, continuing to underpin our operations.

CEO Richard Allely

We're very comfortable with our balance sheet position, including debt levels, gearing and interest cover, but we also prefer to be conservative in the current environment, and we'd like to see our debt level reduce a little further in the next year or two.

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PMP has declared a dividend of 1 cent per share, unchanged from the previous year. You've also recently announced a resumption of your buyback program, for up to 20 million shares. Together these will distribute about \$6.5 million to shareholders. What factors would prompt a higher level of cash return to shareholders?

CFO Geoff Stephenson

As previously flagged, our dividends are largely subject to the availability of franking credits and for the next few years while we use up our tax losses, our capacity to pay dividends is relatively limited. These tax losses, which currently amount to around \$130 million, should be used up by the end of 2014.

We're still required to pay tax on a portion of our income, even though we've got substantial tax losses. The 20 percent of our taxable income on which we still pay tax enables us to generate franking credits and pay a small franked dividend

CEO Richard Allely

We'll also continue to generate shareholder wealth by investing the cash retained in our business on the Transformation Plan over the next 12 months, and as our debt levels fall, our board is likely to look at other ways of rewarding shareholders.

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PMP has commissioned a management consultancy to develop a strategy for top-line growth. Given the maturity of your markets, to what extent will achieving growth depend on investment in acquisitions or entering new markets? What will be the key goals of any growth strategy?

CEO Richard Allely

As I mentioned earlier, we don't see growth coming from our traditional product markets in printing and distribution. Whilst we think those businesses will continue to produce good earnings for some time to come, the real growth opportunities lie in our Digital business where we already have a good product footprint but very little market share. The work we've been doing with the management consultancy is identifying those product markets where PMP already has either a capability or a relationship that it can leverage with a small investment. Our aim is to grow a suite of marketing service products we can leverage.

We don't see the need for significant investment in this space, and any acquisition would most likely be a small bolt-on to fill a gap in the product suite. Certainly, we're committed to maintaining our balance sheet strength, but we see an opportunity to participate in an attractive growth area.

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Thank you Richard and Geoff.

For more information about PMP, visit www.pmplimited.com.au or call CEO Richard Allely on +61 2 9412 6001.

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