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CEO & CFO on FY13 Outlook

Open Briefing interview with CEO Magnus Nicolin and CFO Rustom Jilla

Ansell Limited
Level 3
678 Victoria Street
Richmond VIC 3121

In this Open Briefing®, Magnus and Rustom discuss:

- Active acquisition program: expansion into new areas of personal protective equipment market (high end protective clothing and fall protection)
- Continued investment in sales and marketing people & programs, innovation and integrating acquired businesses
- Base business expected to accelerate in H2; confirmation of full year EPS guidance

Record of interview:

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Ansell Limited today reported net profit of US$57.1 million for the first half ended 31 December 2012 (H1), down 14 percent from the previous corresponding period (pcp), and EPS of US$0.437, down 14 percent. Revenue was US$648.1 million, up 6 percent, driven by acquisitions, and EBIT was US$68.8 million, down 8 percent, reflecting increased SG&A spend. You've maintained your guidance for the current year ending 30 June 2013 of US$1.07 to US$1.12, up 6 to 10 percent. This implies year-on-year profit growth of at least 25 percent in H2. What are the expected drivers of this turnaround?

CEO Magnus Nicolin
H1 organic sales were flat in a difficult global environment, reflecting adverse forex impacts and significant distributor de-stocking but we're starting to see some positive signs, especially in the US in areas such as the auto industry. We also actively invested in the future through spending on a number of new product launches, sales and marketing staff, increased R&D and advertising and promotion of our SKYN brand in targeted countries.

We recognise that the H2 challenges are significant, but are confident that we can achieve our guidance. Traditionally H2 is better than H1 due to seasonality, we expect new products to contribute much more, distributors to step up purchases after having de-stocked in H1, and some help from raw material costs.

CFO Rustom Jilla
No question that the "ask" in H2 is tougher than we would have wanted. Delivering our commitments will mostly come down to executing our revenue growth and cost control plans. Interestingly, the level of internal confidence is quite high. Magnus and I went through the H2 projections with the rest of Ansell's executive leadership team a couple of weeks ago and there was unanimous confidence that the Company would deliver EPS within the full year guidance. So what we need now is to focus, focus, focus.

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Ansell made three acquisitions during H1; investing US$137.9 million, up from US$18.8 million in the pcp. Given these are the first substantial acquisitions Ansell has made for some time, to what extent did the distraction of integration account for the poor H1 earnings?

CEO Magnus Nicolin
Ansell is a lean organisation. Many of our team members have invested large amounts of time in evaluation, due diligence and now on integration. This inevitably would have taken a little focus off the rest of the business. Nevertheless, this was not the main reason for H1's weakness. As I've said previously, the markets were difficult and we chose to continue investing in the future, seeing the long-term benefits outweighing the short-term cost.

And, as Rustom noted a moment ago, H2's focus will be on delivering results from those acquisitions and on delivering our base business plans.

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Gross profit after distribution expenses (GPADE) was US$238.8 million, up from US$225.0 million and in line with sales growth, but SG&A expenses were up US$19.7 million, to US$170.0 million, including US$13.6 million of additional spending on new product development, advertising and promotion, and additional sales and marketing staff. In an environment where sales, excluding acquisitions, were flat after slowing growth last year, how effective can this kind of spending be?

CEO Magnus Nicolin
We've gone through a major program of reviewing brands and SKUs with the aim of focusing on our long-term core brands, looking to grow in emerging markets which are in fact the growth engines of the world, and focusing on new product development as the life blood of the Company. I truly believe in making these investments to take Ansell to a higher rate of organic growth. We will stay the course and continue to invest. However, we clearly have to look in the mirror and ask ourselves if we're getting an adequate payback from these investments.

CFO Rustom Jilla
The GBUs were set up just over two years ago to bring a global perspective, to make choices on brands, SKU rationalisation, and new products. This has happened, but, we now need to reap the benefits from these investments before starting additional initiatives. We're still planning to invest in sales and marketing in H2, but are now asking for our teams to be more selective, and hardnosed.

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Originally, Ansell planned to continue the global roll-out of its new ERP system, Fusion, in 2013. While optimisation initiatives are underway in North America (NA), where Fusion was first introduced, you've now flagged an SAP project for Europe, Middle East and Africa (EMEA). What is the rationale for this and will the SAP system replace the need for Fusion in EMEA? Will the systems be compatible?

CEO Magnus Nicolin
We've been a little frustrated with the pace of improvement in our ERP platform in NA and Latin America, Caribbean (LAC). Although a lot of progress has been made and the system is fully operational, there is room for further improvement and optimisation.

When purchasing Comasec we were aware that it was a reference site for SAP and that it had implemented SAP for a very reasonable cost and on schedule. Comasec has a well-qualified IT team with a strong background in SAP. So to speed up integration we decided to put our EMEA Industrial and Specialty Markets businesses onto Comasec's SAP platform (a reverse integration if you will). This will also help deliver some planned synergies quickly.

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The Medical business was Ansell's only GBU to book increased earnings and margins in H1, with EBIT of US$17.2 million, up 6 percent, and EBIT margin of 10.4 percent, up from 9.5 percent. Sales were down slightly in EMEA and NA though, so to what extent did this reflect

pricing pressure from the public sector? Will the growth opportunities for the business remain outside these mature markets?

CEO Magnus Nicolin
Medical segment EBIT grew 6 percent, with sales in our dominant business (surgical gloves) up 4 percent while sales in our smaller exam glove business fell about 21 percent. Pricing pressure is strong in EMEA in particular but our teams have been able to compensate for this with mix management i.e. greater focus on more attractive product ranges within surgical

Our growth opportunities lie in both developed and emerging markets. We continue to create new exciting high end products such as our new polyisoprene anti-microbial technology surgical glove, and the new sensoprene synthetic surgical glove without any allergy causing chemical accelerators. These gloves are utilised more in developed markets and polyisoprene surgical glove sales were up 57 percent in H1. We also have a range of gloves designed for emerging markets at a lower price point, so as you can see we're driving hard in both spheres.

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The Industrial business booked sales of US$265.4 million, up 9 percent, due to the contribution or Comasec and growth in North America. However EBIT was down 4 percent to US$38.1 million, reflecting increased sales and marketing and R&D spending. To what extent will the sales and marketing and R&D spending levels of H1 be maintained? Can earnings growth return in the current uncertain macro environment?

CEO Magnus Nicolin
Yes they can! Don't forget Ansell is the world leader in this space, and we plan for this to continue. Look, H1 had a number of issues, the major one being the global contraction. We're starting to see the global economy settling down, and as I mentioned earlier, the US in particular seems to be gathering a little pace. We also spent a lot in H1 on marketing, launching new products, creating a new R&D centre for Industrial in Sri Lanka, and on more sales personnel who take time to get up to speed and bring in revenue. Although some of these costs will continue, we expect to get a return on our investments in H2.

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The Specialty Markets business, which includes household and military gloves, booked sales of US$102.6 million in H1, up 19 percent, driven by acquisitions. EBIT was US$2.6 million, down from US$4.8 million, reflecting higher sales and marketing spending. With sales of existing products falling, where do you see the earnings improvement opportunities for the business?

CEO Magnus Nicolin
SM had a difficult half. Some of its markets, such as the military, are contracting (as soldiers are coming home from Afghanistan) and many of our new exciting products, such as our flame resistant oil and gas glove, have just been launched. Great progress has been made in many areas, and we'll see higher profits in H2. We're also very pleased with our acquisitions APS and Hercules, and there is great opportunity to grow globally with their great product ranges.

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The Sexual Wellness business booked EBIT of US$14.5 million, down 23 percent, on sales of US$114.8 million, up 5 percent. The drop in EBIT reflected increased advertising and promotion spending on the SKYN brand and costs associated with the relocation of the US packaging facility. Sales of branded condoms increased 7 percent. To what extent will sales growth require continued A&P investment? How is SKYN now positioned in the market, and what has been the competitive response to your more proactive advertising?

CEO Magnus Nicolin
SKYN is a fabulous product and the SKYN family is even more powerful. Our major

advertising and promotions program has been most successful and we remain the only global player with a polyisoprene condom. Certainly it has stirred up the competition – we expected it would – but at the same time our market share has grown and that was the aim of the exercise.

CFO Rustom Jilla
The Sexual Wellness business performed better than the numbers seem to indicate. Firstly, forex movements reduced sales growth from around 10 percent to around 5 percent (the euro, the Brazilian real and the Indian rupee). Secondly, the relocation of our US condom packing operation cost us management time and money but is now operational. Finally, the investment in SKYN in H1 will help H2 sales, and there's no reason that profits should not bounce back strongly in H2.

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Free cash flow was US$48.1 million in H1, up from US$6.3 million in the pcp. As at 31 December, working capital was US$305.8 million, up US$53.2 million from 30 June, with US$48.8 million of the increase coming with the acquisitions. Is there scope for near term improvement in free cash flow as you integrate recent acquisitions and expand in new verticals?

CFO Rustom Jilla
In H1, our teams delivered the sort of working capital management that Ansell expects. In fact, this was one of our best H1 performances, even though there was still not enough progress in inventory management, which is now more complex than before with the range of products the acquisitions have brought to our portfolio. Yes, there is scope to improve working capital metrics at the acquired businesses and of course to generate more cash. We continue to expect at least US$100 million of free cash flow for F'13, with higher EBITDA in H2 partly offset by higher interest and cash taxes. And, in F'14, the acquisitions will be contributing, and free cash flow should increase even further.

CEO Magnus Nicolin
We've bought good businesses, but the working capital turns of Comasec were well below Ansell, so with solid integration outcomes we expect F'14 will be a strong free cash flow year.

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As at the end of December, Ansell had net debt of US$202.2 million, up from US$56.1 million six months earlier. Gearing was 20.6 percent, up from 7.2 percent. Since the end of H1 you've acquired Brazilian protective equipment company Hercules for US$77 million and announced a 2 million to 3 million share buyback. Does the buyback signal an end to the recent acquisition activity? What is the outlook for gearing at the end of the current year?

CEO Magnus Nicolin
No it isn't the end of acquisition activity. We continue to evaluate attractive acquisition opportunities and to build the pipeline. Realistically however, we need some time to integrate the five businesses we've bought in the current year. So it's just a pause for a few months.

CFO Rustom Jilla
Our gearing (net interest bearing debt/net interest bearing debt + equity), was just under 27 percent right after the Hercules acquisition. We expect to be strong cash generators in H2 as well. What gearing ends up at by June 30 depends not just on our free cash flow but also on how many shares we buy. This is a fairly small buyback and it will probably be best for shareholder value creation if we end up buying back just the bottom end of the range over 12 months.

Incidentally, we've had better accretion in H1 from the acquisitions (rounding to US$0.01) than we had projected and we'll probably do a bit better in H2. Of course, this is after counting transaction and integration costs. We play in fragmented industries with plenty of room to make good, value adding acquisitions so M&A should continue to play a key role in growing sales and earnings. But, we must also keep ROA/ROI and risk in mind when we acquire – not just EPS accretion.

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Ansell announced an unfranked interim dividend of A$0.16 per share, up from A$0.15 per share last year. Given EPS fell 14 percent in H1, what was the rationale for increasing the dividend? What is the outlook for the full-year dividend?

CEO Magnus Nicolin
The rationale for increasing the dividend is that we have confidence in H2 and have generated and are generating plenty of cash. Dividends are a Board call but there is no reason that the full-year dividend should not be increased as well.

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Thank you Magnus and Rustom.

For more information about Ansell, visit www.ansell.com or call David Graham on (+61 3) 9270 7215.

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