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CEO and CFO on Half Year Results and Outlook

Open Briefing with CEO John Rawlinson and CFO Martin Brooke

Talent2 International Limited
Level 4, 77 Pacific Highway,
North Sydney, NSW, 2060

Talent2 International Limited (ASX: TWO) is a human resources outsourcing and managed services provider. Talent2 has two main segments, Managed Services and Recruitment Services, and operates from more than 40 offices delivering services to 31 countries across Asia Pacific, Middle East, the UK and the US.

Current Market Capitalisation: $81 million

In this Open Briefing®, CEO John Rawlinson and CFO Martin Brooke discuss

- **Half year results and outlook**
- **Outlook for the Managed Services and Recruitment Services businesses**
- **Investment in infrastructure for future growth**

Open Briefing interview:

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Talent2 International (ASX: TWO) reported revenue growth of 7 percent to $158.2 million for the first half ended 31 December 2011, and EBITDA fell by 59 percent to $5.3 million, this resulted in a net loss of $1.7 million for the first half, compared with a profit of $3.9 million in the previous corresponding period (pcp). The results reflected clients' deferral of hiring decisions, and an increase of 13.3 percent in cash costs. What caused this result, particularly the increased costs and what is the expected trend in revenue and operating costs over the remainder of FY2012?

CEO John Rawlinson

We've invested in marketing, human resources and systems and this had an approximate $2 million impact on earnings in the first half, with the costs spread between our two business segments, Recruitment Services and Managed Services. These are strategic investments for the long-term growth of our business. Importantly, we didn't lose any major clients in the first half and don't see any signs of potential client losses in the current half.

In our Recruitment Services segment, we increased average head count from June 2011 by 13 percent in anticipation of growth that didn't arrive. The result was an 11 percent reduction in first half gross margin and a fall of 21 percent in productivity per consultant. We're assessing our headcount against expected demand over the current half and while we may need to fine tune, we don't intend to implement an aggressive redundancy program like we did during the global financial crisis.

In our Managed Services segment, margins have fallen due to a changing revenue mix and our investment in the growth and scalability of the business that will begin contributing to earnings in the near term.

In the second half we expect the Managed Services segment to generate revenue growth without increasing its cost base. The Recruitment Services segment is more difficult to predict. We're in the process of assessing market demand and making sure we have sufficient recruiters in place to meet client needs.

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In December 2011, Talent2 first warned of a fall in its half year EBITDA. Why was this downgrade announced so late in the year, given the continuing uncertainty in Europe and ongoing volatility in financial markets?

CEO John Rawlinson
We felt our comments at the start of the year were conservative, highlighting some of the uncertainties in the market. Our first quarter was subdued, but not to a degree that would cause concern. Then, after poor trading in October, our November result made it clear we were not going to make up for the previous months' underperformance in the final months of the calendar year. And it's worth noting that the Recruitment business can typically have very big final months leading up to the reporting date and can surprise on the upside.

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Can you comment on Talent2's current business model and cost base? What differentiates you from other human resources outsourcing and managed services providers in the market? Given the inherent cyclicality of your markets, do you see any need for restructuring?

CEO John Rawlinson
The good news is that our business model remains robust, albeit we are taking a number of initiatives to increase the efficiency of the model, reduce costs and also skew our recruiting business towards those areas where demand is more robust.

Our key differentiators are geographical diversity, operations in eighteen countries servicing thirty one countries, and the ability to deliver to clients an end to end HR solution.

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Talent2 had net debt of $25.9 million as at 31 December 2011, with gearing (net debt/net debt + equity) of 21.0 percent, up from net debt of $4.2 million and gearing of 3.8 percent at 30 June 2011. Is this level of debt sustainable? How are debt levels expected to trend over the second half?

CFO Martin Brooke
Our debt level is sustainable but higher than our preference and thus we are focused on collection of debtors and cost reductions in the first instance. We have a $10 million working

capital facility and are looking at putting in place a trade receivables facility to better manage our working capital needs.

In the first half, we had an increase in debt of $6.2 million in relation to the Origin HR acquisition and the buy-out of minority holders in our Japan recruitment business. We have further payments of $3.9 million in staged acquisition payments due throughout calendar year 2012, which will all be debt funded.

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At 31 December 2011, you had cash and equivalents of $5.3 million, down from $18.1 million a year earlier. Cash outflow from operations was $5.7 million, versus cash inflow of $7.2 million in the pcp, primarily due to the increase in operating costs. What scope is there to improve cash flow in the absence of a demand recovery in your markets? What are your expectations for cash flow in the second half of 2012?

CFO Martin Brooke
There are a number of factors impacting our cash flow. Obviously our trading performance is one, and investing in people and infrastructure for the next phase of growth is a major component of that. Globally headcount has increased from 1,481 at December 2010 to 1,665 at June 2011 and 1,778 at December 2011. Cash outflow also increased due to a major payroll project and growth in the contracting business. We spent $4.2 million on the payroll project in the first half, and will spend an estimated further $3 million on it in the second half.

Our contracting business grew 29 percent in the first half, and we generally pay contractors fortnightly, but don't usually receive payment from the client until the following month or later. So, as we tailor the recruiting business to meet growing demand for "flexible resources" in the skilled and professional workforce, this too uses more cash.

We've implemented measures that will see less spending in the second half compared with the first. If trading improves, we expect cash flow to improve in the second half, although it's unlikely to completely offset the first half performance.

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How do you expect the investments in Origin HR and your recruitment operation in Japan to perform in 2012 and what assumptions underlie this expectation?

CFO Martin Brooke
The Origin HR business operates in the vocational training market and is performing well. The volume of students enrolling is up on last year and we're updating our internal management system to better cope with the volume of enrolments. The government continues to promote vocational training, and we expect this business will continue to grow.

While the Japanese business was profitable in the first half, it was naturally impacted due to its financial services focus. This business is changing its focus refocusing away from financial services into other markets and is expecting a stronger second half.

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Talent2's Managed Services segment reported EBITDA of $5.8 million for the first half, down 41 percent, on revenue of $94.6 million, up 8 percent, and gross profit of $59.2 million, up 4 percent. Within this segment, revenue from Recruitment Managed Services rose 2 percent,

Payroll rose 4 percent, and Learning rose 24 percent. Is revenue growth sustainable in the nearer term? How do you expect your increased investment in the business to improve EBITDA?

CEO John Rawlinson
In the Recruitment Managed Services business, excluding the impact of pass-through revenue, predominantly derived from contractors on site, revenue was up 15 percent on the pcp. Excluding pass through revenue, revenue generated in Australia grew 12 percent and in Asia by 24 percent, but EMEA revenue fell 7 percent.

We didn't lose any material clients in the first half and some of the more material wins we expected in the half haven't yet eventuated or will only be implemented this year. Margins fell as the mix of revenue changed from revenue gained through additional placements with existing customers, to revenue from new customers which carry a lower margin. For the period, excluding pass-through revenue, the business generated approximately 55 percent of its revenue as fixed fees, and 45 percent variable. In addition, the business increased its investment in areas including account management, sourcing and business development.

In the Payroll business, we have a major project that is adding to revenue, but it is in the early stages of development so has not as yet impacted our earnings. Excluding that project, revenue fell by 3 percent and within that, annuity revenue increased by 8 percent while transactional revenue, derived predominantly from our consulting workforce, fell by 35 percent. We didn't reduce consultants in line with the reduction in revenue as our consultants are highly skilled and contain large amounts of intellectual property that is difficult to replace. We had a number of wins in the first half that will move into implementation in the second half and because of this, we expect consultant productivity to improve.

Revenue in the Learning business was driven by growth in our vocational training business, which also reported earnings growth, versus earnings from the other Learning businesses which were marginally down.

We believe the revenue growth is sustainable. Our revenue streams include both fixed and variable revenue contracts, which mean there's always an element that is difficult to forecast. While it is still early, at this point we're not seeing any significant reduction in volumes as compared to the first half.

We expect our investment in the business to generate earnings growth over the medium to long term by helping to win more new clients, retain existing clients, improve account management and expedite client renewals.

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The Recruitment Services segment reported an EBITDA loss of $0.5 million for the first half, versus profit of $3.1 million in the pcp. Revenue was $63.4 million, up 5 percent, but gross profit was $32.4 million, down 11 percent. Average consulting headcount increased by 13 percent, to 370 and productivity fell 21 percent compared with the pcp. What ability do you have to improve productivity in the current environment and what will be the key drivers of a turnaround in this business?

CEO John Rawlinson
Within the Recruitment Services segment, contracting grew by 29 percent while permanent recruitment dropped by about 15 percent. Recruitment revenue was weakest in our businesses focusing on the financial services sector such as Hong Kong and to a lesser extent Japan, the UK

and Singapore. Revenue in our China business more than doubled – the business was profitable in the first half and the star performer in our Recruitment business.

With recruiter headcount increasing in the first half, related costs such as administration support, travel, training and client entertainment also increased. We're refocusing our consulting force away from financial services and expect a net reduction in headcount costs over the remainder of the year as people leave financial service focused roles and we hire for other higher demand industries.

While we need market conditions to improve to achieve significant productivity improvements, productivity will also benefit as the team becomes more experienced. New staff takes time to achieve full productivity, and the experience and maturity of consultants is a key to the profitability of the business.

The impact of a recent management restructure should also positively affect second half results, and in current trading conditions, the contracting business is expected to continue to grow.

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What has been the earnings performance of Talent2's key geographic segments? What is the expected trend in geographic earnings over the remainder of the year?

CEO John Rawlinson
Our strongest revenue growth came from Australia and New Zealand with a 13 percent increase. Asia was up 4 percent but EMEA was down 18 percent. Gross margin, excluding corporate allocation, was flat in ANZ, down 5 percent in Asia and down 13 percent in EMEA, largely due to the UK Recruitment and Recruitment Managed Services businesses.

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Given the drop in earnings, what is the outlook for dividends in the current year?

CFO Martin Brooke
Typically we pay annual dividends, so any dividend would be based on our profits for the year to June 2012. The board will continue to review this but it is more likely we will seek to reduce debt than pay dividend given the uncertainty in the market.

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Where do you see the key growth opportunities for Talent2 in the medium term?

CEO John Rawlinson
We've invested in the business to enable long term growth. We see growth opportunities from our geographic reach, our range of products, our strong alliances with the likes of Allegis Group Services and our strong client base.

We are in the process of due diligence of a small Vietnam based recruiting firm which, if completed, will add a new important geography where we already have a payroll outsourcing office and where several existing clients want us to support them.

We also have a very broad, established client base across Asia, a broad product offering with new recruitment, payroll, recruitment managed services and training. We see growth opportunities from selling more of our products to more of our existing client base.

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Thank you John and Martin.

For more information about Talent2 International, visit www.talent2.com or call CEO John Rawlinson on +61 3 9918 0918.

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