ASX ANNOUNCEMENT

28 February 2017

SPOTLESS DELIVERING ON RESET STRATEGY

Spotless Group Holdings Limited (ASX: SPO), a leading provider of integrated facility management services in Australia and New Zealand, today announced its results for the six months to 31 December 2016 (1H17).

Highlights

- Significant progress in delivering initiatives outlined in 2016 strategy reset
- New business win rates improving and pipeline of quality opportunities has grown
- Impairment, restructuring charge (largely non-cash) of $391m (post tax) resulting primarily from contract portfolio restructure
- Free cash flow significantly improved and net debt well within debt facility requirements
- Dividend policy reset for greater capital management flexibility. Payout ratio adjusted to 40% to 60% of adjusted NPAT
- Interim dividend of 1.35 cents (1H16 : 3.5 cents) representing a payout ratio of 40%
- Revenue and EBITDA decline reflects prior year contract losses and renewals, margin pressure in certain sectors, and investment in business development, marketing and innovation
- FY17 profit guidance after tax (pre-exceptional items) of between $80m-$90m reflecting increased depreciation and investment in future growth

Financial result summary

Half Year Ended 31 December	2016 $m	2015 $m	Change
Reported result			
Sales Revenue	**1,455**	1,606	(9.4%)
(Loss) / Profit after tax (including exceptional items)	**(358)**	48	n.a
Interim dividend per share (cents)	**1.35**	3.5	(61%)
Operating cash flow	**74**	18	n.a
Net leverage (times)	**2.7x**	2.5x	n.a
Excluding exceptional items			
EBITDA	**121**	137	(11.8%)
EBITDA margin (%)	**8.3**	8.5	(20bps)
EBITA margin (%)	**5.1**	6.0	(90bps)
Net profit after tax	**33**	48	(31.4%)

Spotless Chairman Garry Hounsell said the interim results reflected a transitional period for the company as the company continues to execute the 2016 strategy reset.

“As foreshadowed, the 1H17 result reflects the impact of prior period contract losses, margin pressure in some sectors and increased depreciation from investment in prior years. It also includes costs associated with investment in business development, marketing and innovation,” he said. “However, we are confident in the strength of the underlying business and that the pipeline of new business opportunities supports re-stimulation of organic growth. As part of our strategy, we are undertaking the necessary steps to restructure the business and progress initiatives that provide a platform for growth.”

“The Board has reset the dividend pay-out ratio to 40% to 60% of Adjusted NPAT (previously 65% to 75%), which brings Spotless in line with domestic and international peers, will allow greater capital management flexibility and is consistent with our near term priority of reducing gearing and strengthening our balance sheet.”

Directors have declared an interim dividend (unfranked) of 1.35 cents per share (1H16: 3.5 cents) which represents a pay-out ratio of 40%, at the bottom end of the revised range.

Mr Hounsell extended his thanks to his predecessor as Chairman, Margaret Jackson, who retired last week after almost three years in the role.

“Margaret has made an outstanding contribution to Spotless, providing great leadership through what has been an exciting and challenging three years for the company,” he said. “On behalf of the Board and management team, I thank her for her commitment and support and wish her well for the future.”

Spotless Chief Executive Officer & Managing Director Martin Sheppard announced the company was restructuring its contract portfolio and progressing delivery of its reset strategy.

“A key constraint on current performance is the number of small, underperforming contracts,” he said. “As part of our strategy reset outlined last year, we are focused on driving value through long-dated, expandable, multi-service contracts which leverage our scale, geographical footprint and breadth of capabilities.”

“Restructuring our contract portfolio will unlock value and reduce operational complexity. Investment in our priority sectors and higher growth technology solutions will differentiate us in the market.”

“The fundamental strengths of our business have not changed. These include a blue chip customer base, a strong portfolio of long term Government, Health, Defence and PPP contracts that provide diversification across sectors and service lines, and an appropriate cost structure. Our intent is to focus on these strengths, leverage them to drive growth without the distraction from underperforming contracts in highly contested markets which have low barriers to entry.”

1H17 result

Revenue in the Facility Services business declined 9.2%, reflecting previously identified contract losses, completion of lower margin construction business and weakness in the Business & Industry and Resource markets.

The EBITDA margin remained in line with the prior period reflecting the impact of mix across the contract portfolio. Our core business remains solid with continued strong performance from our priority sectors of Government, Health and Defence and our portfolio of PPP contracts.

Revenue and EBITDA decline in the Laundries business reflects margin and volume decline in hospitality linen, driven by new competition in certain markets and operational issues in two facilities, offsetting the benefits arising from the resolution of the integration issues. However, margins in the Laundries business remain stable and Spotless is focused on initiatives to drive improvement.

During the half, Spotless was awarded a number of new and renewed contracts, valued at over $71m (new business) and $99m (renewal business) in annual revenues. These include:

- PPP contract for Australian National University
- Facilities management and integrated services contracts for Ballarat Convention Centre, Santos, Youi and Parliament House
- Contract renewals for Western Power Corporation, Clayton Church Homes, Vicinity Centres, Ergon Energy & City of Melbourne
- Renewal and extension of the Healthscope linen contract

Debt and cashflow

Spotless' net debt of $848.1 million at 31 December 2016 (31 December 2015: $802.4m), represents net leverage of 2.7 times, which is well within debt facility requirements. Our near term priority is reducing gearing and strengthening our balance sheet, with clear targets established to reduce debt.

As expected, net debt is slightly higher than June 2016, reflecting the Nuvo acquisition, payment of the FY16 final dividend and seasonal skew of earnings and cash flows.

Spotless has extended the maturity date of $200m in bilateral facilities to 2H18. The company will refinance debt facilities in the 2H17 to extend the weighted average committed debt facility maturity profile. Lower investing cash flows reflect a lower level of capital expenditure during the period of $47.1m (1H16: $74.9m) and reduced acquisition activity of $23.1m (1H16: $102.9m).

Strategy reset progress

As part of our strategy reset, Spotless is focused on stimulating organic growth and delivering improved win and retention rates within high return, low capital intensive sectors, such as Education, Health, Government and Defence. Significant progress has been made executing this strategy, with highlights in the following key areas:

Contract portfolio restructure

As outlined earlier, Spotless has undertaken a detailed review of its contract portfolio and identified potential areas to unlock value. We have a strong portfolio of contracts, however growth is constrained by a large number of mostly small underperforming contracts. We are applying a more focused lens to our contracts, with higher hurdles on new business and renewals. This will allow for a focus on long-dated, expandable and multi-service contracts in line with our stated strategy.

This program provides the platform for growth by simplifying our business model, reducing complexity and overheads, and leveraging our strengths to drive organic growth.

The portfolio restructure has resulted in a largely non-cash accounting charge of approximately $391m (post tax), representing impaired goodwill, software development intangible write-downs, write-down of P,P&E and charges for contracts that become onerous by virtue of the Group's revised expectations of tenure.

A one-off cash impact from the restructure of between $25m and $35m, representing contract exit costs, potential redundancy costs and other associated costs is expected to be incurred over the contract run-off period. This process will include the planned and orderly run-off of contracts that don't meet our metrics, while we are also exploring the sale of certain contract bundles.

Continued success in PPPs

Spotless is the leading operator of social infrastructure PPPs across Australia and New Zealand, with thirteen projects operational and three contracts currently mobilising. In the half, four PPP contracts became operational (including the Australian National University campus accommodation contract secured during the period) which is an important milestone and a real credit to the efforts from our team and partners.

We continue to be encouraged by the improvement in our pipeline of PPP opportunities (>$100m). PPP revenues were ~$93m in the half (1H16: $63m), with strong growth expected as projects reach full operational phase in FY17 and beyond.

Progress with business development

Business development investment is important to drive growth and resources have been added across PPPs, tertiary education, government and aged care. Spotless has successfully:

- Enhanced our new business opportunities pipeline, with value increasing to $1.6bn (1)
- Developed business development frameworks and capabilities, which is translating into improved bid and tender quality

(1) *the value of new business opportunities reflects the annualised revenue from new business opportunities expected to come to market in the next 24 months.*

We previously outlined that there is a lag between the investment in business development and the returns. Overall win rates have improved slightly and we are encouraged by:

- Renewal rates improved by contract number to 95%, with a more strategic approach to marginal contracts
- New business won in the half of $71m (annualised revenue), with a high life time revenue profile
- 77% of new work won this half is in higher growth, higher return priority sectors
- Continued improvement in win rates for long term opportunities

There are minimal contract renewals for the remainder of FY17. Investment in business development and focus on account management will ensure we are well placed for a higher level of renewals in FY18.

Continued investment in innovation

Innovation continues to be a key component of Spotless' strategy, helping to enable growth through identifying and commercialising new smart technology solutions across a range of sectors. Current initiatives include:

- Spotless Advanced Metering: a whole-of-life smart metering solution that includes meter supply and finance, installation, maintenance and remote digital services
- Building technologies and IoT (internet of things): smart solutions such as remote asset sensor monitoring, digital facilities management workforce optimisation and safety, customised building automation systems and hi-tech electronic security systems
- Sustainability solutions: Green tech solutions such as solar as a service, LED lighting systems and energy solutions as a service
- Drone technology: Harnessing emerging drone technology to improve safety, efficiency and accuracy in high risk maintenance inspections such as rooftops, gutters, fencing and bridges

Acquisition of Nuvo group

On 31 October 2016, Spotless purchased Nuvo, a privately-owned electrical and technology services business, for cash of $23 million. This enables us to provide customers premium electrical and technology solutions, covering the design, installation, project management and maintenance of commercial and industrial projects. Nuvo operates in key sectors important to our growth strategy - tertiary education, health aged care and infrastructure.

Brand repositioning

In recent years, Spotless has added new capabilities, entered new markets and become more focussed on being a more innovative company. A brand refresh is underway and marketing collateral has been built to reposition our brand as the largest integrated facilities management services provider in Australia and New Zealand. This program aims to ensure our current and potential customers have a better understanding of our expertise, range of services, and value proposition.

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Outlook

Our core business including Defence, Government, Health, Education and PPPs remains strong and is largely unaffected by the contract portfolio restructure.

The investment in business development is achieving positive outcomes in win rates for large, long dated contracts in priority growth sectors and increasing the size of our pipeline.

As previously outlined, FY17 is expected to be a transitional year. Subject to economic conditions, NPAT (pre-exceptional items) for FY17 is currently expected to be between $80m and $90m.

The outlook reflects business development returns being slower than expected and the benefits to date being more than offset by weaker business performance in the Business and Industry, Construction and Resources sectors.

The outlook reflects increases in depreciation and investment in business development. This year on year increase has been previously foreshadowed.

Spotless is committed to undertaking the necessary steps to restructure the business and progress initiatives to provide a platform for growth.

Improved underlying earnings performance beyond FY17 is expected to be driven by:

- Successfully rationalising our contract book and simplifying our overhead structure as outlined today
- Continuing to leverage market leading positions in Government, Defence, Health, Education and PPPs
- Achieving the returns from recent investment in business development
- Significant focus on cash flow conversion
- Capital management discipline

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