

ASX Announcement : 27 August 2012

Results and FY2013 Outlook

Open Briefing interview with Greencross Limited Managing Director, Dr Glen Richards



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Greencross Limited (ASX: GXL) is focused on consolidating the fragmented veterinary services industry in Australia. Earnings growth is expected to be generated via improved efficiencies at individual practices and via further active acquisition of established practices.

Market Capitalisation - \$85 million

In this Open Briefing®, MD Dr Glen Richards discusses

- Expects EPS accretion of at least 15 percent for FY2013
- Acquisition and capital management strategy
- Outlook and milestones for FY2013

Record of interview:

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Greencross Limited (ASX: GXL) reported net profit of \$5.6 million for FY2012, up 40.8 percent from the previous year. EPS was 15.78 cents, up 30 percent and at the top end of your guidance. You expect EPS to increase by at least 15 percent, or to be at least 18.15 cents, in FY2013. How do you expect trading conditions to trend? With fee increases slowing and visit numbers flat, what assumptions underlie your forecast EPS growth?

MD Glen Richards

We expect EPS accretion of at least 15 percent for FY2013. We are a company in active growth mode and the main driver of growth is through acquisitions, but we also expect reasonable revenue growth on the back of organic initiatives such our Healthy Pets Plus program.

Indicators suggest that trading conditions will remain flat for the next 12 months, with expected patient visit numbers to remain fairly steady. However, we're excited that our Healthy Pets Plus program is getting good traction. This program gives us the opportunity to grow revenue from our existing practices through the provision of more products and services to our existing client base.

Healthy Pets Plus is a proactive health care program where pet owners seek the best care for their pets to give them every opportunity to stay healthy. At least 12 per cent of clients seen have enrolled in Healthy Pets Plus since the program was launched on 1 May. This has equated to just over 5,000 members in this short period.

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EBITDA was \$11.2 million, up 35.7 percent, on revenue of \$82.6 million, up 34.9 percent. EBITDA margin dropped to 11.8 percent in the second half, down from 15.6 percent in the first half. This seems at odds with your better like-on-like EBITDA performance in the second half. Where do you expect revenue and EBITDA margin to trend over FY2013?

MD Glen Richards

EBITDA margins are traditionally weaker in the second half of the year due to the extra number of public holidays and autumn and winter being our quieter periods.

We also opened two new emergency services centres in the second half which impacted margins. As we enter FY2013 those new emergency centres will ramp up and start to generate more revenue. While we're continuing to expand through acquisitions, we're not significantly expanding corporate expenses so we're seeing margin improvement as corporate overheads decrease relative to turnover.

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What ability do you have to increase fees in the current environment? To what extent will meaningful growth in like-on-like revenue depend on recovery in macro factors such as consumer sentiment?

MD Glen Richards

There is a slight discretionary aspect to our business but for about 90 percent of our clients their pet is an integral family member and spending on the pet is non-discretionary. Only around 10 percent of our clients are discretionary spenders who may decide to delay a vaccine, watch a lump grow without doing something about it, or may not purchase premium pet food or medication.

Nevertheless, we're aware that things are tight for many clients and we are reluctant to make major fee increases. We're fortunate to be in a business where we can closely monitor costs, especially wages and rents, and where we can raise fees to keep pace with increases in the cost of doing business.

We continue to focus on organic initiatives to grow revenue like Healthy Pets Plus, expanding new services and engaging better with our clients.

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Over FY2012 Greencross acquired 21 new general practices and opened two new animal emergency centres. Capital investment, including investment in new practices, totalled \$17.2 million for the year, up from \$8.8 million. Free cash flow was negative \$8.8 million, versus negative \$2.7 million in the previous year. What is the outlook for free cash flow in FY2013 and is the recent level of acquisitive growth sustainable?

MD Glen Richards

We'll continue to execute our business plan, supported by bank debt, vendor finance and free cash flow. What will change is that we'll utilise more free cash flow and less debt for our acquisitions which will see gearing decrease over time.

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Can you comment on the current competitive landscape for acquisitions in the veterinary industry? Are you seeing the emergence of other aggregators in the sector?

MD Glen Richards

Acquisition multiples remain at our historical levels of between 3.5 and 4.5 times EBIT. The average acquisition price for a good quality practice over the last 12 months was around 4 times EBIT. We're not seeing any price pressure but at the same time, vendors have a reasonable expectation that we pay a fair price for their practice.

To our knowledge, there are no other significant aggregators in the industry on the horizon.

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Net debt was \$28.4 million as at 30 June 2012, up \$10.5 million compared with a year earlier. Gearing (net debt/equity) was 78.6 percent up from 57.9 percent, and debt/EBITDA was 2.6 times, up from 2.3 times. When do you expect gearing and debt/EBITDA to reach the company's short term target of 65 percent and less than 2 times respectively?

MD Glen Richards

We always expected gearing to kick up over our short term target of 65 percent. We expect gearing to peak in FY2013 and then start to reduce significantly over FY2014.

Our main focus is our ability to service debt. Debt to EBITDA is our one and only banking covenant. The Commonwealth Bank of Australia is supportive of our five year strategic plan. We believe that driving shareholder value through executing this plan will generate the best outcome for our stakeholders.

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You have declared a fully franked final dividend for FY2012 of 4 cents per share, bringing the full year dividend to 8 cents, up from 6 cents. The payout ratio was 51 percent, similar to the previous year. What is the outlook for dividends in FY2013? Given your focus remains on growth, can you sustain this level of payout while continuing your active acquisition strategy?

MD Glen Richards

We'll continue to pay out 50 percent of earnings to shareholders, as is our policy. Our focus is around growth and our acquisition strategy requires us to have a dividend reinvestment plan (DRP) that is 50 to 100 percent underwritten. The DRP is a great tool for us as it means we have cash available. It provides the option for shareholders to take their dividend and slightly dilute their shareholdings, or reinvest the dividend without any dilution.

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What are the key operational and corporate milestones investors should look for from Greencross over the next 12 months?

MD Glen Richards

We'll continue to grow shareholder value through our organic and acquisitive growth programs and as I said earlier, expect to grow EPS by at least 15 percent this financial year.

We'll continue promoting Healthy Pets Plus widely to our client base and target at least 10 percent of our patients enrolling in the program over the next 12 months. Our acquisition program will continue, with a target of at least 12 practices acquired and integrated in the next 12 months.

We'll continue to execute our education program for our team to improve their capability in servicing clients, providing best care to patients and improving our retail offer for clients. We'll also promote and expand our new veterinary pathology company to the wider veterinary industry.

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Thank you Glen.

For more information about Greencross, visit www.greencrossvet.com.au or call Glen Richards on (+61 7) 3435 3535

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