

Wednesday, 24 February 2010

Pacific Brands earnings in line with expectation. Transformation on track.

Pacific Brands today announced operating earnings were in line with expectation for the six months ended 31 December 2009 (1H10), with results being impacted by currency compared to the previous corresponding period and difficult market conditions. Underlying sales (being sales of continuing businesses and brands¹) were down by approximately 3.2%. The balance of the portfolio that has been, or is being discontinued was further impacted. The company also announced cash flow and net debt reduction were strong, and its Pacific Brands 2010 transformation strategy remains on track.

1H10 Group results

	Before significant items*		Reported	
	\$ millions	% Change**	\$ millions	% Change**
Sales	960.8	(7.8)%	960.8	(7.8)%
EBITA	80.3	(31.0)%	61.4	n.m.
NPAT	35.5	(39.7)%	22.2	n.m.
EPS (cps)	3.8	(63.8)%	2.4	n.m.
Cash flow***	107.7	290.2%	60.9	n.m.
Net debt	419.1	(48.3)%	419.1	(48.3)%

* Before asset impairment and restructuring expenses

** Percentage change relative to previous corresponding period (ie 1H09)

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

Note: n.m. = not meaningful as prior year was negative

Pacific Brands Chief Executive Officer Sue Morphet said: "As indicated to the market in August last year, our earnings in the first half have been affected primarily by the delayed impact of the sharp decline in currency rates. The impact was caused by historical hedge positions not being fully recovered in price or transformation savings – realised exchange rates will improve in the second half as hedges unwind but are expected to still be below the previous corresponding period. Transformation benefits are expected to have a positive impact on earnings in the second half of the year.

"For the first time in many years we have a cost efficient platform, on which we will continue to build the future of the company. We now have a sound base to take advantage of the new and extended capability sets to grow the business."

¹ Defined as total group sales less sales from divested businesses and brands subject to discontinuation.

Pacific Brands 2010

The implementation of the Pacific Brands 2010 transformation strategy, which was announced twelve months ago, is on track and the company has met all key milestones.

Ms Morphet said: "When we announced Pacific Brands 2010 last year we said it would be an extended 3 year, all encompassing and critically important plan that would strengthen the company and deliver future growth and shareholder value for the long term. We are well advanced with the transformation – but there is still 2 years to go.

"We are beginning to realise the positive impacts of the strategy on the way we do business. We are reducing our cost base, focusing on margin and bedding down new systems and processes across the group. All these measures will ultimately deliver us a stronger more profitable business.

"We are very pleased with progress to date, particularly the way in which manufacturing closures are being managed to plan by our people in close co-operation with our unions.

"The whole company continues to make enormous progress towards the successful implementation of the strategy including the realisation of cost savings and the drive for organic growth in the business" Ms Morphet said.

The cost-out part of the program is on schedule to achieve more than \$50 million of savings in F10 and is tracking towards annualised savings of \$150 million by the end of F11 with full impact in F12 (based on current market conditions and currency rates, and before any reinvestment).

As planned, implementation achievements during 1H10 included:

- Extended and accelerated brand portfolio rationalisation
- Decreased the non-manufacturing workforce by more than 650
- Reduced cost of doing business by \$36 million
- Closed 7 factories and sold another with 3 more to close next month
- Sourced products identical to those previously made locally
- Reduced inventory by \$93 million versus previous corresponding period
- Sold 3 properties for more than \$8 million
- Continued to build capabilities across the group

As part of the supply chain and operations transformation, 7 factories have closed at Nunawading, Bellambi, Cessnock and West End as well as Palmerston North and two in Christchurch in New Zealand. In addition, after the reporting date, Pacific Brands divested its China footwear operations as a going concern, transferring the business and employees to a new owner. By March 2010, through rationalisation and divestment, the Pacific Brands workforce will have been reduced by approximately 3,000 employees.

During 1H10 Pacific Brands has executed several incremental brand divestments, sold 3 properties, divested Icon Clothing, transferred the Merrell footwear business, and subsequent to reporting date has sold the Pacific Brands international footwear business and the China manufacturing operations. The company will continue with its strategy of brand and business portfolio rationalisation and simplification, and disposal of surplus property assets.

Operating performance

For the six months to 31 December 2009 (1H10), total sales revenue was down \$81 million or 7.8%. This was due to aggressive portfolio rationalisation of brands subject to discontinuation (~\$43m of decline), lower Australian underlying sales (~\$24m of decline) and poor underlying international sales (~\$14m of decline).

Ms Morphet said "While brand and business divestments and discontinuations have, as expected, impacted sales, key continuing brands had performed well.

"Our key brands such as Bonds group (up 4%), Mossimo (up 22%), Clarks (up 12%) and Volley (up 6%) have grown, affirming our strategy of focusing on our top performing brands.

"Our continuing portfolio of brands represented approximately 90% of our sales revenue in 1H10 and declined by 3.2% compared to 1H09. Other brands being discontinued declined sharply.

"We saw good growth in the department store and supermarket channels, but there was some softness for us in the discount department store channel and the independent retailer channel was particularly impacted by economic conditions. Beds, Bicycles and Industrial categories were impacted by demand and our international business performed poorly, particularly in the USA and New Zealand.

"The absence of fiscal stimulus packages, higher interest rates, price rises, lower consumer confidence and lower retailer inventory levels adversely impacted sales in many of our categories and channels. All of our businesses are responding to these challenges and we have strengthened the management team through key appointments in critical roles.

"As foreshadowed in previous announcements, operating earnings were significantly affected by the impact of currency on cost of goods sold. The average AUD/USD rate in 1H10 was in the high 60s compared to the high 80s in 1H09. The FX impact was partially offset by price increases and transformation benefits. Significant business, functional and corporate overhead costs have been taken out across the group as the implementation of Pacific Brands 2010 strategy continues. Total cost of doing business was down \$36 million or over 10%. The implementation of manufacturing closures is on track and expected to partially impact 2H10 results with full impact in F11. Operating cash flow was exceptionally strong at \$108 million, with cash conversion of 118% driven by a focus on working capital management with inventory down \$93 million and lower capital expenditure compared with the previous corresponding period" Ms Morphet said.

As is especially appropriate in the current economic climate, Pacific Brands continues to manage its balance sheet conservatively. Net debt was reduced by \$34 million from 30 June 2009, with gearing of 2.2 times and interest cover of 3.6 times at 31 December 2009. Pacific Brands balance sheet is in a substantially stronger position than this time last year with the combined impact of the equity raising and strong operating cash flow reducing net debt by \$392 million from its high point of \$811 million at 31 December 2008 to \$419 million at 31 December 2009.

Segment results

As announced to the market on 16 February 2010, Pacific Brands has introduced a new segment reporting structure incorporating the requirements of AASB 8 Operating Segments and reflecting changes to the group's operating structure implemented in connection with Pacific Brands 2010 transformation strategy.

The Workwear Group has been separated from the previous Outerwear & Sport Group and includes KingGee, Yakka, NNT, Dowd, CTE and Yakka NZ. The Footwear, Outerwear & Sport Group combines the Footwear Group and the remaining businesses within the former Outerwear and Sport Group including Everlast, Slazenger, Dunlop, Bicycles and Brand Collective. There have been no changes to the Underwear & Hosiery, Home Comfort and Other reporting segments (other than a change in the name of the Home Comfort segment to Homewares).

Underwear & Hosiery sales were down 4.6% to \$297.1 million and EBITA (before significant items) down 23.0% to \$34.9 million. Its two largest brands, Bonds and Rio grew but this was offset by the loss of sales from discontinued brands and the closure of the New Zealand Thermals business. New Zealand was also down in line with very difficult market conditions.

Workwear sales were down 7.6% to \$186.5 million and EBITA (before significant items) down 24.9% to \$16.6 million. Sales were down in the first quarter but improved in the second in line with economic conditions and as new B2B customers came on line. Major new contracts won in the half include St George Bank and Asciano. Overall sales were impacted by a slowdown in the construction and mining industries, reduced corporate spending and higher unemployment. Although relatively small to date, Workwear is continuing to grow its uniform business offshore and in October 2009 was awarded Strategic Supplier of the Year by Compass Group UK and Ireland, whom it now supplies with uniforms in seven countries.

Homewares sales were down 10.0% to \$209.7 million and EBITA (before significant items) down 27.1% to \$15.6 million. The more discretionary categories, including beds and branded bed-linen continued to be depressed. Sheridan discontinued a number of minor brands and Tontine was down in discount department stores as private label increased. Industrial sales declined but remained profitable and resilient.

Footwear, Outerwear & Sport sales were down 7.0% to \$262.4 million and EBITA (before significant items) down 45.1% to \$19.1 million. EBITA was most impacted in the group by currency with all product being imported. Slazenger, Volley, Clarks, Grosby and Mossimo all performed well and grew. The group discontinued a large number of minor brands representing almost all of the total sales decline. Own retail stores and the independent channel disappointed. Footwear, Outerwear & Sport was also significantly restructured in the half when it sold Icon Clothing and transferred Merrell to new licensees, and closed down Women's Fashion Footwear and the Boydex outerwear apparel business. Subsequent to reporting date, Pacific Brands has also divested its international footwear business based in the UK and its China footwear manufacturing operations.

The focus on innovation and new product development continued. Examples include Bonds' hipsters revamp and roomies ranges, the New Vintage range by Hard Yakka, Tontine's Summer Cool Quilts range, the Sleepmaker Gel bed and KingGee's very successful workboardie. In its "Steel" range, King Gee also introduced odour-free work garments and Workwear is now using new body scanning technology for optimum fit in new uniform programs for selected major clients.

Dividend

The Board has decided to preserve the company's capital and continue to reduce net debt. No interim dividend will be declared or paid. The Board will make a decision in respect of future dividends at each half having regard to the company's financial position, operating performance and outlook at that time.

Outlook

Although the currently inconsistent trading environment, the cycling through of stimulus packages, and uncertain market conditions make it difficult to predict performance, Pacific Brands is confident that 2H10 EBITA before significant items will be up on the previous corresponding period. This will be primarily due to the realisation of transformation cost savings.

Based on current market conditions and currency rates, earnings momentum is expected to continue into F11 with the benefit of manufacturing closures and other transformation cost savings flowing through.

As previously stated, consistent with the strategy to rationalise and focus the portfolio, reported sales revenue is expected to reduce further 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.

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