Smartgroup Annual General Meeting, 23 April 2015

Address by:

Deven Billimoria, Managing Director and Chief Executive Officer

Tim Looi, Chief Financial Officer

Deven Billimoria:

Good morning everyone and lovely to have you all with us here today. My name is Deven Billimoria, and I am the Managing Director and CEO of Smartgroup. We also have with us here today, Tim Looi, our CFO, who will take you through our financial results in just a while.

But first, let's turn to **slide number three** and give you an overview of our performance in 2014. As you can see, Smartgroup delivered another year of strong performance; in fact our team produced a record result in 2014. First of all, as mentioned by Michael, our revenue came in at $72.8 million, and NPATA at $17.4 million. Both exceeded our prospectus forecasts by 5%. Secondly, our salary packaging customer base, at over 118,000 as at year end, represents growth of almost 13,500 packages, and that is in line with the prospectus forecast. Third, our novated leasing car park has grown consistently over time, and is now over 32,000, representing a growth of 7% on the prior year.

Fourth, we continue to improve our operational efficiencies, and I will touch on this a little later. And finally we are pleased to have declared a maiden dividend of 6.1 cents per share, fully franked, and that represented a payout ratio of 70% of NPATA for the second half of the year. As Michael said, this 70% payout ratio is at the top end of what we indicated in our prospectus.

Turning to **slide four** now, as you can see we exceeded both our top and bottom line prospectus forecasts by 5%. This was due mainly to the continued growth in our Novated leasing business, as well as stronger supplier margins that we have worked on over the past year or so. Our package numbers are broadly in line, as I mentioned, with the prospectus, and head count looks just under our forecast. So you should know that we have completed a round of recruitment in early 2015, and it puts us at over 350 people in the business.

The graph on **slide five**, one you may be familiar with, is our long term public tender win loss record since we started capturing the data back in 2007. In 2014 we submitted 9 small to medium sized public tenders. Of these we have won 3 of the clients, including of note the Peter MacCallum Cancer Centre in Victoria, which brings in almost 2,000 employee customers. And we have lost an existing client. In fact that client loss now is our second client loss of greater than 1000 packages in 15 years of business history. As we said during the road show, we do believe that is the strongest client retention of any company in the industry, though it does pain us, as always, to lose clients. Outside of Public Tenders, we have now retained 4 longstanding Public Health Sector clients. Further, we have also just added NSW Health Pathology, with around 2500 employee packages.

On **slide six**, you can see that our Novated Leases under management continue to grow.

Turning to **slide seven**, we get an indication of our operational efficiencies. They are driven by technology and process improvements. One of the moves to technology is our long term trend in adoption of self-service online forms. You can see that trend heading up to over 40% now in the past year.

We also have a long term trend as regards to salary packaging cards. Both of these things result in less admin work, and greater service efficiencies. But importantly they also result in much better service to our customers. In fact in

2011, as you can see on the right, we are now 23% more efficient than we were back in 2011 and with all of our service metrics and satisfaction metrics also trending in the right direction.

Turning to slide **eight now**, this is some of the key data that we are really proud of. In 2014, we were accredited as an Aon Hewitt Best Employer, for the second year in a row. In fact we were one of only 16 companies to be accredited a Best Employer in Australia and New Zealand. In 2015, our team maintained an impressive engagement score, though narrowly missed out on being accredited a Best Employer for a third year.

In the middle of this page, you can see our increasing audit score awarded by the Customer Service Institute of Australia. In 2014, this score was good enough to gain us the Best Medium Business Award in NSW for the 4th year running. It is quite a rigorous evaluation process, so it is nice for the team to be recognised for their commitment to customer service. Finally, in the graph on the right you will see our net promoter score. We have averaged for the second year running a 45% net promoter score, with a few months actually just over 50%. You may know that very few organisations in Australia have a higher net promoter score. For the company it is not just a score, but it is the philosophy on how we manage the business, with daily inputs from right across the business to make sure we keep improving our service for our customers.

Turning to **slide nine**, this triangle encapsulates how we run the business and it also hints at our company culture. Beneath the triangle, we outline our vision, which is to be 'the easiest salary packaging and vehicles services company to deal with.' We put engagement right at the bottom of the triangle because we think it is the foundation of everything we do. Lean, agile, and innovation are three operational best practices within the company. Finally, we put customer loyalty right at the top of the triangle because we think it is the ultimate validation of whether our strategy is working.

It is always nice to have external validation of so many dimensions of this triangle. In 2014, in addition to our Aon Hewitt Best Employer accreditation, and our NSW Best Medium Business Award by the Customer Service Institute of Australia, we were also acknowledged by the BRW as one of Australia's most Innovative Companies for the second year in a row.

On that note, perhaps this is a good time for me to hand you over to Tim Looi.

Tim Looi:

Thank you Deven. 2014 was another record year for Smartgroup.

We continue to have the highest client retention and strongest tender record in the industry. Our packages and leasing volumes are at record levels since inception and our operations are more efficient through the use of technology and our lean and agile work practices.

Deven covered off some of the headline financial performance against our Prospectus. I am going to give the 2014 results some context by comparing it to the prior year. On page 11, you can see:

- Our revenue grew by 17% from the prior year;
- Our operating profit, measured as Earnings before Interest Tax and Amortisation (or EBITA) excluding our listed company cost, increased by 15% to $24.8m.
- EBITA in 2014, which includes $1.1m of recurring listed company costs, was $23.7m

The financials have a high level of non-cash, non-recurring amortisation from a historical business re-organisation. As such, Profit After Tax is not a relevant measure until this amortisation subsides.

Net Profit After Tax adjusted for the impact of non-recurring and non-cash amortisation, or NPATA is the most relevant measure for Smartgroup's after tax profits. In 2014, NPATA was $17.4m

The NPATA headline growth is 32%. This number is overstated as the 2013 NPATA had higher interest expense due to higher debt levels prior to our IPO. Our IPO occurred in early July 2014. With the proceeds, a significant proportion of debt was paid down. Adjusting for the impact of the lower debt levels and the lower interest expense, the 2014 NPATA growth would have been 15%.

Deven has already talked to the operating metrics earlier and as such I will not cover this but will make references to it later.

Turning to page 12, 2014 was a significant year in respect of package uptakes. We have seen close to 10,000 packages transitioned from other packaging providers and also from packaging performed in-house by the employer.

2014 was a continuation of a strong 2013 year where around 9,000 packages were transitioned.

In late March 2014, Northern NSW Local Health District and St Vincent's Sydney transitioned approximately 6,000 packages collectively to Smartsalary from, in the case of Northern NSW, another salary packaging provider and for St Vincent's Sydney, in-house salary packaging.

In early December 2014, St Vincent's Melbourne transitioned from another salary packaging provider to Smartsalary.

Together with these large transitions, we saw a further three and a half thousand package growth arising from within our existing customer base. We ended 2014, with over 118,000 packages, with 27,000 packages added on in the last two years.

Turning to slide 13, our operating profit increased by 15% from the prior year with growth in both our packaging segment and fleet segment.

In packaging, the increase in revenue came primarily from growth in novated lease volumes, the sale of more products associated with a novated lease such as insurance and as we increase in scale, better pricing from suppliers.

In fleet, as forecasted in our prospectus, the revenue growth is due to higher wholesale margins recorded in the business for novated leasing insurance products sold to the industry and also to Smartgroup's subsidiary, Smartsalary.

Our staff number, at 343 at the end of December, increased by around 9% or 28 roles. The majority of the increase, 20 roles, was in sales, with the remainder in service and support.

Staff expense increased $6.0m from the prior year, of which.

- c$2.0m increment was due to full bonuses being paid in 2014, whereas in 2013, bonuses were significantly reduced due to the impact of the Rudd Government proposed changes

- the remainder of the increase was due primarily to increased staffing levels with a skew towards sales staff which have higher average salaries.

There was no material change in all other expenses

Corporate costs, representing the additional cost of being a listed company increased from $0 in 2013 to $1.1m as Smartgroup transitioned from a privately held company to public.

EBITA before corporate costs, which best represents the profit growth from the prior year on a like-for-like basis, grew by 15% to $24.8m representing a pre-tax margin of 34%, in line with 2013.

Going forward, we will be using EBITA as the metric for pre-tax profit.

Turning to the cashflow on slide 14, we were also pleased to report, for the full year, cashflow from operations of $24.1m or approximately 139% of NPATA. This is slightly stronger than the prior year of 115%.

139% is a strong figure as we had several late supplier payments that were deferred from December 2014 to January 2015. Adjusting for that, the cash-flow conversion is still at a strong 120% of NPATA.

As flagged in the prospectus, we expanded our offices in Sydney to increase our floor space by 800 square meters. The fit-out, costing $1.3m, was completed in December on time and on budget.

Otherwise, our recurring capital expenditure remains low at $200k for the full year. This capital expenditure is for the provision of staff IT equipment – laptops, desktops, mobile phones and the likes.

We have a very high cash flow conversion due primarily to three reasons.

Firstly, under the salary packaging business model, there is no time lag in fee collections as we deduct our fees directly from the employees' pre tax salary.

Secondly, we have a capital light business. We deliberately do not take on and manage operating leases, which means we don't have to require or refresh vehicles to maintain our earnings, and we're not at risk of any falls in second-hand car pricing.

Lastly, with a conservative accounting policy to expense all on-going software development, 100% or more of our reported profits are converted into cash.

Turning to slide 15, at December year end, our balance sheet is conservative with a net cash position of $6m comprising of cash on hand of $28m, and debt of $22m.

We have around $10m of identifiable intangibles comprising of software and customer contracts. These intangibles were recognised from the group restructure in 2012. The amortisation of these intangibles will be around $5.6m in 2015 and $2.2m in 2016 and $0.8m in 2017.

As the amortisation is non-operational, non- recurring and non-cash, once these assets are fully amortised, our Profit and Loss will be 'cleaner' with Profit after Tax accurately reflecting the on-going financial performance of the Group.

In this presentation, we have presented certain pro-forma numbers, that we believe best reflect the underlying performance of the business for the full year. In doing so, we have had to adjust the statutory financials for certain material items such as the cost of the IPO and the impact of the change in the capital structure from the IPO. We have attached as appendices the reconciliation from the statutory accounts to these pro-forma numbers and we have had our auditors review them to ensure that they are accurate and reasonable.

I'd like to hand back to Deven for the wrap up.

Deven Billimoria:

Thanks so much Tim. Let's just turn to **slide 17** for a summary and conclusion.

To provide an update since we delivered our 2014 Full Year Results, we can confirm two further Public Tender wins. These new clients include the Peter MacCallum Cancer Centre with around 2,000 employee packages.

Outside of tender wins, we have now on-boarded NSW Health Pathology with about 2,500 existing packaging employees. Both NSW Health Pathology and Peter MacCallum started packaging with us on 1 April 2015.

We have also recently renewed another long-standing health sector client.

We are often asked about our progress in the Corporate salary packaging sector, and about the size of that opportunity. In fact, since the IPO we have added 7 new Corporate clients, bringing around 5,000 eligible employees, with only about 100 of those employees currently packaging. These are relatively small wins but significant in that we are making headway into the Corporate sector.

As regards the financials, we had a record result in 2014 with our full-year results 5% ahead of prospectus forecast and a fully franked dividend of 6.1 cents per share, representing a 70% payout ratio. We have a conservative balance sheet, with net cash of $6m as at 31st December.

And finally**,** we would like to provide our outlook for H1 2015. Our business trends are tracking well with packages and novated leases under management continuing to grow. As such, subject to stable market conditions, we are pleased to provide earnings guidance for H1 2015 NPATA of $11.5m. This figure includes $1.2m (after tax) of non-recurring earnings.

Now allow me to hand back to our Chairman, Michael Carapiet.