



## **Chief Executive Officer & Managing Director**

### **AGM Address**

**Thursday 28 January 2016**

#### **Welcome and introduction**

Thank you Chairman.

Good afternoon everyone and thank you for your attendance here today.

I am delighted to provide a more detailed commentary on our operations and briefly cover our current performance.

When reflecting on the results it is worth reminding ourselves that in recent years we've encountered the most significant period of price deflation to the PBS, increased retail competition along with its associated promotional discounting and a fluctuating consumer sentiment.

API's results reinforce a strategy and an operational capability that provide a real foundation of confidence for API shareholders in building our long term value.

In 2015 we were very pleased to increase the reported net profit to \$43.1 million, the highest on record by API, and, increase earnings before interest and tax to \$74 million. Over the last four reporting periods we've seen compound growth in underlying net profit of 25% and underlying EBIT of 9%.

Our financial disciplines have seen us place the company in a very strong position:

- The use of shareholder funds also improved on the prior year with return on capital employed up 12.7% and return on equity up 31.2%,
- We've established investment grade debt metrics, with interest cover at more than 5 times earnings;
- Our cash management focus has resulted in the cash conversion cycle improving from 36.7 days to 32.3 days; and
- Our average net debt declined by \$39.3 million to \$145.5 million at the end of the financial year.

The operating business also had a number of significant highlights for the year.





Looking first at the Retail business, the Priceline Pharmacy network recorded a very good result, with like-for-like store growth of 4.5% in 2015 following the 6.0% recorded in 2014. Our total sales growth of 10.4% reflected the strong like-for-like store growth along with the addition of 27 new stores which took the total network to 420 stores at the end of August 2015.

Our customer offer continues to be developed and innovated in-line with consumer demand. Our range across health and beauty has the widest selection of famous brands at great value and with a service environment that is expert in both health and beauty.

Our success is demonstrated with our number one market share position in both colour cosmetics and skincare. These categories grew at 12.6% and 21.9% respectively in the year. They were complemented by the vitamins and medicinal health categories growing at more than 17%.

Our services from pharmacists and our health and beauty advisors are being developed to extend our advantage. In the last year we opened up new health checks, vaccination services and online bookings for makeovers in store to highlight a few of our initiatives. Accentuating such services is essential to the overall store experience.

The popularity of our loyalty program, Sister Club, is testament to the value customers find in store with our current membership now at 5.7 million. This is the largest loyalty program in health and beauty in Australia and one of the largest in any sector.

The Sister Club program is one of several assets that we use to increase customer engagement with the brand. When combined with a growing social media presence; sponsorships and events; brand ambassadors; print, radio and TV advertising; our catalogues and multimedia screens, it is responsible for maintaining high awareness and frequent shopper visitation.

The other key element behind our growth is our network size; generated by attracting and retaining pharmacist franchise partners. Pharmacists are willing to join us and re-sign with us because they can see the sustainable success of the brand.

Given the market conditions I mentioned earlier, we're confident that Priceline Pharmacy is more relevant than ever for our franchise partners by providing a high profile brand with a sustainable point of differentiation. We expect store numbers





will continue to grow with ongoing demand from potential partners and many opportunities for sites that will complement our existing store network.

Moving onto Pharmacy Distribution, the business where we continue to service more than 3500 pharmacies, and offer a suite of business and value-added retail services such as the Soul Pattinson and Pharmacist Advice brands and the Club Premium program.

Although the result was still very good, early in the 2015 financial year, our major pharmacy distribution competitors acquired two retail banners groups that had traded with API for many years and as a consequence the business had a potential revenue exposure of \$300 million. As an indication of our capability, we retained many accounts for an extended period and captured new business to recover our position by the end of the financial year.

The demand for our business and retail services continued to increase, the strongest growth came through the independent pharmacy program, Club Premium, which grew member stores by more than 10% to over 750. This keeps more than 1,100 pharmacies as first line accounts and associated with one of our brands or programs.

The revenue growth rate in Pharmacy Distribution was broadly in line with last year, demonstrating the effects of PBS Reforms, and gross profit dollars were also steady. We expect price deflation to continue as a consequence of PBS Reforms and to retain an acceptable return on our capital employed, we will have ongoing trading terms adjustments. While this is not a desired position it is largely understood by pharmacies as a direct result of having no changes to the Community Service Obligation payments for distributors in the 6<sup>th</sup> Community Pharmacy Agreement.

Underlying our strong overall performance was the improved efficiency and effectiveness of our supply chain operations. In 2015 we delivered more products for less cost and it was a fundamental component of the entire business lowering our cost of doing business and generating what we term our 'operational productivity'. These efficiencies are substantial and allow us to deliver better returns to shareholders.

In New Zealand our consumer brands operations were restructured in 2014 and the results were greatly improved in 2015. Overall sales were up 17.5% on the prior year as the changes provided benefits and that flowed into gross profit that was up 12.9%.





The business continued to play an important role in delivering exclusive product into our Australian retail operations, a tactic we will leverage into the future.

All the operational highlights were achieved during a year in which the company completed its \$45 million investment in a new enterprise wide reporting platform, SAP. Our employees navigated ongoing business needs with a new system that touched virtually every critical area of our operations and did so without effecting business results.

The system was implemented in April and is a world first for SAP that combines retail and wholesale operations. Considering the scale of the implementation it is a pleasing outcome and we are now working to fully settle the new system and extract the expected benefits.

The ability to manage what we did in the last 12 months comes down to commitment and skill of our people. We have invested more in training and development to ensure the business remains strong through our excellent employees.

We are also about improving our safety. We aim to have everyone attending any API site to do so safely. This focus resulted in our distribution centres recording a decrease of 11% in Lost Time Injuries in the last financial year and we know there is further improvement possible.

Before I finish I would like to make a special mention of the Priceline Sisterhood Foundation, which is API's corporate social responsibility program. The Foundation supports five charity partners; Perinatal Depression and Anxiety Australia, Look Good Feel Better, Children First Foundation, Alzheimer's Australia and the Australian Cervical Cancer Foundation.

The last year for the Foundation has been truly remarkable, raising more than \$750,000. All proceeds are contributed directly to the charity partners and put towards specific programs. Shareholders can be proud of this Foundation and know that all the funds raised are going directly to programs in need.

In concluding, we have optimism for sustained growth in our existing business. This growth is underpinned by the major investments we have made in the Priceline Pharmacy brand, in supply chain capability and the SAP reporting system.

These investments have resulted in a compelling business model for our pharmacy partners; an unmatched health and beauty expertise in Australia that is driven by market insights to meet consumer demands; and that our integrated business





infrastructure can be adapted to continue to drive efficiencies that will add incremental value to the business.

Our intention is to deliver long term value to shareholders.

### **Current trading performance**

Prior to finishing, an overview on our trading status for the year to date remains positive and similar to this time last year.

- Pleasingly, we are expecting an underlying net profit after tax result for the half year of at least \$24 million (excluding CH2);
- Overall retail sales are up 8%, with like-for-like stores up 2% for the period ending 23 January;
- Store openings are on track to meet 20 net new stores for the year, making 440 by the end of the financial year;
- Steady performance from Pharmacy Distribution continues; and,
- Following the implementation of SAP we took a cautious approach to protect our trading performance, and particularly, for the Christmas period and increased our working capital levels, for which increased financing costs are already factored into the NPAT expectations for the half year.

Finally I would like to thank the Board for their support, my Executive Leadership Team and all employees at API for their efforts over the past year. Our challenge is to continue the pursuit of our strategy and deliver long term growth for all API shareholders.

