

Wednesday, 26 August 2009

Pacific Brands earnings in line with guidance and transformation on track

Pacific Brands today announced that the company had achieved solid operating earnings and cash flow in challenging market conditions during the 2009 financial year.

Group results

\$'millions	Before significant items and amortisation*	Reported
Sales	2,000.0	2,000.0
EBITA	205.3	(175.2)
NPAT	102.5	(234.3)
EPS (cps)	17.4	(39.9)
Cash flow**	161.9	183.5
Net debt	452.8	452.8

* Before asset impairment, writedowns, restructuring costs and amortisation of acquired intangibles

** Operating cash flow pre interest and tax (OCFPIT)

Pacific Brands Chief Executive Officer Sue Morphet said: "Earnings are in line with guidance and, importantly, the company is starting this financial year with a stronger balance sheet following its equity raising and debt refinancing completed in 2H09.

"Reported earnings in F09 were impacted by a number of significant items not related to ongoing operations. The group booked non-cash asset impairment and write-down charges and incurred restructuring expenses associated with the implementation of the Pacific Brands 2010 strategy.

"In the past six months we have made good progress implementing our Pacific Brands 2010 strategy to transform and strengthen our business model. Our cost base is being restructured through overhead reductions and manufacturing closures, brands have been discontinued and stock-keeping units (SKUs) reduced. New skills and systems are being rolled out across the group.

"In line with our strategy, this has allowed us to devote more resources to our key consumer brands such as Bonds, Berlei, Sheridan, Hard Yakka and King Gee. Despite seeing many markets that we participate in decline in the current economic climate, our key brands have experienced some growth, reinforcing our Pacific Brands 2010 strategy of focusing on our top performing brands. In addition, our B2B contract uniform business has had a successful year and has grown 6%, with new contracts and roll outs including the NSW Police Force and Compass Group in Europe.

"Overall group sales contracted by \$116.6 million as we divested businesses, discontinued brands and due to the general economic slowdown. Excluding divested businesses and discontinued brands, sales in the underlying business were down by approximately 1%.

“Earnings were impacted by volume declines and adverse mix changes as consumers traded down, and by an increase in raw materials and input costs, partially offset by price adjustments. Currency also had an impact on the company’s profitability over the year with imported unit costs increasing sharply from the unprecedented currency volatility in F09. Our hedging program has delayed the impact by six to nine months, however, as anticipated, earnings were impacted in 4Q09.”

Segment results

Underwear and Hosiery sales were down 1.8% to \$625.6 million and EBITA (before significant items) down 7.9% to \$93.4 million. Hosiery, Bonds and Berlei grew but this was offset by declines in Clothing New Zealand and Holeproof.

Outerwear and Sport sales were down 2.3% to \$641.4 million and EBITA (before significant items) down 3.8% to \$56.0 million. Streetwear (within outerwear) and sport segments were up, with workwear flat and unbranded down.

Home Comfort sales were down 13.1% to \$456.0 million and EBITA (before significant items) down 18.3% to \$40.6 million. The tough housing and construction markets, consumer slowdown, and higher fixed cost structures in the manufacturing businesses all impacted profitability. Sheridan and Sleepmaker were adversely impacted by softer consumer demand and Tontine was the standout performer with sales up in all channels. Foams and Flooring grew market share in markets that were down.

Footwear sales were down 7.0% to \$251.9 million and EBITA (before significant items) down 23.0% to \$28.0 million. Footwear sales were down mainly due to the poor performance of Grosby, unbranded and international operations, and profitability was impacted by currency movements. Management is in the process of restructuring the international footwear operations. Branded businesses such as Dunlop Volley, Hush Puppies, Clarks, and Julius Marlow performed strongly.

Significant costs have been taken out in all businesses as the implementation of the Pacific Brands 2010 strategy was accelerated in response to the volatile and softer market conditions. Across the group operating expenses were down \$61.7 million or 8.5%.

In line with the broader market, sales to Supermarkets and Discount Department Stores were stronger than Department Stores and the independent/specialty channel.

Innovation and new product development continued to drive each business. Examples include Bonds’ revamped cottontails, Hard Yakka Women’s workwear, Everlast hydrolast boxing shoes, Tontine’s pure happiness pillow, Uggly Volleys from Dunlop and the new Berlei intimates range.

New capital structure

Pacific Brands equity raising and solid operating cash flow in 2H09 has seen net debt reduce by \$289.9 million to \$452.8 million. Tranche 1 of the debt has been fully repaid, while Tranche 2 has been reduced by \$117.5 million.

Gearing has improved from 2.9x at 30 June 2008 to 2.0x at 30 June 2009 compared with a covenant of 3.5x. Interest cover has declined from 3.5x at 30 June 2008 to 3.2x at 30 June 2009 compared with a covenant of 3.0x as at that date. Interest cover is lower due to the 12 month trailing impact of historic interest expense not adjusted for debt repayments during 2H09. The company now has no significant debt refinancing due until March 2012.

Pacific Brands 2010

The implementation of the Pacific Brands 2010 strategy and the business transformation, which were announced in February, are on track. The cost-out part of the program delivered in excess of the targeted \$5 million savings in F09, is on track to achieve \$50 million of savings in F10 and is tracking towards an annualised \$150 million by the end of F11 with full impact in F12 (based on current market conditions and currency rates, and before any reinvestment).

One-off cash restructuring costs to be brought to account in F09 were originally estimated to be \$79.0 million (\$56.2 million after tax) and have increased to \$104.3 million (\$75.1 million after tax). This is mainly due to costs associated with additional redundancies, the retraining program, plant decommissioning and site make-good. Further one-off cash restructuring costs of approximately \$35.7 million (\$25.0 million after tax) are expected to be incurred in F10 and F11 compared with original estimates of \$15.0 million (\$10.5 million after tax).

The Board believes the payback and shareholder value creation potential of the transformation remain compelling. The Pacific Brands 2010 strategy program has six core themes set out below. The business is accountable for implementing the initiatives, which are being co-ordinated and tracked centrally:

1. Rationalise and focus the portfolio
2. Optimise the revenue base
3. Rebase overhead cost structures
4. Transform supply chain and operations
5. Reduce capital employed
6. Build organisational capability

Implementation achievements during F09 included:

- Divested, discontinued and merged more than 150 brands and reduced SKUs by 10%
- Increased pricing for the first time in many years for some businesses
- Prioritised marketing spend to increase effectiveness
- Decreased the workforce by more than 800
- Re-negotiated more than 50% of China supply volumes
- Closed four factories and part of Nunawading
- Reduced inventory holdings
- Rolled out a 'brand excellence' improvement program
- Introduced new product development processes to the majority of the group
- Implemented new product lifecycle management and financial reporting systems

Four factories, at West End, Queensland; Bellambi, NSW; and Palmerston North and Christchurch in New Zealand, have closed as part of the supply chain and operations transformation. The Holeproof factory at Nunawading in Victoria is part-way through its closure program.

Ms Morphet said: "To assist our departing employees re-enter the workforce, we have worked closely with our unions to develop an extensive retraining and re-skilling program.

"All affected manufacturing workers have been offered retraining and have access to \$3,000 worth of retraining and up to three weeks paid retraining leave while they are still in their jobs, which is over and above any government retraining they may be eligible for.

“We are determined to support our employees and assist them with their transition to new work and new opportunities.”

Speaking of the overall Pacific Brands 2010 strategy, Ms Morphet said: “We are pleased with progress achieved to date on the transformation which will improve the financial performance of the company and position us to achieve sustainable growth in the future. This means being relevant to and engaged with our consumers, and being the must-have business partner to our customers.

“The Pacific Brands 2010 strategy is cementing our position on this path, helping us to build brand excellence into everything we do and optimise a new, stronger core of brands and categories. We still have more to do, including reducing complexity through fewer brands and SKUs, warehouse consolidation, upskilling our workforce and developing our processes. Following implementation of the Pacific Brands 2010 strategy, with a sustainably lower cost base and the appropriate skills and business model, we will be much better able to capitalise on growth opportunities over time.”

Significant items

The company incurred \$380.6 million (\$334.6 million after tax) of significant one-off cash and non-cash expenses to be brought to account in F09. These expenses are comprised of total restructuring costs of \$106.7 million (\$104.3 million in cash referred to above), and non-cash asset impairment and write-down costs of \$273.9 million relating to goodwill, brand names, plant and equipment, land and buildings, inventory and other assets.

Divestment update

Consistent with the Pacific Brands 2010 strategy, the company announced in May 2009 that in response to a number of approaches it had commenced separate processes in respect of potential business, brand and property divestments.

Pacific Brands has executed several incremental brand and property divestments, and will over time divest its surplus property assets to reduce capital employed.

The company will continue with its strategy of rationalising and managing the business portfolio in the best interests of shareholders.

New management structure

Ms Morphet said that as part of the Pacific Brands 2010 strategy, the company had introduced a leaner management system, with five direct reports to the CEO from the key operating businesses and two other direct reports from finance and operations, and human resources.

“The new structure allows the company to be much more agile in responding to market conditions, while keeping the Pacific Brands philosophy of giving our business heads as much responsibility and flexibility as possible,” she said.

Dividend

In the current period, the Board has decided to preserve the company’s capital and continue to reduce net debt. No final dividend will be declared or paid.

The Board will make a decision in respect of future dividends after assessing the company’s operating performance at each half and the outlook at that time.

Trading update and outlook

Since the start of the financial year, trading has been mixed with some businesses performing well and others marginally down on the prior corresponding period. Although the economic environment and outlook remain uncertain, the company notes cautious optimism in the market and recent signs of improving consumer confidence.

F10 is expected to comprise two distinct halves. 1H10 underlying EBITA is expected to be down compared to the prior corresponding period primarily as a result of the full impact of currency volatility in F09 and the roll forward of existing contracts put in place when the Australian dollar was at lower levels. The company expects this to be balanced by 2H10 underlying EBITA, which is expected to be up compared to the prior corresponding period primarily due to the realisation of transformation cost savings.

Consistent with the Pacific Brands 2010 strategy to rationalise and focus the portfolio, reported sales revenue is expected to reduce over the course of the transformation period. Importantly, implementation of the Pacific Brands 2010 strategy is expected to result in a more robust and profitable business.

For further information contact:

Investors

Lisa Pendlebury
Investor Relations Manager
Pacific Brands Limited
+61 3 9947 4926
investorrelations@pacbrands.com.au

Media

Matthew Horan
Cato Counsel
+61 2 9212 4666
+61 403 934 958