Chief Executive Officer's Presentation

to the

2014 Annual General Meeting

of

Pacific Brands Limited

Tuesday 14 October 2014

Melbourne

Introduction

Thanks Peter.

Good morning everyone and thank you for attending our AGM.

My presentation today will cover the following:

- Firstly, a summary of our results for the year
- Secondly, I'll cover the operational performance of our four business units – being the Underwear Group, Sheridan Tontine, Workwear and Brand Collective
- Thirdly, I'll take you through the Group's financial results including a review of the income statement and balance sheet
- And lastly, I'll give you an update on our strategic review, Workwear divestment and first quarter trading and outlook for the current financial year

Hopefully this will give you a better understanding of our results for last year and plans for the year ahead.

It will take about 15 to 20 minutes and I'll then hand back to Peter who will chair the formal part of the AGM agenda

Results summary and key messages

- So firstly, moving to the results summary…
- As the Chairman mentioned, we reported a substantial loss in F14 due to significant non-recurring items, most notably the non-cash impairment of the Workwear business recognised at the half
- Reported sales were up 3.8%. This was due to growth in our Underwear and Sheridan Tontine businesses – with Bonds up 20% and the Sheridan brand up 16% which were both highlights for the year
- Consistent with our strategy, we made meaningful progress in shifting the shape of our business, with retail increasing from 14% to 19% of sales, and online growing rapidly from 2% to now 4% of group sales and a much higher proportion of sales for some of our key brands
- Growth in retail and online more than offset lower wholesale sales which were down due to a significant decline in the industrial market, reduced distribution and sales of portfolio brands, and key account underperformance in the discount department store and department store channels

- However, Earnings Before Interest and Tax and Net Profit After Tax before significant items declined, with Underwear and Sheridan Tontine down materially, and Workwear continuing to be impacted by reduced demand from the manufacturing, construction and resource sectors. Brand Collective was up in the second half due to the benefits of their restructuring program, to end the year flat overall but still at near breakeven levels
- As a result, we have accelerated and expanded performance improvement and cost reduction initiatives across the Group
- Working capital levels increased materially driven by wholesale sales underperformance versus plan, investment and growth initiatives, and the inflationary impact of a lower Australian dollar. This along with restructuring costs and lower earnings led to an increase in net debt to $249 million
- Reducing net debt is one of our key priorities for F15. To that end, and as the Chairman mentioned earlier, we have therefore taken the difficult but appropriate decision not to pay a final dividend this year

Operational Performance

I'll now take you through the operational performance of each of the business units starting with Underwear.

Underwear

- Underwear's sales were up 8% with continued strong performance of Bonds which is our biggest brand, up 20% and now accounting for nearly a quarter of Pacific Brands group sales
- Bonds benefitted from range expansion as we continue to innovate and grow, particularly in underwear where you probably saw the Collectibles, Lacies and BOOBS campaigns during the year, but also increasingly in outerwear and activewear particularly in retail
- Retail sales grew significantly, both online which is now 8% of Bonds sales, and in store with 23 additional Bonds stores opened during the year. We also successfully rebranded the Underwear outlet network to 'Bonds Outlet' which improved the performance of those stores
- Bonds wholesale sales were up 4% despite challenges in the Discount Department Store channel
- Berlei sales were also up, but all other brands were flat to down due to key account underperformance and private label penetration, along with the fall in consumer sentiment and generally tough trading conditions
- EBIT before significant items was down 19% due to lower wholesale gross margins driven by promotional and clearance activity, product mix and currency depreciation, and the impact of declines in hosiery and portfolio brands. This was partially offset by price increases and benefits of a shift in mix towards retail and online

Sheridan Tontine

- For Sheridan Tontine, total sales were up 12%. Sheridan is our second largest brand behind Bonds, with significant potential to extend its position as a luxury brand both here and overseas
- Sales were up in retail, online and wholesale. The total number of stores increased by 17 during the year, over half of which were in the UK, largely new outlet concessions in that market. Online was up significantly in branded and outlet sites. The second half also saw the move into broader lifestyle categories including the launch of Sheridan baby and loungewear which you have hopefully seen in store
- Tontine's sales were up overall, particularly in the second half, despite losing Kmart distribution earlier in the year as Kmart continued with its private label strategy
- EBIT before significant items was down 22%, impacted by increased investment in brands, new categories and capability, along with some margin pressure from promotional activity

Workwear

- Turning now to Workwear and noting that we have entered in to a conditional agreement to sell this business to Wesfarmers which I will come back to later
- While international sales were up, this was largely due to the acquisition of IncorporateWear in the UK
- Domestically, sales were heavily impacted by double digit declines in revenue from the Industrial sector, which represented 45% of sales. Imagewear was also down in the second half due to lower indent volumes
- Overall sales were up marginally
- At the same time, we have seen growth in vertical resellers and value players competing heavily on price in the industrial market. These increases in competitive activity have resulted in a change in the shape of the business which has adversely impacted earnings
- During the year we implemented an extensive cost reduction and profit improvement program. The cost savings underpinned earnings during the year, particularly in the second half, and also supported the sale of the business to Wesfarmers
- Notwithstanding, EBIT before significant items was down 41%
- The reported earnings result was a significant loss due to the impairment charge taken in the first half and costs associated with the restructuring program

Brand Collective

- Moving to Brand Collective, sales were down 8% with the vast majority of the decline caused by brands which we exited or discontinued. The Stussy and Naturalizer licences were not renewed, and the business decided to exit the unprofitable Diesel licence
- Sales from key brands were up 9%, particularly Hush Puppies which grew both wholesale and retail sales
- Over the past year we have restructured the cost base of this business unit, and continue to exit underperforming assets and retail stores to mitigate the impact on profitability
- Earnings for Brand Collective have been under pressure in the last few years with a decline in revenue and margins caused by a combination of challenging trading conditions, increasing private label penetration and the loss of key licences. The near breakeven performance of the business led to an impairment of some of its assets, which impacted reported earnings in the period, mainly in the first half
- EBIT before significant items was broadly flat, supported by the significant restructuring program and lower depreciation
- However, earnings and returns from invested capital are still far below required levels and much work is required

Group Financial Results

So that covers the operating performance of our four business units – I'll now take you through the Group Financial Results

Income Statement

- Turning to our summary Income Statement, on the left hand side are the reported results and on the right hand side are the results before significant items
- The key movements that I would like to highlight for you are:
  - Reported sales up 3.8%
  - Gross margins before significant items down 2.1 percentage points to 47%
  - CODB up 5.4% to $531 million
  - And other expenses classified as significant items amounted to $312 million which were largely non-cash

  As a result:
  - EBIT before significant items decreased by 25% to $91 million
  - At the bottom line, net profit after tax was down 28% to $53 million before significant items, with a reported loss of $224.5 million after significant items
  - And dividends per share reduced from 5 to 2 cps in the absence of a final dividend

Group Sales

As you can see from the sales bridge which highlights the key changes year on year by channel, the increase in group sales was driven by direct-to-consumer or retail and online growth, primarily in Bonds and Sheridan

- This was partially offset by a decline in wholesale, mainly in independent accounts driven by industrial Workwear and portfolio brands, and key account underperformance in the discount department store and department store channels
- Reported sales growth was also supported by acquisitions, partially offset by divestments and lost licences. Excluding the impact of these factors underlying sales or organic growth was a lesser 1.9%

Gross Margin

- Turning now to Gross Margin
- As previously mentioned, gross margin declined by 2.1 percentage points to 47% as a result of increased promotional and clearance activity, a shift in Workwear sales towards lower margin channels and the unfavourable impact of the depreciating Australian dollar which particularly impacted the fourth quarter
- These factors were partially mitigated by the positive channel mix effect of growth in higher margin retail and online, as well as increased relative growth in the higher margin businesses of Underwear and Sheridan

Cost of doing Business

- Moving to cost of doing business…
- Total CODB increased by 5.4% to $531 million primarily due to investment in retail with a net increase of 34 stores during the year, mainly in Bonds and Sheridan
- Excluding the impact of retail store expansion, total costs decreased due to restructuring initiatives
- Freight and distribution expenses were up, largely volume driven, and advertising increased incrementally as a result of investment in key brands and online
- This was offset by a reduction in administrative expenses which were down due to the various restructuring and cost control initiatives across the group

So in summary – essentially the higher cost but profitable growth in the retail part of our business, was not sufficient to offset a decline in the sales and margins in the traditional wholesale part of our business which is what we need to balance going forward. We need a sustainable wholesale business supplemented by growth in adjacent categories, retail and international

Significant Items

- Lastly in relation to the income statement, significant items had a material impact on the reported result for the period and consisted of three components:
  - Firstly, impairment charges mainly related to the impairment of goodwill and brand names in Workwear, and other asset write offs in Brand Collective
  - Secondly, costs incurred in restructuring Workwear, Brand Collective and shared corporate functions. Such costs included redundancies, site closures and onerous leases, and will assist with mitigating earnings pressure; and
  - Thirdly, going the other way, the non-recurring profit on sale of the Bonds' Wentworthville site in Sydney as well as a tax settlement refund from the ATO

Balance Sheet

- I'll now highlight some of the key movements in the Balance Sheet at 30 June compared to last year
- Working capital increased by 18% to $309 million due to the significant increase in inventory as noted earlier
- Intangible assets declined by 40% to $350 million due to the impact of the impairment charges relating to Workwear
- On the funding side, net debt increased to $249 million which I will cover in the next slide, and as a result of this and lower earnings our credit metrics were not as strong as they were a year ago

Net debt

- As illustrated in the bridge, net debt increased by $90 million compared to last year due to:
  - Lower operating cash flow
  - An increase in capital expenditure as a result of retail store roll outs and office relocations and consolidations
  - Significant restructuring payments across the group
  - Acquisitions mainly of IncorporateWear, the UK-based corporate imagewear business, and a 50% equity interest in a JV with Iconix; and
  - Dividends paid during the year being the final dividend from last year and the interim dividend from this year
- This was offset partly by property divestments, mainly the Wentworthville sale
- Our syndicated debt and securitisation facilities were refinanced and extended during the year to provide appropriate levels of funding with a staggered maturity profile

Strategic Review and Outlook

- I'll now cover the strategic review that the Chairman discussed earlier

Update on Strategic Review

- The review is now well progressed and our corporate priorities for this year are very clear:
  - First and foremost to restore balance sheet strength, primarily through achieving higher operating cash flow
  - Second, to adopt a more balanced growth and disciplined cost agenda while continuing to invest in our brands, particularly Bonds and Sheridan which have the most potential in terms of category growth, retail expansion and international markets
  - Thirdly, continue to move to a more decentralised organisation model to provide greater end-to-end accountability to operational management
  - And finally, to review and implement portfolio rationalisation options. The Workwear divestment is a key element of this strategy, and we will continue to review other options with a view to simplifying the business and maximising shareholder value
- Individual business unit strategies as previously communicated to the market are largely unchanged at this stage subject to having a more balanced growth and cost agenda in the future

- Moving now to the Workwear divestment…

Divestment of Workwear

- We announced in August that the Company had entered into an agreement to sell the Workwear business to Wesfarmers Industrial and Safety (WIS) for gross proceeds of $180 million
- The ACCC is currently making market enquiries with a public invitation to make submissions on the acquisition. The closing date for these submissions is this Thursday with the provisional date for announcement of the ACCC's findings of Thursday 13th of November. If this timetable is met along with certain other consents and approvals, we expect to complete the transaction before the end of the first half
- Subject to timing, costs of disposal and completion adjustments, the Company expects to recognise a profit on sale of approximately $35 million in F15 – with no tax effect
- An element of corporate and shared services costs related to Workwear will remain following full transition of the business, estimated to be $3-4 million per annum net of savings from other restructuring initiatives which are currently work in progress with a view to minimising this
- Net proceeds are expected to be approximately $175 million after transaction costs and will be applied to reduce net debt to a proforma level of $75 million before restructuring costs
- This divestment will reduce exposure to the challenging industrial market, simplify the business and restore balance sheet strength to the Company

F15 trading update and outlook

Turning now to the F15 trading update and outlook.

- The Company expects a continuation of challenging and variable market conditions
- In F15, sales for the first quarter are up versus PCP
- In relation to 1H15 compared to 1H14 (before significant items and Workwear divestment):
  - Sales are expected to be up due mainly to growth in retail and online
  - Gross margins are expected to be down due mainly to competitive and FX pressures net of price increases and channel mix benefits
  - CODB is expected to be up due to increased investment in retail net of restructuring initiatives
  - EBIT is expected to be down materially (but up on 2H14 which was $36 million)
- Operating cash conversion and net debt reduction will be a key focus, notwithstanding the lagged impact of committed inbound stock flows, first half weighted retail store capital expenditure and the payment of F14 restructuring provisions
- Further cash restructuring costs are expected in 1H15 related to the Workwear divestment and as the Company continues to take action to reduce costs and improve performance

- The timing of the outcomes of the strategic review could potentially have a material impact on the above outlook statement

In conclusion:

- While your management team worked hard during the year and there were highlights, our results overall were far from acceptable and much work is required to improve performance
- Looking ahead – consumer, trade and currency market conditions continue to be difficult, but our strategic and financial priorities for this year are very clear and will help us to take on these challenges
- My key priorities over the next couple of years are to reshape the business and to stabilise performance while laying down the foundations for more sustainable growth in the future
- We will focus investment on our key brands and channels and adopt a more balanced growth and disciplined cost agenda
- I personally feel ready for the challenge and I'm confident that the changes we need to make will make a difference going forward

Thank you again for joining us today and I look forward to meeting you after the formal part of the agenda. I'll now hand back to Peter

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