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CANDLE AUSTRALIA LTD

open briefing

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Candle Australia Limited
Level 5, NAB House
255 George Street
Sydney, NSW 2000

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Title: Open Briefing. Candle. MD on Record Interim Profit

Record of interview:

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Candle Australia Limited increased net profit after tax 59 percent to a record $3.3 million from $2.1 million in the six months ending December 2004. Revenue increased 35 percent to $115 million. What are the key factors behind the strong performance?

MD Rob Collins
Market conditions have been buoyant and are likely to remain so, in light of the strength of the economy and relatively low unemployment. This has lead to an increase in demand for white collar staff, particularly in the Information, Communication and Telecommunications (ICT), office support and accounting support markets. Given our strength in these areas, we've seen a marked increase in recruitment activity and demand for contractors and temporary staff.

Equally important has been our focus on a range of productivity measures and KPIs to ensure we're operating efficiently. We've contained growth in fixed costs and improved our EBIT to sales margin, which has steadily grown from around 2.4 percent in December 2001 to 4.35 percent in the half year just ended.

Our success with acquisitions has also driven growth. Workskills Professionals, Premier Personnel and The One Umbrella business are all performing above expectations.

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In the latest half year, revenue rose 35 percent to $115 million from $85 million. What was the underlying revenue growth of the businesses on a like-for-like basis? What was the contribution from acquisitions?

MD Rob Collins
We generated around $13 million revenue from the addition of The One Umbrella, Workskills Professionals and Premier Personnel. Excluding these businesses, our revenue grew around 20 percent half on half on a like-for-like business.

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EPS in the six months increased 46 percent to 7.9 cents and the interim dividend increased 37.5 percent to 5.5 cents, reflecting a pay-out ratio of approximately 70 percent. Why not pay out more, given you have no net debt and a net cash position at balance date of $2.5 million?

MD Rob Collins
Our dividend pay-out ratio is in line with historic levels and reflects our desire to reward shareholders with income and growth. We are currently comfortable with a conservative balance sheet, providing maximum flexibility to fund organic growth and acquisitions. However, in light of international financial reporting standards changes, profits will improve as we will no longer expense goodwill from acquisitions. Consequently, capital management and dividend pay-out ratios will be reviewed in the period ahead.

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Operating cash flow in the period fell to $1.3 million from $3.6 million. Why is cash flow weaker and not rising in step with revenue and profit?

MD Rob Collins
The lower operating cash flow is really a reflection of our growth in contractor and temporaries on assignment. The trend isn't a negative, but rather a reflection of the strong demand for our services.

In the ICT segment, we fund payments to contractors from the start date of their assignments to the time we collect the first payments from our clients; this typically involves a funding period of six to eight weeks and can be anything between $6,000 to $20,000 per contractor on assignment. Increasing the number of contractors on assignment soaks up operating cash flow.

In addition, we've had to fund the working capital requirements of the businesses we've acquired, which are also growing at a fast rate.

Given our low gearing, the lower operating cash flow is not a concern to us at all.

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To what degree are strong returns sustainable? What has been the trend in fixed costs?

MD Rob Collins
We've worked very hard to ensure sustainability of earnings. We've been focusing on areas such as income diversification, costs and succession planning. We've diversified our earnings across a range of segments, without in any way de-emphasising our traditional focus on the ICT segment. We've also managed to broaden our client base to ensure we're not dependent on any single client. Our largest client represents less than 8 percent of total billings.

We have also reduced fixed costs in relative terms by 15 percent over the past 3 years and have begun to review our use of assets such as office space and the customer databases. There are other initiatives designed to keep efficiency high.

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EBIT to sales margin has improved 19 percent to 4.35 percent of sales in the last six months. What productivity and efficiency measures do you monitor?

MD Rob Collins
Overall, because of our efforts, our margins have held up against the industry trend to lower margins. On the income side, our diversification strategy and cost improvements have allowed us to enjoy higher margins.

In recruitment, the biggest cost relates to staff. So we look at a number of measures of staff productivity, one being EBITDA per employee. Our half yearly EBITDA per employee has risen steadily to over $25,000 in the latest half from about $15,000 in 2001.

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Candle is an industry leader in employment services relating to the ICT segment. How does the ICT growth rate and market conditions within that segment compare with your other businesses?

MD Rob Collins
Overall, our ICT business has grown about 15 percent half on half.

The ICT segment, which typically posted double-digit growth every year, was hit very hard post-2000 and has a long way to go to achieve a peak again. Following a period of corporate under-investment from 2001 to 2003, we're seeing increased activity in ICT and believe ICT is entering into another period of sustained demand. We've seen a little softening of ICT contracting in New Zealand, but that's been more than offset by increased permanent staff demand there and contracting and permanent demand in Australia.

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ICT aside, how would you characterise the performance of your other businesses?

MD Rob Collins
The business support area comprising Freeman Adams, Alliance Recruitment, Premier Personnel, Workskills Professionals and The One Umbrella have all performed exceptionally well. Alliance experienced strong organic growth as a result of the establishment of its Sydney office. Freeman Adams, our business

focusing on banking and finance back office technical support also performed very well, particularly our Melbourne office.

In addition, we've opened Executive Search and Selection, a business focused on senior and middle management permanent recruitment. We anticipate good prospects for this business over the next 12 months or so.

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You have a history of making smaller acquisitions. Would you consider a much more substantial acquisition?

MD Rob Collins
We operate in a recruitment industry market estimated to be about $10 billion and there are a lot of opportunities for us. We have made some good acquisitions and, due to our strong balance sheet, we believe we have the capacity to pursue additional acquisitions. In terms of size, we would look at any proposition. We do have strict financial criteria and we won't be tempted to loosen the reins simply to chase revenue growth. Sustainable earnings are the key.

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Are there opportunities to further streamline your businesses?

MD Rob Collins
The streamlining of our business is ongoing. We currently perform at or above the industry benchmarks and will continue to focus on efficiency gains in our businesses, without giving up market share. We've made considerable progress in the last four years and there's more that can be done.

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Where is Candle in the demand cycle for employment services and what is the outlook for the sector?

MD Rob Collins
Demand will continue to improve as we move to periods of relatively full employment and solid corporate profits. There seems to be a general expectation of sustainable demand for personnel and there's a lot of press around skills shortages.

A market characterised by an increasing demand for staff and skills shortages underpins the value proposition for recruitment companies. Our proposition is to locate talent that would otherwise not have been found by employers when using their own standard search methods or in-house services. We have very strong brands, a very good geographic spread and many long-standing and loyal clients. In improving market conditions, we are well-positioned to repeat the kind of growth we've experienced over the last three years. On a full year basis our expectation is for strong profit growth.

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Thank you Rob.

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For further information on Candle Australia Limited, visit www.candle.com.au or email Rob Collins at rcollins@candle.com.au.