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HOODSWEENEY

Masters of Investing

**Knowledge share:
The value of good
management**

At Hood Sweeney we have a vision...

To enhance the future of our clients, our team and our community through a shared journey.

On the evening of October 31st, we hosted another of our Masters of Investing events at Adelaide Oval to help educate our clients and guests.

Our presenters included Peter George of PMP Limited, Nicholas Yates of BSA Limited, Tony Michaels¹, Director and Head of Financial Planning at Hood Sweeney and fellow Director Adrian Zoppa². The evening was facilitated by David Prescott, Portfolio Manager of Lanyon Asset Management and member of the Hood Sweeney Securities Investment Committee.

Following a Q&A format allowed us to conduct due diligence and the ensuing discussion was robust and informative.

The event was very well received by attendees and we are pleased to provide you with a summary of the discussion.

Introduction

Part of our strategy is to share information that transfers relevant, inspiring and useful information to our clients, so they can be an integral part of the decision-making process.

Our decision to ask Peter George and Nicholas Yates to be expert panellists was twofold:

- Our clients may hold PMP & BSA indirectly through Lanyon & NAOS Emerging Opportunities Company (NCC) and directly through share positions
- Both Managing Directors/CEOs have successfully transformed their respective companies through making tough decision and providing strong leadership.

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Background

PMP Ltd (formerly Pacific Magazines & Printing Ltd) is recognised across Australasia as the largest printer and distributor of catalogues, magazines and marketing materials.

Peter George

- Is an experienced Executive and Non-Executive Director with an extensive background in telecommunications, media and corporate finance including four years on the Board of Australia's second largest telecommunications carrier, Optus Communications.
- Was a Non-Executive Director of Asciano Ltd for nine years.
- Was also Executive Director, Strategy and Policy Development, Cable and Wireless Optus Ltd for four years, and the Executive Chairman of Nylex Limited for three years.

BSA Limited (formerly Broadcast Services Australia Ltd) is an Australian communications and technical services company.

Nicholas Yates

- Forged an extensive career in the building services and facilities management industries, progressing through various management roles within Lend Lease and eventually moved on to become CEO of APP Corporation Pty Limited, Australia's leading Construction Project Management consulting business.
- When APP was acquired by Transfield Services, he moved into a series of leadership roles within Transfield Services, most recently Chief Executive Officer, Infrastructure ANZ.
- Sits on the Boards of a number of private companies and was appointed Managing Director and Chief Executive Officer of BSA Limited on 13 March 2014.

How we invest

At Hood Sweeney our investing is based on a four-pillar philosophy:

1. Value investing

- Buy shares that are undervalued
- Margin of safety – difference between share price and business intrinsic value
- Markets driven by sentiment short-term and fundamentals long-term

2. Absolute return

- Aim is to produce consistent positive return
- Benchmark unaware
- Concentrated portfolio

3. Capital preservation

- Margin of safety / value driven
- Importance of cash to remain flexible
- Focus on risk

4. Contrarian

- Good companies can be oversold
- Do the analysis and think independently
- Remain patient, investment is about probability and batting average

What we look for in a company

When our Investment Committee is assessing a share, the key criteria are whether the company:

- Is underappreciated or unloved by the market
- Can generate substantial cash flows to shareholders
- Has strong management that is aligned with stakeholders and can make good decisions
- Holds a sustainable advantage within its industry.

Peter George – PMP Limited

Can you please tell me a little about PMP?

PMP is in the business of printing and distributing catalogues, suburban newspapers and real estate advertisements.

You came in when the company was on its knees, was unloved by the investment community, had loads of debt, shares wallowing at 20c.

When I stepped into the Managing Director role in 2012, the market was plagued by declining prices. At the time I summed up the situation as follows:

"We had this perfect storm of demand declining, prices driven down by rampant competition, overcapacity... and we're sitting there as the biggest operator with the biggest cost structure."

In 2012 PMP was holding \$145 million in debt. We addressed the debt and unfavourable market conditions by shutting down 13 presses and shedding 1,400 jobs in a short space of time to enable balance sheet repair.



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Stock is now trading at 75c. How were you able to turn the company's fortunes around?

We focussed on:

- Restoring shareholder faith via improved cash flow
- Setting realistic targets to the share market
- Sticking to printing and predictable business when competitors were burning through cash to finance digital advertising
- Minimising new investments in capacity and maximise existing assets.

Shareholders are being a far better allocator of capital than I am.

You are primality a printer of catalogues. Surely, they are being substituted away though iPhones, email and other digital mediums?

Our decision to focus on existing assets and capabilities has proven fortuitous as research shows that within Australia catalogues are the most effective way to sell liquor and groceries. This was contrary to what many retailers thought.

Aldi is a prime example, where since its entry into Australia 4-5 years ago it has become the biggest catalogue producer in the country, despite original intentions not to distribute a catalogue. While the catalogue and magazine market are not growing markets, they can still produce large cash flows to shareholders going forward.

Following ACCC decision in December, can you please tell me about the current market structure?

PMP recently underwent a merger with IPMG creating a duopoly in the print industry in Australia and a monopoly in distribution.

You have guided to \$95-100m of earnings (EBITDA) in the first full year after proper operation of the joint venture.

- **What does this mean for cash flow?**
- **When will you be debt free again?**
- **Do you have any tax losses?**
- **Franking credits?**

We are planning to return to net debt 2018 (after reconstruction costs). Current bond payments restrict distributions to shareholders, but we are looking to pay back within 1-2 years to maximise cash flow to shareholders. There are quite a lot of franking credits available.

Should shareholders expect a big acquisition with the cash or do you have other plans? A dividend?

There are not currently opportunities for acquisitions. While the market is fairly saturated with capacity, it is watching Fairfax in case they are letting go of assets in a push for digitalisation. My thesis is the Sun is going to set a lot longer into the future than what people think (of the company) and there is a lot of cash to be generated.

Nicholas Yates – BSA Limited

When you arrived at BSA it was in a challenging position with a history of poor contract discipline, an inappropriate capital structure for a contractor, a highly levered balance sheet. What did you do to fix it?

At the start of my tenure (2014) BSA was carrying unsustainable debt. I'd inherited legacy issues such as the offices of State Revenue NSW and Royal Adelaide Hospital (RAH).

I introduced discipline in contract management which is fundamental to the business.

I also focused on better forecasting (monthly cash flow). They didn't have that before.

Can you tell me a bit about the business now? The share price is now 35c, so some things have obviously gone very well.

The State Revenue issues were recently settled and resolved and the RAH settlement deed was signed last year so the bulk of the risk has gone. However, some risk remains on the table.

The NBN is incredibly topical. BSA have some contracts with the NBN.

We hold one of three available contracts: the OMMA (Operate and Maintain Master Agreement) contract. It is awarded to build and maintain NBN in the country. The other two are Telstra and Service Steam contracts.

Public perception is that the NBN is a mess. Even the Prime Minister is telling us it's a mess. Can the NBN work be profitable business for BSA?

The NBN is a tough gig but I see opportunities for BSA. A focus on high quality customer service is important and will win over clients.

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How long are these contracts?

The NBN building contract work will plateau next year with estimated completion in 2020/21. The maintenance contracts are heavily sought after as they run indefinitely.

You recently reinstated dividends to shareholders. What is the policy around dividends and should shareholders get comfortable with expectations of future dividends?

We were mindful of retaining the long-term interest of shareholders. We have started paying dividends with firm belief that it will be ongoing. I am a top 20 shareholder in BSA and, this aligns my decisions to what is best for the company.

Managing a business, as with investing in businesses, is not without risk. Contracting is a tough industry. What could go wrong for BSA over the next few years?

We need to keep some cash for working capital through large working capital swings in the industry. We do have opportunities to invest. All our markets are buoyant at the moment and we are exploring new markets. Margins in the telco business are lifting and I foresee further margin expansions going forward. We have recently moved into smart metering which aligns with BSA competency of small jobs in retail markets and keeping customer satisfaction high.

Thank you to everyone involved in the event.

Please note that this does not constitute advice on individual investment strategies or suggested investments. For more information contact Hood Sweeney's Financial Planning team on 1300 764 200.

We look forward to the next one in March 2018.

Hood Sweeney Securities is our Financial Planning arm, specialising in optimising the total financial position of professionals and self-funded retirees, including:

- Creating a financial strategy for your life's journey
- Advising you on how to accumulate wealth, including direct share investment
- Managing your investment portfolio
- Advising trustees of self-managed superannuation funds
- Planning for mainstream superannuation and retirement
- Protecting your wealth.



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