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CEO & CFO on Results & Outlook

Open Briefing interview with CEO Richard Allely & CFO Geoff Stephenson

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In this Open Briefing®, Richard and Geoff discuss:

- Profit reduction reflects volume falls due to cyclical and structural factors
- Outlook for volumes and earnings
- Cash flow and balance sheet to improve now Transformation Plan complete

Record of interview:

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PMP Limited today reported net profit of $4.6 million for the half year ended December 2011, versus a loss of $14.8 million in the previous corresponding period (pcp). EBIT excluding significant items was $23.1 million, down 28.2 percent on revenue of $577.5 million, down 7.1 percent. You expect EBIT for the full year ending June 2012 to be in the range of $43 million to $47 million, implying second half EBIT of $20 million to $24 million, down 2 to 19 percent from the pcp, on weak market conditions and increased competition. Why is the EBIT decline expected to moderate in the second half and what are the key risks to your full year guidance?

CEO Richard Allely
At the back end of the first half we did some restructuring of the business, including redundancies and cost reduction initiatives, and those benefits will flow into the second half. We're also looking at further restructuring, which should also deliver benefits, probably by the final quarter. We think these measures will moderate the second half earnings reduction.

We expect the retail sector to continue to be challenging for us and that magazine printing will continue to decline in the second half. The main risks to our guidance would be around those two markets, particularly if they are worse than we've assumed.

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Print Australia volumes dropped 9.2 percent to 122,000 tonnes, with EBIT before significant items down 23.2 percent to $23.1 million, on revenue of $239.3 million, down 2.9 percent. EBIT margin was 9.7 percent, down from 12.2 percent in the pcp and lower than the 2011 second half's 11.2 percent, generated on significantly lower revenue. To what extent was

this due to price cutting in a more competitive environment? What scope is there for further cost cutting in Print after the recent Transformation Plan?

CEO Richard Allely

It's important to remember that during the half we lost a major publishing contract, Pacific Magazines, to a competitor at a pricing level that for us was uneconomic. Smaller clients of course are chasing similar prices, and with volumes declining across the industry, that translates into pricing pressure.

The Transformation Plan we embarked on last year was primarily in our New Zealand operations; by contrast the Transformation in Australia was quite small. As a result, the opportunity for us to drive more efficiency in Australia is significant.

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What insight do you have into whether the recent weakness in Print volumes is structural rather than cyclical? Will you need to reconsider your Australian press configuration?

CEO Richard Allely

We think there are both cyclical and structural factors at play. Macro conditions aren't strong in publishing or retail, the core of our client base. Clients in those industries are finding it difficult to secure advertising dollars and we see that in reduced pagination. Clients are still printing their magazines or catalogues, but with fewer pages.

At the same time, there's no doubt we're seeing a structural decline, particularly in publishing. That's less so in retail but we are seeing fewer pages in retailers' catalogues. This is an issue for the industry as much as it's an issue for us: we think it will need to be addressed across the industry.

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The Distribution Australia business booked EBIT before significant items of $2.1 million, up from $1.4 million. Revenue was $49.2 million, up 1.3 percent, on flat volumes, with one major new customer won. You've attributed the EBIT improvement to freight and logistics efficiencies and a reduction in employee costs. Are the cost reductions sustainable? With retailers reducing advertising spending, how defensible are your Distribution margins and market share in the nearer term?

CEO Richard Allely

The cost reductions are sustainable: the costs we've taken out are mainly fixed costs, with the exception of freight, which is variable on volume. Certainly the changes we've made to employee costs and logistics are "hard wired" in the business.

Distribution is largely a two player market: we have about 30 percent of the market and Salmat has about 70 percent. In reality, it's easier to maintain 30 percent of a market than 70 percent, and our challenge is to continue to grow our market share. By doing so, we believe we can defend and grow our Distribution margins. This is a fixed cost business: our network of 'walkers' costs the same whether they distribute one catalogue or four catalogues to each letterbox. Therefore, the more volume we can put into that fixed cost structure, the higher the marginal profits.

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Gordon & Gotch booked EBIT before significant items of $1.4 million, down from $2.7 million, on revenue of $185.5 million, down 14 percent. While the business achieved overhead savings through restructuring and the closure of the Scribo book distribution business, volumes were down 8.0 percent and freight costs increased. What is the outlook for volumes? To what extent are costs fixed in Gordon & Gotch and how is the business positioned if magazine circulation remains in decline?

CEO Richard Allely
I believe we've done an excellent job in Gordon & Gotch in continuing to drive out costs in what's been a structurally declining market. The business remains profitable, and we continue to find innovative, creative and in some cases unique ways to do the same thing at lower cost.

However in a declining market, we have to look for ways to drive maximum value from our fixed cost outlay, for example, a truck delivery is largely a fixed cost, so with lower magazine volumes we need to look at what else we can put on our trucks.

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PMP Digital booked EBIT of $0.1 million, down from $0.2 million, on revenue of $14.2 million, down 5.1 percent in soft retail market conditions. What ability do you have to increase volumes in the current environment?

CEO Richard Allely
Our volumes in this business are very much a by-product of how well the retail sector performs. Nevertheless, about 18 months ago we launched a workflow management software application called Dmarketer that gives us the opportunity to tap a wider range of clients in other market sectors, including the finance sector and the corporate and government sectors.

We believe Dmarketer is one of the best workflow management tools in the market. Last month we signed a three-year contract for the software with a major customer and we have a number of opportunities in the pipeline. We believe the future revenue growth and prosperity of our Digital business will come from new products and services of this type.

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PMP New Zealand booked EBIT of $0.5 million, down from $2.8 million, on revenue $89.4 million, down 7.1 percent. First half EBIT was impacted by continuing subdued trading conditions, delays in installation of a new press and higher paper costs. With your New Zealand Transformation Plan completed in January, what earnings benefits are expected over the next six months?

CEO Richard Allely
Our Transformation Plan in New Zealand is expected to deliver some earnings upside in the current second half, primarily in the fourth quarter. Nevertheless, we expect the full run rate of the earnings benefits in the 2013 financial year.

The savings are significant, however some of the upside will be partially offset by the current trading conditions in New Zealand. At present we believe the net impact will be positive, but if trading conditions worsen, there would be downside risk to our New Zealand earnings in the second half.

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PMP had free cash outflow of $12.5 million in the first half, compared with inflow of $25.0 million in the pcp, partly reflecting the impact of lower revenue and capex under the Transformation Plan. What assumptions underlie your free cash flow projection of $13 million (inflow) for the second half?

CFO Geoff Stephenson
Our first assumption is around the volumes in our Print business. We've looked out six months and based our projections on the forward orders we have or are expecting. We're also assuming an improvement in our working capital in the second half. We expect both our inventory and receivables positions to improve.

Lastly, we've taken into account the timing of the capex on the Transformation Plan. These payments were skewed towards the first half and hence we'd expect second half cash flows to revert to more normal levels.

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As at December 2011, PMP had net debt of $153.5 million, up from $141.0 million six months earlier, but you expect net debt to fall to around $140 million by 30 June 2012. Gearing (debt/equity) was 43.3 percent, up from 39.7 percent, and interest cover for the first half was 5.5 times, down from 7.1 times in the pcp. You've indicated that $52.2 million of debt due in May has been refinanced. Given the earnings outlook for 2012, can you comment on how you stand versus your banking covenants?

CFO Geoff Stephenson
We've assessed the impact of our current second half profit expectations on our cash flows and net debt over the period. We expect to be well within our covenants and to have sufficient headroom to operate the business.

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PMP has declared a fully franked interim dividend of 1 cent per share. This is the first interim dividend PMP has paid since 2008. Given your weaker cash position, what is the rationale for re-instating an interim dividend while continuing with your 20 million share buyback program?

CFO Geoff Stephenson
We've stated in the past that our dividend policy is subject to the availability of franking credits. Given the recent tax payments we made, we currently have franking credits available and made the decision to distribute them for the benefit of shareholders. Certainly we've taken into account the impact of the dividend payment on our net debt and interest cover.

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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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