

ASX Announcement : 28 February 2013

CEO on H1 Results & Outlook

Open Briefing interview with CEO Glen Richards

Greencross Limited
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In this Open Briefing®, Glen discusses:

- Organic growth as well as acquisitions drive underlying earnings growth
- Cash flow growth maintained, recent placement for acquisitions strengthens balance sheet
- Forecast EPS growth of at least 15 pct per annum maintained

Record of interview:

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Greencross Limited (ASX: GXL) recently reported net profit of \$1.0 million for the first half ended December 2012, versus \$2.5 for the previous corresponding period (pcp). Excluding accounting treatment and one off items, NPAT was \$3.5 million, up 35 per cent, and EBITDA was \$7.8 million, up 32 per cent, on revenue of \$51.2 million, up 30 per cent. Eight new veterinary practices were acquired, bringing the total to 89 at the end of the half. What was the contribution of the acquisitions to the growth in earnings and what have been the drivers of organic growth?

CEO Glen Richards

Acquisitions continue to be the main driver of growth and the company will continue to target one to two new acquisitions per month.

Of course, we're very aware of the importance of managing our business well and ensuring we achieve organic growth on a yearly basis. We're very pleased to report an improvement in like for like organic revenue and EBITDA growth for the period of 3.8 per cent and 12.1 per cent respectively.

The main driver of organic growth has been the successful implementation of our Healthy Pets Plus wellness program. We now have over 10,000 members, with sign-up rates continuing at approximately 200 new members per week. On top of this, our veterinary teams have been engaged in a number of other organic initiatives which have complemented organic revenue and EBITDA growth, including the promotion of high standards of veterinary care, better healthcare compliance by our pet owners and customer service training programs.

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Underlying EPS was 10.74 cents per share for the first half, up 24 per cent, and you continue to expect EPS growth of at least 15 per cent in the current year. Taking into account the placement earlier this month of 3.3 million new shares, is this forecast growth still achievable?

CEO Glen Richards

We're pleased to confirm that after the completion of the placement of 3.3 million new shares to institutional and sophisticated investors, we expect underlying EPS growth of greater than 15 per cent for the full year. Growth will continue to be assisted in the second half by

organic initiatives such as Healthy Pets Plus. Furthermore, a number of acquisitions are scheduled to be completed, including the settlement of the Ku-Ring-Gai veterinary hospital.

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The reported result for the first half included a one-off, non-cash charge of \$1.9 million relating to an adjustment to the accounting treatment of deferred purchase payments for eight past acquisitions that had to be reclassified as remuneration expenses. How has the emergence of this issue impacted the way you structure new acquisition contracts and payments? Are further such adjustments likely in the future?

CEO Glen Richards

During an initial review of the business purchase agreements relating to previous acquisitions undertaken by the Company, our new auditors noted that eight of our most recent acquisitions contained erroneous links between the employment of the vending vet and the payment of the deferred purchase payments. This then brought forward this expense, and as such all deferred purchase payments with a link to employment have now been fully expensed, as required by the accounting standard.

It should be noted that we encourage as many of the vending vets as possible to remain with the Company to work as a veterinary director, however we did not intentionally link, and will not in the future link, any deferred purchase payment with the continued employment of the vending vet.

The auditors conducted a full, detailed review of our accounts and no other material accounting adjustments have been brought to our attention. Therefore, we do not expect to see any further adjustments.

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Cash flow from operations was \$6.7 million, up 50 per cent year on year in spite of substantial rises in both finance costs and taxes paid. Greencross's current ratio remains negative, with suppliers "funding" working capital. Is the improvement in operating cash flow sustainable and can the working capital model be maintained as the company gains scale?

CEO Glen Richards

The negative working capital ratio is due to the receipt of payments from customers at the time of service, as we run minimal accounts receivable in each of our clinics, and negotiate standard trade terms with our suppliers. Running a negative working capital ratio is standard for this type of cash flow business and we are very confident in our ability to manage cash flow. Furthermore, our forecast net cash inflows from operations are sufficient to cover our current liabilities as well as allowing us to grow through acquisitions. Our forecasts also show that this is sustainable as scale is increased.

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Cash outflow on acquisitions was \$5.4 million in the first half, down from \$9.3 million in the pcp, and since the end of the period you've announced the acquisition of a large Sydney veterinary hospital for \$5 million. Is this to suggest that your traditional, smaller sized acquisition targets are becoming harder to find and that future acquisitions are likely to be fewer but larger in size? Do you see further opportunity for growth in the Sydney market?

CEO Glen Richards

The acquisition opportunities that exist in the Australian veterinary industry for Greencross have not changed over the last 12 months. We still have multiple conversations running at any one time with numerous vendors. We'll continue to target one to two new acquisitions per month, or \$12 million to \$15 million of new revenue per annum.

The funds received from the recent placement will be applied to a number of acquisitions that fall outside our stated growth rate of one to two new acquisitions per month. Ku-Ring-Gai veterinary hospital which we just acquired is the first of these, and \$5 million of the \$11

million we raised has been applied to this acquisition. The remaining funds will be deployed later in the year.

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As at December 31, net debt was \$30.1 million and gearing (net debt/shareholders' equity) was 84 per cent, up from \$28.1 million and 80 per cent six months earlier. You've indicated that gearing would fall to around 65 per cent post the recent placement. Can debt reduction continue from the current levels? What is the outlook for debt and gearing at year's end?

CEO Glen Richards

As we've said previously, gearing was set to stabilise this financial year as the Company used less debt and more free cash flow to fund acquisitions. However, making a number of larger acquisitions, including the recent Sydney acquisition, would have meant gearing levels would have peaked around 95 per cent. The directors believed the large Sydney practice was an excellent opportunity for Greencross and its shareholders to acquire one of the signature veterinary hospitals in the country. The directors believed it prudent to undertake the \$11 million placement to enable the Company to acquire this veterinary hospital and help reset gearing levels to circa 65 per cent.

Going forward the Company will continue with its funding mix of debt, cash and vendor deferred payments. We believe gearing will remain at 65 per cent in the short term before starting to drop to below 50 per cent in the medium term as we use less debt and more free cash to acquire clinics.

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Can you comment on current trading conditions? How is spending at your practices being impacted by the still subdued levels of discretionary spending?

CEO Glen Richards

We're fortunate to be in a resilient industry, with a large client base of non-discretionary spending pet owners willing to pursue high standards in the diagnosis, treatment and care of their pets. Contrary to media reports of tougher economic conditions in other industries, annualised visit numbers and spend per patient continue to increase.

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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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