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HGL Limited
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HGL Limited today reported net profit of $3.7 million for the first half ended March, compared with a loss of $2.9 million in the previous corresponding period. Core profit, excluding the contribution from listed investments, was $2.2 million, down 56.0 percent. This was nevertheless higher than your February core profit guidance of $1.5 million to $2.0 million for the first half. What factors caused the variance from expectations?

CEO Kevin Eley
Demand was stronger than we anticipated at the time of our AGM, when we provided the guidance, and our measures to reduce costs and improve margins were more effective than expected. In addition dividend income from our core listed investments was slightly higher than anticipated.

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You expect core profit for the current full year ending September 2009 to be down from last year's $8.4 million. Can you comment on current trading conditions within the core businesses?

CEO Kevin Eley
The big question is how much of the economic slowdown is still to impact consumer demand and our customers. However our core businesses operate in niche markets and trading conditions remain better than we anticipated at the beginning of the year.

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HGL has announced a fully franked interim dividend of 3.0 cents per share, down from 7.0 cents last year. This is equivalent to a payout ratio of 70 percent of core profit, the lower end of your stated payout policy range of 70 to 80 percent. If the current weak demand conditions persist, how sustainable is the dividend at this level?

CEO Kevin Eley
Under normal conditions our businesses generate high levels of free cash flow and therefore we can sustain this dividend payout ratio as well as retaining some earnings to fund growth. Given demand is holding up, we believe our policy of paying a dividend of between 70 and 80 percent of core profit is sustainable.

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EBIT from HGL's operating businesses was $5.9 million, down 36 percent, on revenue of $82.5 million, up 4.6 percent. You've attributed the earnings fall to the depreciation of the Australian dollar, which increased product costs by about $10 million in the period, and to the general weakness in the economy. How were volumes affected in the first half and what is the outlook for product costs and volumes in the current second half given the recent strength of the Australian dollar?

CEO Kevin Eley
Volumes were flat compared with the same period last year, so it was price rises that generated the increase in sales in the six months to March 2009. Our businesses are currently operating at a level similar to the corresponding period last year.

The recent strengthening of the Australian dollar is positive for us and will help reduce the cost of our products and assist in increasing our level of profitability.

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With the Australian dollar currently trading at around US$0.78, compared with an average of US$0.67 in the six months to March, how exposed are your businesses to potential inventory write-downs and to customer pressure for exchange-rate related price reductions?

CEO Kevin Eley
Inventory within our operating businesses is closely managed and there are adequate provisions for redundant inventory. There's always pressure for price reductions when the Australian dollar strengthens, however, in the current uncertain environment we believe we'll be able to maintain our selling prices.

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Excluding $0.2 million in dividends received, "Central Items" generated costs of $1.0 million, down 4.4 percent from the previous corresponding period. How sustainable are costs at this level and is there scope for further reductions if demand conditions remain weak?

CEO Kevin Eley
At head office, the reduction in overheads was primarily due to costs saved through postponing acquisitions and discontinuing investing in listed equities. We therefore believe this level of costs is sustainable in the current environment.

If our operating businesses experience a further fall in demand, there's scope to trim costs throughout the group and still keep our strong management team together.

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Non-core profit was $1.5 million in the first half, compared with a loss of $8.0 million in the previous corresponding period. This largely reflected the $2.6 million profit on the sale of your stake in MMC Contrarian, versus impairment charges of $7.7 million in the previous corresponding period. With the non-core segment reduced to $7.8 million in listed equity holdings, what is your commitment to these non-core investments?

CEO Kevin Eley
We're in the process of selling our listed investment portfolio. Funds from the sale will initially be used to reduce debt. When the opportunity arises, we'll use the funds for acquisitions.

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HGL booked cash flow from operations of $0.4 million in the first half, down from $8.0 million in the previous corresponding period, reflecting reduced earnings and an increase in working capital. What ability do you have to contain working capital in the current environment and what is the outlook for cash flow over the remainder of the year?

CEO Kevin Eley
During the period there was a small increase in inventory however we were able to substantially reduce debtors. These funds were used to repay creditors which resulted in a net increase in working capital. This, in conjunction with a fall in operating profit, reduced the cash flow generated from our operating businesses as shown in the accounts. Our working capital currently remains static amid tough economic conditions but we're aiming to reduce working capital and borrowings further in the second half

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As at the end of March 2009 HGL had net debt of $19.1 million, down from $34.1 million six months earlier, primarily reflecting funds received from the MMC Contrarian sale. Net debt to equity was 24.4 percent, down from 42.9 percent and core interest cover in the first half was 5.4 times, down from 7.0 times. What capacity do you have for acquisitive growth with interest cover at this level?

CEO Kevin Eley
We'll only resume our acquisition program when the profit outlook for our businesses is restored. As I mentioned earlier, we also aim to reduce borrowings by selling listed equities and will therefore have a strong capacity to fund acquisitions.

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You've indicated you remain confident about the long-term future of HGL after a difficult 2009. Do you have any visibility regarding 2010 earnings? What are your grounds for optimism about the longer term?

CEO Kevin Eley
We don't have visibility through to 2010: although there are favourable signs, we still don't know whether the worst is over. In the first half we achieved a pre-tax return on capital employed in our operating businesses of around 16 percent in spite of the precipitous fall in the value of the Australian dollar. In addition we reduced borrowings, contained working capital, altered our cost structure, acquired further agencies, strengthened our relationship with our customers and suppliers and retained our key managers. It's these factors that give me optimism about the long term.

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Thank you Kevin.

For more information about HGL, visit www.hgl.com.au or call Kevin Eley on (+61 2) 9221 7155

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