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# ASX ANNOUNCEMENT

## 2011 ANNUAL GENERAL MEETING CHAIRMAN & CEO ADDRESSES 25 October 2011

### CHAIRMAN'S ADDRESS TED KUNKEL

It will be no surprise to anyone in this room when I say that the 2010-11 financial year was extremely difficult for the Billabong Group. It was a year of great economic uncertainty around the world; a year of very significant foreign exchange rate fluctuations; and a year in which natural disasters struck multiple countries in the Group's highest margin territory of Australasia. These events further eroded what was already fragile consumer confidence, in particular in Australia and, late in the year, Europe, which ultimately impacted wholesale and retail sales. Added to this, the Group faced a year when the cost of raw materials such as cotton reached all-time highs and significant wage cost pressures emerged in the China supply chain, with little or no ability to recover these costs in competitive, price-sensitive markets. All of these factors combined to reduce the Group's overall profitability.

Important as these issues have been, some ongoing and helping to shape the future and some, hopefully, never to be repeated, the real determining factor on the continued growth of the Billabong Group business is the success of the strategies employed to respond to the structural changes that have occurred within the boardsports industry over the past three years or so. These structural changes, as I will discuss shortly, necessitated a response, the most obvious being the Group's deeper move into direct-to-consumer sales through the acquisition of specific retail banners and the purchase and/or development of online businesses.

So what was that structural change and why did the Billabong Group respond the way it did?

When discussing structural change it is important to understand the evolution of the boardsports industry. There are two key groups in the industry, being the brand owners and the specialty retailers. The brand owners are the product innovators, the supporters of the athletes and events and the providers of the merchandise, while the retailers are the important interface through which the brands connect with the consumer.

Historically, these retailers have predominantly been independent operators of small businesses and, while servicing their local communities well, their capacity to reinvest into their businesses, particularly through an extended downturn in consumer sentiment, has been limited. Many of these retailers were the first generation of boardsport retailers and, given they had been operating their stores for most of their working lives, were looking at opportunities to exit their businesses.

Over the same period, there was also the emergence of several large chain retailers specialising in the boardsports sector. One particular trend among the larger mall-based retailers has been a transition to vertical product, thereby reducing the floorspace available to authentic boardsport brands and, in many instances, watering down the appeal of the stores to the core boardsports consumer demographic. This vertical product trend, where the retailer creates an own brand and sources goods directly from offshore, is more attractive when the purchasing currency is strong, as the AUD has been for some time.





The historical model of the boardsports retail structure has therefore been undergoing rapid change and with it the traditional long lead-time indent system. Retailers, generally, were indenting less, ordering much later and preferring to rely on in-season buying.

The Billabong Group had observed these trends over several years, primarily in North America and parts of Australasia, but noted a sharp acceleration in recent years principally driven by the economic forces resulting from the global financial crisis. Left unchallenged these trends had the capacity to undermine the future growth prospects of the Billabong Group.

Following extensive market analysis, it was determined that the Billabong Group would, in some regions, look to gain greater control of its route to market. This led to a series of small retail acquisitions and, in the past year, the acquisitions of larger retailers including Canada's West 49 and Australian retailers Surf Dive 'n' Ski, Jetty Surf, Rush Surf and Surffection. While there were sound commercial considerations supporting each of the acquisitions, there was also an acknowledgment by the Group that there would be a year of transition when margins and profitability would be adversely impacted as the Group evolved from wholesale supplier to the stores to the owner of the stores. At the time of the acquisitions, management stressed that the benefits of the retail acquisitions, primarily the capture of the vertical margins, would only start to flow from the second year of ownership. To the close of the 2010-11 financial year, the Group had owned the major Australian retail acquisitions for approximately seven months and the West 49 business for just 10 months. So, the message here is that the Group is now through its previously-foreshadowed transition year and expects the benefits from the retail acquisitions to start flowing in the 2011-12 financial year.

It is worthwhile pointing out that the above dynamics are only apparent in markets that have been established for many years. In destinations such as Asia there is no wholesale channel and therefore the route to market is to build retail, which the Group has done very successfully and profitably to date and continues to do so. Markets such as South America and most of Europe, on the other hand, still have a developing wholesale account base so there is likely to be lower retail investment into those regions.

Another major retail trend that emerged in the past year is the migration of consumers to online sales platforms. This has been an area in which the Billabong Group has invested in recent years. Online sales, primarily through the Swell.com and SurfStitch.com businesses, accounted for approximately 3% of Group sales in the 2010-11 financial year and their contribution to Group sales should rise by in excess of 50% in the current financial year. This remains a very fast growing business unit and is considered complementary to the Group's bricks-and-mortar retail assets. To give you a feel for the success of the Group's online operations, in the past month alone SurfStitch was awarded the Online Fashion Retailer of the Year by the Australian Interactive Media Industry Association and the Best Online Pure Play and Best Use of Technology awards at the annual Australian Online Retail Industry Awards.

Of course, the overall re-balancing between the wholesale and retail operations has been reflected in some internal restructuring within the Billabong Group. The Group already had its own retail operations and these have been expanded and, where appropriate, duplication within the acquired businesses has been removed. So, when the acquired assets are fully integrated into the Group there will be ongoing synergies in areas such as warehousing, IT and back-end services that should further benefit the business into the future.



Just to give shareholders a feel for where the Billabong Group is at in the retail integration process, the Group has:

- Installed new management at West 49 in Canada, closed its loss-making Off The Wall banner and is now beginning to generate a healthier level of profit. As an example, let me describe for all shareholders the progress the Group is making with West 49 in what is a somewhat depressed Canadian market. Prior to the acquisition, which cost \$99 million, the annual EBITDA contribution to the Billabong Group on previous wholesale sales made to West 49 was approximately \$5 million, with a store penetration level of 15% company owned product. For the year ending 30 June 2012, Billabong anticipates an EBITDA contribution in excess of \$15 million with approximately 35% penetration of company owned brands. This EBITDA contribution is expected to rise further in the 2012-13 financial year as company owned brand penetration increases and additional operational synergies are realised.
- In Australia, the Billabong Group is now in the final phase of the migration of all retail businesses across to a common IT platform, the consolidation of multiple warehouses into a single warehouse, the wrapping of all back-office support and systems into the Billabong Group's existing structure and the elevation of the Group's in-store brand presence.
- Currently, the Group's direct-to-consumer sales (company owned retail and online businesses) account for approximately 40% of the Group's global sales.

Going forward, the wholesale account base appears to be stabilising in the US, remains volatile in Australia and Europe and continues to grow in emerging markets including South and Central America. Online sales are expected to grow strongly, while in company owned retail a concentration on family brand penetration and innovation will help lift sales, profit and returns.

As disclosed at the time of the full year results, cash flow from operating activities was significantly lower in the 2010-11 financial year compared to the prior year, reflecting, among other things, increased inventory driven by the significant move into retail, coupled with an increase in inventory in the wholesale side of the business. The Group is focused on improvements in these areas and remains on track for a significant improvement in cash flow from operating activities in the 2011-12 financial year.

I would like to remind shareholders that in the 2010-11 financial year the net profit after tax result for the Group was supported by some large one-off tax benefits that are not expected to recur in the 2011-12 financial year, so I would encourage shareholders to judge the Group this year on strong underlying EBITDA growth and strong operating cash generation as a consequence of the anticipated improved EBITDA and a reduction in working capital as a percentage of sales.

Additionally, I can assure shareholders that the Group is acutely focused on the delivery, over time, of a continuous improvement in return on capital employed that is above the Group's cost of capital.

In relation to Board composition, shareholders will be aware that Margaret Jackson is retiring at the conclusion of this meeting and I will make the appropriate comments at that time. With the currently available pool of funds, there is capacity to bring up to three new Directors onto the Board. The Group is targeting specific retail, financial and HR governance expertise and will remain patient in order to secure the services of appropriate individuals.



Finally, before handing over to Derek O'Neill, I would like to take this opportunity to acknowledge the performance of the Group's employees globally. I can assure all shareholders that, within the boardsports sector, this Group remains the standout performer and I thank all employees for their contribution to this most progressive of companies.

**CEO'S ADDRESS**  
**DEREK O'NEILL**

Thank you Ted. Good morning everyone and thank you for your attendance.

As you are no doubt aware and as you've just heard in the Chairman's address, the 2010-11 financial year was not one without challenges. The key among these were the subdued consumer environment in Australia, the moderation of growth in Europe late in the year and the perceived performance of the Group's acquired retail interests. I'll come to each of those points shortly, but first I will just remind you of the Group's overall financial performance for the year.

The Group had reported global sales of \$1.68 billion that was 23.8% higher than the prior year in constant currency terms (or up 13.6% in reported Australian dollar terms) and this was driven largely by the first-time inclusion of some acquisitions. Net profit after tax of \$119.1 million was down 6.9% in constant currency terms (or down 18.4% in reported AUD terms), partly due to the initial impact of acquired assets. For those of you who attended this meeting last year, you will recall my reference to the 2010-11 financial year as being one of transition and that is certainly how it played out. It was a year in which the Group made strategic moves to enhance the long term growth prospects of the business – and the cost of that was the loss of some short term profitability. It is also worth pointing out that there was a negative impact to profit translation from the very strong Australian dollar, whose appreciation against the USD and Euro in particular, reduced the Group's sales revenue by \$123 million and net profit after tax by \$18 million. I remind you that the AUD has been one of the most volatile currencies in the world and it is this volatility, not the strength or weakness of the currency, that is particularly challenging for international businesses like ours.

From a regional perspective, the Group had a strong performance from the Americas region, a good performance in Europe, with the exception of the final two months of the year, strong results in Asia (excluding Japan) and some obvious challenges in Australia.

So what has happened in some key markets since the close of the financial year?

Overall, the business in the first quarter generally performed to internal expectations. In revenue terms, total sales for the Group to 30 September 2011 were up 24.7% over the same period in the prior year in constant currency terms. Excluding acquisitions, Group sales revenue was up approximately 6% and the business remains on track to deliver strong underlying EBITDA growth in constant currency terms in the 2011-12 financial year. I can advise that the vertical margin contribution that the Group anticipated from the move deeper into retail is starting to become apparent, so that gives us confidence that the direct-to-consumer strategy is sound.

Our largest sales territory, the United States, has continued to perform well, in particular within company owned retail. The Group has seen same store sales growth for the first quarter of 6.4%, with the month of September up a strong 9.0%. The Group has also experienced quite a stable environment in the wholesale channel, particularly among the smaller specialty retailers.



There are some similarities in Australia, with the smaller wholesale specialty account base performing quite well. Overall, it is interesting to note that retail sales in areas including Sydney remain reasonably weak, as does the Group's lower-margin outlet store business. It is encouraging, however, that the areas where the Group has been investing – the full-price direct-to-consumer channel, which includes company owned bricks-and-mortar retail and online business – generated positive comparable store sales growth in the first quarter. Overall, the Group's direct-to-consumer business recorded positive comps around 3% to 4% in the first quarter and is beginning to see some vertical margin flow through as summer has presented the first opportunity where the Group has had full control of the selection of products on the floor in acquired retail businesses. While talking about growth, I should indicate that the sales revenue contribution from the Group's online business – being SurfStitch and other banners – is expected to be in the range of 7% of overall Australian sales in the current financial year. This shows that Australians are confident to shop at proven and trusted domestic online platforms.

Moving back to bricks and mortar retail, another early trend of note in Australia is that the small number of acquired retail stores that have undergone a refit are generating double-digit increases in sales per square metre. I have recently been through a number of stores and I have found the Billabong Group's ranges to be among the strongest I have seen and, while the Group is still dealing with the final parts of the integration of retail warehouses and IT platforms, this places the business in a good position heading into the important retail months of November, December and January.

I should point out that the family brand share in all of the Group's acquired retail operations has been lifting and this is leading to better profitability for the business. So the direct-to-consumer business model the Group is pursuing is starting to benefit the business. I do realise that the market often has a short term focus on performance, but the Group is working on longer term outcomes and those should start to become apparent in the current financial year.

As a final note on Australian retail I wanted to let you know that the Group has appointed an executive to oversee the performance of the Group's domestic banners. Chris Athas, one of the country's leading authorities on youth retailing and the founder of the Group's Surflection retail banner, has accepted the role of head of Australian retail. It is an exciting appointment and I welcome Chris and look forward to his contribution.

Looking elsewhere, the Group's business in Asia continues to perform strongly, particularly in Japan which is recovering well from the tragic earthquake and tsunami of March 2011.

In Europe, the Group continues to see solid revenue growth year to date, although margins have softened slightly due to higher product input costs from earlier in the year. As investors are no doubt aware, there is great uncertainty about the economic fundamentals of several European countries so – despite the continued growth in sales – the Group remains cautious in our outlook for this region until greater clarity emerges.

As identified at the time of the full year results, I remind shareholders of the significance of the December and June trading periods and their weighting in our full year results. Both of these months, which represent the peak of Christmas trading in company owned retail stores worldwide and key product deliveries windows in the northern hemisphere, are very important to the overall performance of the Group.

So, overall, I can reiterate that the Group is performing to plan and anticipates strong underlying EBITDA growth in constant currency terms in the current financial year.



I think it important to also provide a broader view of the business outside of the financials, so let's have a quick look at some of the recent non-financial achievements of the Group.

Two weeks ago I was in New York and accepted a Leader of Change award on behalf of the Group. The award, presented by the United Nations-supported Foundation for Social Change, was one of only 10 awards granted in recognition for the range of social and environmental initiatives under way throughout the business and I note this is the first time an Australian company has received this award. While on environmental matters, it worth mentioning that the Group is just finalising the audit of its global carbon footprint and it is expected to be in the range of 28,000 tonnes of CO<sub>2</sub>-equivalent. This would be up on the prior year, which was to be expected given the Group accounted for more than 200 additional locations due to recent retail acquisitions. It is also worth mentioning that the Group continues to look for ways to improve social and environmental outcomes and, with this in mind, we will be signing on to a call-to-action from the International Textile, Garment and Leather Workers Federation to eliminate all sandblasting throughout the supply chain.

In terms of innovation, the Billabong Group remained at the forefront of the industry. The Group received 13 nominations in the most recent US-based Surf Industry Manufacturers Awards and ultimately won categories including Men's Apparel Brand of the Year for RVCA, Women's Apparel Brand of the Year for Billabong and Wetsuit of the Year for Xcel. In Europe at the EuroSIMA Awards Billabong also won the advertising campaign of the year for its compelling "I Surf Because ..." series.

Innovation has continued through to the Billabong Group's world tour surfing events. At the Billabong Pro in Tahiti, Billabong introduced industry-leading heat analysing functionality to its live international webcast. It added to an extraordinary event, during which Billabong broadcast the most watched live surfing event in history – a tow surf session in which the world's premier big wave riders took on one of the biggest swells ever witnessed in Tahiti. The broadcast attracted 4 million website visits, 25 million page views, 2.5 million live views, 4 million YouTube video plays and 330,000 viewers on mobile phones. It was also broadcast live on television around the world, with the signal reaching into more than 5 million households through networks including Fuel TV and Time Warner. At the Billabong Pro Jeffreys Bay, Billabong continued to set the standard in its environmental education and reporting initiatives, which have previously been the subject of a congratulatory speech in the South African Parliament. At the Billabong Pro Brazil, surfing was taken into the populous Rio de Janeiro, one of the world's most exciting surf destinations and a major growth market for the Group.

Finally, innovation is evident with the Group's global online operations leading the boardsports industry. In Australia, as indicated by the Chairman, SurfStitch.com has recently picked up three major industry awards.

These are just a few of the initiatives under way throughout the Group and I trust they give you a sense of the progressive approach of this company, your company.

Thank you for your ongoing support and I look forward to rewarding you through the delivery of a strong performance for the Group through the year.