

# HEADLINE

*Group Limited*

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24 August, 2009

**For immediate release to the market**

## **MERGER TRANSACTION COMPLETED**

Please find attached for release to the market an announcement from the Company's Executive Chairman and Managing Director regarding completion of a merger transaction.

**Headline Group Limited**



**Ian Gordon**  
**Company Secretary**

## **MERGER TRANSACTION COMPLETED - SKANSEN/BEANIE KIDS AND KIDS CENTRAL**

The board of **Headline Group ("HLD")** are pleased to announce the exchange of contracts merging **Kids Central/Early Learning Centre** with **Skansen/Beanie Kids**. The merged business has **exclusive rights to Mothercare in Australia** (as announced 22<sup>nd</sup> June, 2009).

### **THIS TRANSACTION TRANSFORMS HLD**

#### **From a company managing:**

- **One children's brand (Beanie Kids)**

#### **To a company growing:**

- **Four leading brands in the Parenting & Children's segment including Mothercare (the most exciting retail growth opportunity in Australia at this time), with an expanded management team, greater business scale and synergy potential.**

#### **Investment Highlights – Business opportunity and Capability**

- 4 Brands - synergistic, profitable base business (~\$40m sales excl. Mothercare)
- Management team with a track record in brands, retail, on-line and wholesale
- Exclusive Australian rights to global brand, Mothercare (UK listed, global market leader)
  - Highly successful in the UK (425 stores) and internationally (609 stores in 50 countries).
- 70% of sales are Mothercare own-branded product
- Targeting a \$3.9bn relatively fragmented, children's/maternity market in Australia
- Major growth potential into target segment through launch of Mothercare. First store will be opened in March 2010
- Competitively advantaged product offer through differentiated proprietary product attracting higher gross margins
- Infrastructure in place to enable further synergistic acquisitions and business expansion in the target segment

#### **Investment Highlights – HLD Valuation and Share price**

- No dilution to existing shareholders through transaction
- \$4m committed immediately for growth initiative; i.e., accelerated launch of Mothercare in Australia.
- No cash taken out in transaction – management incentive is future value creation:
  - Initially, Kids Central management own ~ 33% of merged entity
- Short term growth upside – e.g., a 1% market share gain for Mothercare doubles current revenue of the merged entity
- HLD retains ~ \$5m surplus cash for additional synergistic acquisitions
- Re-rating potential to bring valuation in line with peers as Mothercare business is launched

Overview of HLD Brand & Portfolio

Brand	Description
	<ul style="list-style-type: none"> <li>• 21 stores full service retail plus online, proprietary brand</li> <li>• FY09 Revenue ~ \$27M</li> <li>• One stop kids shop - toys, fashion, furniture, home wares and nursery products from world's best brands.</li> <li>• Core business is ELC toys</li> <li>• Featuring developmental &amp; educational toys &amp; games, art &amp; craft, books &amp; DVDs, games &amp; puzzles, sports, home wares, fashion &amp; fashion accessories, etc.</li> <li>• <a href="http://www.kidscentral.com.au">www.kidscentral.com.au</a></li> </ul>
	<ul style="list-style-type: none"> <li>• 11 stores full service retail, 20 year exclusive rights to brand</li> <li>• FY 09 Revenue ~ \$5M</li> <li>• Offering ELC toys and books with educational content</li> <li>• Featuring specialist developmental toys &amp; games baby &amp; toddler, outdoor, dolls, dress-ups &amp; role-play, action figures, cars, trains &amp; construction, learning &amp; books, art &amp; craft, music, puzzles &amp; games</li> <li>• <a href="http://www.elctoys.com.au">www.elctoys.com.au</a>, <a href="http://www.elctoys.com.nz">www.elctoys.com.nz</a>, <a href="http://www.elc.co.uk">www.elc.co.uk</a></li> </ul>
	<ul style="list-style-type: none"> <li>• Wholesale through independent retailers and online</li> <li>• FY09 Revenue ~ \$9m</li> <li>• Collectible plush toy range, online games/ activities, learning and social networking and various giftware under licence</li> <li>• <a href="http://www.beaniekids.com.au">www.beaniekids.com.au</a></li> </ul>
	<ul style="list-style-type: none"> <li>• \$4m committed to launch full service retail in Australia</li> <li>• First Australian store scheduled to open in March</li> <li>• Exclusive rights to brand with roll-over options</li> <li>• Mothercare is a specialist retailer of products for mothers-to-be, babies and children up to the age of eight</li> <li>• Featuring exclusive/proprietary product in pregnancy &amp; maternity, prams &amp; strollers, nursery, in-car restraints, apparel &amp; footwear, bathing, feeding, home safety, kids bedroom</li> <li>• <a href="http://www.mothercare.com">www.mothercare.com</a></li> </ul>
<p><b>HLD Online</b></p>	<p>HLD seeking to become market leader online in the parenting/ kids ecommerce segment via:</p> <ul style="list-style-type: none"> <li>• <b>Retail on line</b> <ul style="list-style-type: none"> <li>○ <a href="http://www.beaniekids.com.au">www.beaniekids.com.au</a></li> <li>○ Will add Mothercare Direct to current ELC and Kids Central e-commerce</li> <li>○ Kids Central FY09 Revenue ~ \$1.5m</li> </ul> </li> <li>• <b>'Edutainment'</b> (Entertainment and learning) <ul style="list-style-type: none"> <li>○ BK World (<a href="http://www.beaniekids.com">www.beaniekids.com</a>) with potential international expansion</li> </ul> </li> <li>• <b>Directory/content provider</b> <ul style="list-style-type: none"> <li>○ Online parenting and baby directory and content service provider to support Mothercare roll out</li> </ul> </li> </ul>
<p><b>HLD Corporate</b></p>	<ul style="list-style-type: none"> <li>• ~\$5m cash (after \$4m investment for Mothercare launch)</li> <li>• ~ \$1.8m property asset</li> </ul>

**Strategic Rationale for the Merger**

**1. Important synergy opportunity for HLD's Skansen business**

- Beanie Kids remains a strong brand however it requires a synergistic business to leverage fixed costs; i.e., warehousing and logistics, finance and admin., marketing resources
- Beanie Kids may be cross sold into Kids Central stores, with international expansion through the merger a future possibility. There is also substantial marketing opportunity to leverage customer databases in the common segment.

**2. Kids Central has a strong store portfolio from which near-term improved returns may be extracted:**

- ELC, the heart of the Kids Central business, generates high margins and continues to provide growth for the company
- The introduction of the Mothercare offer will drive greater sales productivity in the non-ELC m<sup>2</sup> space within Kids Central stores
- Greater Gross Margin – in the order of 10% - will be achieved on the Mothercare merchandise versus third party product
- KC provides the retail system platform and ELC synergy necessary for an accelerated successful launch of Mothercare in Australia

**3. Unique opportunity to roll out Mothercare.**

- Mothercare has clearly demonstrated its ability to establish successful franchises in international markets; extensive research has shown Mothercare products will be very competitive from a quality and value stand-point in Australia
- Australia remains under-served in terms of a national specialist retailer in the segment
- Demonstrable store roll-out opportunities in aspirational locations and with attractive retail rental commerce

**Balance Sheet – Effect of the Transaction**

HLD Balance sheet All Calcs in \$000	Dec-08	Merge Skansen with Kids Central Group	\$4m investment for Mothercare launch	Pro Forma
		a.	b.	c.
Cash	9,475		-4,000	5,475
Operations	<b>3,900</b>	<b>4,500</b>	<b>4,000</b>	8,500
Asset held for sale	1,782			1,782
Other net assets	1,039			439*
Net assets	16,196			16,196
Net assets per share				13.5cps

Surplus cash per share				4.5cps
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\* Note: Tax/consolidation treatment of goodwill/identifiable intangible assets not yet considered

The summary after the transactions described above is that **HLD will initially own ~ 67% of the subsidiary**, and the vendor/ management group will retain ~ 33%.

HLD has structured the transaction to ensure the venture has sufficient capital, that the vendor management group is incentivised to drive growth, and to provide HLD downside protection. The detail around the structure is as follows:

- a. A new subsidiary entity is formed to acquire Skansen and the Kids Central Group (referred to above as Skansen KCG). HLD receives \$4.5m in equity in Skansen KCG, and the vendors /management of Kids Central receive \$1.65M of equity and a \$2.5m convertible note (redeemable, 10% coupon payable quarterly in arrears, conversion into subsidiary shares on a one for one basis at a liquidity event). The Vendors have in addition an earn-out based on Kids Central's 2010 store contribution to EBIT for an additional \$0.35M of equity in Skansen KCG. There is no new issue of HLD shares.
- b. HLD invest \$4m to the subsidiary to fund the launch of Mothercare and general working capital. HLD receives \$4m convertible note (secured ranking ahead of the vendor note, redeemable 10% coupon accruing and settled on termination 50% in equity, 50% in cash, conversion on 'liquidity event').
- c. HLD receive an option to invest a further \$3m by way of convertible notes on the same terms. The vendors receive an option to invest a further \$1m by way of convertible notes on the same terms.
- d. In addition to the \$4m invested, HLD will retain more ~ \$5m of cash, and expects to dispose the HLD property asset and increase the cash balance further.

**Indicative Profit & Loss - excluding EBITDA impact of 1st year investment in Mothercare launch**

\$M	Indicative 'Base Business' FY 2010
Revenue	40.5
EBITDA	3.3
Interest, D & A	-1.4
Provision for tax	-0.6
NPAT Operations	1.3
Less minority interest	-0.5
Plus HLD Convertible Note Income	0.4
Less HLD provision for tax	-
NPAT HLD	1.2
Shares on issue (m)	119.7
EPS (cents per share)	0.010*

*Note: EPS number refers to base business only, and does not include EPS impact of investment in Mothercare launch during 2009/10. See notes below.*

It is forecast that the actual EBITDA earnings for the merged Skansen KCG entity will be \$2.2M, after establishment of the management infrastructure, marketing and store openings to launch Mothercare and the opening of two stores in Year 1.

In evaluating the financial projections for the new business, the following should be noted:

- a. Based upon expectations for 2010, the 'base business' which includes Kids Central, Early Learning Centre, and Skansen/ Beanie Kids would in the absence of the Mothercare launch be **EPS positive in year one**.
- b. In addition to the profitable underlying business, an additional and significant \$4m investment is being made in the launch of the Mothercare brand. This investment cannot be measured over one year. The Board believes that Mothercare will contribute a substantial increase in current revenue and earnings on an annualised basis after investment of the capital committed (and retains the option to invest further funds thereafter). The five year projection for the business with Mothercare as the engine for growth is that EBIT will reach \$10M on Sales of \$159M.

### **Organisation**

HLD have augmented the Kids Central management team with three key executives:

- (i) Ross Bartlett, ex-Coles Myer and Kmart senior executive;  
Ross will have responsibility for Buying & Merchandising, and for the product offer component of the Mothercare rollout. Ross will also be elected to the HLD board at this week's HLD meeting of the Board of Directors.
- (ii) Roland Cage – ex-OneTel UK CEO, and Country Cars executive prior to the Fairfax acquisition;  
Roland will lead the business's aggressive online expansion, including short term marketing initiatives to achieve reach in regional Australia, as well as following up on acquisition options in this area which would add exciting growth potential to the e-commerce area of Skansen KCG.
- (iii) Ted Allen – ex Brand Agency General Manager and shareholder – will take the overall lead on marketing strategy and launch of the Mothercare brand in Australia

### **Merger Transaction Next Steps**

Settlement of the merger will take place in early September and management will focus on the following:

- Integration of the businesses with focus on cross selling opportunities, cost savings and efficiency gains in operations and administration;
- Roll out of selective Mothercare offer into existing Kids Central stores;
- Launch Mothercare destination 'parenting centres' initially in NSW and VIC;

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- Focus of the on-line/ e-commerce growth initiative through Mothercare Direct and the expansion of the ELC e-commerce activity.

## Summary

The Board believes that this transaction marks a turning point in the company's history, moving to a model focused on a single market segment. The company now has the market opportunity and the portfolio of brands that can best utilise available HLD capital and management expertise to expand the existing business into a much larger, substantially more valuable business.

HLD is confident that with the management team it has acquired in the transaction, combined with the additional experience it has added to the executive group, it is very well placed to achieve its forecasts and the Mothercare rollout.

The expanded management capability also allows HLD to continue to seek suitable synergistic acquisitions to further build the company in the segments in which it is focused.

Gordon Elkington  
Executive Chairman

Brent Dennison  
Managing Director

Locations of current Kids Central and ELC store locations:

**Australian Capital Territory:** [Belconnen](#), [Canberra Airport](#), [Fyshwick](#)

**New South Wales:** [Belrose](#), [Bondi Junction](#), [Campbelltown](#), [Castle Hill](#), [Chatswood](#), [Erina](#), [Hornsby](#), [Kotara](#), [Miranda](#), [Moore Park](#), [Mosman](#), [Pagewood](#), [Parramatta](#), [Penrith](#), [Rhodes](#)

**Queensland:** [Broadbeach](#), [Chermside](#), [Indooroopilly](#), [Upper Mt Gravatt](#)

**South Australia:** [Oakland Park](#), Victoria, [Chadstone](#), [Cheltenham](#), [Doncaster](#), [Geelong](#), [Glen Waverley](#), [Richmond](#)

**Western Australia:** [Booragoon](#), [Claremont](#)

**New Zealand:** [Auckland](#)