FAIRFAX MEDIA LIMITED
2013 RESULTS COMMENTARY

SYDNEY, 22 August, 2013: Fairfax Media Limited [ASX:FXJ] today delivered its 2013 financial results. 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

Good morning everyone,

Thank you for making the time to join me, and our chief financial officer David Housego, today.

I'd like to welcome all of our shareholders and analysts that cover Fairfax. And we welcome our friends from ASIC who are joining us today as part of their information gathering on market briefings.

Before we turn to the detail of the numbers I will make a few introductory comments.

Today's results, and this presentation, show you how Fairfax is continuing to lead the change in the media sector.

In these tough times this media company will not blink. We are staying on course with a stable and highly effective management.

We're doing this right across our business – responding to difficult conditions by transforming our operations and the way we engage with customers and audiences. In our traditional publishing business we're pulling the levers hard to reduce costs. We are also investing in digital and new business growth.

It's a necessary part of our evolution that there will be plenty of talk of our cost reduction programs today. However, leading the change means a great deal more than being good at cost cutting.

Starting today we will be telling you more about what we're doing to build new revenue opportunities, new businesses. While it is inevitable that the changes in our industry will put continued pressure on traditional revenues, we have a running start at a range of exciting opportunities.

This morning I will tell you about some of the initiatives that sit adjacent to our existing activities. As we pursue these, the values that have underpinned Fairfax for more than 180 years, the capabilities of our people, and our relationships with audiences and advertisers will prove just as relevant in today's digital age as they have been throughout our history.

Turning now to the 2013 financial year… Our commitment to leading the change is reflected in the critical milestones that we have ticked off since the beginning of the calendar year.

In March we launched the compact weekday editions of The Sydney Morning Herald and The Age – a necessary step to enable the planned rationalisation of our printing footprint in 2014, and executed without our publishing business skipping a beat.

In April we announced an organisational restructure to create our new Australian Publishing Media division – a far more efficient structure for managing our Australian print and digital publishing businesses.

We also announced the formation of the Digital Ventures unit, which is already providing a better structure for our digital transaction businesses, and for reviewing new digital opportunities aligned with our core business.

And in July – just two days after the end of the financial year – our new digital subscriptions for The Sydney Morning Herald and The Age went live. As we will discuss in a few minutes – the early signs are very promising indeed.

All the while – the projects that contribute to our Fairfax of the Future program are tracking ahead of schedule. More on that, too, in a moment.

But first, you will have seen that we have announced a statutory loss of $16.4 million while underlying profitability was in line with expectations. The statutory loss includes print asset and intangible impairments of $444 million in the Regional, Printing and Agricultural operations in the second half.

David Housego will talk about the basis for the impairment charges in his presentation.

As I said a moment ago, on an underlying basis the result is in line with guidance we provided.

Group revenue declined by 8.2%, on a statutory basis, which translated to an operating EBITDA of $366 million. Including only continuing businesses, underlying operating EBITDA was $316 million.

On a like-for-like basis, revenue performance varied considerably across the Group. Metro Media recorded a 9.5% revenue decline while Regional was down 7.5% and New Zealand was down 4.7%. Good growth was recorded from the Broadcasting business – up 8% – while Domain's digital revenues were up 16%.

Underlying EPS for continuing businesses totalled 4.6 cents, which compares with 6.2 cents last year. The final dividend of 1 cent per share, fully franked, is in line with last year, bringing the total dividends for the financial year to 2 cents per share.

In this environment, responding to structural change and cyclical downturn has been, and will continue to be, our greatest priority. And we are making good progress.

We're pleased to update you on the continued transformation of our business. David Housego will provide an update on the Fairfax of the Future program, and his perspective on our cost initiatives now that he's been with us for around eight months.

David will talk in detail about the numbers, and you will see that the benefits of the program are increasingly coming through in our results. Without Fairfax of the Future, the EBITDA result announced today would have been $118 million lower than the $316 million recorded by our continuing businesses.

By the end of June, Fairfax of the Future savings had achieved annualised run-rate savings of $193 million as we head towards our June 2015 target of $311 million in total annualised savings, which includes the additional cost savings announced in June.

After adjusting for the impact of the 53rd week, some one-off expenses in the corporate segment and changed accounting treatment of newsagent delivery fees and radio production costs, Group expenses were down 6% for the financial year.

At times like these – having a strong balance sheet is a pre-requisite to support necessary organisational change. Strengthening the balance sheet has been a focus for us over the last couple of years, and proceeds of earlier business disposals were applied to partial redemption of our USPP notes in the second half. Net debt totalled $154 million at June 2013, which is $760 million lower than the same time last year.

Net debt now represents just 0.4 times EBITDA.

Just as significant as the dollar value of cost savings targets is the effect of our transformation that you can feel and see if you walk around Fairfax and talk to our people.

We've completely changed the working environment in Sydney and Melbourne to use our space more efficiently. While this will save $32 million over four years, we've also created a better and more collegiate working environment.

We have completely revolutionised editorial and production – producing content throughout the day and night far more efficiently than ever before.

And there's plenty more change to come.

In the weeks since the Investor Day in early June, great progress has been made with streamlining middle management and sharing services as we deliver the benefits of reduced duplication that naturally flow from the formation of the Australian Publishing Media division.

There's also plenty of activity in the new Digital Ventures unit which houses our digital transaction businesses including Stayz and RSVP. We're grateful to Daniel Petre and Alison Deans for the role they have played in steering the formation of Digital Ventures, and reviewing each of our digital businesses over the last nine months. We've now appointed Guy Reypert – who worked with Daniel and Alison at Netus – to build upon this early work and take executive leadership of Digital Ventures.

You would also recall that we announced a Product Review at the Investor Day – a step-by-step review of what we produce, what we do ourselves and what we can do differently. This is a major exercise. Fairfax publishes 431 publications, 337 websites, we have 7 radio stations and almost 100 apps. While it's too early to make any announcements in relation to the outcomes of this review, the opportunities for cost savings are substantial. We will have more to say at the Annual General Meeting in a couple of months.

Another benefit of the new organisational structure is that the company is now more agile. The Fairfax strategy is increasingly focused on new revenue opportunities – we've got a hunger to pursue them, and we're well-placed to do so.

In early July we launched domestic digital subscriptions for the SMH and The Age. As we look towards a predominantly digital future, this is an important long-term project. In this context, the data should be treated with some caution as we haven't experienced the full impact of early churn. That caveat aside – we recorded half of our first year budget for paid subscribers in the first month, with minimal impact on total visitor numbers to our websites. About a third of our total paid digital subscribers are iPad-only.

Digital subscriptions are just the first of a number of revenue opportunities that we are looking to build.

There are three more areas where our planning is at an advanced stage. For each of these, we are looking to take an existing niche presence that sits within Fairfax, to impose more structure around our activities and build a substantial business.

The first opportunity is in SME digital and marketing services. What we're talking about here is having Fairfax provide a suite of services to assist smaller businesses to build an online marketing presence. We're tackling this at a time when 47% of smaller businesses say that they will increase their digital presence over the next 12 months, but when business people in local markets are also saying that there are material barriers to growing online. A lack of knowledge, cost, lack of time and lack of local skilled specialists are often identified as challenges.

We will first focus on regional areas – where we estimate the SME spend on marketing services is currently around $290 million to $390 million, and where the opportunity is greatest – due in part – to a shortage of local specialists. The arrival of the NBN is another factor. The services we offer will leverage our local websites, Facebook presence, sales relationships and content to provide a suite of integrated ROI marketing services.

We already provide some of these services to 4,000 SME clients, but we're now looking to expand the product offering and the client base. We've identified target industries and we will soon establish SME marketing services as a standalone business.

The second area of opportunity is Events. Fairfax already has a strong presence across a range of event types. We're responsible for mass participation events including the City2Surf and the Night Noodle Markets, a range of business media forums and conferences, and regional events and field days.

Our Events activities generate more than $25 million in revenue at present, and are successful despite being structured as an adjunct to a range of other businesses across the Group. We've succeeded in this area because we only organise events that leverage Fairfax Media's audiences and capabilities. We've demonstrated that we can do well in Events integrated with a vertical where we have a leading presence – the connection between Good Food Month and The Good Food Guide springs to mind. Our broad reach provides a real boost to mass participation events including our fun runs and ocean swims, while AFR leverages our strong content, editorial positions and brands through events including the Future Forums and Women of Influence.

Now – the Events industry is highly fragmented and we're only setting out to be a small player in a large market – on some definitions the market size is larger than $8 billion. However, what we do see is a three to five year opportunity to build a business that is several times larger than our existing Events activity.

The final new revenue opportunity that I wanted to touch on today is Content Marketing – an area that's growing rapidly in Australia and globally as Chief Marketing Officers increase their focus on more targeted and engaging marketing activities.

The term Content Marketing may not be familiar to some of you. It covers a broad suite of media and publishing content that actively engages and builds a relationship with a customer to drive customer trial, acquisition or loyalty without actively selling. This could be through a newsletter, a mobile app, a webinar, or a research white paper. Content Marketing has been around for a long time – think of custom publishing, think of the airline inflight magazines – but digital delivery has brought a proliferation of opportunities.

Today, around 25% of marketing budgets in Australia are allocated to content marketing, with spend in the area growing at around 20% annually. It's an industry that's served by a range of publishers, digital media specialists, marketing agencies and other niche players. With strong capabilities in content creation and distribution to mass audiences, as well as our digital step-outs, such as Essential Baby, Fairfax has a number of the bases covered to offer clients real differentiation in their content marketing.

We'll be establishing our Content Marketing business under a new brand – quite distinct from our editorial brands – in coming months. Clear rules of engagement will be put in place for the way in which the content marketing business interfaces with each of sales, content and distribution activities within the broader Fairfax business.

We'll have a great deal more to say about each of the new revenue opportunities down the track. Right now, we're working hard to get the people and systems together to make each of these businesses a success.

As we focus on new revenue opportunities, our priorities are the same as for all of our strategic decisions. Every decision we make is focused on creating shareholder value and building a long-term business model.

In my introduction I've already explained the key profitability measures of the business. However – this slide provides some more context.

I referred earlier to EBITDA for the period of $366 million. This includes a $50 million contribution from Trade Me Group and US Agricultural publications, which were sold in the first half of the year.

EBITDA for continuing businesses was therefore $316 million, which was 23.7% lower than 2012.

Now – let's take a look at Fairfax's cross-platform audience reach.

For the first time, the Australian publishing industry has consistent industry-wide data for measuring readership across traditional print and digital platforms. The data is compiled by Ipsos and is known as Enhanced Media Metrics Australia or 'emma', which launched this week. 'Emma' data is telling the same story that our internal surveys previously showed – that Fairfax mastheads reach large, educated and affluent audiences. Indeed, Fairfax mastheads attract an audience of 9.6 million Australians across print, web, mobile or tablet. That's 1 in 2 of the population over 14.

Here we can see the 'Emma' data for National and Metro mastheads – where we are reaching 7.5 million Australians each month.

You can see how the Metro and National audience breaks down across print, web and mobile in the chart – there are clearly a large number of people who access our content across two, or even three, of these platforms. And in terms of digital platforms, 4.5 million Australians access content from these mastheads via web, mobile and tablet.

'Emma' also gives us transparency on how the readership of our mastheads lines up against our competitors.

What we can see here is that The Sydney Morning Herald is the clear number one across platforms – with an audience that's 400,000 more than its nearest rival.

Factor in the quality of Fairfax's demographic – with a heavy bias towards tertiary educated professionals and managers – and the cross-platform potential of our mastheads is clear.

A further observation – and one that really stands out as you look at this graphic – is our strong position in building digital audiences. We're doing well on digital engagement, with audiences to theage.com.au and smh.com.au spending an average of 1.5 hours each month on the sites, more than double the time spent on competitor websites.

Slide 12 is a new addition to the pack this year and shows our strong advertising market share. The slide on the left shows the percentage of the overall market that we captured relative to our major competitor, with a significant increase in 2013 over the prior year.

The graph on the right explains in part why our total share of the market has been improving. We've been consistently growing our online display revenue. However – it is important to note that this data is expressed before the impact of rebates and discounts.

This slide gives a picture of our digital revenue performance across the Group – and now expressed after rebates and discounts.

While the growth story is strong – digital revenue has increased from 7% in 2007 to 14% in 2013 of total revenue.

The next six slides address our Metropolitan Media division.

Let me start with a snapshot of the performance for the entire division.

In what was another tough year, underlying advertising revenue decreased 14.4%. The higher headline decrease of 21.1% reflects the sale of the Victorian Community publications at the beginning of the financial year.

Underlying circulation revenue increased by 5% due primarily to reduced discounting and increases in cover prices. The headline improvement in circulation revenue of 17.4% was boosted by a change in revenue and cost reporting for home delivery charges.

The cost line shows the early benefits of the Fairfax for the Future program with underlying costs being 7.5% lower than in 2012.

Overall metropolitan digital revenue increased by 3.6% to $260.8 million in the 2013 financial year. Much of this growth was from Domain, where revenue increased by 16%. In contrast, Drive and MyCareer have made minimal contributions and have been repositioned to focus on content and display.

Australian Media's digital performance was held back a little by a decision to reserve premium inventory for the promotion of our internal digital brands. The broader display market grew strongly in the second half.

In the transactions space, RSVP revenue remained flat in a competitive environment, while Stayz recorded revenue growth of 10% for the year.

I mentioned the impact of grossing up revenues and expenses of home delivery. These impacts are fully reflected in Metro News, Print and Digital.

It is worth highlighting a few items here. The decrease in Advertising revenue of 16.7% reflects a 24.9% decrease in print advertising, offset somewhat by a 3.4% increase in digital advertising revenue.

The underlying increase in circulation revenue of 7.1% reflects our circulation strategy – which includes cover price increases and a focus on profitable circulation.

You would recall that in April we promised greater transparency on the Domain business – that's what we've shown here.

Digital growth was a highlight of the Domain business – the number of agents with listings on Domain grew by 21% to more than 7,700; digital EBITDA grew by 31%; and the full-year digital margin was 38%.

This is an impressive, high-growth business.

Meanwhile, despite its bold claims of increasing market leadership, the only thing REA is moving away from is Agents who are getting increasingly angry over price gouging. This is not a winner takes all environment. There is room for two strong players in this market – that's what the agents want, and we're going to get there with Domain.

We've already seen the Digital transactions revenue numbers. Here you can see how this translates to an EBIT line, with investment in Stayz and RSVP leading to a bottom line decline, but positioning the businesses for future growth.

The headline results for the Financial Review Group shown here mask an improvement in the performance of the business when compared with the second half of last year.

In the second half of 2012, the division recorded an adjusted EBITDA loss of $2.2 million. The result for the comparable period this year was a profit of $1.6 million.

Digital advertising revenue growth was strong; and cost reductions including moving to a single print edition, relocating copy sub-editing, and a focus on headcount, resulted in an underlying cost reduction of 3.6%.

Our regional and agricultural business experienced weaker trading conditions during the period due to subdued mining-exposed markets, poor mining employment trends, and a downturn in national advertising.

Underlying revenue was down 7.5%. Revenue was down 16% in mining-exposed markets in Newcastle and Illawarra, while smaller scale Queensland and other mining related areas were down 12%. This weakness led to an impairment charge in the Regional business and Printing operations of $406 million. David Housego will explain this in greater detail.

What's important is that there has been no deterioration in our mastheads' local reach, which underpins the resilience of this business. Our mastheads remain highly valued by our audiences and advertisers in the communities we serve.

Turning to our New Zealand business, where revenues were down 4.7% for the year. Advertising revenues were impacted by weaker trends in the property, retail, employment and travel categories.

I note that total revenue comparisons for the second half were affected by an insurance claim settlement a year ago.

Cost reductions accelerated in the second half, primarily due to headcount reductions.

Our radio business has enjoyed a good year – achieving cross-platform benefits in content and sales.

Overall ratings and market share have improved, with 96fm the highest rating station in Perth and 3AW holding its top spot in Melbourne.

In a radio market which grew just 0.7%, Fairfax Radio increased advertising revenue by 7.7%. This revenue growth underpinned a 35% increase in underlying EBITDA for the full year.

I will now make a few comments on the current trading environment and outlook.

Trading in the first six weeks of FY14 has seen a slight moderation of previous trends with year-on-year revenue down 8% on the comparable period.

On the current run rate of cost reduction, inflators and current reinvestment plans, we expect to deliver costs in the vicinity of $1.6 billion in FY14.

Our Fairfax of the Future program is on track to deliver between $100 million to $120 million of cost benefits in FY14.

I note that the actual cost outcome will depend on opportunities for investment.

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

David Housego

Thanks Greg.

Before we get into the detail I wanted to make a few comments about the progress we are making at Fairfax.

This result shows a business that is undertaking a significant transformation. I think it's clear that we are facing the realities in our industry and we know what we are dealing with.

I've been in the role as CFO for eight months now – and have been impressed by work undertaken so far and the dedicated team I am working with.

A few points of emphasis:

There is cost discipline, which these numbers show, and a real commitment to driving the business for performance.

We are taking all necessary actions and the write-downs we have taken in this financial year's result, reflects our best assessment of operating conditions for the business in the immediate to near term.

The new organisational structure announced in April should not only greatly simplify our business operations, but allows us to further reduce costs and achieve efficiencies.

We are on the front foot with new revenue opportunities as Greg has highlighted, optimising our sales force, improving how we use data to drive yields and we have a much clearer line of sight on what products we bring to market.

Importantly, I note the deleveraging that has occurred across the business over the last few years. This year net debt has fallen by $760 million to $154 million. This deleveraging has reduced our financial risk and puts us in a stronger position to be able to invest across the business where opportunities arise.

Now, turning to the detail…

Slide 26 gives you the detail behind the net significant items and the loss of $144.5 million we have recorded in this result.

A decline in the profits of our regional and agricultural publishing business this year and a lowered expectation for future years is the basis for $406 million of the impairment charge of $419 million.

Also included in the regional impairment is the write-off of $127 million of residual goodwill relating to external printing contracts in the regional business.

We have further reviewed our cost to closure estimate for our print assets in preparation for the sale of our Chullora and Tullamarine sites – we have impaired these assets by $37 million in Property Plant & Equipment and this is reflected in the metropolitan media segment. The sale of these sites is expected in FY15.

Periodically we revalue our radio licences for Australian Communications and Media Authority reporting. Our review this year has seen us write down some individual licences by $7.6 million. It's worth noting that our Broadcast network has a carrying value of $114 million.

In the first half we recorded a gain of $303 million on the sale of our Trade Me and US agricultural businesses. It is also worth noting that an additional $183 million of the profit from this sale for was recorded in equity. The reporting of Group trading performance on slide 27 is complicated this year by the asset sales and the statutory definition of discontinued operations, together with the significant items which occurred during the year.

Starting at the left hand column you will see our financials as reported in our 4E. Moving towards the right, we've added back Trade Me which was treated as a discontinued item in the 4E. We've then added back the impact of the significant items which include the impairments I've just discussed, as well as the profit on sale of Trade Me and the US Ags which were reported in the first half. That gives the normalised operating EBITDA figure of $366 million and a corresponding net profit of $128 million. Adjusting for Trade Me and other entitles disposed gives a trading performance for continuing businesses in the far right hand column where we are reporting EBITDA of $315.7 million and net profit of $107.4 million.

Slide 28 provides a summary of our FY12 performance on the same basis.

Slide 29 gives you a segmental breakdown of revenue and EBITDA.

We have made a change to our reporting segments in that you will note that we have collapsed the printing division revenue and EBITDA into the publishing divisions where they more properly belong.

Appendix 3 gives you the detail of this EBITDA allocation between the Metro, Regional and New Zealand media segments. The external revenue is overwhelmingly attributable to the regional business and that is where it has been allocated.

The contribution from TradeMe reflects only the H1 FY13 contribution given the sale took place in December 2012.

The significant increase in costs in corporate and other reflects the $13.2 million asset and investment write-offs recorded in the first half plus costs associated with the delivery of the Fairfax of the Future program in the second half.

For FY14 we will continue to use these reporting segments which will align with our new management structure. There will be a minor change which will involve the New South Wales' Communities moving out of the Metropolitan Group into the Regional Media segment.

We've included the historic figures for the NSW Communities Group in Appendix 1. We will continue to provide the higher level of detail on Domain and our Digital ventures businesses which we have included in this results pack.

As highlighted on slide 30, we've made significant strides in implementing our Fairfax of the Future program with $193 million run-rate savings achieved at June.

We've adjusted our targets for FY13 onwards to reflect the additional savings we announced at our investor day in June. This chart has historically tracked EBITDA savings. This year we are providing additional detail around the revenue upside from the circulation benefits which are incorporated into the Fairfax of the Future targets.

I would now like to address overall cost guidance for FY14.

Our business, on an ongoing basis, reported a FY13 cost base of $1.677 billion. Adjusting for the extra week, one-time items and changed accounting treatment for news agent delivery fees, this is a drop of approximately 6% from FY12.

For FY14, on the same basis of reporting we would expect costs to be approximately $1.6 billion.

In giving this guidance we are incorporating our best estimates around the costs savings flowing from Fairfax of the Future as well as the offsetting cost impact of increases from cost inflators and expected investment across our business in FY14 to support a number of the Initiatives Greg has spoken too.

As you would know it often takes investment to identify and remove costs and to establish and grow revenue with the benefit flowing in future years.

Turning to slide 31, you will see the reduction in our net debt position over the past 12 months. Our net debt has reduced from over $900 million a year ago to $154 million at June 2013 mostly through asset sales but also through cash generation. Since balance date we've announced the early redemption of some of our outstanding US Private Placement notes which has used approximately $270 million of our cash balance. We repurchased US$224 million and have US$206 million remaining.

The reduction in net debt resulted in net interest expense falling from $112 million in FY12 to $57 million in FY13. As part of the redemption of the fixed US Notes we will be booking a profit (both accounting and cash) relating to the close-out of the associated interest rate swaps of approximately $10 million before tax which will be applied against Interest expense in FY14. This would give us an expected net interest expense around $15 million to $20 million for the year.

You can see also that we remain well within our banking covenants.

Turning to our cash flow on slide 32… The business this year generated a trading cash flow of $377 million.

We paid out $96 million in restructuring and redundancy payments to implement Fairfax of the Future in FY13 and we expect to pay out the balance of the provision of $94 million in FY14.

Our investment in property, plant and equipment totalled $61 million in FY13 and budgeted capex for FY14 is $70 million which includes approximately $40 million for upgrades to Nth Richmond and Ballarat print sites which should be completed in the year.

We spent $65 million on a number of small acquisitions in FY13.

Slide 33 shows our current facility maturity schedule as at July 2013 following the early redemption of a portion of our US Private Placement. We have some of the remaining US notes maturing in January 14 and in July 15 as well as our major bank facility.

– ENDS –

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