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FREEDOMGROUP LIMITED

open briefing
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Freedom Group Limited
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Lane Cove NSW 2066

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Freedom Group Limited today reported net profit of $18.0 million for the year ended June 2003, up 16 percent from the previous year. EBIT was up 25 percent to $28.3 million. Which sectors of the business were the principal drivers of the earnings growth?

MD Rod Walker
The Freedom brand in Australia and New Zealand continued to produce good results and underpin the business, even though we did experience a sharp drop-off in sales in the second half. New Zealand had an exceptionally strong year, with excellent top-line growth and a profit improvement of nearly $1 million on the previous year.

The Guests brand, as we've informed the market, had a disappointing year overall. It didn't achieve breakeven as we'd forecast due mainly to poor second-half sales.

Capt'n Snooze maintained its market position but we expanded it into Western Australia with mixed results. The core franchise business performed to expectations, but a number of company stores, particularly some of the new Western Australian ones, had a very poor year and brought overall profitability down.

And the Bayswiss business didn't live up to expectations because of the number of new stores and the associated costs, and a much slower third and fourth quarter than we expected.

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What are your earnings expectations for the current year?

MD Rod Walker
We're confident there'll be continued growth. A lot depends on how sales pan out in the first half of the year. So far, there's been a slight pick up but it's difficult to tell whether it'll be maintained or not.

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You've said you plan to open 18 new stores group-wide in the coming calendar year. Will you maintain that plan if the sales environment slows further?

MD Rod Walker
I believe the opportunities tend to arise when there's a downturn in sales. That's when properties become available. We'll certainly continue to expand the business as opportunities come up.

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The breakeven performance from Bayswiss was below earlier expectations. What's needed for Bayswiss to move into profit and will you review your roll-out plans for the brand?

MD Rod Walker
The recent new stores have been performing at or above expectations. As you're aware, we've built an infrastructure for Bayswiss that will support more stores than we currently have, so as we build new stores we should be able to leverage that overhead. We're confident Bayswiss will achieve the goals we've set for it.

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Guests continued to under perform, again failing to break even in 2003. Can you continue to support this brand in the face of continuing losses?

MD Rod Walker
There's a core of profitable stores in the Guests business and our plan is to maintain those stores, expand into similar catchments and exit underperforming stores.

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The core Freedom brand continues to account for the great majority of group earnings. Given its strength in a tough retail environment, some investors feel the other brands are a distraction for management and detract from shareholder value. What's your rationale for maintaining the other brands?

MD Rod Walker
Each of the brands has potential. Bayswiss is a great format that's proven to work in all sorts of sizes and locations. It's just a matter of time. In the Guests business, we may have to make some tough decisions on some of the stores, but we know the remaining stores will produce the sort of returns our shareholders expect.

And in the Capt'n Snooze business, as the company stores get to profitability, the overall business will achieve the profit levels we expected at the time we purchased it. Bear in mind that the earn-out for Snooze ends in June 2004 and directly relates to earnings. So one way or the other, shareholders won't have over-paid for the business.

CFO Michael Gordon
The beauty of having Bayswiss is its homewares and food mix, which have different demand cycles to furniture. Bedding has a different cycle again. So the mix of brands and the different products in those brands gives our earnings greater resilience.

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Freedom Group's system sales grew by 16 percent in 2003 to $565.1 million, with growth slowing to 1 percent in the second half from 34 percent in the first six months. How are sales currently tracking across your brand portfolio and what's the outlook for sales in the current year ending June 2004?

MD Rod Walker
Overall, we're a little bit more optimistic than we were at the beginning of the June quarter. But we'll have a better idea of how things are shaping up at the end of the current quarter.

We've seen a slight improvement in the first six weeks of this year. We delivered our catalogue just last week, and there's been a good initial response. We've also had a good response to our advertising on The Block for the Freedom brand. And traffic seems to be returning in shopping centres, which should have an impact on Bayswiss. Capt'n Snooze company stores are also showing some improvement.

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Do you plan to introduce special offers or discount campaigns at any of the Freedom brands in a slower sales environment?

MD Rod Walker
Our philosophy over the last couple years has been that we're not going to chase sales by discounting, particularly in the core Freedom brand. We have done some interest-free and other campaigns in the Guests business because it's a different sort of business but we've been able to improve Guests' margin at the expense of sales.

We'll continue to follow the strategy of driving the top line without discounting for the time being. It's one of the reasons we've been able to produce a growth in bottom line profit of 15 percent during a period of tough sales.

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Freedom continued to improve its gross margin in 2003, with a rise to 48.0 percent from 47.1 percent in 2002. Is it realistic to expect further improvement in a slower sales environment? Where would it come from?

CFO Michael Gordon
Improvement would come from additional product coming through our supply chain channels – our strategic partnership with Steinhoff and through our import division – and the benefit of having additional Bayswiss stores within the group for a full 12 months. Bayswiss has higher gross margins than the rest of the group because of its homewares and food sales.

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The 49 percent fall in cash flow from operations to $14.2 million was partly due to an increase in inventories to $64.8 million at the end of June from $54.4 million a year earlier. What was the reason for the inventory build-up?

CFO Michael Gordon
As in the first half, our import division bought forward to take advantage of the favourable forex rates and that will benefit our gross margins going forward.

The other point is that we opened a number of new stores just before or just after year-end and we bought stock in advance for those. We opened four Bayswiss stores after year-end at Manly, Greenwood Plaza and Market City in Sydney, and St Kilda in Melbourne. We also opened two new Freedom stores – at Richmond in Melbourne and Ballarat – just after year-end.

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You've announced a fully franked final dividend of 5 cents per share, bringing the full year payment to 10 cents, equal to the previous year. The payout ratio dropped to 59 percent from 69 percent. What's your payout policy and what's the outlook for dividends in the current year?

MD Rod Walker
The board doesn't have a set policy. It reviews the dividend each half and decides what's most appropriate. The reason the ratio has dropped is because our plan is to keep the balance sheet as strong as possible so that when opportunities do present themselves, we're ready to move and have the cash available.

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You've also announced a proposal to take the Freedom Group private, via a scheme of arrangement, with a cash offer of $2.10 per share. What's the rationale behind this proposal?

MD Rod Walker
Since I took over as managing director over three years ago, we've delivered on virtually everything we told our shareholders and the market we would. We've paid fully franked dividends totalling over 40 cents over the last three years, in addition to doubling the share price and the market cap of the company. So our shareholders have done exceptionally well.

But, we're a small-cap, publicly listed retailer, and to grow the business and take it to the next level, we have to make some decisions that may negatively impact the share price in the short term and potentially result in us paying a lower dividend. We've always said we'd try to find a low/no risk opportunity overseas but the truth is, if we go offshore, it's likely to require some sort of capital outlay by us. That's not necessarily going to make our retail shareholders happy in the shorter term.

So what management is saying is that we're willing to pay what we believe is a very fair price and then take our own money and look at aggressively expanding the company, potentially offshore. We're taking a longer-term view than we believe the market would be prepared to take. And it's not without risk.

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What are the off-shore opportunities you're looking at?

MD Rod Walker
We're in discussion with parties in Asia, Europe and South Africa. Most are local retailers who are interested in bringing the Freedom brand to their markets, but they do want us to share in the risk.

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You've said you have the support of Steinhoff for the proposal. What's their involvement?

MD Rod Walker
We approached Steinhoff in relation to the scheme. It's an international supplier and we thought there was a greater chance of successfully expanding the business with its support. Steinhoff's agreed to take a minority equity stake of less than 25 percent in the privatised company. Management will take 75 percent.

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Compared with yesterday's closing price of $1.94, the offer seems to be at a relatively small premium. What is the basis for the offer price?

MD Rod Walker
We believe it's a fair price. Over the past 12 months, our shares have oscillated between $1.70 and $2.00, and have never gone above $2.00 for any period of time. The offer is a 13 percent premium to our volume weighted average price over the past six months and 14 percent premium to the VWAP over the past 12 months. We'd argue that yesterday's price is at the top of the recent trading range.

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Thank you Rod and Michael.

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