

THOMSON REUTERS STREETEVENETS

# EDITED TRANSCRIPT

BBG.AX - Interim 2013 Billabong Earnings Conference Call

EVENT DATE/TIME: FEBRUARY 21, 2013 / 11:30PM GMT



## CORPORATE PARTICIPANTS

**Launa Inman** *Billabong International Limited - Managing Director and CEO*

**Peter Myers** *Billabong International Limited - CFO*

## CONFERENCE CALL PARTICIPANTS

**Craig Woolford** *Citi Investment Research - Analyst*

**Phillip Kimber** *Goldman Sachs - Analyst*

**Daniel Broeren** *CIMB Equities - Analyst*

**Grant Saligari** *Credit Suisse - Analyst*

**Michael Simotas** *Deutsche Bank - Analyst*

**Jordan Rogers** *Commonwealth Bank of Australia - Analyst*

**Shaun Cousins** *J.P. Morgan - Analyst*

**Ben Gilbert** *UBS - Analyst*

**Tom Kierath** *Morgan Stanley - Analyst*

**David Cooke** *Nomura Group - Analyst*

## PRESENTATION

### Operator

Thank you for standing by and welcome to the Billabong half year results conference call. At this time all participants are in a listen only mode. There will be a presentation followed by a question and answer session. (Operator Instructions) I must advise you that this conference is being recorded today, Friday the 22nd of February 2013. I would now like to hand the conference over to your first speaker today, Launa Inman. Please go ahead Ms Inman.

---

### Launa Inman - *Billabong International Limited - Managing Director and CEO*

Thank you very much. Good morning everyone. A short while ago we posted at our half year results to the ASX. I appreciate that you haven't had an opportunity to go through those in detail, so this morning we will go through the presentation which is also available on [www.billabongbiz.com](http://www.billabongbiz.com) followed by questions. Just to remind you today's call is being recorded and a transcript will be made available on our investor website.

If anyone within or outside of Billabong still believes we don't need to radically change the way we run this business, today's half year results ends that illusion. Billabong is undergoing significant structural change. To unlock the opportunities within the Group, it must be transparent and directly addressed and learned from the events of the past.

Turning to page three in the slide pack, net loss after tax of AUD536.6 million for the half year is heavily impacted by AUD567 million of significant items, consisting of AUD428 million impairment for goodwill and brands; and AUD107 million relating to the partial sale of Nixon on 16 April 2012. Yet despite the well publicised distractions in the last six months, the Group has seen improvements in key parts of the business. Excluding Nixon and significant items adjusted EBITDA of AUD57.2 million increased by 12.9% in constant currency terms compared to the prior corresponding period.

Pleasingly driven in a large part by cost reduction EBITDA increased 45% in constant currency terms in North America, with that figure being 29.3% for Australasia. However EBITDA in Europe is down 78%. That result is not only disappointing it is unacceptable. We are taking direct steps to address it through commencing a restructure of the operations.

In late August I announced a transformation strategy for Billabong. Six months later we are broadly on track with what we aimed to do if not always at the speed of which I would have liked. Equally it is in the shareholders' interests that management gives appropriate focus to the previously announced potential takeover processes. Costs have been reduced in particular through the store closure program with 119 stores already closed and approximately 14 more closing by June 2013. Next month we are reducing our apparel suppliers from over 270 to 50.

We have put in place a global leadership structure, made key appointments and are shifting from being three regional business units to one global company. Today I will address all these issues in more detail, along with our CFO Peter Myers who joined us just four weeks ago.

Before we proceed further I want to provide you with an update on the due diligence process being conducted on the business by both Sycamore and VF/ Altamont consortia. Due diligence by the consortia is ongoing. Albeit at an advanced stage. Representatives from both consortia have and continue to meet with management and conduct site and store visits in Australia, Asia, North America and Europe. Due diligence is expected to conclude next month.

I will now turn to the transformation strategy that I last updated the market on our October AGM. This is outlined on slide nine in your presentation. In January I detailed to all staff a new management structure that moves away from regional reporting lines, to a global structure. The business has made several key appointments to that new structure including CFO Peter Myers, Jason Millett to head our IT, e-commerce and transformation initiatives. And Peter Bryant as Commercial Operations Executive. We have a short list of several executives for key roles such as global supply in chain. Given the current process being conducted on the business those appointments have not been finalised.

Reporting lines for our finance and IT team are now global. A wider reorganisation of the business to align globally is now under advanced development. This is not simply a structural or administration change but an important step in having clear accountability across the business and improving transparency. As I highlighted earlier 160 stores are forecast to be closed by June 2013. This does not mean the focus on retail performance ends.

Working with our global head of retail, Colin Haggerty, the equation for every store across our operations is quite simple. Grow it, fix it or close it. Similarly in every company in which we operate we are investigating the best distribution model for the business. Late last year we moved from running our own operations in Thailand to entering a third party distribution agreement. Likewise in India we have entered into a distribution agreement with Arvind who work with a number of global apparel brands.

The appointment of Peter Bryant will see us accelerate a country by country review ensuring that it will be retail, wholesale and online that we have in place the best, most efficient and cost effective distribution systems. Next money we will implement a significant reduction in the number of suppliers we work with. Not only will this bring cost savings but efficiencies in the way and the time it takes our products to get to the market. Quality has always been a benchmark our brand deliver and ensuring appropriate controls are around that will be made easier with streamlined supplier relationships.

Under the direction of Jason Millett, we have in place a transformation office, which reports through to myself and the management team on progress or issues that will be addressed. Jason is also focused on integrating and improving our various IT and reporting systems. There's a long way to go but again it's amazing what a little global collaboration between teams can achieve in a short time.

We recognise the growth of e-commerce is essential to the future success of the business. Ensuring we have a robust infrastructure and websites that are visually appealing to our customers and easy to use are critical. We are in a testing or design phase of new mobile phone apps for our brand and to drive traffic to both our online and retail stores. The initial AUD700,000 e-commerce investment has commenced.

Brands are at the heart of our business and as I have previously called out we need to invest in them and in particular brand Billabong to arrest its decline. The first and important step of that process is the development of a global women's wear strategy which is well advanced. We reviewed the success of Billabong in the past and it was evident that women's wear was a critical part of that success. We also know from our own research in recent months that in both retail and online women are key drivers of purchasing both female and male Billabong apparel.



Finally along with running the day to day business and managing the uncertainty for the last six months the team across Billabong has had to change long standing ways of doing things and engrained organisational thinking as we implement the transformation strategy. As it is natural that is challenging for some. The majority love the brand, love the business and want the best for it. I thank them for their contribution to change over a testing time.

Heading now to the slides on regional performance. I don't intend to go through all the details on those slides but naturally we're happy to take questions. I will however make some general comments. Trading conditions globally remain tough. Europe is of course of most concern but Canada is also weak. There's heavy discounting occurring in retail in the US but I think we're getting far better at adjusting our operations to meet that challenge and implement sensible promotional activities to drive sales.

Australia has performed well overall especially online. I am also pleased with the cost the management team have been able to take out of the business to date. Globally online retailing is a bright spot for business. In Europe, SurfStitch is growing but still loss making as it establishes itself in that market. In Australia, its performance is positive. In the US in recent months the changes we made at SWELL are starting to have a positive impact.

Now let me hand over to Peter Myers to address financials in more detail.

---

**Peter Myers** - *Billabong International Limited - CFO*

Thanks Launa and good morning to everyone. It's great to be up --

---

**Operator**

Sorry we seem to be having a technical difficulty at the moment.

---

**Peter Myers** - *Billabong International Limited - CFO*

Hello. Can you hear me?

---

**Operator**

Thank you, we now have the speakers back on line.

---

**Peter Myers** - *Billabong International Limited - CFO*

So, at the risk -- I'm not sure where that dropped out but I just wanted to say good morning and it's good to be here on the Gold Coast and to those who I have had the opportunity to meet, I'd say hello and to those listening who I have not yet caught up with, I hope I can rectify that and get an opportunity to do so soon.

Obviously I joined Billabong at a very interesting time and just like you, curious as to how the next little while plays out. For me, it makes for an interesting situation and an interesting opportunity. As I said, I caught up with some of you and the feedback was extremely helpful and we tried to make a few changes to the way we present but I would be very keen to do more.

From my perspective, there is a little bit of everything in today's results. The impairment charges made for a large headline loss. We have got a very difficult trading result in Europe. We have improved performances in Australasia and the Americas but mostly on the back of cost outs. Finally, since we are beginning to cycle tougher comps, the costs in H2, of course, is outlook.



A couple of observations, if I may. From my brief time at Billabong, I look at a business that has landed hard from better times. But I also see opportunity and some strong ingredients for recovery. The result today is no more than an outcome of what has been in place. The opportunities will take time to execute, the confidence will take time to rebuild and as Launa has clearly said, it won't be easy.

There is no doubt things must change and whilst I have only been here a short time, it is clear that we must improve our systems and our toolkit and that is underway. I will also reorganise our resources to focus more closely on forward looking things, our planning and our capital and investment decision-making. We also need to continue to improve our communication.

So this first page, and I am talking really to slide 11, is a repeat of prior years. It has a lot of data on it but it is hard to describe it as information. So, for example, we need to help you understand things like the impact of the sales of Nixon as we compare our year-on-year results. Hopefully we have assisted you in your efforts to do that as we have stripped this out in most of the tables where it is appropriate. Again, I am sure there are more opportunities for us to make further improvements.

But turning to page 12, significant items, today we have announced a number of significant items, including impairment charges, as we foreshadowed in the market statement back in December, and those impairment charges total AUD428 million and we've also announced a write down of our investment in Nixon to AUD29 million. The impairments relate mainly to brand Billabong and to goodwill in our North American CGU. The impairment charges are non-cash and reflect the necessary response to our accounting obligations recurring value.

The directors continue to believe in our brand for the long term and continue to believe in the opportunities outlined in the transformation plan. The Group's investment in Nixon has been written down to AUD29 million and directors appreciate that this is a material write down but note the valuation of the Group's investment in Nixon is subject to more volatility than traditional DCF style valuations of intangibles, because of the impact of the Nixon capital structure and including the financial leverage that is inside the new Nixon entity.

The valuation exercise is driven by point in time estimates, the future EBITDA and estimates of future transaction multiples and is very sensitive to changes in key assumptions. But Nixon is currently under-performing its original forecast and you can see from the contributions from our equity accounted share of Nixon's impact, which was just AUD1.1 million for the period. However, the directors believe that there are opportunities for Nixon to improve its performance from current levels and we will be working very hard on those.

Apart from impairment charges and significant items like bid costs, transformation consulting costs and the impact of the SurfStitch acquisition, whereby a significant part of the option value was classified as a payment for service and therefore taken through the profit and loss. Finally there was some increases in provisions for owners' contracts and the like.

Moving to page 13, the balance sheet. We have made progress in reducing our working capital. Twelve months ago our working capital represented 25.4% as the percentage of the prior 12 months' sales. This year it was 19%. Inventories are well down year-on-year but we have not made as much progress during the current half, the December half, as we would like, especially in Europe which has clearly been impacted by its sales decline and this is a major area of focus for us.

Net debt has been relatively steady for the period, with the retail proceeds of the equity raising offset by deferred payments from DaKine acquired by (inaudible). Since December last year, net debt has come down by more than AUD350 million, including the nearly AUD300 million proceeds derived from the partial sale of Nixon. The first purchase consideration outstanding has been reduced to AUD55 million, of which AUD9 million for the Jetty SDS acquisition is due later this calendar year.

The accounts note that at that balance date, we have classified our bank debts as a current liability, since the impairment charges taken today would have caused a covenant breach. Since the end of the year, our banks have amended the shareholders' funds covenant such that we are now in compliance and as of today the facilities do not mature until July 2014.

Turning to cash flow. Operating cash flow was well down on the prior year which included the operating cash flow of Nixon. Excluding Nixon, our operating cash flow was satisfactory, having regard to the payments that were made in respect of significant and exceptional items from prior periods which amounted to about AUD30 million.



Capital expenditure was much reduced and we have introduced increased rigour around our investment cases. During the period we paid out AUD68 million for acquisitions but the vast majority of this was for the deferred pay outs that I mentioned a moment ago. No dividends were paid during the half and the directors announced there will be no dividend in respect of the 2013 year.

In terms of depreciation and amortisation, the charges were down, mostly due to AUD2 million in Nixon in the prior period but we are seeing some benefit from the store closures as well. That interest expense was down nearly 50% for that half, reflecting a savings on the proceeds of the Nixon transaction. The overall income tax charge is low but once you strip out the impact of the significant items, we see an effective tax rate of 36% and I just note that we did not book certain tax losses in Canada and Europe, which is why that looks just a little high.

Turning to page 16, the directors met yesterday and they approved an outlook statement such that since the December trading guidance of full year EBITDA excluding significant items of AUD85 million to AUD92 million, the Group has continued to post difficult trading conditions in Europe and the performance of Nixon has not met expectations. Performance of the rest of the Group remains broadly in line with expectations. As a result, the Board now expects full year underlying EBITDA excluding significant items to be in a range of AUD74 million to AUD85 million in constant currency terms.

Thank you for your attention and I think we'll now invite questions.

---

## QUESTIONS AND ANSWERS

### Operator

Thank you. We will now begin the question and answer session. (Operator instructions). Your first question comes from the line of Craig Woolford from Citi Investment Research.

---

### Craig Woolford - Citi Investment Research - Analyst

Morning, Launa and Peter. I just wanted to start off with a question about the health of the brands. Can you give some commentary about brand sales performance over the first half?

---

### Launa Inman - Billabong International Limited - Managing Director and CEO

Okay. Good morning, Craig. Let me just kind of talk to you a little bit about where the brands are and also the outlook for them for the second half because I think that is important as well because we do have some sense of it. So let us just start off with the brand Billabong. Brand Billabong has, as you know, been problematic and that is why there is a lot of work going on as to how we restructure it, strategy-wise and where we are going to position it. That is why I actually called up that we need to have a real focus on the women's wear brand because they are key to getting the customers back into the stores, first for women's wear and men's wear.

If I was to give you a summary, overall Billabong right across the board did not perform to the expectations that we would have liked for summer here in Australia and particularly winter in Europe which is was well down.

Going forward from January to June, I am pleased to say that the Billabong orders going forward for America are actually up but they are flat or slightly down for Canada. For Australia, they are down on last year as they are as well for Europe. So Europe right across the board has had a disappointing performance with all their brands.

Having said that though, DaKine is one of the better brands in Europe as is Element but we have not had that success with Element to the same degree in America. But of course the real stand out, and I think this is what is really important, is our up and coming brand [Ruka]. That has been phenomenal, well up, and in fact that's really going to be offering us opportunities going forward.

**Craig Woolford** - *Citi Investment Research - Analyst*

So just to follow up because I'm looking at note A where you've got the impairment of intangibles and the brand value of Billabong is about AUD29.5 million which is actually below DaKine at AUD43.6 million. So should I take a literal interpretation there that the current profitability and outlook for Billabong is worse than brand DaKine?

---

**Peter Myers** - *Billabong International Limited - CFO*

Well, I was just going to say that I think you have got to be a bit careful on some of those granular observations around carrying values. You do end up inevitably in a situation where some of the bigger brands end up carrying a bigger percentage of Group overhead when you start to do those calculations. So I do not think that I would be completely granular as that. I think it is more a directional question for a lawyer in terms of the relative merits of those brands.

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Craig, look, we have called out that Billabong is a concern and that is why it is our number one focus. That is why we are doing all the work on understanding where the brand used to be positioned. That is why we have done all the research and understanding how the customers view the brand. As I said, it is looking better in the US but there is no doubt about it. They are still issues both in Australia and Europe.

---

**Craig Woolford** - *Citi Investment Research - Analyst*

Okay. My only other question was just in the past you've provided the retail store, your own stores, share of sales and EBITDA margin. Can you provide that information again, please?

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

I do not have that on here right now in front of me but what I can give you is I will give you a sense of how retail has performed over the last six months. Just to give you a sense, in North America, Canada, still continues to be problematic. As you know, that has been a chain of stores that has been consistently down in comp store sales on the previous year since we have bought it. In fact, we were about -8% in Canada for the first half.

We have moved Colin Haggerty over to the United States and he's already starting to have some impact on the retail. I'm pleased to say that we managed to arrest what was going to be a very poor December. January and February are still down but now in the bottom end of single-digits. The USA was minus 0.1% in comp store sales, so in total we were minus 6% for the Americas. For Europe we were flat but at the same time margins were really under pressure there because we weren't getting the sales we were requiring so it was very much driven at the expense of margin.

Then finally with Australia we actually ended up in positive territory there. That was particularly driven by the fact that our online business is going exceptionally well. Our comp stores sales, our actual bricks and mortar, were down, but overall our total sales -- and we do include online -- were up for Australia -- or Australasia.

---

**Craig Woolford** - *Citi Investment Research - Analyst*

Okay. So is there any chance we can get that retail sales split maybe after the call or you can provide that?

---

**Peter Myers** - *Billabong International Limited - CFO*

We'll see if we can get it before we sign off.



---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Yes. Look, as you know our retail sales provide 56% of our total sales, but if you're looking for additional information Craig will get that for you.

---

**Craig Woolford** - *Citi Investment Research - Analyst*

Okay. Thank you, Launa, thanks, Peter.

---

**Operator**

The next question comes from the line of Phillip Kimber from Goldman Sachs. Please go ahead.

---

**Phillip Kimber** - *Goldman Sachs - Analyst*

Hi, guys, just a quick clarification to start off with. The EBITDA guidance, does that include the NPAT contribution from Nixon and did the old guidance include that?

---

**Peter Myers** - *Billabong International Limited - CFO*

Yes, it did.

---

**Phillip Kimber** - *Goldman Sachs - Analyst*

Yes. I guess really around the guidance for fiscal '13, if I look at your first half EBITDA of AUD 57 million, last year even including Nixon it was about -- I think it was -- reported AUD74 million. So it was about 75% of the last year's number but your new guidance is suggesting that relative to last year including Nixon, your second half is going to be in the order of half. I just wanted to explore a little bit more why you think it is deteriorating to that extent when, you know, the Americas, if anything, looked like it's picked up momentum a little bit?

---

**Peter Myers** - *Billabong International Limited - CFO*

I think there are two big issues, Phil. One, Nixon is certainly a part of that in terms of its contribution to that sort of number. You know, our expectations that were baked into the previous number, as we said, that's certainly deteriorated. But in terms of a relative year-on-year sense we're certainly going to come up against some harder comps in the second half, around some of the cost outs where they started to come out in this period last year, for sure. I think, and Launa, you might like to talk to this. The closeout channel, I think is going to be -- that we've got a very different strategy in relation to that.

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Okay, just to give you a sense on that, Phil, we did a substantial amount of business in closeout, particularly in America where we sold to such companies such as T.J. Maxx and so on. Now, of course we will still continue to use those avenues where you have an overstock situation but our intention is to pull back on that. We have managed our stock in America much better and we certainly won't have as much stock that we need to clear. So that is very much the one issue that's been a conscious decision in our strategy, to pull back on that.



The second thing is, as I've called out earlier when I spoke to Craig, the orders that are booked forward, particularly for the Billabong brand for both Australia and Europe, are not looking where we would like them to be and therefore as a result we have also been very modest in what our expectations will be for actually in (inaudible) which often, that occurs if the brands do well. So we are being cautious.

---

**Phillip Kimber** - *Goldman Sachs - Analyst*

Okay and on that, I mean, those forward orders being down, is that on a comp basis, is it each -- stores are ordering less or is it a case that you've actually got less accounts now and that's part of why the forward orders are down?

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

It's a number of things. In Europe we've had over 25% of all our accounts closed in the last year, so that of course is going to affect the orders for the current season for them which is going into spring and summer. That's for various reasons, either they've actually gone out of business or we put a credit hold on them, because they've been unable to pay or take big quantities that we would like. Or the third issue is that because they're also consolidating and had some stock left over from the previous season, they have ordered down. So there's a number of contributing factors. Also as I said, we need to look at how do we position Billabong as a brand better.

With regards to Australia we have certainly pulled back on our buying within our own retail, that we are managing our stocks a lot better. If you recall, we had too much stock last year when we were -- between January and June last year so we are cautious on that. But then with regards to the wholesale, as I called out, Billabong brand hasn't had the forward orders that would have liked. Interestingly enough, that's been particularly in the women's wear, which is why there's a lot of work going on in that strategy.

---

**Phillip Kimber** - *Goldman Sachs - Analyst*

Okay and one last one, given if you're sort of looking at giving some additional info, I mean, it would be great if we could get the reconciliation between the first half last year as you reported a year ago and how you've restated it today. I'm assuming the two big ones are you've stripped Nixon out and there was the -- I think your significance might have been a little bit, for first half '12, a little bit different now than what you reported a year ago. Am I missing something else or is it possible to get that reconciliation at some point?

---

**Peter Myers** - *Billabong International Limited - CFO*

Look, it is -- just in terms of the significant items, I'm sure that information is there.

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Sorry, just hold on. We're just looking to see if we can actually find it on hand.

---

**Phillip Kimber** - *Goldman Sachs - Analyst*

Yeah, I think you can get that in--

---

**Peter Myers** - *Billabong International Limited - CFO*

Sorry, I am just informed, Phil, there was one minor change to the classification. I think there's AUD3.7 million you can see on page 20 there that's been identified in the comp in the terms of a specific doubtful debt issue. But you should be able to work that out but I will happily talk to you later and just step you through how that comparison works.

---

**Phillip Kimber** - *Goldman Sachs - Analyst*

That would be great. Thanks.

---

**Operator**

The next question comes from the line of Daniel Broeren from CIMB. Please go ahead.

---

**Daniel Broeren** - *CIMB Equities - Analyst*

Good morning. I've just got a question on Nixon, please. It looks like this is really a Nixon-led downgrade, so can you please just provide a little more transparency as to the operating performance there around sales and EBIT? Just secondly, the vehicle's obviously heavily geared, so can you also give us an update on the covenants and where they sit at the moment, please?

---

**Peter Myers** - *Billabong International Limited - CFO*

Nixon is complying with its covenants and there is no recourse out of any of the Nixon debt back to Billabong, so to answer your last question first. In terms of its performance, its performance is materially down on the expectations at the time of that transaction and I think if you sort of build back up from -- it's probably a couple of issues, Daniel, but if you build back up from a very small contribution in NPAT through the Nixon P&L you end up with EBITDA that is significantly down on last year's number at the half year.

---

**Daniel Broeren** - *CIMB Equities - Analyst*

Okay, just going back to your answer to the second half of the question, around the covenants, I mean by the time we get to the end of June the earnings are going to be very low relative to last year. I think you mentioned that the contribution was just over AUD1 million for the first half. You'd have to think that it would be approaching at breach at that point? I mean, do you think there are risks? Would the Company have to look at an equity-raising and, in that case, would you intend to participate?

---

**Peter Myers** - *Billabong International Limited - CFO*

Let me be clear, the comment I made before in terms of Nixon leverage, because I think that's what you asked me before -- and to give you a bit of an order of magnitude, that Nixon decline is in the 30% or 40% year-on-year, so in terms of its own performance. But the other point I'd make is that the share of associate income from Nixon makes no contribution at all to our banking and never did make any contribution to our banking arrangements, because it's a non-cash item for us.

---

**Daniel Broeren** - *CIMB Equities - Analyst*

Okay. But the vehicle itself, it operates as a separate entity--

---

**Peter Myers** - *Billabong International Limited - CFO*

Yes.



**Daniel Broeren** - *CIMB Equities - Analyst*

--I assume.

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Yes.

---

**Peter Myers** - *Billabong International Limited - CFO*

Completely.

---

**Daniel Broeren** - *CIMB Equities - Analyst*

So if it does breach its own covenants then as a shareholder Billabong would be required to follow its money in a raising or risk being diluted; is that right way to look at it?

---

**Peter Myers** - *Billabong International Limited - CFO*

Yes. Look, it's not staring at a breach.

---

**Daniel Broeren** - *CIMB Equities - Analyst*

Okay, okay. Alright, thank you for that.

---

**Operator**

The next question comes from the line of Grant Saligari from Credit Suisse. Please go ahead.

---

**Grant Saligari** - *Credit Suisse - Analyst*

Thank you. Good morning Launa. I'd just like to explore, if I could, just a couple of clarifications on the cash flow outlook for the second half. First, would it be correct to look at the EBITDA guidance as broadly indicative of the likely operating cash flow coming out of the business in the second half?

---

**Peter Myers** - *Billabong International Limited - CFO*

It would be but for some cash payments of the significant items that are provided as at December.

---

**Grant Saligari** - *Credit Suisse - Analyst*

Okay. So that was going to be just I guess the follow on from that. In terms of some of the stores closures that you've flagged for February is there likely to be any significant cash outflows associated with the store closures, or any of the other transformation initiatives?

---



**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

We have--

---

**Peter Myers** - *Billabong International Limited - CFO*

There's only a couple of million dollars tied up in the store closures and very limited capital in this period in respect of any of the transformation initiatives.

---

**Grant Saligari** - *Credit Suisse - Analyst*

Okay. Your comment on forward orders being a little low heading into the spring summer for the northern hemisphere, and actually a bit low in Australia as well, is that likely to lead to any significant increase in working capital requirements during the second half?

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Let us say one thing, Grant, the orders aren't low for America, and they were of course going into their spring/summer. Australia was going into winter and that's on the Billabong brand, that those orders are looking low.

---

**Grant Saligari** - *Credit Suisse - Analyst*

Just one final one -- thank you -- one final one, if I could. Just the finance costs look quite high relative to I guess the headline debt that appears on the balance sheet, through June through to this period. Is there any particular reason for the finance costs sitting where they are?

---

**Peter Myers** - *Billabong International Limited - CFO*

Just give us one second. Oh yes, sorry, Michael reminds me. It's the timing of when the retail projects come in. If you just take an average set, you don't get that.

---

**Grant Saligari** - *Credit Suisse - Analyst*

Okay. Alright. So just to wrap it up, are you comfortable that you're going to have the cash flows coming through in the second half to continue to finance the transformation?

---

**Peter Myers** - *Billabong International Limited - CFO*

Yes.

---

**Grant Saligari** - *Credit Suisse - Analyst*

Okay. Thank you for the clarifications.

---

**Operator**

The next question comes from the line of Michael Simotas from Deutsche Bank. Please go ahead.



**Michael Simotas** - *Deutsche Bank - Analyst*

Good morning guys. Could you give us a sense for what the expected lease outgoings will be this year, as well on a run rate basis, once you reach the 160 store closure target?

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Sorry, you sounded very faint there. Can you just speak up again, please?

---

**Michael Simotas** - *Deutsche Bank - Analyst*

Sure. I'm just hoping you could provide some detail on what the expected lease outgoings will be in FY13 as well as on a run rate basis once the 160 store closure target is reached?

---

**Peter Myers** - *Billabong International Limited - CFO*

Look, I haven't got those numbers completely at hand but I'm looking at a number in the sort of AUD90-odd million range, plus or minus.

---

**Michael Simotas** - *Deutsche Bank - Analyst*

AUD90-odd million for FY13 and then presumably a little bit lower once additional stores are closed?

---

**Peter Myers** - *Billabong International Limited - CFO*

Yes.

---

**Michael Simotas** - *Deutsche Bank - Analyst*

Okay. With the impairment charge that would have led to a breach of covenant and you've come to an arrangement with the banks, will there be any charge incurred in the second half or ongoing associated with that?

---

**Peter Myers** - *Billabong International Limited - CFO*

Yes there's a slight dip up in margins but nothing otherwise.

---

**Michael Simotas** - *Deutsche Bank - Analyst*

Okay. So there's been mention of the shareholder funds covenant and there's some discussion of the net debt to EBITDA metrics in the pack. Can you talk a little bit about what the headroom is across the covenants now that the shareholder funds covenant has been renegotiated and there's no mention of fixed charges--

---

**Peter Myers** - *Billabong International Limited - CFO*

Look, I think that in my dialogue with the market since I joined the Company, I think everybody appreciates that the various tests are relatively tight for the Company, and we don't make any secret of that. We're comfortable as we look forward that we remain in compliance with those but we do have to watch our cash flow, there's no doubt about that.

---

**Michael Simotas** - *Deutsche Bank - Analyst*

Thanks. Then final one for me, can you just give us some sense please on what the likely outlook is for CapEx for the next half and then potentially the next year as well?

---

**Peter Myers** - *Billabong International Limited - CFO*

Yes. Look, I think we've traditionally run CapEx in around about the sort of AUD40-odd million per annum range. We'd look to do a little bit better than that. We'll certainly redeploy the CapEx focus towards some of the transformation initiatives.

---

**Michael Simotas** - *Deutsche Bank - Analyst*

Okay, thank you.

---

**Operator**

The next question comes from the line of Jordan Rogers from Commonwealth Research. Please go ahead.

---

**Jordan Rogers** - *Commonwealth Bank of Australia - Analyst*

Thanks. I just have a question around the IT integration which you're rolling out from mid-2013. Launa, could you just provide a few of the steps involved and maybe a timeframe of what you're doing there?

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Can you just repeat that question again? The line's breaking up a little.

---

**Jordan Rogers** - *Commonwealth Bank of Australia - Analyst*

Yes, I just had a question around the IT integration roll out from mid-2013.

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Okay. One of the biggest challenges, that you all well know, is that we do not have, as such, a true general ledger right across the business. In order to improve our reporting systems we are introducing a recording system called Lawson. Now that is actually going to be introduced initially first into France, which will be kind of mid-year, and then from there it will then go on to both America and Australia. Realistically for it to be fully operative it will take about two years from then.

---



**Peter Myers** - *Billabong International Limited - CFO*

Just maybe to give a bit of flavour to that, it was certainly -- in my earlier remarks I talked about the need for improved tool kits. That was at the heart of my remarks there. What I can say is I see excellent engagement and sponsorship for the project in the business and I think everyone's looking forward to seeing that improved tool kit that will be available to us right across the business.

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

That's why we've actually appointed an IT General Manager. If you recall in the past we've never really had that. The IT personnel reported through to each region, so it was very difficult to get a full understanding of what was happening IT-wise within each region. Now having one person to go to, who's actually pulling together the whole IT and the needs that are going to be required ongoing for us to be able to deliver the strategy, has already been beneficial in the last couple of months, I mean, just for me alone. At least I've got the one person I can go to.

---

**Jordan Rogers** - *Commonwealth Bank of Australia - Analyst*

Sure. Just the last question from me. I know a lot's changed since the FY12 result but are you still working towards the AUD239 million EBITDA FY16 transformation strategy target or is that now under review?

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Yes. No, I'm not going to comment on that one. As you can appreciate there is so much going on within this organisation. My objective is to stabilise the business, get the right people in place and really push the organisational structure to where we believe it should be so that we can make decisions quicker and faster, and I truly believe that we'll also lean -- create a leaner organisation. But at this stage I'm not prepared to comment on that.

---

**Jordan Rogers** - *Commonwealth Bank of Australia - Analyst*

Sure. Thank you.

---

**Operator**

The next question comes from the line of Shaun Cousins from J.P. Morgan. Please go ahead.

---

**Shaun Cousins** - *J.P. Morgan - Analyst*

Thanks. Thanks very much. Just a question regarding the receipt of cost saving benefits this year. I think it was AUD30 million in cost savings and then another AUD6 million of cost savings during fiscal '13. Are they on track and did they come through equally 50/50 across the first half, second half?

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Yes, they did, and they are on track. As you know, we have certainly made progress on closing the stores, et cetera, so yes.

---

**Shaun Cousins** - *J.P. Morgan - Analyst*

Yes, okay. Fantastic. In terms of the significant items, your intangible assets in your fiscal '12 result were based on 11.4% EBITDA margin and achieving that fiscal '16 EBITDA target that Jordan just asked about. If you've impaired your intangible assets to I think down by AUD4.28 million, does that not mean that fiscal '16 EBITDA target is not achievable?

---

**Peter Myers** - *Billabong International Limited - CFO*

No--

---

**Shaun Cousins** - *J.P. Morgan - Analyst*

Well, certainly the Board don't believe that.

---

**Peter Myers** - *Billabong International Limited - CFO*

Shaun, let me talk to that. The science of impairment testing is a relatively interesting one. I'm not sure whether describing it as a science is the right thing to do. I guess it's a starting point for any impairment testing, you'll often look to some external factors and you'll look to things like overall market cap for the organisation and the like.

That, I think, gives you a sort of guide as to -- perhaps you know these things as well as I do but -- gives you a guide in terms of perhaps increase in WACC, and the discount rates and all of those sorts of risk factors that you want to build in -- changes to terminal values. So a lot more goes in to it than just imagining that as night follows day you give up on a target three years from now in terms of impairment calculations.

---

**Shaun Cousins** - *J.P. Morgan - Analyst*

But to be fair your market cap wasn't AUD428 million higher in June last year either.

---

**Peter Myers** - *Billabong International Limited - CFO*

Well there was impairment charges taken in June last year and there were more impairment charges taken in December. My reference to the market cap is really about testing for indicators of impairment, and you've got to have that as one of your benchmarks as you go through.

---

**Shaun Cousins** - *J.P. Morgan - Analyst*

Ok. You've downgraded earnings, having provided -- or downgraded on the 19th of December -- what was -- I mean obviously you've highlighted Europe and Nixon, what occurred in the last eight weeks that caused such a significant issue? Because I think Europe was called -- Europe and Nixon were both called out as somewhat problem divisions, problem areas at that time. So I'm just curious how things can deteriorate so quickly in an eight week period?

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Well, can I -- I'm going to let Peter answer that as well, but let me just first start off with where we were in December. When we went out with the downgrade in December, we called out also the United States and Europe, because even though the United States today is up on last year, it was not making its forecast and that was one of the things that was evident and hence we out there.



The second thing is we were getting clarity of what our backend of our orders were going to be on the wholesale, which was from April through to kind of June for your wholesale selling for the final part of the financial year. So that was why we also called it out.

Then what has also really deteriorated though has been Europe, where we have had some orders; we've ended up not in fact shipping to the various customers due to the fact that they were either going out of business, or unable to take it, or we chose not to send it to them due to potential bad losses, and the fact that we were having to discount heavily as well in the retail stores. So as I called out, we may be flat but the margin has certainly been under pressure. Looking forward, I'm cautious about what Europe's going to be.

---

**Peter Myers** - *Billabong International Limited - CFO*

Yes, let's be clear, the outlook statement today identifies that this is a Nixon and a European issue. I think we've already made the point about the significant leverage that comes from our returns out of the Nixon deal -- the Nixon arrangement with the financial leverage that's in that business. So, every -- I think we went to some pains to make the comment that elsewhere, everything's on track as what it was in December.

---

**Shaun Cousins** - *J.P. Morgan - Analyst*

Just finally in regards to -- I think Craig asked the question earlier on and hopefully you do provide us with the EBITDA margins across retail and wholesale. But is retail lower EBITDA margin at the moment? How does that differ if you back out the vertical contribution?

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

I would have to get that for you. As I've said, it's varied. It has varied according to which region it's in.

---

**Shaun Cousins** - *J.P. Morgan - Analyst*

Oh yes I mean regional or divisional retail wholesale EBITDA margin splits would be fantastic as well please.

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Europe is well done. Overall, the margins have been -- just to give you a little bit of a sense -- overall the margins in retail have been down on the previous year, but as you recall we were looking to clear stock so we're trying to introduce that. Our stock improvements have been exceptionally good in both the US and in Australia. However, I'm calling out to you now that we have too much stock in Europe. That is also what was taken into consideration going forward and into the second half we will have to clear that as well.

---

**Shaun Cousins** - *J.P. Morgan - Analyst*

Ok, we await those retail wholesale margins. Thanks very much for your time.

---

**Peter Myers** - *Billabong International Limited - CFO*

Just to give you a flavour, the retail -- full vertical margins for retail has been held flat, notwithstanding the kind of sales as a result of the improvements we've seen since we added the store closures.



**Shaun Cousins** - *J.P. Morgan - Analyst*

Ok, thank you.

---

**Operator**

The next question comes from the line of Ben Gilbert from UBS. Please go ahead.

---

**Ben Gilbert** - *UBS - Analyst*

Good morning, Launa and Peter. Just a first question, just a clarification on Nixon. Were there any -- did you have any guarantees or anything in place? I know there was something around retail distribution, but in terms of guarantees around minimum earnings or anything like that that means that the impact's greater.

---

**Peter Myers** - *Billabong International Limited - CFO*

No. There are no guarantees in relation to Nixon that would cause a write-down. There are no guarantees in relation to the earnings of that business. There are preferred returns, and so you do get increased leverage that impacts on our valuation.

---

**Ben Gilbert** - *UBS - Analyst*

Ok great. Just the second one from me, just in terms of the trajectory advantage, (inaudible) gone from a plus 10 to mix sort of down around 30 normalised in the second half based on guidance. Obviously you're going to have to cycle weaker Nixon through first half of '14 and your fixed charge coverage looks like it's sort of around 1.5 times. I'm just wondering in the absence of the bidders if hypothetically they were to go away, how the discussions have been with the banks and whether you feel you'd need to investigate any divestments or potentially the partial sell down of SurfStitch which was speculated a little while ago?

---

**Peter Myers** - *Billabong International Limited - CFO*

Look, I don't think today's the day to be ruling things in and out as to what we might do, with or without the proposals that are around. But suffice to say, the discussions with the banks have been extremely constructive; I think we all recognise that there's a lot of accounting that is going on in their impairment charges rather than massive, immediate impacts around current term cash flow. To repeat the point about Nixon, the reduction in our expectation for our share of associates out of Nixon has absolutely no bearing on our banking relationships at all.

---

**Ben Gilbert** - *UBS - Analyst*

So the covenants for an EBITDA basis are actually NPAT contributions?

---

**Peter Myers** - *Billabong International Limited - CFO*

They've always excluded the non-cash share of associates out of Nixon. So to the extent that we've been disappointed in terms of our guidance as to what that will deliver for us, that has no impact on the banking relationships.

---

**Ben Gilbert** - *UBS - Analyst*

Okay, fantastic. Thanks very much.



---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

All right. Can I just call out that we've just got time for two more questions?

---

**Operator**

The next question comes from the line of Tom Kierath from Morgan Stanley. Please go ahead.

---

**Tom Kierath** - *Morgan Stanley - Analyst*

Morning Launa, and Peter. Just a question on the covenants. Can you provide what the fixed charges covenant is?

---

**Peter Myers** - *Billabong International Limited - CFO*

Well, we've -- I think, in the past, not done that. I'm a believer that -- feel free to ask us some questions as to whether we're going to comply with our covenants, that's perfectly sensible. I think the problem otherwise is that every time there's a tweak here or there we end up having to come back and report to the market. So I think the message is that market standards -- we are satisfied that we'll continue to comply with our covenants. I made the point earlier that I don't think any of you imagine that this business is luxurially (sic) placed in respect of its financial ratios, and I don't know what I could add to that really.

---

**Tom Kierath** - *Morgan Stanley - Analyst*

I mean I just don't see how any investor can invest in your Company when they don't know how far you are away from breaching, that's all.

---

**Peter Myers** - *Billabong International Limited - CFO*

Well, the thing -- I don't think, unless you tell me differently, I don't think we see every company putting their covenants out there.

---

**Tom Kierath** - *Morgan Stanley - Analyst*

I mean yes -- I mean maybe it's a discussion for later, but I mean a lot of companies do. Given the history with covenants it would make sense.

---

**Peter Myers** - *Billabong International Limited - CFO*

Okay. Well, look, let me -- I've been here four weeks. Let me take that on board. I'm happy to think about that and talk to the Board about it.

---

**Tom Kierath** - *Morgan Stanley - Analyst*

Sure. Were any of the covenants renegotiated when you rolled over the date post the balance date?

---

**Peter Myers** - *Billabong International Limited - CFO*

No, only the shareholders' funds.

---

**Tom Kierath** - *Morgan Stanley - Analyst*

Okay. Thank you.

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

Okay, last question.

---

**Operator**

Your final question comes from the line of David Cooke from Nomura. Please go ahead.

---

**David Cooke** - *Nomura Group - Analyst*

Hi, guys. A couple of questions, if I may, on your value of your intangibles. I note on note 8 that you're expecting Billabong to grow by 35% each of the next three years. Looking at the brand value that you've got in there, I would suggest that, considering Billabong hasn't grown the last three years, there seems to be a big step up to be able to support that brand value. So if you can give us a feel as to why you think you're going to be able to turn that around, considering, to date, we haven't seen any sign of that turnaround.

---

**Peter Myers** - *Billabong International Limited - CFO*

I think that we actually made a particular point in the various notes -- somewhere buried in there -- that those growth rates that you see, in many instances, are now coming off a very -- relatively small base and, obviously, a base that is much lower. So one doesn't -- there's a bit of mathematics, frankly, in that. I think the other point I'd make is let's not forget that that DCF has to cover quite a lot of valuable -- the enterprise value of that DCF is large and covers a significant amount of hard assets and inventories and receivables and so forth as well before you get to intangibles. So I don't think we should just imagine that the whole brand Billabong piece is reflected only in the intangible piece that you see in the accounts. We're still strong believers.

---

**David Cooke** - *Nomura Group - Analyst*

Okay. Could you give us a feel please as to what's happened to your cost of goods sold? I'm looking at things like cotton costs and other costs going in there, and what your outlook is over the next 12 months?

---

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

All right. We have seen cotton prices come down over a period of time, so our cost prices are stabilised. As you know, we are endeavouring to become more globalised, and by that I mean that we're looking to try and do more styles that will be available throughout the various countries in which we trade. By doing that we will then be consolidating units under [investment] styles, more units, and therefore we believe our cost prices will come down. Having also said that, you need to recognise that there is price harmonisation occurring within the world, particularly with the fact that we have online, so that's something that we also need to manage at the same time. What we need to do is to endeavour to ensure that we maintain the margin.

---

**David Cooke** - *Nomura Group - Analyst*

So the benefit from the cotton coming down, how much of that did you get in the first half? How much left in the second half?



**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

I couldn't give you that right now, but I can just say that we have certainly seen price increases at -- prices not increasing -- but we have also seen at the same time, retail prices not increasing, but it hasn't naturally changed margin, because we have had to react accordingly to the market. Prices have been coming down -- retail prices that I'm talking about.

**David Cooke** - *Nomura Group - Analyst*

Final from me, your AUD10 million of quick wins that you highlighted at August, how much is that -- did you actually pull out in the first half?

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

I can really give you full facts on that because, if you recall, we only did the presentation at the end of August. We're really starting to see that start to happen now. I've called out that we will not see that immediately. I mean we're doing the things that I've spoken of with the consolidation of suppliers. We are moving towards reduction of SKUs as well as style. What you do need to appreciate is that we have very long lead times in the wholesale business. The decisions that start to get made today you will only see the benefits at the end of the year.

So, as you can appreciate, I mean I did the presentation at the end of August. We then started to pull together the right people and actually work out the clear plans of what we need to do in order to get those quick wins. We are doing that, but it will take time before you immediately see the benefits.

**David Cooke** - *Nomura Group - Analyst*

Thanks a lot, and thanks, Peter.

**Launa Inman** - *Billabong International Limited - Managing Director and CEO*

All right. I think that's all. Thank you everyone and thank you for your time.

**Operator**

That does conclude our conference for today. Thank you for participating. You may all disconnect.

**DISCLAIMER**

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2013, Thomson Reuters. All Rights Reserved.