

ASX Announcement : 29 August 2012

CEO on Full Year Results and Outlook

Open Briefing interview with CEO and MD Kym Quick

Clarius Group Limited
Level 3, Suite 302
70 Pitt Street
Sydney NSW 2000

Clarius Group Limited (ASX: CND) is a specialist provider of contracting, staffing and recruitment services to corporate and government organisations across the Asia Pacific region.

Market Capitalisation - \$32 million

In this Open Briefing[®], Kym discusses:

- FY2012 results and outlook
- Capital management and dividend policy
- Strong positioning for longer term

Record of interview:

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Clarius Group (ASX: CND) recently reported NPAT (excluding impairment charges) of \$2.1 million for the year ended 30 June 2012, compared with \$4.3 million in the previous year. What has been the recent trend in trading conditions and what visibility do you have regarding revenue and NPAT over FY2013?

MD Kym Quick

Trading conditions in FY2012 were mixed. In the first half we saw permanent recruitment revenue showing signs of strengthening and contract revenues remained fairly steady. Contract numbers across the year remained at around the 2,400 level. In the second half, permanent recruitment revenue flattened and we're continuing to see that into FY2013. For at least the next six months, we expect a similar trend where contracting demand is fairly steady and permanent revenue remains flat.

Over the next six to 12 months we expect some growth in our NPAT. We've made savings on our cost base and continued to look at where we can minimise costs. We've also made a concerted effort to improve the productivity of our consultants which will help us weather the lower permanent recruitment numbers. Our investment in our business in China is also expected to deliver an improved result in the next half.

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Clarius recorded a goodwill impairment of \$11.5 million in FY2012. This compares with an impairment of \$14.6 million in the previous year. You've written down to zero the goodwill associated with Candle New Zealand, Lloyd Morgan Australia and JAV IT Group. What are the earnings prospects for these units in the nearer term, and considering ongoing volatile market conditions, do you expect further impairment to the carrying value of assets in FY2013?

MD Kym Quick

Some of the businesses we impaired are performing quite strongly and had reasonable results in the last half. Those businesses were acquired around the peak of the market, and the market has continued to show signs of weakness, so we've taken the opportunity to write down the goodwill in those brands to zero.

We expect stronger results from Candle New Zealand this financial year. It has a new management team in Auckland who are delivering good results. Lloyd Morgan Australia is focused on the finance, banking and accounting sector. The commercial accounting market is reasonably good and we're focused on gaining traction in that market. The banking sector is still struggling. When the market starts to turn, we expect the banking and finance sector to grow and have a positive impact on the trading results of Lloyd Morgan Australia.

The other part of the impairment was related to the Alliance Brand which is the consolidation of about eight different brands acquired over a period of time. Alliance should continue to perform well, after a very strong second half which has flowed through to the start of this financial year.

The goodwill left in the balance sheet is largely attributable to Candle. We don't expect to see future impairments there as Candle was grown organically and there's no goodwill against the primary business. The goodwill relates to the accumulation of three different businesses acquired some time ago, so there is plenty of headroom. Alliance is the other large component of goodwill and given the impairment we've just taken, we don't expect further impairment unless trading conditions change severely.

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Clarius booked gross profit of \$46.3 million in FY2012, down from \$51.9 million in the previous year. Employee costs and overheads were reduced \$0.6 million and \$1.1 million to \$32.3 million and \$9.9 million respectively. What is the outlook for gross margin in FY2013 and what ability do you have to further reduce costs in the absence of a turnaround in the broader economy?

MD Kym Quick

We'll see a similar trend to what we've seen over the last two years: continued slow growth in contracting margin and reasonably flat permanent margin. We don't expect that will change in the current half. If sentiment is a bit more positive, it may translate to some growth in permanent revenue versus current trading conditions.

Controlling costs is a significant issue as we don't know when the market will turn and demand for permanent hires and contracting margin will increase. We have further capacity to reduce costs. The upside of the position we're in at the moment is that with our current head count, we have the capacity to increase our revenue and if the market turns, we have the capacity to deliver a better permanent result without adding to our cost base. This will allow us to quickly respond to market conditions.

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The Contracting Business accounted for about 75 percent of total gross profit in FY2012 while Permanent Recruitment accounted for 25 percent. How do you expect this segmentation to trend in FY2013 and how do you plan to deal with ongoing uncertain market conditions in permanent recruitment?

MD Kym Quick

That trend is not going to change significantly soon. The ideal revenue mix we aim for is 70 percent contracting and 30 percent permanent, but in the ideal world, the raw numbers under that mix are higher. We're conscious that the permanent market continues to show negative signs. Despite this, opportunities exist and we're making the most of these.

Where the market isn't necessarily growing, it's important to focus on productivity and conversion rate. We're trying to get a larger piece of the existing market and convert more opportunities into revenue by focusing on service delivery and maximising every opportunity put in front of us.

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Why have Candle, Clarius and Alliance delivered stronger results than your other brands? What is your approach to securing new clients and increasing market share?

MD Kym Quick

Those brands are in a strong position because of their large contracting and temporary bases. Their speciality is delivering contracts and temps. This positions them well in the current market as they have ongoing revenue streams and opportunities. Clients are still hiring, they're just not confident about hiring permanent staff. Projects are still taking place and there is demand for labour in the marketplace but clients are more comfortable taking labour under a contract or temp arrangement.

These brands have strong relationships with their clients. This puts them in a strong position to secure roles and convert them to a permanent basis when clients start to hire permanently. They're also very aggressive with their sales strategies and have won quite a few new clients over the last six months. These brands are also in sectors where there is strong demand for their services. In the Candle and Clarius businesses we continued to see solid demand for IT contracting.

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What is the outlook for your China business? When will the business have a significant effect on revenue and EBIT?

MD Kym Quick

We've completely restructured the China business and have a new managing director. She's put together a very high quality team in Beijing who are delivering good revenue results. We will invest further in that business over the next six months as we build the team. In the current financial year we expect China will either break even or deliver a small profit. That will be a significant turnaround compared with the losses we've incurred previously there.

There is a boom market for labour in China and we have a different business model there. In Australia, we proactively look for opportunities to sell to hiring clients. In China, there is strong demand for labour and a skill shortage so we adopt a candidate focused strategy. In China, we know that if we have good quality candidates, we'll be able to place them.

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Cash outflow from operations was \$2.0 million in FY2012, versus inflow of \$8.7 million in the previous year. The second half saw a turnaround to inflow of \$2.1 million. Is the cash flow improvement in the second half sustainable in FY2013? What scope is there to reduce working capital management?

MD Kym Quick

We believe the improvement is sustainable in the current year. We had challenges in FY2012 in a couple of areas that had a negative impact on the cash flows. We had clients who apparently wanted to hang on to their cash at balance date, but we've been able to come to arrangements with them that ensure they're within their trading terms. We're working very hard to make sure those lines of communication are open. For a couple of larger new clients, we had a challenge at first in getting the process established at the start of the trading relationship. This caused some delays to payment but these issues have now been resolved. In the second half, we put a lot of effort into making sure we were across all our debtors, and becoming more efficient at processing our accounts and understanding the process clients require from us to help them to pay on time.

Working capital is challenging at present because much of the growth we're experiencing is in contracting which puts a lot of pressure on working capital. That will continue to be a challenge while there's more contracting demand than permanent demand.

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As at 30 June 2012, Clarius had net debt of \$1.76 million and gearing of 2.2 percent (net debt/equity). This compares with net cash of \$4.0 million a year earlier. What is the outlook for debt? Given market conditions, are you still structuring your balance sheet to respond to potential acquisition opportunities?

MD Kym Quick

We're always focused on cash flow and maintaining as high a positive cash flow as we can: we want to reserve our cash for acquisition opportunities when and if they arise, and more importantly for some infrastructure projects that will deliver efficiencies down the track.

We're certainly always open to good acquisition opportunities but the challenge is finding good quality businesses that fit our profile and comply with our fairly stringent list of requirements. We focus on getting good quality contracting and temp businesses as opposed to businesses that have a high permanent placement revenue mix. At the moment there aren't a lot of businesses on the market with that profile.

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Clarius will not pay a final dividend. Given an interim dividend of 1 cent per share, your payout ratio for FY2012 (of pre-impairment profit) was 43.2 percent. Previously you stated that the suspension of a dividend payment would only occur under fairly extraordinary market conditions. What drove the decision not to pay a final dividend?

MD Kym Quick

We felt it was prudent. We believe we're seeing extraordinary conditions in terms of how long the weak market is lasting: after the GFC, a couple of times we thought we were seeing signs of recovery, but we've continued to bump along the bottom. In the short term we don't think that's going to change, so we took the view that it would be prudent to conserve our cash resources and reinvest in some infrastructure projects that will deliver more productivity, more efficiency, and consequently more profit and more capacity to pay dividends down the track.

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On a medium to longer term view, how do you see Clarius emerging from the current downswing in the recruitment industry cycle?

MD Kym Quick

We're in good shape: we've got a very solid contract workforce and very good relationships with key clients, clients who have continued hiring through the downturn, and that's been a real plus for our business mix. In the industry there's an age-old theory that your contracting revenue and margins pay your bills and your revenue from permanent placements is the cream on top. That's proven to be true for us. Our contracting capacity gives us strong backing to work through the difficult times, and while the loss of permanent revenue has impacted our gross margin, we're well positioned when the market turns to be able to fill that capacity. Our cost structure is far stronger, our productivity is increasing and we believe we'll come through this cycle with a much stronger business than we had going into it. We believe we'll be well positioned to capitalise on market opportunities ahead of the curve.

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Thank you Kym

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