FAIRFAX MEDIA LIMITED
FY14 H1 RESULTS COMMENTARY

SYDNEY, 20 February, 2014: Fairfax Media Limited [ASX:FXJ] today delivered its first-half financial results for FY14. Accompanying commentary from Chief Executive and Managing Director, Greg Hywood, and Chief Financial Officer, David Housego, is set out below. The comments should be checked against delivery.

Greg Hywood

Slide 4

Good morning everyone. Thank you for making the time to join me, and our Chief Financial Officer, David Housego, today.

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For the six months to 31 December 2013, Fairfax delivered an operating EBITDA for continuing businesses of $178 million, which was 2.3% better than a year ago.

This result shows the first year-on-year increase in EBITDA since June 2010.

Before I dive in, I would like to make some introductory comments.

I would like to congratulate everyone at Fairfax for this result. From the Board to the management team to our people right across Australia and New Zealand who have shown great skill and resilience through an extremely demanding period – your performance is reflected in today's result.

We know that in the media industry revenue remains under pressure. So we can't say that we have turned the corner. But let me say that we are certainly accelerating through it.

Today's result shows a 48.5% increase in net profit year-on-year for continuing businesses.

It shows that the Metropolitan Media publishing division recorded an EBITDA of $81.5 million, up 52% on last year.

It shows that our absolute determination to become more efficient and simplify our business through our transformation program is having the result we planned. Total annualised run-rate efficiencies achieved through to December 2013 stood at $260 million, with an expected EBITDA contribution of around $238 million for the 2014 financial year.

As we progress with the transformation of our business we continue to identify savings over and above our original targets. These additional cost savings are expected to drive future earnings performance.

The increased profit announced today is a great achievement and a result that some thought could not be delivered. The conventional wisdom some years ago was that, because reductions in print advertising could not immediately be offset by increases in digital revenue, traditional media companies faced a bleak future.

What we have shown is that by a mixture of efficiencies and a commitment to drive revenue through different streams, we are transforming this business. The effects of this transformation are evident right across Fairfax. While we have reshaped some activities, we are operating an at-scale, high quality multi-platform media business across Australia and New Zealand, and doing it significantly more profitably.

We have made decisions to balance revenue and cost with a focus on growing profits on a sustainable basis.

We are running this business for profitability and improving the core of what we do: high-quality journalism and content.

You can see in our Walkley Award recognition and the Royal Commissions and ICAC inquiries triggered by our investigative journalists that our impact has never been greater.

At Fairfax we have highly experienced journalists and through our transformation are giving opportunities to a whole new generation of talent. We have journalists coming through who are as good as any who have come before them and they are delivering great journalism across all forms of media.

We refreshed leadership across our mastheads. We have taken the same approach to our sales, marketing and operational functions, where we are rethinking all aspects of the traditional media model, and giving our people the opportunity to create and innovate.

The numbers tell the story of our success.

Fairfax reaches an audience each month of 10.2 million Australians aged 14-plus, as measured by the accepted industry metric, ‘emma’, which also shows that The Sydney Morning Herald is the nation’s No. 1 – the most read masthead across all platforms.

The changes that we have made over the recent years have made the company better in every sense.

We are unique in this industry. We are taking our people, our investors and our readers through the details of this transformation in a transparent and open manner.

I will talk in greater detail about each of our divisions in a moment, but one highlight was Domain’s online revenue growth – up 33%. Domain’s total digital EBITDA was up 50%.

In our publishing businesses, the impact of cost reduction is either substantially offsetting – or more than offsetting – revenue declines.

As we go through our transformation we are pursuing profitability. In some instances we are forgoing revenue, but only if it means we will become more profitable.

Metropolitan Media’s EBITDA turnaround underpinned the Group’s profit growth, and we believe the business is making significant headway in a demanding market environment. While the division recorded a like-for-like revenue decline of 7.1% this is partially attributable to product closures and strategic portfolio repositioning.

EBITDA was flat in New Zealand in local currency – a solid result – with an 8.1% decrease in costs offsetting an underlying 4.3% revenue decline.

The Australian Community Media (ACM) result was disappointing. Revenue was down 12.4% on a like-for-like basis, and despite substantial cost reductions, underlying EBITDA was down 17.4%.

Drought in the eastern states and a downturn in resource sector activity aren’t helping this business. There are a range of initiatives underway in ACM as we respond to the operating environment – and we've now brought them together in a co-ordinated review that will be completed later this financial year. We're preparing to make more substantial structural change in this business.

Turning briefly to Radio, we've been making significant changes on the sales and programming side and we are looking for traction to build in the second half.

On a like-for-like basis, Fairfax Group revenue declined 5.5% after adjusting for the extra week's trading in FY13.

Trading in the first five weeks of the second half of FY14 saw revenues 3% below the prior year. This is an improvement on the trend in the first half.

Slide 6

Now to our new revenue initiatives – and you will recall that I talked about these in some detail with the full-year result in August.

Good progress was made during the half year.

Digital subscriptions for The Sydney Morning Herald and The Age continue to track well ahead of expectations, now with more than 116,000 paid digital subscribers, and an additional 100,000 eligible print subscribers who have signed up for digital access, as at February 9th.

Digital subscriptions have contributed almost $10 million of revenue in the first half.

Our Events business already generates close to $30 million in revenue and is being taken to the next level. Andrew McEvoy – former Tourism Australia MD – has joined us as Managing Director of Fairfax Events and is leading the geographic expansion of key platforms including Food and Sport.

Our Content Marketing business, led by Simon Smith, is attracting significant interest from major corporations and has a strong pipeline of activity.

Our SME Digital and Marketing Services business was rolled out during the period when we entered into an arrangement with US publisher Hearst to bring their LocalEdge marketing services solution to Australia. We're now in seven markets with our offering, and momentum is building.

We are progressing our Data strategy, and in active discussions with potential partners, as well as having positive commercial discussions with a number of Australia's largest advertisers.

Antony Catalano is firmly in the seat as CEO of our Domain business. Domain's premium depth products have revolutionised its business over the last two years. Agent subscribers continue to grow, totalling more than 8,000, up 19% from a year ago.

Slide 7

The Group's expenses for continuing operations reduced 9.2%. On a like-for-like basis and adjusting for the extra week's trading, costs were down 6.8%.

In August we told you that we expected full-year costs to be around $1.6 billion. On the current run rate of cost reduction, inflators and reinvestment plans, we now expect to deliver costs below that.

Our Fairfax of the Future cost savings program continues to deliver against its objectives and targets, finishing the half with annualised run-rate savings of $260 million. We continue to identify further operational cost savings.

During the half we divested a number of businesses, including the Stayz Group at almost 17 times EBITDA, which was a pleasing result as this business was experiencing emerging global competition in the domestic market. These asset sales meant that Fairfax finished the half year with net cash of $80 million.

On the back of these results, it is pleasing to have been able to deliver an interim dividend of 2¢ per share, fully franked, which is double the interim dividend a year ago. This reflects the improved operating environment.

Slide 8

Before we get into the detail of results across the business – here is a snapshot of the Group numbers.

Underlying EBITDA performance excluding significant items for the period was $184.4 million. This included a $6.4 million contribution from the businesses that we sold during the period – FRG Asia, InvestSMART and our travel businesses Stayz and Occupancy.

EBITDA for continuing business was therefore $178 million, which was 2.3% higher than a year ago.

Slide 9

This slide gives a picture of our digital revenue across the Group – showing that digital revenue has increased from 7% of Group revenue in 2007 to 16% this period.

Group digital revenue increased almost 5% on the prior period.

Digital subscriptions and the strong growth from Domain online contributed to the result, which was somewhat offset by the change in strategy for Drive and MyCareer, one month less revenue from Stayz, and an accounting change for internal digital traffic.

Further detail can be found in Appendix 14.

Slide 10

The next six slides address our Metropolitan Media division.

Behind this turnaround is the profound success of the circulation strategy we initiated two years ago. At the core of this was the notion that the relevant measurement metric for newspapers was not circulation – which was just a production metric – but rather readership.

We took an approach that said we wanted a business that reflected the people who read and bought our newspapers. We deliberately took our circulation down to reflect that reality. We did so through changes in pricing, reductions in production and changes in format.

These changes will enable us to later this year shut Tullamarine and Chullora which were operating way under capacity. Let me emphasise the point that we still have strong market share in readership and print advertising.

This is counter intuitive to the way this industry has operated for generations, and has been misunderstood by some, but as this result shows has been profoundly successful.

You can see underlying circulation revenue growth of 9.6% reflects our strategy to lift yield in print. I noted earlier our digital subscriptions performance.

And you will note the cost outcome – a 17% reduction to $362 million.

Improved profitability from Metropolitan Media was a highlight for the half year with EBITDA of $81.5 million, up 52% on the previous corresponding period. This performance demonstrates the effectiveness of our initiatives to transform and simplify the business, amid a prevailing operating environment that continues to be demanding.

The adjusted EBITDA margin lifted from 11.3% to 19%.

Slide 11

Domain is accelerating its growth and successfully managing the migration from print to digital.

Domain's online revenue grew 33%, driving digital EBITDA growth of 50% as margins expanded.

Tight cost control across the print and digital operations contributed to a 33% increase in Domain's EBITDA to $29.4 million.

Our EBITDA margins have expanded by almost 10 percentage points, which is driven by both our digital and improving print margins.

Depth products now contribute 60% of digital revenue. Our market-leading mobile apps continue to be a source of differentiation, with 60% of all visits to Domain now coming from mobile devices.

Domain continues to increase its penetration across Australia. The number of real-estate agents placing their inventory on Domain is up 19% from a year ago and represents 79% of the agent market nationally.

Slide 12

This slide provides a snapshot of Domain's performance, including recent organisational changes, and the acquisition of Property Data Solutions. We expect this acquisition to have meaningful cost and revenue synergies with our existing Australian Property Monitors business.

Slide 13

Digital Ventures EBITDA increased by 10%, despite the inclusion of Stayz for only 5 months.

We are actively repositioning our RSVP online dating business to withstand competitive pressures.

We are pleased with the performance of other businesses, particularly Weatherzone.

Slide 14

Following the sale of Stayz, Fairfax maintains an extensive portfolio of digital-focused assets, as you can see from this slide.

Slide 15

We are managing our digital portfolio for value by building, growing and investing in digital businesses that fit our strategy, including actively seeking out international and local partners.

Recent investments include a minority stake in Sydney-based digital health services company Healthshare and an Australian joint venture with leading international job search engine Adzuna.

Slide 16

Our Australian Community Media business includes our regional, communities and agricultural publishing businesses. FCN NSW and ACT Publishing now also form part of this division following recent organisational changes.

ACM was hit hard by the severe drought that has affected agricultural regions in the eastern states.

A pullback in mining-exposed markets is evident in the numbers, with weaker employment also a factor. We also saw reduced federal government spending and lower spend from national brand advertisers.

As I said in my introduction – we see significant further opportunity for cost reduction through reshaping the operating model in ACM, and we will have more to say about this at the full-year result in August.

The piloting of a new newsroom model – called NewsNow – at the Bendigo Advertiser has provided us with some useful guidance on how to achieve significant growth in digital audiences in our regional areas.

The more progressive newsroom structure, new systems and ‘digital first’ editorial production practices resulted in significantly improved digital publishing capability and performance while maintaining newsroom focus where it should be: on the journalism and local reporting.

This is just one example of the tremendous upside of our transformative initiatives in the ACM business.

Slide 17

Turning to our New Zealand business, where underlying revenues were down 4.3% on the previous corresponding period but EBITDA – in local currency terms – was flat due to substantial cost reductions.

Advertising revenue received some benefit from local government elections while auto and property advertising stabilised – although we saw weakness in a number of other categories, including employment.

Slide 18

Our Radio business was coming off a strong 2013 result, and the half-year result was affected by the substantial improvements we’ve been making in the business.

Management has restructured sales teams in Sydney, Brisbane and Melbourne, and has also put in place substantially new programming line-ups, which became effective in January.

We expect that tangible traction from the changes made over the last six months will be evident by the time that we report the full-year result in August.

Slide 20

As I mentioned earlier, trading in the first five weeks of the second half saw revenues 3% below last year, an improvement on the 5.5% like-for-like decline in the first half.

On the current run rate of cost reduction, inflators and current reinvestment plans, we expect to deliver costs below $1.6 billion for the full year.

I will now hand over to David Housego to take you through the financial results in more detail.

David Housego

Slide 22

Thanks Greg.

Like Greg, I am really pleased with the progress this result demonstrates.

The business is making solid progress with the transformation; cost discipline is apparent; and the numbers show the benefit of managing each business for profitability.

We expect to deliver costs below $1.6 billion in FY14 with the existing Fairfax of the Future program on track to deliver around $120 million of EBITDA benefit in this year to give us n cumulative run rate of $238 million, and well on track with previous guidance.

Some of the major Fairfax of the Future initiatives have included the rollout of the call centre program, additional outsourcing of ad production and optimising our real-estate footprint.

We will expect some additional costs around building capability across the new revenue areas in H2 as well as completing a number of the Fairfax of the Future initiatives.

We announced the sale of Stayz in December for approximately $220 million, a 16.8 times FY13 EBITDA multiple, and a great return on the $43 million we had invested in the business.

You will note a profit on sale of $106.7 million, which includes a write-off of allocated goodwill of $95 million. Due to tax accumulated losses we expect a tax payment around $6 million on the gain.

The deleveraging of our balance sheet has given us opportunities for capital management, reduced our financial risk through providing the necessary financial support as we continue our transformation, and puts us in a strong position to be able to invest across the business where opportunities arise. A good example of this is the $30 million investment in Property Data Solutions to support the Domain data offering.

We have doubled the interim dividend to 2 cents per share fully franked.

The performance of Australian Community Media will remain a significant focus in H2 along with Radio.

We will start full implementation of our plans around the performance of our new revenue initiatives, capitalise on the strong opportunities for growth of Domain, and extend our Digital Ventures footprint into areas that make good strategic sense for us.

Slide 23

Our segmental breakdown of revenue and EBITDA is outlined on Slide 23.

As we indicated at the time of our full-year result, our community titles in FCN NSW have moved from the Metropolitan Media segment to the Australian Community Media segment. We have also moved ACT Publishing from the Metropolitan segment into ACM in line with our new organisational structure.

Appendices 6 and 7 provide the FY13 and FY12 full-year financials for Metropolitan Media and ACM on the same basis.

You'll note that corporate expense has increased compared with the first half a year ago. This reflects some costs that we are now holding in the centre that are associated with the transformation and restructure and also costs associated with the development and initiation of the revenue adjacencies.

The full reconciliation of our Group Trading Performance as reported in our 4D to the performance for continuing businesses can be found in Appendices 1 and 2.

Slide 24

Turning to slide 24, you will see the reduction in our net debt position over the past 12 months, and we finished the half year with a net cash position of $80 million.

Our net interest expense fell to $3.3 million in the first half. As we indicated at the time of the full-year result in August last year, as part of the redemption of the fixed US Notes we booked a profit (both accounting and cash) relating to the close-out of the associated interest rate swaps. This amounted to approximately $10 million before tax which was applied against interest expense in the first half. On an after tax basis the gain was $4.6 million. Interest is also down reflecting the lower debt position through the half. We now expect net interest expense of $10 million in H2.

Slide 25

The summary of our cash flow is outlined on slide 25. The business generated a trading cash flow of $154 million in the first half.

We paid out $34 million in restructuring and redundancy payments in the first half and we expect to pay out the balance of the provision of $55 million in FY14. This largely reflects the closure of Chullora and Tullamarine print operations.

Our investment in property, plant and equipment totalled $32 million in the first half, and budgeted capex remains around $70 million for the full year. This includes approximately $40 million for upgrades to the North Richmond and Ballarat print sites which will be completed in the year with the upgraded facilities supporting the weekend compact editions.

We spent $38 million on a number of acquisitions and investments in the first half including Property Data Solutions, Healthshare and Adzuna.

Slide 26

Slide 26 shows our current facility maturity schedule following a refinancing which we anticipate to complete today. This will extended our bank facilities into a $275 million facility with a 3 and 4 year tranche to February 2017 and February 2018. The next significant maturity is one of the US notes maturing in July 2014 totalling $125 million.

Thanks for your attention and we'll now open up for questions.

– ENDS –

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