SALMAT

# Salmat Half Year Results

# Teleconference Presentation

**Phil Salter**

**Slide 1**

Good morning and welcome to this presentation of Salmat's results.

Thanks for taking the time to join us today on this call. During the presentation, we will be referring to the slides that relate to the media release. They are available on our website for anyone who doesn't have them yet.

My name is Phil Salter and I'm the Joint Managing Director of Salmat. With me, I have Peter Mattick and our CFO Ashley Fenton.

What we intend to do today is:

- Firstly I'll take you through the highlights of the half
- Then Ashley will take you through the financials
- and finally, Peter will talk about what we will be focusing on for the next six months and how we see the full year shaping up.

When Pete has finished we will open up for questions.

OK

**Looking at the Highlights Slide**

Looking at the first half there's been some key milestones we've achieved:

The first one is a 40 per cent return on capital.
Capital efficiency is a critical part of our operating strategy. We are as tough on the use of capital as we are on costs…so this is a great result and an important measure of our success.

We tendered for two financial services contracts in 2003. ANZ and Westpac.

We won both.

This gives us undisputed market leadership in the financial services industry.

Also in December St George Bank voted us their Supplier of the Year. Given the number of suppliers St George have and the bank's leading edge in technology and customer service…this award is a real vote of confidence in our technology and ability to deliver.

**Moving on to the second half of the highlights**

We've talked to you for a while now about the shift we are seeing from mass media to direct media. In the last six months we have had a significant number of non traditional customers move a part of their spend to our Targeted Media division. These have included Telcos, financial services institutions and real estate companies. Car manufacturers and computer hardware suppliers such as Del.

From the ASX release you've seen a continuation of the great turnaround in our Voice business. A massive 145 per cent growth.

In Australia, we have met Telstra's operational requirements and are pleased that they have now given us an extra 40 seats in our Bundaberg call centre.

In the Philippines our partner Service Zone was taken over by ClientLogic. ClientLogic is an international operator with 52 locations in 12 countries throughout North America, Europe and Asia.

Its blue chip client list includes: TiVo, National Geographic Television, Hewlett-Packard, British Telecom, Bellsouth and Sony Corporation.

ClientLogic will help to add depth to our expanding client base in Contact World and will fuel our expansion in this exciting Joint Venture.

All of these developments show you just how serious we are about delivering on our objective of double digit growth over the long term with low risk.

**Ok, let's move on to the Operational Highlights slide**

As you would have seen from our ASX release Salmat once again produced double digit sales and earnings growth.

Sales were up 18 per cent and earnings up 15 per cent.

We had very strong cash flow, up 22 per cent and we are sitting on about $10 million in cash.

The strong cash flow and solid operating performance saw a lift in interim dividend to 5 cents a share, up 67 per cent.

What was pleasing about the result was that we were able to drive sales across the group.

Targeted media was up nearly 18 per cent. Voice up a whopping 145 per cent on the back of the Telstra contracts and other clients, and in a tough market BPO increased sales by nearly 3 per cent.

What that means is that across the company our portfolio of businesses are positioned for continuing growth.

At the same time we have dealt with the challenges thrown to us.

We drove a $1.3 million turnaround in our voice business.

BPO was profitable despite the currency and margin pressure
And we dealt with the issues in Asia.

Let me now ask Ashley to take you through the financials.

**Ashley Fenton**

Thanks Phil.
Good morning.

I'm going to go through a summary of our results, talk about the results for each division, then run through the cash flow performance and balance sheet.

Starting with the Group results.

**[Double digit revenues and earnings slide]**

Once again Salmat has produced a strong result with double digit sales and earnings growth.

While we saw sales rise across the group the majority of the increase came from the standout performance of our Targeted Media division with 18 per cent growth.

As Phil said, the impact of the new Telstra contract comes through our Voice numbers for the first time, with revenue up 145 per cent.

As you can see EBITDA was flat.
That's due to three main factors.

Firstly our corporate costs were $1.6 million higher than the prior year half.
As we have told you at our AGM, we expected these costs to be up because of our first year as a public company, and they were.

They were also up due to higher costs from the implementation of our new financial systems, which went live in January and which will give us much better control over the whole business.

In addition we incurred approximately $600,000 in legal costs defending the WA proceedings.

Secondly, as we also previously flagged, we needed to provide additional loan funds for the expansion of our Voice Joint Venture in the Philippines. The great news here is that the sales of this business have already significantly increased due to some major contract wins.

The flipside is that these wins meant we had to further expand the call centre.
As a result, we have further funded the JV by $2.5 million during the half. As in the past, we have provided in full against these loans until we see solid cash and profit generation so that's contributed an extra $1.1 million of expense.

The final factor in the lower EBITDA was the impacts of pricing pressure and competition on our BPO business and the $300,000 negative foreign exchange impacts of the stronger Aussie dollar on our Asian results.

On the amortisation line, we had a one-off significant item charge for the write-down of goodwill of $1.1 million on our Philippines BPO operations. This followed the loss of a large customer that had been worth about $3 million in sales annually.

Entering into tax consolidation has allowed us to take advantage of $900,000 of tax losses that were previously unrecognised. This has lowered the effective tax rate to 32 per cent - our underlying rate is more like 35 per cent.

Our net capital expenditure of $4.5 million was slightly up on the prior year but at only 2.7 per cent of sales – well below our 4-4.5 per cent guidance level. We still anticipate reaching this level by the full year.

Moving onto revenues which were up 18 per cent.

**[Revenue up 18 per cent Slide]**

Sales were up $25 million across the business. But as you can see here, our Targeted Media and Voice divisions delivered the lion's share.

BPO was up a bit over $3 million and you can see the impact of FX in Asia, a $1.5 million negative.

Going now to the results of each of our divisions.

**[Targeted media slide]**

Targeted Media continues to deliver exceptional growth, benefiting from the shift to direct media. Total revenues were up nearly 18 per cent.

New customers and increased frequency of deliveries saw catalogue volumes up nearly 17 per cent.

What was pleasing about this result was the new customers who have switched part of their media budget to direct marketing.
We saw new customers from the real estate, telcos and financial institution sectors.

And over the last three years this business has had a compound annual growth rate in volumes of over 15 per cent.

Recent acquisitions accounted for less than 1 per cent of revenue growth in the half, so our underlying organic revenue growth was over 16 per cent.

We're pretty happy to have maintained our margins. The benefits of increased efficiences and higher margin targeting contributions have been reinvested in strengthening the network.

**[Voice Australia Slide.]**

Voice is a great story.

The management there have taken a $2.2 million EBITA loss at the last half and cut it back to $700,000.

The Voice division has gained new momentum with total sales up 145 per cent.
This was mainly due to the Telstra contract for inbound work but also driven by some solid organic growth from existing outbound customers.

This improved scale of operations has allowed us to achieve efficiencies that have resulted in the division nearing its cash flow breakeven point.

The level of inbound work as a percentage of outbound increased from 42 per cent in the previous year to 64 per cent. This is a major contributor in our drive towards profitability, as inbound work generally allows better margins and provides a steadier income stream than outbound.

EBITDA and EBITA margins have both increased considerably, and the division is starting to develop the scale required to move into profitability.

**[Voice Philippines slide]**

In the Philippines, our Voice JV is continuing to grow strongly. It is now getting real scale.

The number of call centre seats was more than doubled to nearly 1200 to accommodate contracted revenue.

Major US inbound work drove the excellent revenue growth, with sales up from $1.8 million to $8.7 million. Losses more than halved to $1.1 million.

Funding of $2.5m was advanced to the JV for this expansion and in accordance with our past practice, this has been expensed during the period.

On to BPO.

**[BPO slide]**

As you know the BPO market has been very competitive.

Excluding the impacts of the stronger Aussie dollar on our Asian businesses, revenues still grew by 4.9 per cent.

Organic volume increase and new customers helped grow total revenue in Australia by 7.6 per cent on last year, with mail pack volumes up 11.0 per cent. Three year CAGR in volumes now stands at 8.3 per cent.

It appears there is now some stability in pricing returning to the market.

This is a business we are very committed to ..… we are a serious player ..…have significant scale and technology advantages….and a great track record.
In a very competitive environment we have maintained market share and even grown it.

However, as you can see what was going on in the market did impact our results.

Cost saving and efficiency initiatives achieved during the period of $800,000 helped reduce the impact of lower pricing. However EBITA of $6.9 million was down 9.6 per cent on the previous period as a result of the pricing pressures and higher costs associated with new products and tenders.

Mail volumes in all our Asian markets were lower than the prior year, reflecting the difficult trading environment in this region. EBITA improved by 29 per cent to $1.2 million, despite the lower volumes and the foreign exchange impact. This was mainly due to further realisation of the benefits of prior year restructuring initiatives, an ongoing focus on cost control and lower depreciation.

**[Cash flow and Balance sheet slide]**

Turning now to cash flow performance and the balance sheet.

Our strong underlying business performance as well as a continued working capital focus drove pre-tax operating cash flows up 22 per cent to $18.9 million.

Tax paid increased due to a higher instalment rate and payment of prior year taxes in the period.

Capex, acquisitions and JV funding totalled $8.3 million. Of this, $1.7 million related to payments made for acquisitions.

As Phil pointed out earlier…return on capital employed continues to be very healthy – above the 40 per cent mark.

And, we have a strong ungeared Balance Sheet, with unutilised finance facilities of $65 million and cash reserves of $10 million. This leaves us well placed to execute our strategic growth plan.

And of course, we still have franking credits available in excess of $40 million.

I'll now hand over to Pete.

**Peter Mattick**
Thanks Ashley

**Referring to the Three Year Strategy slide**

Most of you know our strategy.
Put simply, it's solid double digit growth over the long term with low risk.

We aim to continue to strengthen our business through driving organic growth.

Where they make sense, meet our tough criteria and due diligence, we will make very selective acquisitions but let me say clearly, we don't feel under any pressure to do anything.

We've been in business for a long time and we look at a lot of possibilities. We are very careful about spending our shareholders money, particularly when a lot of it is ours!

As you can see from these results we are building on the shift from mass media to direct media.

All companies want to invest their money more efficiently, whether it's capital spend, or advertising spend. That's why more of them are shifting into direct media where they can very carefully target the customers they want and improve the results of their advertising.

They are doing the same in outsourcing.

The second leg to our strategy is sustainability.

We spin off a lot of cash but we are very careful with capital and we have a very conservative balance sheet. This is probably why we've survived 25 years without recording a loss.

As well, we are always driving productivity to improve our results. Particularly with the introduction of new, more efficient technology.

And we have a very easy third leg to our strategy, which is to reward all our shareholders. At then end of this presentation I'll show you our scorecard.

**In the meantime, we'll turn to our key focus areas for the second half of 2004.**

Targeted Media is the fastest growing part of the media.

Salmat is the market leader in this low risk industry.

We produce strong returns and spin off cash with low capex.

We have begun to see the impact of our innovative targeting and data tools. These help drive real value for our customers and we have been pleased with the take up of them.

Our key focus areas over the second half will be:

- Continuing to build and strengthen our national distribution network. This will involve bedding down the recent acquisitions made and implementing new web enabled systems to improve efficiencies;
- Growing our market through substitution from mass media; and
- Further expanding our data capabilities.

As we said earlier, our Voice division is a great turnaround and growth story.

The Australian Outsource Voice industry remains at an early stage of development with approximately 10 per cent of call centres outsourced compared to more than 70 per cent in the US. Our focus is to convert some of these high cost in house call centres to the outsource model.

The Telstra retail contract is extremely important to Salmat and we will continue to strive to meet and exceed all our customer service expectations.

In Asia our focus will be on increasing the number of US inbound customers and driving cost efficiencies. We will do this by working closely with our new partner in the Philippines, ClientLogic. They bring a wealth of international call centre expertise operating 52 call centres globally. Their board and management demonstrate impressive call centre and outsourcing experience, we believe the relationship will be an extremely positive one for Salmat.

**Turning to the Second half FY 2004 BPO slide**

BPO is the leader in the financial services sector. We have worked hard to develop large blue chip clients in this area. This half we won both the ANZ and Westpac bank tenders. We were also successful in winning the American Express' disaster recovery work.

Our primary focus in BPO will be on driving cost efficiencies and bedding down our new customers. In addition, we continue to drive sales through the introduction of new data products and systems. These will help diffuse the pricing pressure currently experienced.

In Asia our local management teams will be working to broaden the depth of our products and grow our customer base.

**Outlook Slide**

Turning to the outlook.

Subject to the normal caveats, the group is confident of a strong full year result. Whilst double digit revenue growth for the second half is expected, the rate of growth is expected to ease slightly compared to the exceptional growth experienced in the first half.

We expect second half EBITA growth to be higher than the first half primarily due to the impact of public company costs, we see net earnings for the full year growing in line with consensus expectations by 20% - 25%.

**Returns to shareholders slide**
Earlier I promised to show you our scorecard on returns to shareholders. So please refer to the last slide.

First let me say this is our anniversary. Next month marks the start of our 25th year in business.

Over the last ten years we've produced compound sales growth of 13.6 per cent and since listing a bit over a year ago we've produced a 107 per cent return for our investors.

Our focus continues to be on growing returns to our shareholders.

-- Ends --