Fairfax Media

FAIRFAX MEDIA LIMITED
FY15 H1 RESULTS COMMENTARY

SYDNEY, 19 February 2015: Fairfax Media Limited [ASX:FXJ] today delivered its 2015 half-year financial results. Accompanying commentary from Chief Executive and Managing Director, Greg Hywood, and Financial Controller, Carla Webb-Sear, is set out below.

Greg Hywood

Slide 4

Good morning everyone.

Thank you for making the time to join me this morning. Unfortunately, our Chief Financial Officer, David Housego, cannot be with us today because he is at the funeral of his father. Our thoughts are with David and his family.

Our Financial Controller, Carla Webb-Sear, is joining us.

The result we have announced today is a solid outcome. It is the result that we had planned for. There are no surprises.

As we foreshadowed in August, during the half year we made substantial investments in our growth businesses – which include Domain and Events – with $25 million in additional operating expenses introduced in the half year.

Domain is continuing its strong growth with digital revenue up 37.8%, and revenues in our Events business were up 35% year-on-year

Despite investing for the future, we have continued to lower Group expenses. This reflects the continued successful transformation of our business and careful cost control.

Fairfax has reported EBITDA for continuing operations of $162.4 million in the six months to December 2014. Excluding the impact of investment in our growth businesses, earnings have remained stable, in line with the previous corresponding period.

We continue to work hard to realise the full potential of Fairfax's publishing businesses. Our Metropolitan Media publishing business recorded a 20% increase in EBITDA for the half year. Metro publishing costs fell 8% during the period.

We are well into the process of applying the same principles that transformed the operations and performance of our Metro business to our Australian Community Media division.

We now expect to deliver annualised savings of up to $60 million in Australian Community Media by FY16 – our previous target was at least $40 million.

There is a lot of activity, and investment, continuing to take place at Fairfax – I'll have more to say about that in a moment.

We are mindful of the need to both maintain balance sheet strength and reward shareholders in an efficient fashion.

We will pay an interim dividend of 2 cents per share, fully franked, which is consistent with last year's dividend.

In addition, today we have announced details of an on-market buyback of ordinary shares over the next 12 months of up to 121 million shares representing approximately 5% of the company's ordinary shares. The buyback is expected to commence on 23 March 2015. The buyback is being undertaken as part of the company's ongoing capital management strategy.

We were building so much cash on the balance sheet that we thought it appropriate to return some to shareholders.

We retain considerable flexibility to continue to invest – both in our existing businesses and via acquisition – as we continue the transformation of the company.

Slide 5

Turning to group trading performance, Group revenue for continuing operations was $941.7 million, down 2.4% on the prior corresponding period.

Group operating expenses for continuing operations reduced 1.2% to $780.1 million. Excluding investment in new opportunities and some one-time costs, Group expenses were down around 4%.

Lower depreciation and amortisation expenses contributed to underlying EBIT of $128.7 million, down 1.7%.

Net profit for continuing businesses of $86 million was in line with the same period a year ago.

Slide 6

At a divisional level, profitability improvement continued in our Metropolitan Media division during the half year, with EBITDA including printing contribution up 4% on the previous corresponding period, notwithstanding the sale of Stayz.

There was a meaningful reduction in the rate of revenue decline during the half, with total Metropolitan Media revenues down by 2.6%.

On a standalone basis, excluding Domain, EBITDA for the Metropolitan publishing division increased 20% on the prior corresponding period.

By itself, the Domain Group delivered strong revenue performance, with digital advertising revenue growth of 37.8%. Domain.com.au saw revenue growth of 26%.

We have seen some moderation in the rate of revenue decline in our Australian Community Media operations, with welcome signs of stability coming through in retail and local advertising.

We understand the challenges this business faces and have committed to – and are delivering – transformational change across our hundreds of rural and regional newspapers and websites.

Our New Zealand business outperformed a weak local advertising environment, with the business's total revenue down by 4.8% in local currency terms on the prior half. The business ramped up its investment in growing digital revenue and is showing early signs of success.

Radio has stabilised its performance, with EBITDA down 4% compared to the prior period.

For the Group, early FY15 H2 revenue run rate is 2% to 3% below the prior corresponding period.

Slide 7

Before we jump into the divisional numbers, I will talk to some highlights.

Domain is making a strong contribution and successfully delivering on its aggressive national expansion strategy. Agent subscribers were up by 20% and total listings grew by 16% compared to the prior corresponding period.

We acquired the remaining 50% of Metro Media Publishing Holdings that we did not already own, clearing the way for the national roll-out of the agent ownership model which was pioneered in the Victorian market.

As part of the MMPH deal, its foundation shareholders – which include several leading real estate agents – received Fairfax equity, approximately 2.5% of our issued capital. This is a show of support and confidence in Fairfax and our Domain strategy.

Together with the investment in Allhomes and Property Data Solutions, MMPH brings our acquisition investment in Domain to more than $150 million in just over a year.

In December 2014 we announced the merger of Fairfax Radio Network and Macquarie Radio Network. Following completion, expected in late March, Fairfax will own a 54.5% shareholding in an enlarged national radio network including the leading News, Talk and Sport stations in Sydney and Melbourne. The merger creates a genuine national Talk radio network that was not previously available to advertisers.

Revenue in our Events business was up 35% year-on-year, reflecting strong organic growth and the impact of acquisitions.

Fairfax has also partnered with global digital news leader, The Huffington Post, to launch a local edition, HuffPost Australia, at the end of this year.

Slide 8

During the half we invested in Stan, the Streaming Video On Demand (SVOD) joint venture with Nine Entertainment Co. The service launched on Australia Day and early adoption has exceeded expectations. Stan is tracking to have more than 100,000 sign-ups by mid-March.

Our confidence in the transformation program underway in our Australian Community Media business is reflected in our increased cost reduction target, the benefits of which start to fully ramp up from July this year.

Slide 9

Let's now take a closer look at Metropolitan Media, which includes Domain and Digital Ventures.

There was a meaningful reduction in the rate of revenue decline during the half, with total Metropolitan Media revenues down by 2.6%, notwithstanding the impact of the sale of Stayz and merger of RSVP with Oasis Active.

This performance was underpinned by a reduction in the rate of print advertising revenue decline and benefits from our investment in Domain, Events and Digital Subscriptions.

Our Metropolitan Media business is serviced by a flexible and fully utilised printing operation following the closure of Tullamarine and Chullora print sites in 2014. The re-scaling of our printing operations for efficiency – and the adoption of new ways of delivering our journalism and content – has helped sustain our publishing profitability. Metro publishing costs were down 8% in the half.

Slide 10

You can see on this slide, there was a moderation in the rate of decline in print advertising – down 10% in the half, which compares with a 24% decline in FY14. Metro Digital advertising revenue increased 14.8%.

The full detail of our Metro Digital trends can be seen in Appendix 7 of this Investor Presentation.

Total circulation and subscription revenues were up by 2.3%. Print circulation revenue declined modestly, with volume declines largely offset by yield improvements. Digital subscription revenue increased 61% during the half.

As at 9 February, The Sydney Morning Herald and The Age had more than 158,000 paid digital subscribers, and an additional 100,000 eligible print subscribers had signed up for digital access.

Slide 11

Domain continues to power ahead in expanding its national footprint, having invested heavily in sales and product development and successfully integrated several acquired businesses, in addition to moving to full ownership of MMPH.

Growth in the number of agents placing their inventory on Domain gained momentum in the half. We now have more than 9,650 agents on Domain, representing 88% of the agent market. The rate of agent growth almost doubled compared to the preceding six months. Agent growth has supported a strong lift in listings, which were up 16% at the end of the half.

Premium depth products continue to be a driver of Domain's digital revenue and now represent 68% of the business's digital revenue.

Despite significant investment in the aggressive expansion of Domain and the impact of some one-time costs, EBITDA grew 21.7%. Digital advertising revenue grew 37.8%, with total revenue up 27.2% on the same basis.

Slide 12

For the half, Fairfax had exposure to $168 million of real estate related revenues.

The acquisition of Canberra's leading real estate listings business Allhomes for approximately $50 million was completed in October 2014.

Allhomes and Domain are now combined with a single go-to-market strategy and salesforce in Canberra.

Our acquisition of MMPH was completed in late January and simplifies the ownership structure and operations for the Domain Group in Victoria. The agent ownership model has now been introduced in other states. This model allows agents to participate in new state-based entities and incentivises them to use Domain products and services.

We expect to gain significant traction in key markets over the next 12 months as we deepen our relationships with agents around the country and introduce the agent ownership model. The success of the model in Victoria has been closely observed by agents nationally and many are keen to embrace this structure.

Slide 13

This slide shows the impact the investment in Domain has had on real estate agent subscriber growth. During 2014, Domain added 1,592 new subscribers, achieving 88% market penetration, up 10 percentage points year-on-year, with the momentum continuing.

Achieving full market penetration and listings parity provides consumers with greater incentive to use Domain in all markets across all platforms.

In late March we will be holding an investor briefing session focused on Domain.

Slide 14

This is a terrific slide. It shows the rapid growth in our mobile app downloads, which grew 37% during the year and continue to be the most highly rated in the real estate category by independent reviews from Australian consumers.

We have seen significant growth in visits to our mobile sites and apps, with a 40% lift in the half, and a 19% increase in total visits. Around 55% of our visits now come from mobile, up from 47% a year ago.

Slide 15

Our Digital Ventures business continues to execute its strategy of value creation through investment in digital opportunities and managing our portfolio of digitally-focused assets.

During the half we added to our portfolio with a number of strategic investments.

The revenue decline reported in Digital Ventures was due to sale of Stayz and changed accounting for RSVP.

Slide 16

Total revenue for Australian Community Media declined 7.4%, with advertising revenue down 9%. Local and retail advertising revenues were in line with a year ago, and national advertising was only modestly lower, but employment, print real estate and automotive categories remained under pressure.

While we have seen some moderation in the rate of revenue decline, adjusted EBITDA of $56.6 million was down 31.4% on the prior corresponding period.

Cost benefits of the transformation will be seen in FY16.

Slide 17

Our New Zealand business outperformed a weak local advertising environment, with advertising revenue down by 6.2% in local currency terms on the prior half. Weak retail and employment advertising more than offset a strong performance in real estate, motoring, and house and home categories.

Digital momentum was very pleasing, with digital revenue growth of 25%.

Investment in digital product development and marketing, as well as one-off printing transition expenses, resulted in constrained earnings with EBITDA down 18.8%.

Slide 18

This slide underlines the tremendous success Stuff.co.nz has had in gaining audience, achieving 18% growth year-on-year in unique audience as at January 2015.

Slide 19

Turning now to Radio – where performance stabilised during the half. EBITDA was down 4% compared to the prior period.

The business will derive both cost and revenue synergies from the forthcoming merger with Macquarie Radio Network, with the enlarged entity well positioned in a radio advertising market which continued to gain momentum in the half.

Slides 21

Now to the current trading environment.

Trading in the first seven weeks of FY15 H2 saw revenues 2% to 3% below last year. This is a solid performance. Print advertising started slowly in January.

Our focus in the second half is on continuing Domain's momentum, delivering growth options across the business, both organic and acquired, while delivering further sustained cost reduction.

Carla will now take you through the financial results in more detail.

Slide 22

Carla Webb-Sear

Thanks Greg, and good morning everyone.

Before we get into the detail, I thought it would be useful to provide an overview of the impact that the closure of our metro printing plants at Chullora and Tullamarine has had on our reported results. This major initiative is reflected in our financials as follows:

Firstly, our trading performance for continuing businesses excludes a $3 million EBITDA impact to complete the closure of Chullora and Tullamarine.

Secondly, as Greg mentioned earlier, our Metropolitan Media publishing business delivered an 8% reduction in operating expenses which included the benefits from the operational efficiencies of moving into the smaller regional plants.

Thirdly, the depreciation expense in the Metropolitan Media publishing business reduced by around $6 million as a result of the metro plant closures and we expect a similar saving in FY15 H2.

Fourthly, there was a change in the allocation of external printing profits between our Metropolitan Media and Australian Community Media segments. As the businesses now operate out of shared sites, the allocation of external printing profits is based on the printing volumes of each business. As a result, the Metropolitan Media segment saw an increase of $2.4 million in its contribution while Australian Community Media saw its contribution reduce by almost $8 million. The detail of the Printing contribution can be found in Appendix 3.

Finally, the balance sheet now includes the Tullamarine plant as an asset held for sale. Chullora remains within Property, Plant and Equipment given its finance lease remains in place until FY16.

Slide 23

Turning now to Slide 23, the table provides a reconciliation of our FY15 first half result starting from the left hand side with our statutory 4D numbers, with adjustments to show trading performance excluding significant items, and then trading for continuing businesses.

The total significant item after tax of $56.7 million included two major charges. Restructuring and redundancy charges of $38.3 million net of tax largely relates to the restructuring of our Australian Community Media business, which we flagged at the time of our FY14 result.

Total writedowns of $18.3 million after tax included impairment of investments, print assets and finance systems. The detail of these items is outlined in Appendix 5 of the Investor Presentation.

The EBITDA adjustment from trading performance excluding significant items to trading performance from continuing businesses of $3 million reflects revenues and costs associated with the closure of Chullora and Tullamarine as outlined earlier.

On a continuing business basis, EBITDA of $162.4 million was down from $178 million in FY14, largely reflecting the $25 million investment in businesses which Greg outlined earlier.

Turning to items below the EBITDA line, you'll notice that depreciation and amortisation expense declined significantly from $47.1 million to $33.7 million. There were two key drivers of this reduction. Firstly depreciation declined following the closure of our metro plants. Secondly, some software came to the end of its depreciable life and we are investing in cloud-based software systems. A proportion of this is therefore included in our operating expenses rather than depreciation.

EBIT for continuing operations of $128.7 million was slightly down from $130.9 million a year ago, reflecting this depreciation benefit.

Net interest expense for the half increased to $8.6 million from $3.3 million a year ago. You may remember that our FY14 interim result included a one-time $10 million benefit associated with the close-out of interest rate swaps.

Our tax rate for continuing businesses was 28% reflecting continued R&D credits as well as the lower NZ tax rate.

Net profit of $86 million and EPS of 3.7 cents were both in line with last year.

Slide 24

Turning to Slide 24, Greg has already talked through the detail of the segment results, but I wanted to add some commentary about our expectations for the second half.

Within the Australian Metro Media division, the benefits to depreciation and amortisation expense delivered in H1 should continue into H2.

As Greg highlighted, Domain, which is reported within the Australian Metro Media division, undertook substantial investment in the expansion of the platform and we expect similar trends in H2.

Following the acquisition of the remaining 50% of Metro Media Publishing Holdings, we will be consolidating the business from January 2015 having previously equity accounted the business. As you will have seen in the Domain slide, MMPH's associate contribution in H1 was $3.1 million. Had MMPH been consolidated in the first half, it would have contributed $37 million of revenue, around $12 million of EBITDA and $6 million of net profit. Around 68.5 million Fairfax shares will shortly be issued to the founding shareholders of MMPH reflecting the equity component of the transaction.

The other major recent transaction was the Fairfax Radio Network merger with Macquarie Radio Network and, as a consequence, there will be a substantial change in the reporting of our radio division in H2. The sale of 96FM completed at the end of January so will only be reflected in our H2 results for one month. Once the merger with Macquarie Radio takes effect, we will be consolidating the combined business. We expect considerable synergies from the combined business to be delivered in FY16. Given we will own 54.5% of the combined business, there will be an increase in the non-controlling interest.

Corporate EBITDA improved by 15% to a loss of $22 million in H1. This included the $3 million EBITDA impact of closure costs for Chullora and Tullamarine and our $2.4 million share of start-up contribution for Stan, our Streaming Video On Demand (SVOD) joint venture with Nine Entertainment Co.

Going forward, further funding for Stan will be accounted for as a loan. There will be a further minor earnings impact in H2 but thereafter there will be no recognition on our profit and loss until the business achieves profitability. The full detail of corporate expense can be found Appendix 4.

Slide 25

Slide 25 gives you a summary of our cash flows for the half. We spent $62 million on investments which included the acquisition of Allhomes, a number of investments in our Digital Ventures portfolio, and investments in our Events business and Stan. Investment in property plant and equipment was $30 million, mainly related to the Petone print site upgrade in Wellington. We are on track for $60 million of capex for the full year. Restructure and redundancy payments were $21 million and we expect a higher number in H2 as the restructuring of ACM accelerates.

As a subsequent event, we paid out $18.5 million for the cash component of the acquisition of MMPH and received $78 million of proceeds from the sale of 96FM.

Slide 26

Slide 26 summarises our funding position at December 2014. Our net cash position reduced from $68 million to $37 million reflecting the investment undertaken in the half. However there was a change in the composition, with a reduction in both gross debt and cash as

$137 million was repaid on our USPP notes. Our balance sheet remains strong which supports our decision to undertake an on-market share buyback of up to 121 million shares, approximately 5% of the company's ordinary shares.

As we have indicated for some time, our franking balance will be exhausted after the payment of the interim dividend of 2 cents and we viewed a buyback as the most tax effective way to deliver a benefit to our shareholders. We expect any final dividend for FY15 to be unfranked.

Slide 27

Slide 27 shows our current facility maturity following the July repayment of the USPP notes. We have considerable headroom on our current facilities.

Thanks for your attention and I'll now hand back to the operator for Q&A

– ENDS –

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