Chief Executive Officer & Managing Director

AGM address

Thursday 29 January 2015

Welcome

Thank you Chairman and good afternoon everyone, thank you for making the time to be here today.

Introduction

As the Chairman has already outlined we were very pleased with how the management team has converted our strategic plans into operational results.

To provide some context as to how this was achieved I would like to take the time today to outline the environment in which we've operated and to look at the key business drivers.

Environment

Firstly, I would like to address the key issues impacting our operating environment. The Chairman has already mentioned the changes to the Pharmaceutical Benefits Scheme (PBS) and their deflationary effect on pharmaceutical prices. While we don't expect the government to make any more substantive changes to the PBS reform process, the more pressing matter for our industry is the 6^{th} Community Pharmacy Agreement between the Government and Pharmacy Guild.

Our industry has already made a significant contribution to government savings courtesy of PBS Reforms, and the current policy will deliver savings to the public purse for many years to come. As the Chairman has said, from December 2013 more than $1 billion in annualised savings will come from the PBS. During that time pharmacies, manufacturers and wholesalers have all made ongoing adjustments to retain acceptable returns on investment.

We believe the 6th Agreement will be executed in the next few months and our view is that we do not expect any substantive change to the existing PBS Reforms process nor do we anticipate material adjustments in wholesaler remuneration. Shareholders should take comfort in the fact that we have demonstrated our ability to address these matters constructively and we have every confidence we can do so in future.

Looking to the broader retail landscape, we believe the air of caution among consumers which we saw during 2014, will persist in 2015. The Roy Morgan Consumer Confidence survey showed that 2014 had the lowest average confidence rating since 2009. Moderate conditions in the economy are no doubt linked to this result, although sustained low interest rates appear to have tempered this somewhat. We do not expect any real improvement in consumer sentiment during the coming year.

Retail results and changes

With that background, the performance of the Retail business reflected our very good tactical execution, to drive sales and margin growth. Comparable store growth of 6% placed Priceline/Priceline Pharmacy among the best performing listed retailers in Australia. The top line sales growth of 11.1% reflected the strong comparable store performance and the addition of 27 new stores.

Our result is connected by two key drivers; engagement with consumers and tactical execution by our franchise partners and stores.

In relation to the first driver of consumer engagement, we have driven higher engagement by maximising all our marketing assets, devising strong offers for our targeted consumers and continually refining our offer. We have been able to do this through our market research, which provides insights into further refining the range, choice, value and service that our shoppers want. The awareness of the brand now sits at 98%, with consumer consideration as a health and beauty destination at 86% - both market leading indicators.

The Sister Club program is the centre of all our customer loyalty activities and has more than 4.7 million members, which represents a growth in sign-ups of almost 10% on the prior year. We harness the valuable data it delivers in our ranging and programs to give our most loyal customers more of what they want and they've responded through increasing their purchases with us. Sister Club basket size continues to be a key differentiator for the business with those customers spending 34% more than a non-Sister Club customer.

We have been able to attract consumers to stores with an increased presence on TV every month throughout the year, more events with key magazines and through leveraging our digital and online assets. Our online sales were up more than 180%, the monthly page views on our website rose to 7.4 million, our social media fans up 67% and their engagement levels up 121%.

Once in our stores, shoppers find our range is appealing due to our unique positioning across health and beauty – representing the right products at the right price with an attractive in-store environment for this market. We have the number one market position in Australia across all retailers for colour cosmetics and skin care, with market shares of 41% and 18% respectively. Across beauty categories we have a market share of 27%. At the same time we are also taking market share with our health sales growth of more than 12%.

As a franchisor we know our network believes in our offer. Their level of satisfaction is higher than ever, despite pharmacy facing the period of greatest price erosion. Our independent survey conducted by the Franchise Relationships Institute showed that franchise partners were strongly satisfied and, according to these results, the satisfaction with our brand management and marketing is among Australia's best practice.

Pharmacy business and results

If I turn to the Pharmacy business now, the underlying growth of 11%, which excludes the effect of PBS Reforms, is exceptional. In real terms, growth was still 3.9% or $90 million in revenue. Our results showed that management adapted well in the past year to the environmental changes and also listened to the needs of our customers.

Our independent pharmacy customers continued to enjoy competitive service and a choice of programs to build their businesses. In total we have more than 1100 pharmacies that are aligned to our broader brand and marketing services. The Club Premium model has reached more than 690 members and is the backbone of our independent offer. This model offers pharmacists a range of choices suitable to their markets – from professional consultation programs, to targeted branded offers or product promotional programs – which we leverage from our broad-based retail experience and success. This is seen across all our independent offers of Soul Pattinson, Pharmacist Advice and Club Premium.

These competitive services have been further amplified through efficiencies and improvements of our deliveries in full and on time across our supply chain with the average cost per unit delivered dropping 7% in the last financial year.

As the supply of pharmaceuticals becomes more of a commodity the growth of services is important to retain and grow pharmacy accounts. We believe there are still opportunities to do this – not only via the services that we currently supply to pharmacies, but also in regard to broader services such as vaccinations and health screenings.

The reason we support such service extension is that they can be implemented by pharmacies very quickly, making the most of their skills and experience to improve overall health outcomes.

New Zealand

Our New Zealand operations had a tough year, but I'm pleased to advise that results improved in the second half of the year. Overall revenue was 2.3% up on the prior year with foreign exchange movements and contract volumes being less than expected. The business continued to play an important role in delivering exclusive product into our Australian retail operations, a tactic we will further leverage into the future.

Sales in the New Zealand domestic market from our own products and our Blackmore's agency have been good. We must ensure that our New Zealand operation is at the forefront of product development to deliver relevant, competitively priced products into the Australian and New Zealand markets.

Overall results

In such a challenging environment API was able to deliver revenue growth of 5.7% and keep operating costs in check with growth of only 2.4%. The underlying profit after tax was up 32.5% to $31.7 million. As the Chairman has said, our financial controls and utilisation of shareholder funds has improved with a reduction in net debt to $184.8 million at the year end, down from $201million the prior year. Our cash conversion cycle has improved 14% over the year and our underlying return on funds employed has improved from 7.98% to 11.22%.

One ERP

It is also important that I provide a brief update on the OneERP program. The company will invest $42 million and the program is still planned to go live in March this year. We've had a team made up of internal and external experts working with us during 2014 to prepare the business for a cut over to the new system. This will consolidate our reporting and management systems with a platform that will be scalable and sustainable as we grow the business.

We're confident that implementing this OneERP program will deliver us significant efficiencies that will provide a payback in the next six years. We have engaged in substantial due diligence processes to ensure this is as smooth and successful as possible.

People & safety

I would like to take a moment to acknowledge the entire API team which has contributed to the good results. Every team across the company has played its part in our progress. We have invested in more training and development to ensure the business remains strong. Specifically we developed leadership capabilities and invested in the next generation of leaders at API, which we believe is contributing to the positive results.

We are also investing in making sure our people are safe. Nothing is more important than people going to and returning from work without harm. Our distribution centres recorded a drop of 11% in Lost Time Injuries in the last financial year and we are aiming to replicate this performance across the business.

Priceline Sisterhood Foundation

Since our last AGM we have achieved some wonderful milestones from our corporate social responsibility program which first started in 2011, as the Priceline Sisterhood, supporting six charities aligned to the concerns of women and their families.

In May 2014 the program successfully became a Charitable Foundation with an independent board. This has a number of benefits, such as allowing donations of more than $2 to be tax deductible, to further accelerate the growth of the Priceline Sisterhood Foundation and it makes administration more straightforward.

The Priceline Sisterhood Foundation is something of which we can all be proud – that's all of us involved with API, whether staff, franchise partners, suppliers or shareholders. We are helping charities make a real difference to their work with many thousands of Australians in need of assistance.

Current trading performance

Before I conclude I will update our current trading performance. We expect conditions to remain challenging, however we have a retail proposition that has shown its resilience over the past 18 months and outperformed most other listed retailers on a comparable store basis.

The first few months of the current financial year have seen consumers continue their caution. We believe that the retail market was particularly soft just prior to Christmas with many retailers responding by offering substantial discounts well before expectation.

Added to these conditions we also saw new competition in our market. We're excited about the challenge that presents for improving our business. As an example, our Sydney CBD stores met new competition head on and in fact outperformed our national averages. While we set high standards, this showed our business was all the better for being invigorated and responding to the challenge.

Despite the conditions experienced across the retail sector in December our outlook remains positive. In the current financial year until 24 January, the results for Priceline/Priceline Pharmacy have been:

- A total sales growth rate this financial year of +7.5%;
- A comparable store growth rate of +2.4%;
- Total store numbers of 400; and,
- We expect to reach 20 net new stores for the financial year by May 2015, with more expected to open during the year.

When these results are combined with continued steady performance of the Pharmacy Distribution business, I am pleased to announce that we expect a net profit after tax position for the first half to be up approximately 20%-25% on last year's underlying first half NPAT of $16.2m.

Conclusion

Finally I would like to thank the Board for their support and all at API for their efforts over the past year. I would also like to add my thanks to our team for winning the Australian Retailer of the Year Award, it was well deserved. Through these collective efforts I believe that the company is in good shape and we have the right people and plans to continue growing the business. Despite the prevailing conditions I think we should all remain optimistic as 2015 continues to look promising for the business and we expect to further grow returns for shareholders by leveraging all the assets of the business.