PACIFIC BRANDS

24 February 2011

Solid first half result and resumption of dividends announced despite significant write-offs

Pacific Brands today announced EBITA before significant items was up 30.1% to $104.5m for the six months ended 31 December 2010 (1H11).

The result was driven by improved gross margins from off-shore sourcing benefits and higher foreign exchange rates.

Underlying sales* declined by 2.3% in line with prior guidance as retail conditions remained challenging.

Cash flow continued to be strong, further reducing net debt and facilitating the refinancing of the company's debt facilities on improved terms over an extended period.

As planned, the company also announced the resumption of dividends with a fully franked 3.1 cents per share dividend representing a pay out of approximately 50% of net profit after tax before significant items.

Significant items of $224.1m after tax comprised a $174.8m write-down of the value of the Footwear, Outerwear and Sport business (FOS), plus two previously indicated items, namely the write-down of the Sleepmaker and Foams businesses ($39.9m) and one-off transformation costs ($9.4m).

Group results

$ millions	Before significant items[1]			Reported		
	1H11	1H10	Change[2]	1H11	1H10	Change[2]
Sales	852.1	941.4	(9.5)%	852.1	941.4	(9.5)%
EBITA	104.5	80.3	30.1%	(123.6)	61.4	n.m.
NPAT[3]	58.0	35.3	64.1%	(166.1)	22.2	n.m.
EPS (cps)	6.2	3.8	64.1%	(17.9)	2.4	n.m.
DPS (cps)	3.1	Nil	n.m.	3.1	Nil	n.m.
Cash flow[4]	102.2	112.0	(8.8)%	80.3	65.2	23.2%
Net debt	267.2	419.1	(36.2)%	267.2	419.1	(36.2)%

1 Before impairment charges and restructuring costs associated with the PB2010 transformation program
2 Change relative to prior corresponding period (ie 1H10)
3 Excluding minority interests
4 Operating cash flow pre interest and tax (OCFPIT)
n.m. Not meaningful

* Defined as reported sales less sales from businesses subject to divestment and brands subject to discontinuation

Pacific Brands' Chief Executive Officer Sue Morphet said: "The write-down in relation to the FOS business is obviously disappointing. However, our operating result before significant items was a creditable one in the current market environment and cash flow remains strong.

"We have now completed the cost reduction elements of our Pacific Brands 2010 transformation program which are almost fully realised, 12 months ahead of schedule.

"The revenue benefits of a more focused portfolio and more capable business are also starting to have impact.

"Market conditions remain challenging, but we are well positioned to deal with them and to benefit from any subsequent improvement.

"The resumption of dividends is a key milestone for the company.

"We also recently announced the refinancing of our bank debt facilities, extending the maturity profile of our debt over five years, providing us with greater financial security and flexibility."

Operating performance

Underlying sales in 1H11 were down $17m, or 2.3%, while reported sales declined by $89m, or 9.5%. More than half ($51m) of the decline in reported sales was attributable to prior period business divestments and exits – our footwear business in the UK and China, Icon Clothing and Merrell.

Ms Morphet said: "In the context of challenging market conditions, including a relatively soft Christmas trading period, the modest decline in underlying sales was a reasonable result and in line with previously indicated expectations.

"Some of our key brands are showing the benefits of increased focus and investment, with sales of Berlei, Hard Yakka, Jockey, King Gee, Sheridan, Superdry and Tontine particularly pleasing.

"Gross margins benefited significantly from the transformation benefits flowing from the transition to off-shore supply.

"Operating cash flow remained strong at more than $100m for the half with cash conversion above 90%. This allowed us to reduce net debt by more than $45m or 15% in the last six months despite the seasonal increase in working capital in the lead up to the Christmas period. Gearing is now down to 1.2 times and interest cover is up to 5.5 times."

Segment results

Underwear and Hosiery's reported sales were down 11.5% to $249.2m but EBITA[1] was up 70.8% to $59.6m.

More than half of the decline in sales can be attributed to discontinuation of non-core brands and labels, including termination of the US contract supply business for Lane Bryant and the Playtex license.

Sales were down especially in the discount department stores and supermarket channels, resulting in declines in Bonds, Rio and Holeproof. Temporary supply issues also impacted Bonds' seasonal program. Rio and Holeproof's underwear and children's sock categories were both well down. Berlei, Jockey and Razzamatazz all performed well, including increasing sales to department stores.

Margins improved significantly – through a combination of portfolio rationalisation, off-shore sourcing benefits and improved foreign exchange rates – but are yet to feel the impacts of import and raw material cost increases which will affect results from around 4Q11.

Workwear's reported sales were up 6.6% to $196.5m and EBITA[1] was up 47.0% to $24.4m. Wholesale sales of the industrial workwear business, including King Gee and Yakka, grew due to continued strength in the resources industry and demand from major resellers.

Homewares reported sales were up 8.9% to $224.6m and EBITA[1] was up 32.7% to $20.7m. Sheridan performed well again, gaining market share in a category that performed well with consumer direct retail particularly strong.

Tontine's sales were up, driven by the "Tontine Fresh" campaign, which placed use-by dates on pillows, encouraging customers to change regularly. Margins fell due to up front advertising spend on the campaign and increased raw material prices. Dunlop Flooring domestic sales gained share in a growing market aided by a healthy housing market.

Sleepmaker traded well in an improved bedding market driven by campaign activity with key retailers, whilst Dunlop Foams lost share in a declining and increasingly competitive market. Overall segment margins rose due to an improved sales mix, increased manufacturing volumes and improved foreign exchange rates.

FOS reported sales were down 32.8% to $172.3m, with EBITA[1] down 52.4% to $9.1m. Excluding the impact of divestments, sales and EBITA were down 14.6% and 37.8% respectively.

Premium footwear brands (Clarks, Hush Puppies, Julius Marlow and Naturalizer) were all up. The outerwear business is stabilising and we are investing in our key brands. Clarks and Superdry retail stores opened during the half and traded well in challenging market conditions.

Sport and non-premium footwear sales through the independent retail and discount department store channels were well down. Discount department stores were impacted by de-ranging of brands by some customers. Bikes, Dunlop, Grosby, Slazenger and Volley were all well down as a result. Sport sales were also impacted by inclement weather during the traditionally strong spring/summer period.

Improved exchange rates were more than offset by rising import costs and lower volumes for the FOS division.

Footwear, Outerwear and Sport impairment

The FOS division declined further in the first half. The challenging outlook – especially over the next 12 to 18 months – and execution risk means that at this point there is significant uncertainty regarding the future growth and profitability of the business.

The Board has therefore taken the decision to impair the carrying value of the division by writing off the $174.8m in existing intangible value comprising of $137.1m in goodwill, $28.8m in brand names and $8.9m in other intangibles.

Ms Morphet said: "We expect the FOS business to turn around and remain confident that the restructuring and growth plan put in place by the new management team – including prioritising investment into key brands, reorganising the business and modifying our channel mix – will help stabilise and improve performance. However, we now do not expect to see improvement in the overall FOS business until some time next year."

Other significant items

On 1 November 2010, Pacific Brands announced the sale of its Sleepmaker and Dunlop Foams businesses to Sleepyhead subject to ACCC approval. The assets associated with the two businesses, including an allocation of segment goodwill, have been reclassified as “held for sale” and written down to estimated net proceeds resulting in a $39.9m impairment charge (non-cash, no tax effect).

As previously indicated to the market, there were also one-off period costs associated with execution of the PB2010 transformation program. These amounted to $13.4m pre tax ($9.4m post tax).

The abovementioned items, together with the impairment charge in relation to the FOS division of $174.8m (non-cash, no tax effect), brings total significant items for 1H11 to $224.1m post tax.

Pacific Brands 2010 Transformation

The implementation of the Pacific Brands 2010 transformation program, announced two years ago, should deliver more than $150m of gross benefits in F11.

The cost reduction components of the program are being delivered approximately 12 months ahead of schedule with more than $72m of gross benefits realised in 1H11 alone through gross margin improvement and cost-of-doing-business reduction.

Ms Morphet said: “The main initiatives for cost reductions have now been largely implemented and the benefits are visible in our reported results.

“We are now well into the capability building phase and are seeing our top-line starting to stabilise.”

Debt re-financing

On 1 February 2011, Pacific Brands announced it had finalised an agreement with its existing bank group for the refinancing of its syndicated debt facility with a new $500 million facility. The new facility reflects competitive pricing and improved commercial terms, including an extension of the maturity profile over three to five years. The agreement was subject to customary closing conditions which have all been satisfied and the refinancing has now been completed. At the same time, the Company reduced its securitisation facility by $25 million.

Dividend

In line with indications provided at the F10 full-year result, the company will resume dividends declaring a fully franked dividend of 3.1 cents per share for the half year.

The dividend is consistent with a target payout ratio of at least 50% of net profit after tax, which has been calculated before the impact of non-recurring significant items.

The company’s Dividend Reinvestment Plan will not be offered for the half year dividend and is suspended until further notice.

Outlook

Challenging retail conditions and volatile import costs make it difficult to predict performance in the second half.

The underlying sales movement in 2H11 relative to the prior corresponding period is expected to be broadly in line with that of 1H11 which saw a 2.3% decline. The reported sales movement will also continue to be impacted by divestments and ongoing brand discontinuations.

The key drivers of the 1H11 earnings improvement, being off-shoring benefits and improved foreign exchange rates, will stabilise in the second half. However, earnings in 2H11 are likely to be adversely impacted by soft trading conditions, import price increases (especially due to higher cotton prices which are expected to impact from 4Q11) and FOS performance. Consequently, while EBITA before significant items in 2H11 is expected to be lower than 2H10, the company remains confident that F11 EBITA before significant items will exceed the F10 full-year result.

For further information contact:

Investors

Chris Richardson
Manager, Group Treasury and Investor Relations
Pacific Brands Limited
+61 3 9947 4926
+61 410 728 427
investorrelations@pacbrands.com.au

Media

Matthew Horan
Cato Counsel

+61 2 9212 4666
+61 403 934 958