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BBG.AX - Preliminary 2014 Billabong International Ltd Earnings Call

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PRESENTATION

Neil Fiske - *Billabong International Ltd - CEO*

Good day, everyone, and thank you for joining our year end results call. With me today is Chief Financial Officer Peter Myers. A short while ago we lodged a results statement and today's slide pack presentation with the ASX and posted it on our website, www.billabongbiz.com.

We will be referring to those slides throughout today's update. Today's agenda has three parts. A summary of progress -- a summary of results, progress on our turnaround plan and financial details. On our last call in February I said that this is a complex, difficult turnaround; that the 18 months of turmoil while the Company was in play had taken a major toll, the lingering effects of which would be with us for a while longer.

The year end results reflect that reality. It is also in line with our statement at the half year, that we are seeing growth in Asia Pacific, stabilisation in Europe and continued weakness in the Americas, which was hardest hit by the leadership distraction, market caution and staff turnover during and after the Company's transaction process.

Yet, we feel six months later like we are in a much stronger position. That the restructuring is well underway, that the turnaround is gaining traction and that there are tangible early signs of progress and validation of our seven part strategy. We have strengthened the balance sheet. We have made tough decisions and cleaned up overhanging problems. We have assembled a strong leadership team.

We have implemented a new organizational structure designed to unlock the potential of our brands, while building scale and global capabilities. We have simplified the business and narrowed our focus. We have cut costs and identified millions more in cost reduction opportunities.

With the actions underway, we are laying the foundation to allow for growth and profitability in the years ahead. As one important leading indicator, we are seeing brand Billabong return to growth in the US wholesale channel for the first time in several years based on forward orders.

In Asia Pacific, the brand remains dominate, is up 5% and shows signs of building on last year's growth. Billabong is the largest brand in our portfolio and the first to implement our global brand approach. So these trends are very encouraging. The brand is stacked with talent and poised to gain market share. We are back on offence.

While we are seeing these kind of turnaround indicators across the business, bear in mind that this is a long lead time business in product development cycles, in forward order bookings to the whole sale and in restructuring our operations. Many of the changes we have made during the year are not yet flowing through our financial results.

Recognising that the road ahead remains challenging, I am pleased with our progress overall, confident in our people and optimistic about the potential of our brands.

Turning to results for the year, all figures expressed herein are in Australian dollars, unless otherwise stated. Pete will take us through the detail, but when stripping out all of the noise of the restructuring, the recapitalisation and the businesses we exited during the year, EBITDA came in at AUD52.5 million on AUD1.1 billion in sales.

Pro forma EBITDA minus SurfStitch and Swell is AUD60 million for the year. The narrowed full year and net loss of AUD233.7 million includes AUD219 million of significant items associated with the turnaround and other restructuring, including around AUD7 million in non-cash accounting charges, AUD60 million in tax write-offs and AUD42 million in transaction costs associated with our recapitalisation.

The table on slide four of the presentation summarises our sales and EBITDA with and without the discontinued businesses of DaKine, West 49 and Nixon. In relation to the table, it's important to highlight the impacts of currency movement. The Australian dollar values are based on the average exchange rates across the 12 months and the impact, especially on revenues, is profound.

In the US, for example, in local currency terms, revenue was down 9.9% for the year. However, when converted to Australian dollars, it was down just 1.7%. This is because the AUD versus USD was down for much of the year, even though in the last few months it recovered somewhat.

Europe also sees a very different picture with revenues on a constant currency basis down, but when converted to Australian dollars the revenue is up for the year. The earnings are not nearly as impacted as much. Accordingly and so as to provide a better measure of performance, I will mostly give you the local currency trends during my commentary.

By region, the Americas accounted for all of the weakness in the Group results. We note in the half year call that the period of corporate and leadership turmoil had hit the region particularly hard and that the lingering effects would be with the Company a while longer. The results reflect that continued impact, plus additional softness in Canada and Brazil.

Excluding the discontinued businesses, sales on a constant currency bases for the year decreased 9.9% to AUD442.6 million. Sales for the second half were off 11.9% on a comparable basis. Comp store sales were down 3.3% for the year and 6.2% for the half, reflecting weak US retail traffic data.

Including direct to consumer e-commerce revenue, comparable retail sales were up 1% for the year and down 2.9% for the half. The second half was heavily impacted by Canada, with second half wholesales down $3.9 million and by Brazil, where wholesales for the latest half were down $6.5 million.

Sales were also reduced by a strategic pullback in the closeout channel and by switching Chile and Peru to a distributor model. The Americas EBITDA prior to global allocation fell 42% to AUD40.6 million for the year. After global allocations, EBITDA was AUD23.6 million. Overheads for the Americas were down AUD8.9 million for the year on a constant currency basis, most of which came in the second half.

Gross margins were down 300 basis points for the year and 430 for the second half, driven primarily by higher markdowns, as we took aggressive action to get our inventories in line. Throughout FY14, the Americas suffered the hangover effect of poor buying decisions in prior year periods, a historic tendency to overbuy inventory and lack of good inventory management practices.

This has led to margin compression. We are fixing the problem first, by taking the tough, but necessary decisions to clear inventory and secondly, by installing the rigorous inventory disciplines going forward.

Inventory turns at year end improved from 3.7 to 4.2 times on a comparable basis. As we head into FY15, we are in a clear position and as a result, expect to see gross profit margins benefit, particularly in the second half of the year. Clearly, the Americas region is both our biggest challenge and greatest opportunity.

We have a comprehensive plan to turn it around, including the following actions. Number one, rebuilding the leadership team in the region under Americas president, Ed Leasure. Number two, restructuring our Brazilian operation under VP Latin America, Felipe Motta. Felipe has relocated to Brazil for as long as it takes to get our operations back on track.

He's exactly the right person for the job, given his experience and track record in the country. Number three, investing in and strengthening our sales and marketing teams for each of the brands to generate more top line momentum. Number four, basing the global brand leads, the turnaround office and the new global support functions in the US, giving us proximity to market and extra leadership support in the region.

Number five, aggressively managing our costs. Number six, tightly managing our inventory and buying processes and number seven, deploying surge resources where necessary to fix problems.

The good news is that our two largest brands, Billabong and RVCA are projecting growth this year in US wholesale based on forward orders. These two brands represent nearly two-thirds of the region's brand sales. The Element turnaround will take some time and Brazil and Canada will remain soft.

But I am confident that with the strength of the team now based in the region, we can rebuild the growth and profitability of the Americas. Turning to Asia Pacific, the region had a good year in the second half. Sales were up 1.1% and 4.5% respectively on a constant currency basis, despite the loss of AUD7 million from store closures.

We were pleased to see growth in our key brands. Comparable store sales increased 1.3% for the year and 2.3% for the second half. Constant currency EBITDA increased 7.8% for the year. Gross margins were down 190 basis points for the year and 300 basis points for the half, driven half by exchange rate impacts on costs and half by somewhat higher discounting in the whole sale channel and a higher level of promotional activity at SurfStitch.

Cost cutting and restructuring actions in the region reduced regional overheads by AUD10.2 million for the year. Inventory turns improved from 2.3 to 2.6 times at year end. Overall the APAC team made a lot of progress this year in driving both the top and bottom line, plus piloting a number of programs that show exciting promise for FY2015. The capper were the near sweep of trophies at the annual SIBA Industry Awards. Congratulations again to the team.

In Europe, our restructuring program has stabilised and improved the profitability of the region. We are focused on high quality, higher margin revenue and we have resized the organisation for a lower sales base.

On a constant currency basis, sales were up 7.5% for the year and 14.2% for the second half. Lower closeout sales represented 6% of the second half decline. Comp store sales increased 5.9% on the year and 4.4% for the second half.

Gross margins lifted 530 basis points in the second half over the prior period as we focused on better quality sales and less promotional activity, improving the gross margin for the year by 220 basis points.

Overheads were down AUD5.2 million on the year, all in the second half. EBITDA prior to global allocations improved AUD2.2 million for the year. Stripping out the SurfStitch loss, EBITDA would have been positive AUD5.2 million prior to global allocations.

Inventories are under somewhat better control in the region, with turns improving from 1.9 to 2.4 times at year end. Based on the one rate of improvements we have seen in the region we project Europe should show a continued improvement in profitability.

Now let's turn to an update on the turnaround program, the seven parts of which are listed again on slide 9. The scale of change underway is massive. It is transformational.

It touches nearly every function in every region of the Company. We are fundamentally rebuilding the organisation, processes, and capabilities we need to win.

It is important to emphasise that we are approach the task systematically and strategically, careful to protect our brands and our customer focus at all times. We are stepping our way through a phased approach to the turnaround.

First, we laid out our strategy last December. Then we aligned the organisation structure to that strategy as discussed in our last update.

Next, we built out a senior leadership team to drive execution, bringing in some of the best talent in the industry to lead our resurgence. Importantly, we are also promoting and elevating strong performers throughout the Company into new leadership roles.

Now with the team largely in place we are attacking the big opportunities and seeing results. Early times are indeed encouraging and Billabong has turned an important corner, RVCA is reaccelerating under CEO Jeff Streader and his new operating executives have identified several million dollars in near-term cost savings in the last three months alone.

Significant retail operating improvements continue to materialise in Asia-Pacific; Europe's profitability is improving. We are gaining traction.

The slide pack provides a summary of progress against each of our seven strategic pillars. I won't dwell on each point here but thought it would be useful to provide some commentary on each area.

First is brand. Since our half year update we have put in place the global leadership structure for our big three brands. Each brand is led by a global brand president or general manager.

Shannon North, who previously ran our Asia-Pacific region, has relocated to the US to run brand Billabong globally. Frank Voit who built Element into a strong powerful brand in Europe now runs the brand globally working closely with founder Johnny Schileriff. Bill Bettencourt formally from the DF Action Sports Group and Topsider is the global GM for RVCA, a strong operator with international experience, Bill will be working closely with founder Pat Tenore to scale the brand globally.

Each of these leaders in turn are building their teams and driving a new set of brand processes and disciplines across the global organisation. Our goal is to build strong global brands that are regionally responsive and close to market. So while each of the big three brands has appointed new global leads in merchandising, design, and marketing, they also have extended teams in each region to ensure that we are on trend, fast to market, and attuned to the nuances of customer demand.

I mentioned that brand Billabong has turned a corner in the US. Here we are seeing team accelerating growth in projected orders for the wholesale business all the way into group spring or Q3 season.

The women's business, which we identified earlier as a substantial growth opportunity, has seen particularly good results looking forward. Feedback on our lines has been very positive. Our investments in the brand are paying off.

In Asia-Pacific, Billabong remains a powerful iconic brand. The growth of FY14 looks to continue in FY15.

RVCA: RVCA is a brand with tremendous global potential. We've just scratched the surface in Europe and Asia-Pacific. We know that demand is there, it's just a question of getting organised to go after it.

There's still plenty of untapped opportunity in the Americas. Under Bill's leadership, the global RVCA team is now working much more closely with the regional leaders to accelerate RVCA's growth around the world.

Element: Element is the largest skate apparel brand in the world, and is arguably the best skate team anywhere. Its performance though has been uneven.

Europe, Element's largest region, is a powerhouse with a growing book of forward orders.

Asia-Pacific is stable.

The US however has suffered from inconsistent execution, distraction, and a contraction in its channels of distribution. Frank Voit is a skilled discipline operator and I have confidence that under his leadership the region will rebound, although it will take some time and there will be continued weakness in the short-term. Since appointing Frank we have taken important steps to strengthen the team in the US, leverage our global teams, and tap into the successful playbook on Europe.

Finally a comment on our portfolio of emerging brands. Our approach here is to give these brands more go to market flexibility and operating autonomy. For example, finding better distributors in Europe, Brazil, or other developing countries that can give smaller brands more attention.

Where we are seeing growth, such as Tigerlily, we will invest. If we do not see growth in sales and profitability over time, we will re-evaluate the fit within the portfolio.

Part two of our turnaround program is product. Over the last six months we have significantly strengthened our design and merchandising teams around the world. But equally important, we have begun to build the processes and capability that will generate big improvements in productivity, sales, margin, and inventory terms; what we call the merchant front end.

We have always had great design, but historically our assortments were fragmented and too wide. Without the inventory gap to back up our best ideas too often we looked broken and inconsistent at retail.

Even our best styles were often picked up by 30% or less of our wholesale accounts. Then, a few weeks into the season, we lacked the inventory to replenish our winners or core never out of stock items.

Now we are moving to defined merchandising strategies at the front end of the product development process. Merchants, design, marketing, and sales are aligned from the start. The mantra of fewer, bigger, better is becoming a way of life.

We are cutting unproductive styles and SKUs. SKUs are down more than 20% from the initial past assortment productivity.

More importantly, we are more focused than ever on making the big ideas bigger and backing them up with better buying and depth of inventory. We are clear on category priorities in each brand, what we call best at, win at, and compete at. Style by style, we know where and how we want to show up on the selling floor.

These capabilities are not built overnight. Based on long product development cycles it will take some time to realise the full impact of the merchant front end initiative. We expect the benefits to start materialising in Q3, accelerate in Q4, and build steadily over the next couple of years, with the focus on expanding gross margins, better inventory turns, and stronger sales.

We have also initiated a process called concept to the customer, designed to reduce product development times, increase cross [functional] alignment and position us close to market. This process will link closely to the changes we are making to build a faster more responsive supply chain. More to come on this in future updates.

Part three, marketing. We have taken a small first step towards increasing our marketing spend, funded in part by our cost-out savings elsewhere. More significantly, we think we can get more out of the marketing than we are currently spending.

A number of key initiatives are underway here. First we have implemented the first set of integrated go to market calendars for each of the regions, again with the goal of telling fewer bigger stories, cutting through clutter, and getting more bang for our buck.

Second each of the major brands are strengthening their roster of athletes and advocates. Third we are shifting the marketing mix into the growth vehicles of digital and customer relationship management. Our social media followers from our big three brands globally grew 25% in the last six months to over 12.8 million people.

Finally we are refining our advertising and creative marketing as an outcome of our brand processes. In brand Billabong, we have created a new global campaign for the women's line called A Bikini Kinda Life.

It ties to the aspirational lifestyle of the brand positioning and the strategic category emphasis on swim. It also aligns with the men's campaign of Life's Better in Boardshorts to give us more general gender appeal.

Similarly at RVCA, the team has revamped its creative marketing under its unique positioning of the balance of opposites. As we tighten and define our Group brand processes, our marketing will continue to get clear, more distinctive, and more aspirational.

Part four, omni-channel, a big opportunity for us. Last week we announced the sale of e-commerce businesses Swell and SurfStitch. This action came after a thorough and complete strategic review of these businesses including potential sale to a wide range of strategic and financial buyers.

As a result of this process we now have control of our mono-brand websites where we are critically under-developed. We have additional capital to invest in high growth opportunities and we are more focused.

Strategically our priority in direct to consumer is to build a seamless experience across our stores and websites. We want to service our customer anywhere, anytime, with the benefit of shared inventory, ship to store, ship from store, and a 360 degree view of our customer. We know that a multi-channel customer, for example one who shops in a Billabong store and on the Billabong website, is worth three times the value of a store-only or e-commerce-only customer.

We also know that at less than 5% e-comm penetration we are way underdeveloped in digital commerce for the brand. This asset sale will allow us to focus on getting after our monobrand direct to consumer opportunity and building a unified global technology platform.

A couple of months ago we hired a Chief Technology Officer for our direct to consumer business, Kadima Lonji. Kadima had previously oversaw the development of the e-commerce platforms at Saks Fifth Avenue and JCrew as well as the recent relaunched Omni-Channel global platform for Oakley, an exceptional talent and we are pleased to have him leading this critical initiative for us.

On the retail front, we continue to make progress in rationalising our store fleet, improving the store operations and lifting operating margins. In 2014, we closed 41 underperforming stores and expect to shut another 22 in FY15. We sold West 49 which reduced our multi-brand store count by a further 93 stores.

Other operating initiatives include reducing our wage costs through event scheduling, using newly installed traffic counters to improve conversion and measure the impact of our marketing and selling tactics, renegotiating rents and rationalising banners in Australia under the Surf Dive and Ski (inaudible).

In 2014, we improved the store level profitability of our retail by 210 basis points. We are striving for another gain in FY2015.

In multi-brand retail, our strategy is to focus on those areas where we can have a strategic competitively advantaged position that can accelerate our brands growth. In these stores, we are distorting our presentation towards stronger more complete family brand stories and seeing very promising results from pilot programs in Australia and in the UK.

In October, we will be launching RVCA in our two season stores in the UK. We will also continue to build the RVCA brand in Australia through our fleet of 94 multi-brand stores.

Similarly we expect Element and Billabong to see healthy constant growth within our own retail. Meanwhile, we are seeing good returns on the investments in our mono-brand stores. A new generation store proto type is being developed for Billabong by renowned store designer, Ron Pompei, and will be launched in the second half of 2015 in Australia.

Element will open a great new store in Covenant Garden, London, this year. Each regional leader is on the hunt for opportunities to expand our successful multi mono-brand footprint.

We affirm our view that mono-brand direct to consumer, both retail and in commerce, is a vital growth channel for us going forward and one that can be complementary to our wholesale distribution, which brings me to our wholesale win back strategy.

In the US, our largest wholesale market has strengthened our sales team at Billabong, contributing significantly to the improvement in forward order bookings. We have brought a new VP of sales for Element. We have deployed new shop and shop concepts in our top accounts with good results. We are investing more in trade marketing and we have moved from a generalised approach to the wholesale market to one based on channel segmentation and a more disciplined approach to account planning.

Product lines and trade marketing are being tailored more specifically to the needs of each segment. We are committed to building on our number one position in the core specialty channel and protecting the quality of our distribution.

At Jack's Surfboards shop in Huntington Beach, California, arguably one of the most competitive corners of surf retail in the world. Our remerchandising program has captured significant market share and elevated brand Billabong to the top position.

But that is part four. Omni-Channel. Part five is supply chain, another big opportunity for us. In our strategy work we identified a long term profit improvement opportunity of AUA20 million to AUD30 million in the supply chain plus a cash flow improvement opportunity from faster inventory terms and better supplier terms.

We have previously described the key components of that strategy and listed them again on slide 14. Now we have got the leadership talent to go after the opportunity. COO, Jeff Streader, our new VP of global supply chain Randy Royce, and new head of global sourcing, Kitty Ho, all joined the Company in the last hundred days or so and are accelerating progress.

These new hires are true experts in their fields. They know what a garment should cost. They know the best vendors and factories. They know quality and how to get it. They know how to build margin and turn. They are creating visibility and transparency in our sourcing and product development around the world and they are delivering immediate benefits.

In an additional category pilot, we are seeing substantially better costs, higher quality, shorter lead times, better terms, vendor managed inventory and the ability to service the needs of all our regions from a coordinated global capacity. We have also commenced the redesign of our global logistics and distribution network which we know is high cost and sub-optimally configured.

Part six, organisation. On our last call, we outlined the structure of our new organisation and the orientation toward three groups, brands, regions and global functions. Since then we have filled out the executive team and began reshaping the organisation below.

In the last 10 months, we have filled over 60 key positions with both internal promotions and external hires. While we have brought in new talent at every level and will continue to do so, we have funded these investments with productivity gains and headcount reductions in other areas.

Part seven of our turnaround plan is financial discipline. We have made some important strides in the last six months but have much more work to do here. Short term improvements include reductions in our indirect costs, cleaning up old inventory problems, getting our inventories in line more broadly, a tighter CapEx approval process, vendor term renegotiations and other working capital improvements, taking necessary restricting measures in building a system of the right key performance indicators.

We expect to see continued progress in all of these areas in FY15 but also know that sustained improvement will require the building of new processes, systems and capabilities, in three areas in particular.

First, inventory management has been a major weakness of the Company over the years and one of the underlying causes of year over year margin compression and stale product in our stores. This year we are undertaking an overhaul of our processes, disciplines and functional alignments.

Finance and Operations will take active roles going forward in forecasting demand planning, managing [open] to buy, driving actions and ensuring that timely mark down decisions are made, not deferred.

The second big opportunity area is sales and operations planning, what we call S&OP. These are the processes that lead the merchant front end, the supply chain and finance together to better align supply and demand typically resulting in much better order fulfilment, shorter lead times, faster turns and higher margins.

Finally, standardised financial reporting and IT platforms, moving from highly regionalised systems and practices to one global standard. As a start, we have pulled together the desperate IT groups around the world into a global IT group. In just a couple of months, this team has identified significant cost savings by eliminating redundancies and managing our spend more effectively.

Peter Myers meanwhile is leading the finance team to drive our financial process reform and standardisation across the globe.

Importantly throughout the turnaround program, we are taking a pay as you go approach, offsetting new investments and capability of brand building with cost reductions and cash flow improvements. We know we need to play both offence and defence to learn.

In summary, I am encouraged by the progress in tangible results we are starting to see in all seven parts of our turnaround program. There is much more work to do and the road ahead is challenging but our opportunities are clear. With our much stronger balance sheet, restructured operations and strategic road map, we are laying the foundation to allow for growth and profitability in the years ahead.

With that, I will turn it over to Peter.

Peter Myers - *Billabong International Ltd - CFO*

Good morning to everyone. It is great to be here on the slightly damp Gold Coast this morning.

So this is now my fourth Billabong results call and what an assortment is has been. In the turmoil of last year to the early days with Neil and the February call, it has certainly been quite a ride.

But the last six months have been such a contrast to all that has gone before. Our attention has truly moved to the business and whilst the operational challenges are great, we are now in a position to accelerate the reform. Our leadership team is in place, they are building up the broader management team.

While we have done some early restructuring, both operationally and in terms of the portfolio, we have done some good early work on the turnaround agenda and we are now poised and increasingly resourced to pursue the richer, albeit more complex, reform projects that Neil just outlined.

Moving to the slides, we have included this information in the first financial slide to help people navigate from the statutory accounting results for the period with a set of figures that we believe give investors the key information they want and the performance of Billabong's continuing portfolio of businesses.

At the half-year, we had a material impact on our numbers from significant items and so it is at the full year. Obviously we pick up all the items from the first half, repeat them in the second but there are a number of new items in the second half as well that have impacted the results and I will detail those a little later.

As well, our portfolio of businesses going forward is not the same portfolio that makes up the statutory results. West 49 is in this year's statutory figures up to February and both it and DaKine are in the 2013 statutory comparison for the full year.

So the real purpose of this slide is to clearly identify the performance of what is left. Sales to customers AUD1.2 million, EBITDA of AUD52.5 million being the key measures. In addition, we have identified the impact of SurfStitch and Swell businesses, SurfStitch in both Australia and Europe for 2014. Obviously going forward they will be out and we will be adjusting the comps so as to identify them as discontinued operations.

So what we have done in the slide is to show you the 2014 impact so you can appreciate the earnings of the businesses that we have left. Obviously this is a pro forma table and reflects the SurfStitch and Swell 2014 price and 2014 volume.

Going forward, the actual impact of the sale on our earnings will be somewhat contingent upon the wholesale sales to that new business. But it gives you a clear picture of the 2014 impact.

Most importantly you can see that on the basis of the businesses we own today, or at least we will when the SurfStitch deal completes in a couple of weeks, we generated some AUD60 million with EBITDA in 2014.

We have also included a similar analysis for last year, pointing out the significant items and discontinued businesses as an appendix to this presentation.

Moving to the next slide, Neil's covered a lot of this in his presentation. I don't have much to add other than to reinforce the message that we've included for your convenience, both the as reported change where the differences are on the basis of the actual exchange rates that applied last year, and as well, we've provided a constant currency comparison which is effectively the percentage change expected in local currency that might give you a better measure of the operational performance.

You will see, as Neil mentioned, that those differences occasioned by the FX movements are significant, especially on revenues. Because the monthly calculation is based on the average actual rates for each individual month, not even a simple average. Like Neil, I will talk mostly in local currency, especially where the differences are material.

Turning to the regional slides, you'll see in each slide we've provided some additional data this year, comp store sales and store counts. I hope you find that useful. We also set out the performance before and after the allocation of global costs. Again, we want to be completely transparent.

Neil has already described the impact that the Americas had on the Group results, the decline in the Americas representing effectively all of the decline for the Group. At the half year, we identified the performance (technical difficulty) refinancing in the September or in the back half of last year. We told you to expect more of the same in the second half from the Americas and that's how it's turned out. Overall sales from continuing operations down 9.9% on a constant currency basis for the year.

Now part of this in H2 is the Peru and Chile effect as we moved to a distributor arrangement, partly the double digit reduction in retail sales as we closed stores. The comp store sales were down only 6% with (inaudible) since year end. So while the refit continues in the second half, we are addressing and isolating the issues. In Brazil, the second half revenues [rate] to earnings were a little better, but the big news is that the forward order books for wholesale has us excited. Billabong ahead for the first time in years, and RVCA looking more like the strong performer of recent years that perhaps that of the last six months.

The areas where we have put much of our effort and resource seem to be responding. Cost in the Americas were pretty good in H2, partly through cost out, partly restructure. Inventory down, but so are margins, so whilst we've reduced the inventory and are positioned better going into the new year, it has been painful.

Turning to Asia Pacific, the result here reflects a number of initiatives which have been implemented over the last 12 months. Generally, all key metrics were up. Downsizing in Asia, the restructuring in South Africa, closure of underperforming stores, tight cost controls, all contributed to a solid lift in EBITDA. Comp store sales in Australia are up 2.3% for the second half, following on a 0.6% lift in H1, so about 1.4% for the year.

From a brand perspective, all of the big three brands grew in H2. Billabong sales to external wholesales grew 5% and even more, if we had included our own retail performance. Amongst the small brands, Tigerlily is showing strong growth and indeed further investment by way of new store openings.

In Europe, after a long period of decline, Europe has stabilised somewhat under a new management team. Comp store sales were good, and whilst revenue was down in H2, it was much better quality -- less close out sales and a tighter customer set and better margins. That's very much the story of Europe in this result, a smaller, better business. The Europe result is materially impacted by the start-up losses of Surfstitch, Surfstitch Europe, which is still in its investment phase and generated an EBITDA loss of AUD7.4 million in Aussie dollar terms for the year. You can see clearly that excluding this loss, Europe would have been close to break-even, even after the allocation of global overheads, and in fact, would have contributed AUD5.2 million in EBITDA before that allocation.

Overheads were down significantly in H2, following a lot of restructuring work throughout the first half of the year.

Moving to the significant items, I want to keep the theme of complete transparency here, so we've provided a lot of detail in regard to this item, both here and in the accounts. The main thing is to point out that we've incurred over AUD140 million of pre-tax costs during the period, a combination of cash and non-cash. Obviously, biggest single item is the finance costs which are largely a carryover from H1, the establishment in particular of the Altamont refinancing offer, a large amount of due diligence cost, subsequent break fees.

You will also see a very large number in the cash flow for finance costs.

Then there's fair value adjustments to the assets are worth [AUD49 million] to reflect a deal that was closed in this half and further impairment charges, which we hope has been conservative. We'd like to think that going forward, as the turnaround gains traction, some of these impairments from the last year or so might begin to be reversed.

The other items that are probably self-explanatory, perhaps with the level of adjustments (inaudible) out and in terms of that adjustment, when we negotiated the equity placement arrangement with Oaktree and Centrebridge, we fixed the exchange rate at $0.924 and at the close, it had moved in Billabong's favour, so we had a gain as a result.

In terms of the second half charges, I point out that there's further restructuring, and that begins to reflect the reform agenda that Neil has described. Reforming South America, restructuring a significant amount of the workforce in all regions. We're [beginning] to recognise the cost of rationalisation of the supply chain as well as the cost of renewal of some of our founder relationships.

Finally, the significant items include a fair value adjustment for certain deferred payment arrangements. All up, it's quite a list. I know that that makes life complicated, but you should have no end of detail to help you understand the impacts.

Turning to the balance sheet, we have obviously seen a substantial improvement. Net debt down AUD130 million since last June despite the significant costs we've incurred in terms of all of the restructuring that's gone on. As you'll see from the cash flow, the cash impact has been significant.

Our balance sheet is in a much stronger place. We have good [fix year] money in place. The actual cash flow from trading is quite good, and our working capital ratios have improved. Of course, we have more work to do.

Our interest cost is 11.9% of our term debt, and we've got very little debt otherwise. Hopefully as our turn around takes shape, we'll be in a position to refinance with cheaper funding in a few years.

Turning to cash flow, whilst we disclosed AUD76 million in cash outflow from operations, it's important to put that in perspective. This includes AUD92 million of finance costs, including AUD47 million of significant items, more than AUD10 million in establishing the existing term debt and (inaudible) facilities, and AUD33 million in cash interest. We also paid AUD12 million in tax, most of which is in the first half, and most of which was a legacy issue relating to franking deficits tax.

Our pure trading cash flow, net receipts and payments, was AUD22 million positive, but this too included payments for restructuring and significant items of around AUD45 million. So what does all that mean? It means that post-out the discontinued operations, the EBITDA of AUD55 million that we generated turned into nearly AUD70 million of trading cash. As well, we made AUD40 million of payouts in relation to what were previously outstanding liabilities for deferred payments on earlier acquisitions, and we spent AUD25 million in CapEx as we tightened our processes and priorities. So after all that, we still enjoyed a much stronger balance sheet.

I won't dwell on this next slide. It's pretty self-explanatory. It's there really for detail. Main items really, depreciation down, AUD27 million down from AUD35 million in the prior year with the sale of West 49 and DaKine. I should point out these numbers are the statutory numbers. You can see all of the discontinued componentary identified in the accompanying schedules.

A quick word on tax. Tax is slightly complicated, since it's hard to work out how AUD173 million pre-tax loss attracts such a large tax expense at AUD67 million. Let me be clear, there's not much tax involved in the -- not much cash involved in the tax line -- (technical difficulty) legacy that we've got hangover from Billabong's last dividend.

Last June, we wrote off our tax losses and that related to permanent differences, but we did not write off tax assets that arose from time indifferences. For those of you who endured it, I explained in laborious detail at the half year that we needed to write off the timing differences as well to make sure we didn't continue to encounter a weird situation where we weren't making taxable profit but we were booking large tax expenses. We did that at the half, so that in the second half, the tax looks far more logical.

Notably we had AUD64 million in tax expense for the first half, the vast majority of which was that loss write-off, and we got AUD67 million for the full year, so it's starting to make more logical sense. Let me stress that that tax write-off issue is a non-cash item, and remember that it is, AUD12 million of tax in the cash flow, including the franking deficits issue. Hopefully we won't have to have such a tax discussion again.

I now want to move to the early trading conditions of the new financial year. The directors met yesterday and agreed on a statement that I'm about to read out. We have made it very clear that our plans for communication with the market is to inform you as to our plans, to inform you as to our progress both financially and otherwise, but refrain from making financial promises or forecasts, and we're sticking to that.

As well, we're not planning extensive roadshows, but of course, we're happy to be available for calls. We remain very focused on the turn around and every day is precious to us as we try to rebuild this business. We do want to keep you up to date with the (inaudible) of trading and key matters that you should be aware of and we hope the following statement does that.

The trading to date in FY15 largely reflects the same thematics that have been experienced throughout FY14. Australia and Europe continuing to trade satisfactorily, and in the Americas we continue to confront difficult conditions, but our forward orders for Billabong and RVCA are ahead of last year and our comp store sales in the US, whilst still below last year, have improved relative to the most recent half. As we move through FY15, we are confident we will begin to see the impact of our turnaround strategy in the results, but it is not possible at this time to quantify the extent of such impact.

On that note, I'm sure you'll be happy to hear less from me and I'll hand back to Neil for questions.

Neil Fiske - *Billabong International Ltd - CEO*

Thank you. I think we're going straight to Q&A and open up the lines.

QUESTIONS AND ANSWERS

Operator

We will now begin the question and answer session. (Operator instructions) Your first question comes from the line of Shaun Cousins from JP Morgan. Your line is open, please go ahead.

Shaun Cousins - *JP Morgan - Analyst*

Thank you very much. Good morning, guys. Just a question initially on Australasia. You spoke about an improvement in the second half. Can I just confirm that you made AUD200,000 in the second half. Is that -- have I got my first half/second half splits right?

Peter Myers - *Billabong International Ltd - CFO*

Hi Shaun. Yes, by the time you take into account the global allocations and appreciating that Asia Pac is taking up a bigger proportion this year, and appreciating as you do that the vast majority of the earnings come in the first half for Asia Pac with the large retail buyers. Mathematically that's right, it was an improvement.

Shaun Cousins - *JP Morgan - Analyst*

And -- I mean, should we anticipate that -- obviously there's a strong amount of seasonality in the business, to be fair, more than what has been I guess not so much in 2013 but over previous years. I mean should we anticipate earnings in Australasia being that aggressively skewed to the first half or do you anticipate not necessarily even but you actually -- you know, being two thirds, one third or just something that you actually make a little more than that in the second half?

Peter Myers - *Billabong International Ltd - CFO*

I think you'll find Shaun -- you've probably followed this Company longer than me but certainly if I look back -- that's been the tendency of the business since its strong retail components where the vast majority of earnings come in the first half, obviously, we'll be doing what we can to build out the earnings right across the year. But -- so I think you'll continue to see that in AsiaPac.

I think the observation we probably made back in the half year is that whether we'll see at a Group level that bias remain as pronounced as it is, as we hopefully rebuild the US in particular. I think that's where you might see some shifts.

Shaun Cousins - *JP Morgan - Analyst*

Okay, that's very helpful. Maybe just to think about the broader cost reductions that you've got coming through, I think you noted that you took out AUD22.6 million of overheads in fiscals 2014.

Then Neil, some of your commentary was that there was AUD7.5 million of cost savings identified by your new COO in the supply chain. You want to do another 210 basis points improvement at retail and obviously you've identified losses at an EBITDA level for Surf Stitch and Swell that -- presuming the transaction goes ahead -- come out.

I'm just trying to think about the broader collection of improvements that have been achieved in fiscal 2014 that might be second half weighted and so you'll get an annualisation benefit, and then sort of a continuation of that pool of overhead cost savings -- or sorry, excuse me, broader cost savings -- coming through in fiscal 2015.

Can you help us out if there are key things in terms of when cost savings came through and if there are some factors there that aren't going to occur in 2015?

Neil Fiske - *Billabong International Ltd - CEO*

Sure. First thing, Shaun, I apologise for my American accent. I think I said several million dollars of--

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Shaun Cousins - *JP Morgan - Analyst*

Oh.

Neil Fiske - *Billabong International Ltd - CEO*

--opportunity not AUD7.5 million. I understand that sometimes that gets lost in translation.

Shaun Cousins - *JP Morgan - Analyst*

Must have.

Neil Fiske - *Billabong International Ltd - CEO*

Look, I think going forward we see a pattern where we've just recently brought on a full Executive team, many of whom have joined us in the last three months. We're seeing very clear immediate opportunities but, as you would appreciate, it's still a little early to pin a number on those, particularly in our external reporting sense.

I think as we learn over the course of the next couple of months more specifically about each of those we'll continue to get more specific in our commentary on where those opportunities are and when we will realise them. So we're still early in the game with the team that we've got and, as a result, fairly cautious around promising certain year-end/first-half kind of impact.

As you point out, there are a number of I think important operational improvements that did happen in 2014, a lot of which we should have put in the category of restructuring activities, downsizing Europe, clothing stores, moving to a distributor model. I think those benefits will continue to build for us over the course of 2015. But the new layer of opportunities that we're seeing, we're just at the very beginning of that process.

Shaun Cousins - *JP Morgan - Analyst*

Okay. Maybe -- you kind of touched on this in terms of staff costs and marketing spend. I think your employee costs remained at 21.5% of sales. I think it was 21.6% and the prior year to that didn't really move around. But you intimated there, obviously, that some new highs have come on in the second half.

Where are your staff costs you think you're going to get to and, effectively, do you think you've rebuilt your staff costs and your marketing costs efficiently, or should we anticipate that those levels of -- that expense in that area continues to build on a full year basis?

Neil Fiske - *Billabong International Ltd - CEO*

Yes, good question Shaun, and I think you're on the right theme, which is we are taking a pay-as-you-go approach to our staff investments. We've pulled quite a lot of costs out of the business in order to fund the investment that we know we need to make in critical capability areas that will generate top line growth for us going forward.

It's really this balance of offence and defence that we're going after. We'll continue to maintain that discipline going forward and I think, just to give you a sense of it, some of the opportunity areas for example are the investment that we've made in strengthening our merchandising design teams, which we know will turn into better products which will drive more revenue.

We've invested in our direct consumer platform. We know that's a big growth opportunity. We've unveiled -- invested in rebuilding our sales teams, which have particularly in Americas been a little bit weakened over the years. Those investments, I think we're seeing very strong payback and, again, I think that will continue to build. But in terms of the head count expense line, you should expect us to continue to take that pay-as-you-go approach.

Shaun Cousins - *JP Morgan - Analyst*

Great, thank you very much.

Operator

Your next question comes from the line of Craig Wilson from Citigroup. Your line is open. Please go ahead.

Craig Wilson - *Citigroup Australia - Analyst*

Good morning Neil. Good morning Peter. So the stock turned as that year ran, I wanted to start off with an observation just to make sure I'm on the right -- with the right numbers. The stock turn for Americas 4.2, Australia 2.6 and Europe 2.2.

I think your objective from your early presentation of last year were that you aim to get to four times. So it's interesting that the Americas is already at 4 . I'd like to understand how clean your inventory position is and how much that will continue to drag down gross margin?

Neil Fiske - *Billabong International Ltd - CEO*

Yes. So first, let me comment on the overall target of 4. Again, we would emphasise that's a long range goal for us. It will take us several years to get there. It will be driven by the process improvements and capabilities that we are developing and deploying on the merchant front end and in the overhaul of the supply chain. So while we're seeing some short term improvement, the real gain is going to come from deploying those underlying process improvements.

With respect to the pattern across the regions, particularly contrasting Asia Pacific and the US, I think part of what you're seeing is a business in Asia Pacific that's much more retail-based than the one in the US or the Americas that's much more wholesale based.

We would expect over time that our wholesale inventory turns should be faster than retail and that the (inaudible) average to the Company should get up to 4. So we've got, I think, quite a bit of work to do in retail, but also in those other two regions, work to do to get our wholesale turns up.

In terms of how clean the inventories are, I think we've taken a pretty good sized [burn] to a lot of old stock, pushed it out the door, taken our [lumps]. We are not yet at the point where we're exactly on process and the standards that we're trying to build into the business in terms of buying inventory the right way, taking the markdowns where they need to be taken. It's a major focus for 2015.

Craig Wilson - *Citigroup Australia - Analyst*

Alright, so the close -- because you called out in some of your commentary, the close-out channel was reducing, but is it still higher than where you'd like it to be?

Neil Fiske - *Billabong International Ltd - CEO*

It's getting down there. I think we're pretty close. There will always be some leftovers from our wholesale business that make economic sense to clear out through the close-out channel. That's not necessarily a bad thing. I think where the business got off before was, number one, just having too much of that and number two, looking at that channel as a way to grow top line sales. And that we've completely pulled back on and just strictly using the wholesale channel to clear excess inventory -- I'm sorry, close our channel.

Craig Wilson - *Citigroup Australia - Analyst*

Yes. So the Australian gross margins for full year, they were down about 190 basis points. You did call out FX; is that going to be an ongoing challenge for 2015? Could you maybe clarify the purchase rate through the P&L in FX for FY14?

Peter Myers - *Billabong International Ltd - CFO*

We've had an odd year, Craig, with FX where it sort of dipped in the middle of the year and obviously as we took cover and I'm sure, as did others in the industry, take cover in context of the seasonal cycle, so we certainly felt a bit of pressure there. It wasn't the only contributor to the margin impacts as Neil outlined there a minute ago.

Craig Wilson - *Citigroup Australia - Analyst*

Sure, okay. The US is an intriguing matter and is more of a question of the backdrop there, negative comps to sales trends, it's still a difficult position, it's something that's industry-wide. What do you think is holding back the teen consumer in the US and do you see any light at the end of the tunnel or any improvements heading into winter?

Neil Fiske - *Billabong International Ltd - CEO*

So I think the short answer is it's a sporadic pattern and it would be hard to take any comfort at this point in a rebound in the overall teen market. That's not where our improvements are going to come from. Our improvement is going to come from things that we can control and our own operations.

I think my guess is we'll continue to see inconsistent patterns and weakness in the teen apparel fashion sector; sometimes up, sometimes down. It also varies quite a bit by market. We saw this last half in particular, the Canadian action sports market was really soft and much more so than even the US market. That can't persist forever, but be difficult to call the rebound at this time in the market.

Craig Wilson - *Citigroup Australia - Analyst*

Great, thanks Neil, thanks Peter.

Operator

(Operator Instructions) Your next question comes from the line of Michael Simotas from Deutsche Bank. Your line is open, please go ahead.

Michael Simotas - *Deutsche Bank - Analyst*

Good morning. For now, based on the adjustments you've given us for SurfStitch and Swell as well as the continuing operations, you've got a sales base of about AUD1 billion, is that the sales base we should think about going forward? I know there are some retails stores that will be closed, but is there anything else that needs to come out of that sales base to get a sustainable business?

Peter Myers - *Billabong International Ltd - CFO*

Hi Michael, no, I think that's it. It's one of the key reasons of course that we wanted to give you a sense of what the size of that red box would be once the multi brand e-comm businesses came out. So I think it's still indicative.

Michael Simotas - *Deutsche Bank - Analyst*

So effectively other than some retail sales, sorry, some retail stores, everything that you wanted to clean out has now been done?

Peter Myers - *Billabong International Ltd - CFO*

Good question I think, we certainly have got -- we've done what we most wanted to do in terms of the portfolio, I'd describe it that way. We don't necessarily have the burning ambition to do any more, but equally I think, as Neil made the point, we'll just look it over on a case-by-case basis.

Michael Simotas - *Deutsche Bank - Analyst*

Sure okay and then maybe moving on to those retail stores, can you give us a sense of how many stores across the network are loss-making in their own right?

Peter Myers - *Billabong International Ltd - CFO*

We were looking at a chart the other day and one of our directors suggested every retail operation around the world would probably have a similar looking chart. So we obviously have cleaned up a lot of underperforming stores over recent years and I think we would say we've got it pretty well under control or getting it pretty well under control. But there'll still be some more. I think Neil gave some sort of order of magnitude as to what the size of the list that we've still got to go. I think that'll give you an idea.

Michael Simotas - *Deutsche Bank - Analyst*

Okay, so it's reasonable to assume that those 22 stores that you've got earmarked for closure in 2015 are loss-making?

Peter Myers - *Billabong International Ltd - CFO*

Or certainly underperforming, or making an inadequate contribution, frankly, but by and large loss-making.

Michael Simotas - *Deutsche Bank - Analyst*

Alright and then one on the cash flow please, so from an operational perspective in terms of working capital, it was a very good performance. Now obviously there are a lot of moving parts, restructure costs, et cetera, is there going to be a large effect from that kind of things in FY15 as well or is that the first year in a while where we might see operating cash flow approach EBITDA?

Peter Myers - *Billabong International Ltd - CFO*

Yes, there'll be -- I think we've identified, if you go through the balance sheet, you'll see that there's still some restructuring provisions that will have to bleed out during 2015. The current proportion of those restructuring provisions should theoretically come out through the cash flow in 2015.

But it's a bit like Neil was describing the pay-as-you go approach around our views on workforce and talent management. We've got that same mentality through our cash flow and we've got the same mentality that, to some extent, was on display with the outcomes for the strategic SurfStitch review. We know we have some investment to make there.

So we would like to think we can still push the working capital, the positive working capital benefits such that we'll still see those come through and that should accommodate the restructuring costs that we've got. That's the way we're trying to approach it.

Michael Simotas - *Deutsche Bank - Analyst*

Alright and then just a last one from me if I can, there's been a bit of discussion on gross margins. If I look at second half versus first half, there was a dip across most of the regions. I would have thought clearance was a theme in both first half and second half, you called that FX. Is there anything in terms of seasonality that brings margins down in the second half at the gross margin level?

Neil Fiske - *Billabong International Ltd - CEO*

Certainly not in terms of the year-on-year comparisons. There are no shifts in the seasonal pattern this year versus last year that would explain any of the changes in gross margin rates in the second half.

Peter Myers - *Billabong International Ltd - CFO*

Might get a little mix issue out of the strong retail in Asia Pac in the first half where you've got our own (inaudible) through our big retail footprint, but apart from that, I'm with Neil, I think there are a few other specific factors that you've called out.

Michael Simotas - *Deutsche Bank - Analyst*

Okay, so it's just a matter of more intense discounting in the second or more intense clearance in the second half than FX?

Neil Fiske - *Billabong International Ltd - CEO*

In Australia?

Michael Simotas - *Deutsche Bank - Analyst*

No, across the world. It's a very similar trend across the three regions.

Peter Myers - *Billabong International Ltd - CFO*

Yes, across Europe, there are great performances in the second half and I think across the US we know we worked hard on the inventory, so I think there are different factors at play. Don't think there's a one size fits all approach.

Michael Simotas - *Deutsche Bank - Analyst*

Okay, thank you.

Peter Myers - *Billabong International Ltd - CFO*

Thanks.

Neil Fiske - *Billabong International Ltd - CEO*

Thanks Michael. With that, we'd like to thank all of you on the phone and for the good questions that have come in and we'll conclude our year end results call. Thank you for participating.

Operator

Ladies and gentlemen, that does conclude today's conference. Thank you for your participation.