ASX Announcement : 11 September 2013

MD on FY2013 Results and Outlook

Greencross Vets

Open Briefing interview with MD Glen Richards

Greencross Limited
5/28 Balaclava Street
Woolloongabba,
QLD 4102

Greencross Limited (ASX: GXL) is a veterinary services company 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.

In this Open Briefing®, Glen discusses:

- Underlying net profit up 34.8%
- New business acquisition pipeline
- Vertical Integration Strategy development

Record of interview:

openbriefing.com
Greencross Limited (ASX: GXL) recently reported net profit of $2.92 million for FY2013, down from $4.50 million. Excluding one-off items, underlying net profit was $6.38 million, within your guidance range and up 34.8 percent from the previous year, and underlying EPS was 18.71 cents per share, up 21.6 percent. Growth continued to be driven by acquisitions, although organic growth also contributed, with same-clinic EBIT up 10.3 percent. To what extent does your guidance for the current year of EPS growth of at least 20 percent assume both organic and acquisitive growth? What have been the key drivers of organic growth?

MD Glen Richards
Acquisitions remain a key factor for our continued high rate of growth, however, key initiatives such as targeted marketing to gain new clients, the opening of new to industry clinics, internal education programs designed to deliver quality medicine and our Healthy Pets Plus program will all contribute to good organic growth in the current year.

openbriefing.com
You've announced a final dividend of $0.05 per share, bringing the full-year payment to $0.10, equivalent to a dividend payout ratio of 53.4 percent, slightly above your target of 50 percent. Are you comfortable you can maintain the payout at this level and still support growth? How important is shareholder support for the dividend reinvestment plan, which you've maintained at a 2.5 percent discount, to your ability to grow the business?

MD Glen Richards
We continue to acquire businesses with a combination of debt, free cash and vendor deferred payments, but we expect to be in a position to self-fund acquisitions within the short to medium term through free cash. The dividend remains important to many of our shareholders and to that end it will continue. The dividend reinvestment plan allows shareholders to either choose to take a cash dividend payment, and then be slightly diluted, or it allows them to reinvest back into the future growth of the Company. We will continue to balance our need for cash by having up to 100% of the DRP underwritten.

openbriefing.com
Partially as a result of the $11.16 million equity raising to purchase the Ku-Ring-Gai Vet Hospital, cash on hand sat at $8.80 million as at 30 June, up from $3.34 million a year

earlier. Net debt to equity was 55.8 percent, down from 77.7 percent. Are you comfortable with this level of gearing and what is your targeted gearing level for the end of FY2014?

MD Glen Richards
We operate a strong cash flow business with robust quality earnings which easily supports the current gearing levels of the company. While the recent capital raising helped reset gearing levels to 55% we forecast gearing to increase back to 65% as we continue to fund acquisitions through a combination of debt, free cash and vendor deferred payments. However, we are rapidly moving towards self-funding of acquisitions from free cash flow and as such we have a medium term target to get gearing to 50%, with a long term target of gearing of less than 50%.

openbriefing.com
Greencross acquired 14 practices in FY2013, most in the first half of the year. To what extent did the slower acquisition rate in the second half reflect a change in practice availability or vendor expectations? What is the state of the current pipeline of potential acquisitions?

MD Glen Richards
The acquisition pipeline continues to be full of exciting opportunities with many of these continuing to be negotiated by our acquisitions team, with a continued focus on acquisitions that complement the existing network. Unfortunately, acquisitions will not always land on a straight line basis but I can confirm that the pipeline of acquisitions is no different to that of 12 months ago.

openbriefing.com
With the 50 of the 97 businesses operated by Greencross located in Queensland, what is your strategy for growth in the other states?

MD Glen Richards
We have a focus on being a national veterinary business, with many conversations continuing to take place in New South Wales, South Australia and Victoria. We already have a network of Group Area Managers in each location ready, willing and able to induct, integrate and manage any new clinics acquired in these target markets.

openbriefing.com
In April you opened a new, state of the art veterinary hospital in Morayfield in Queensland. How do the investment metrics of establishing a new clinic compare with those of an acquisition? Will you open more such clinics in future?

MD Glen Richards
After its first six months of trading, we are now expecting returns in this new veterinary hospital to be similar to that of acquired clinics. The benefit of these types of clinics is that they are much better facilities than the average veterinary hospital and we expect them to attract and retain talented staff members.

We will continue with our trial of these new to industry clinics and we have a number of these clinics already in development in areas which we have identified there is an undersupply of veterinary services, a large veterinary services spend and/or within growth corridors. Moreover, these clinics will allow us to enter markets where good quality acquisitions cannot be identified.

openbriefing.com
As part of your vertical integration strategy, recent investments have included two veterinary pathology laboratories located in Brisbane and Melbourne and two pet crematoria in Queensland. What is your expectation for earnings growth and margins from these additions and how do your assessment criteria for these businesses compare with those for a veterinary practice?

MD Glen Richards

We expect the pathology business to have relatively low margins during the current financial year but as this business' life cycle progresses, from start-up phase into maturity, we then expect the margins to increase to approximately 20%. At present 74% of all revenue generated by the pathology business is from Greencross owned clinics. This business will target growth through increasing the number of non-Greencross clinic referrals as well as receiving direct referrals from any newly acquired clinics.

The pet cremation business is forecast to deliver EBIT margin for the current year of approximately 30%. Growth in this business is forecast to be strong as an increasing number of pet owners are expected to take up these services over time.

openbriefing.com

Greencross' target average acquisition price for a good quality practice has been approximately 4 times EBIT, and you've sought to offer a "succession plan" to baby-boomer vets looking to exit their businesses. Can you comment on the longer term sustainability of this acquisitive growth strategy?

MD Glen Richards

We will continue to target one to two new clinic acquisitions per month. As the pool of acquisitions has not changed, we believe this run rate is very achievable. Furthermore, we believe acquisitions multiples will remain at historical levels, being 4 times historical maintainable EBIT. As previously noted we will continue to fund acquisitions through a mix of debt, free cash flow and vendor deferred payments while keeping gearing levels below 65%, then moving to a self-funding position where we will see gearing start to trend down towards our long term gearing targets of less than 50%.

openbriefing.com

Thank you Glen

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

For previous Open Briefings by Greencross, or to receive future Open Briefings by email, visit openbriefing.com