The fixed income experts

19 September 2016

PMP Ltd

Executive summary

- PMP Limited (PMP) is predominantly a catalogue printing and letterbox delivery business servicing the Australian and New Zealand markets. PMP has market capitalisation of $199m (15 September 2016)
- PMP has a blue-chip customer base including Woolworths, Metcash, Bauer Media, Kmart and Target
- PMP has the competitive advantage of being the only one stop print and distribution house in Australia providing end-to-end marketing with a national footprint. It is ranked first or second in each of its main product segments
- PMP has successfully completed a major transformation program that started in 2012 delivering a significant cost base reduction and financial risk minimisation. Net debt has been reduced from $143.2m at FYE12 to $0.4m at FYE16
- Strong balance sheet with high recovery expectations in default: The balance sheet is positioned defensively in response to operating conditions and to give the flexibility of participating in future industry consolidation. There is material asset value on the balance sheet, with minimal senior debt in front of Noteholders
- Underlying free cash flow is a key financial metric for PMP and has driven the significant improvement in its credit profile. The company has posted a total of $144.5m in free cashflow over the last four years to FYE16 or an average of $36.1m p.a. In our opinion, free cashflow of $30m+ appears sustainable going forward
- We believe that credit metrics are solid with EBITDA interest cover of 6.5x and net debt to EBITDA a minimal 0.007x at FYE16
- Management has indicated that it will continue to explore attractive acquisition opportunities within their core business. An acquisition could weaken credit metrics and bring execution and integration risks. However leverage is coming off a very strong base and is restricted by the Note and Senior lender's covenant levels
- The ongoing strength of the catalogue business is in our opinion a key risk for Noteholders. A dramatic collapse in the volume of catalogues would place the company's credit metrics under some pressure, however the catalogue business has remained largely resilient
- We also see industry overcapacity and price deflation as other key issues however management retain the view that heatset pricing has stabilised at a level where there is little margin left for further price erosion
- PMP has issued $40m, 6.43% fixed rate unsecured Notes with a 17 September 2019 maturity. The bonds currently appear to offer fair value. Details of the Notes are summarised in Appendix 1

Background

PMP Limited (PMP) is predominantly a catalogue printing and letterbox delivery business servicing the Australian and New Zealand markets. It also prints and distributes magazines through its Gordon & Gotch business and prints books via its Griffin Press business. The company was first listed on the ASX in February 1991 and has over 1,200 employees. PMP has a blue-chip customer base including Woolworths, Metcash, Bauer Media, Kmart and Target. The company has three main divisions as detailed in Figure 1.

Figure 1: Company divisions

Company	Description	Market position
PMP Australia 61% EBIT	PMP Australia primarily offers design, photography, printing and distribution of catalogues and other print media. PMP Australia also includes the Griffin Press, a printer of books for major book publishers.	The market leader with printing plants and distribution centres covering most of Australia and New Zealand.
PMP New Zealand 31% EBIT	PMP New Zealand provides similar services as the Australian business to clients such as print media, retail, SME's, real estate and publishing clients.	The market leader with plants across Australia and New Zealand.
Gordon & Gotch 8% EBIT	Gordon & Gotch is a magazine distributor offering circulation management, merchandising, and distribution into newsagents and major supermarkets in Australia and New Zealand.	The largest independent distributor of magazines in Australia and New Zealand.

Source: Company reports

PMP has now successfully completed the major transformation program that started in 2012. The first two of the Company's three strategic priorities have been delivered: cost base reduction and financial risk minimisation. PMP continues to focus on its third strategic priority, which is to build a more profitable and sustainable PMP by focusing on its core expertise in print and distribution.

PMP has the competitive advantage of being the only one stop print and distribution house in Australia providing end-to-end marketing with a national footprint. It is ranked first or second in each of its main product segments. This means PMP is the only operator that can, within 48 hours, print and deliver to its distribution network for delivery across Australia. Seven of the company's top 15 customers have now taken up the bundled offer of both print and distribution services.

Capital structure

Figure 2: Capital structure at FYE16

Facility	Security	Drawn	Amount	Maturity	Comments
Notes	Unsecured	$40.0	$40.0	Sep-19	Corporate Bond
ANZ overdraft	Secured	$0.0	$9.8	Feb-17	Multicurrency. Annually reviewed
Commerzbank	Secured	$16.3	$16.3	Sep-21	Semi-annual amortising loan. In EUR hedged to AUD
Contingent					
Bank guarantee	Secured				Primarily supporting property leases. Annually reviewed
L/Cs**	Secured				Supports importing of paper into NZ for PMP NZ
FX/IRS/CCS**	Secured				For purchasing of inputs (paper/ink/capex etc.)
Credit card	Secured				General business purposes

*** Letters of credit, Foreign Exchange, Interest Rate Swaps, Cross Currency Swaps*

The group's debt comprises the unsecured Notes, a Commerzbank facility used to purchase an offset rotary press, and a multicurrency ANZ overdraft facility (AUD/NZD) used for working capital fluctuations. PMP also has other contingent facilities to enable normal business operations. All bank facilities are secured by a first ranking fixed and floating charge over the company.

Financial analysis

Historic figures are taken from audited accounts while forecasts are based upon FIIG's analysis as a conservative debt base case.

P&L Summary ($m)	FY13	FY14	FY15	FY16	FY17*	FY18*	FY19*
Sales revenue	975.8	899.2	811.7	816.0	0.0	0.0	0.0
Other revenue	6.0	4.9	4.5	4.1	0.0	0.0	0.0
Total revenue	**981.8**	**904.1**	**816.2**	**820.1**	**785.2**	**787.6**	**771.8**
Cost of sales	548.4	518.9	456.2	481.9	461.4	462.8	453.6
Gross profit	**433.4**	**385.2**	**360.0**	**338.2**	**323.8**	**324.7**	**318.2**
Total expenses	361.9	321.7	302.0	284.6	276.7	278.7	273.1
EBITDA	**71.5**	**63.4**	**58.1**	**53.6**	**47.0**	**46.1**	**45.2**
Depn & amort	37.8	34.6	31.7	27.9	26.0	23.6	23.1
EBIT	**33.7**	**28.8**	**26.3**	**25.7**	**21.0**	**22.5**	**22.1**
Interest	13.7	12.1	8.8	8.3	4.4	4.2	4.1
NPBT	**20.0**	**16.8**	**17.5**	**17.4**	**16.7**	**18.3**	**18.0**
Significant items	-88.6	-8.7	-5.9	-14.6	-5.0	-4.0	-3.0
Tax	1.6	4.7	3.6	2.6	3.5	4.3	4.5
NPAT	**-70.2**	**3.4**	**8.0**	**0.3**	**8.2**	**10.0**	**10.5**
Balance sheet summary ($m)	**FY13**	**FY14**	**FY15**	**FY16**	**FY17***	**FY18***	**FY19***
Cash	21.2	28.7	49.5	54.1	66.4	80.4	97.4
Accounts receivable	96.2	85.1	78.8	96.3	78.5	78.8	77.2
Inventory	80.7	75.0	69.8	85.6	70.6	70.8	69.4
Property, plant & equipment	233.4	207.4	178.9	155.9	134.9	116.4	98.3
Intangibles	26.5	28.4	26.8	27.5	27.5	27.5	26.5
Deferred tax assets	62.1	58.2	52.8	49.3	47.3	45.3	43.3
Other	29.1	19.7	12.8	8.2	8.2	8.2	8.2
Total assets	**549.2**	**502.7**	**469.5**	**476.9**	**433.5**	**427.3**	**420.2**
Accounts payable	138.9	120.8	107.5	139.4	103.4	103.7	101.6
Secured debt	113.3	33.7	16.7	14.5	12.0	9.5	7.5
Note issue	0.0	50.0	50.0	40.0	40.0	40.0	40.0
Other	38.4	33.3	24.8	23.6	23.6	23.6	23.6
Total liabilities	**290.6**	**237.9**	**198.9**	**217.5**	**179.1**	**176.9**	**172.8**
Total equity	**258.6**	**264.8**	**270.5**	**259.4**	**254.4**	**250.4**	**247.4**
Cashflow summary ($m)	**FY13**	**FY14**	**FY15**	**FY16**	**FY17***	**FY18***	**FY19***
Net income	(70.2)	3.4	8.0	0.3	8.2	10.0	10.5
Depreciation & amortisation	37.8	34.6	31.7	27.9	26.0	23.6	23.1
Δ Working capital	4.1	(1.4)	(1.8)	(1.4)	(3.2)	(0.1)	0.9
Other	35.9	(1.1)	(4.8)	5.2	2.0	2.0	3.0
Net operating cashflow	**7.6**	**35.5**	**33.2**	**32.0**	**33.0**	**35.4**	**37.5**
Capital expenditures	(23.7)	(4.8)	(5.4)	(4.2)	(5.0)	(5.0)	(5.0)
Acquisitions	(0.1)	(0.4)	(0.1)	-	-	-	-
Disposals	74.8	10.7	8.4	2.4	-	-	-
Net investing cashflow	**51.0**	**5.5**	**2.9**	**(1.8)**	**(5.0)**	**(5.0)**	**(5.0)**
Total dividends	-	-	-	(9.7)	(13.2)	(14.0)	(13.5)
Equity raised / (repaid)	-	-	-	(4.1)	-	-	-
Net borrowings	(49.5)	(34.1)	(15.1)	(12.4)	(2.5)	(2.5)	(2.0)
Other financing	(0.1)	(0.1)	-	-	-	-	-
Net financing cashflow	**(49.6)**	**(34.2)**	**(15.1)**	**(26.3)**	**(15.7)**	**(16.5)**	**(15.5)**
Net cashflow	**9.0**	**6.9**	**21.0**	**3.9**	**12.3**	**13.9**	**17.0**
Credit statistics	**FY13**	**FY14**	**FY15**	**FY16**	**FY17***	**FY18***	**FY19***
Funds from operations (FFO)	$56.2	$46.7	$45.6	$42.8	$39.2	$37.6	$36.6
Total debt	$113.3	$83.7	$66.7	$54.5	$52.0	$49.5	$47.5
Net debt	$92.1	$55.0	$17.1	$0.4	-$14.4	-$30.8	-$49.9
Gross profit margin	44.4%	42.8%	44.4%	41.4%	41.2%	41.2%	41.2%
EBITDA margin	7.3%	7.1%	7.2%	6.6%	6.0%	5.9%	5.9%
EBITDA interest cover	5.2x	5.3x	6.6x	6.5x	10.8x	10.9x	11.1x
FFO interest cover	4.1x	3.9x	5.2x	5.2x	9.0x	8.9x	9.0x
Net debt/EBITDA	1.3x	0.9x	0.3x	0.0x	(0.3x)	(0.7x)	(1.1x)
Debt/(debt+equity)	30.5%	24.0%	19.8%	17.4%	17.0%	16.5%	16.1%

*Source: FIIG Securities, Company reports. *Forecasts*

FY16 results main points:

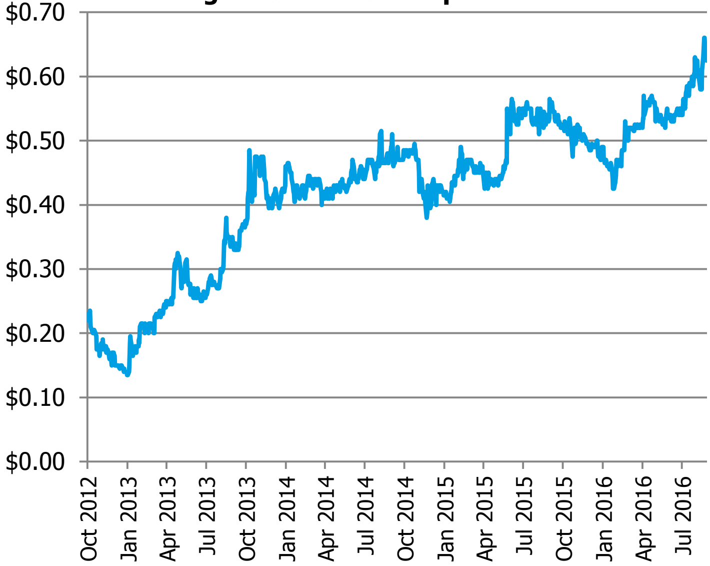
- Total revenue improved 0.5% YoY to $820.1m FY16
- EBITDA reduced by 7.7% to $53.6m which was slightly under full year guidance, due to lower than expected volumes from key heat set print customers and higher than anticipated operational costs at Griffin Press due to continued increase in demand for short-run on-demand printing
- Significant items in FY16 were $14.6m (pre-tax). This included $8.4m of redundancy and restructuring costs, $2.3m of costs relating to capital amendment and a $3.9m bad debt charge for Dick Smith
- NPAT reduced from $8.0m to $0.3m mainly due to the higher significant items
- The group is nearly net debt free. Net debt reduced from $17.1m at FYE15 to $0.4m FYE16. As such, leverage (Net debt/EBITDA) reduced from 0.3x to 0.007x
- We believe that EBITDA interest cover is solid at 6.5x FYE16
- Free cashflow improved 5.7% to $37.5m as better working capital outcomes, lower interest expense and reduced CAPEX more than offset lower EBITDA
- Capital expenditure of $4.2m was slightly down given the useful life of its heatset press fleet and should remain low for the foreseeable future
- The company will provide a trading update for FY17 at the Annual General Meeting in November 2016

Strengths

Successful execution of business turnaround: PMP has completed the major transformation program that started in 2012. In FY12 and FY13, PMP incurred significant losses totalling $94.7m. The business has been resized and refocused in response to market conditions. It has delivered a significant cost base reduction and financial risk minimisation with net debt reduced to $0.4m (FYE16) from $143m at FYE12.

The company's turnaround is evident in its share price performance which has appreciated from circa $0.13 in FY13 to around $0.62 at the time of writing. This translates to an increase in market capital from $42m to $198m (13 September 2016).

Figure 3: PMP share price



Source: FIIG Securities, Bloomberg

Management and board of directors: In our opinion, the board is strong with a diverse educational and vocational background and a good mix of executive, non-executive and independent Directors. The strategic management team also has significant relevant experience. The successful execution of a major business turnaround gives evidence of the Board and management's ability.

After embarking on the significant restructuring programme, PMP delivered on three years of financial forecasts with EBIT, EBITDA, and net debt reduction all exceeding the guidance provided by the company, giving us a high level of confidence in management. Unfortunately, FY16 was slightly below full year guidance, due to lower than expected volumes from key heat set print customers and higher than anticipated operational costs at Griffin Press due to continued increase in demand for short-run on-demand printing

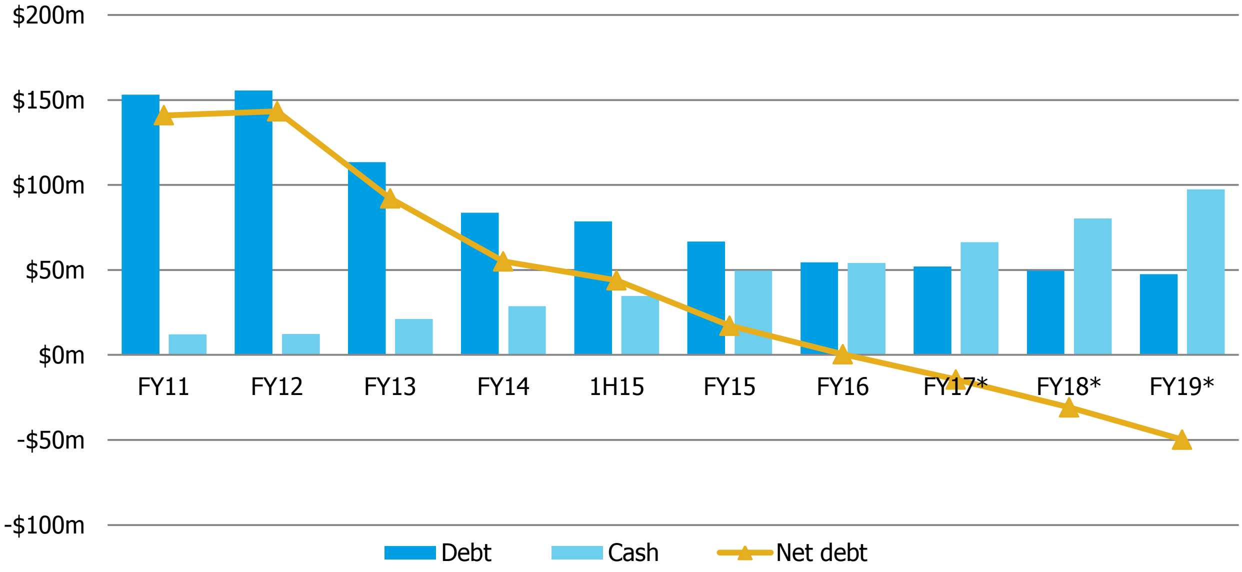
Please refer to Appendix 2 for background on the Board of Directors.

Strong balance sheet with high recovery expectations in default: We view PMP's balance sheet as strong and is positioned defensively in response to operating conditions. It also gives the company flexibility in terms of participating in future possible industry consolidation. There is material value in debtors which represent predominately blue chip clients (FY16: $96.2m), inventory (FY16: $85.6m) and property plant and equipment (FY16 $155.9m) with senior debt of only $26.1m ahead of Noteholders. At FY16 PMP also held cash of $54.1m.

Significant free cashflow and greatly reduced debt: Underlying free cash flow (defined as EBITDA, pre significant items, less interest paid, income tax, capex and movement in working capital) is a key financial metric for PMP. Free cashflow improved 5.7% in FY16 to $37.5m as better working capital outcomes, lower interest expense and reduced CAPEX more than offset lower EBITDA. The company posted a total of $144.5m free cashflow over the last four years or an average of $36.1m p.a. As such, we believe that free cashflow of $30m+ appears sustainable.

PMP has a stated goal to be net debt free. Total debt has reduced from $197.8m at FYE10 to $54.5m at FYE16, while net debt has reduced from $168.0m to $0.4m over the same period. In the absence of an acquisition, we forecast PMP to be in a net cash position through to maturity of the bond (Figure 4)

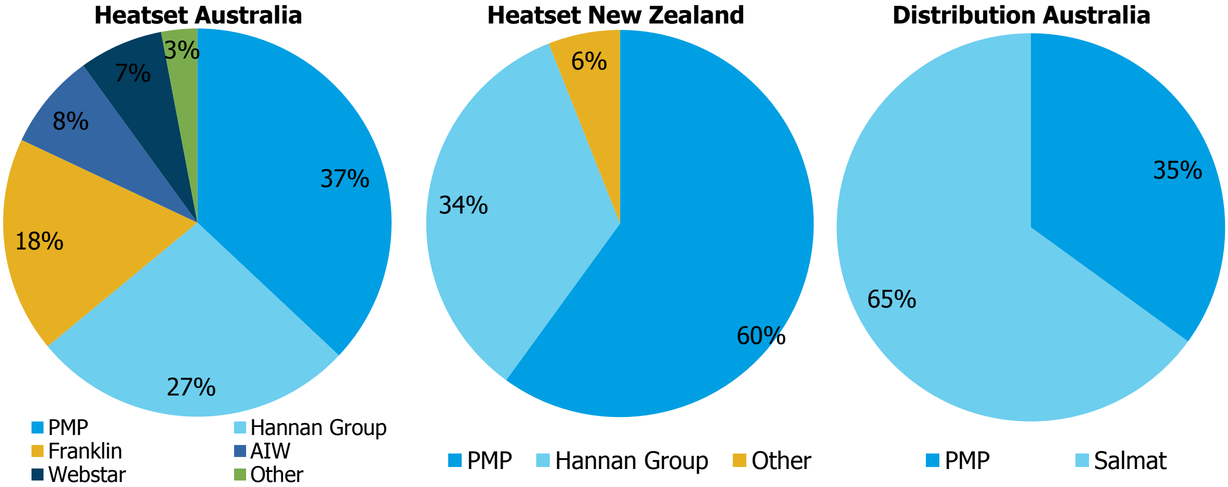
Figure 4: Debt reduction



Source: FIIG Securities, Company reports

Strong market share position in key categories in which PMP operates: The heatset printing market is dominated by five major players in Australia. According to management estimates, PMP with 37% has the largest market share. PMP's major competitor is the Hannan Group, a privately owned printer. Due to its size, Hannan is the key competitor for major national contracts like Coles and Woolworths. Hannan has a presence in all east coast capitals. PMP is the only major printer with a west coast operation. The other three major players, Franklin, AIW and Webstar are based in Melbourne, Melbourne and Melbourne and Sydney only, respectively.

Figure 5: Heatset and distribution market share



Source: PMP management estimates

Competitive advantage: PMP has a competitive advantage in three key areas:

1. The only one stop print and distribution house in Australia providing end-to-end marketing including photography (of product, stock etc.), creative services (design, layout, studio services, etc.), printing and letterbox delivery/distribution. This service ability represents the core of the PMP business and drives the majority of earnings.
2. The only player to have a national footprint with printing plants and distribution centres to cover virtually all of Australia and New Zealand.
3. PMP is ranked first or second in each of its main product segments.

These advantages mean PMP is the only operator that can, within 48 hours, print and deliver to its distribution network for delivery across virtually all of Australia for example 7 million catalogues for one of its major customers every week.

The majority of PMP's customers/debtors are top tier businesses: PMP has a blue-chip customer base including Woolworths, Metcash, Bauer Media, Kmart and Target.

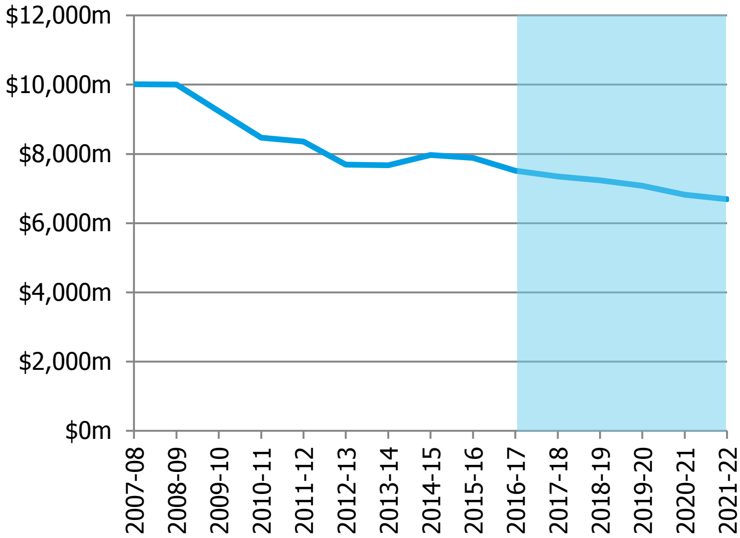
Figure 6: Example clients

Source: Company reports

Weaknesses

PMP operates in a declining industry: Australian printing industry revenue continues to decrease as illustrated in Figure 7. IBISWorld forecasts this trend to continue with revenues decreasing by around 2% per annum though to 2022. There remains overcapacity in the print market as volumes have dropped over recent years. This is particular notable in the magazine and book market. As a result, a number of the companies have mothballed presses and shrunk their workforces. Heatset printing prices in both Australia and New Zealand continue to be squeezed. Management however retain the view that heatset pricing should begin to stabilise at a level where there is no margin left for further price erosion.

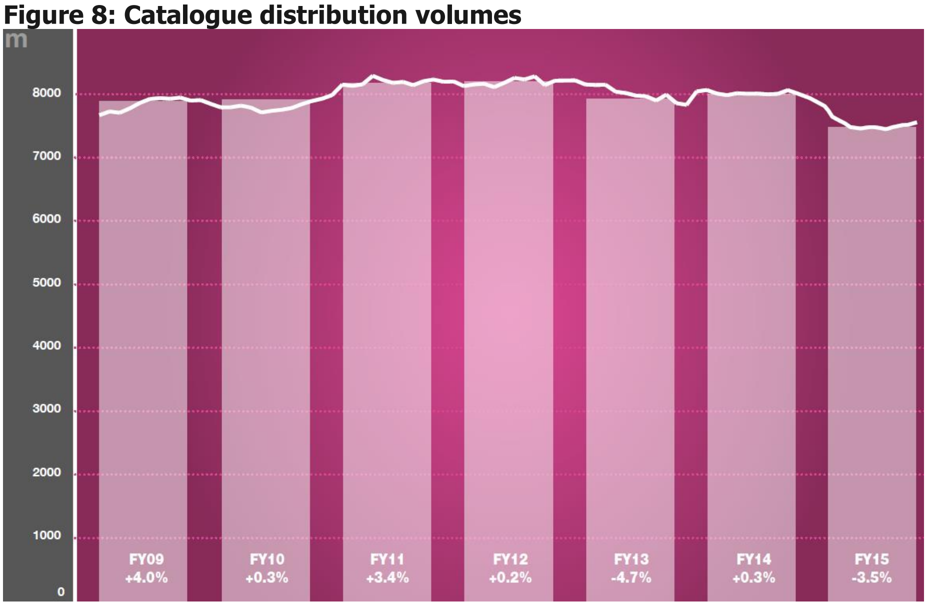
Figure 7: Printing industry revenue



Source: IBISWorld

In mitigation, the strategic focus for PMP has been the catalogue business. Printed catalogues have proven to be a more resilient marketing medium compared to other forms of printed material such as magazines and directories. Figure 8 illustrates catalogue distribution volumes since FY09 and show relative stability when compared to the broader industry represented in Figure 7.

Figure 8: Catalogue distribution volumes



Source: Australian Catalogue Association

This is due to the effectiveness of catalogues as a marketing channel. Roy Morgan research suggests on average 10.4 million Australians (over 14 years) have read a catalogue in the last week and of those 6.5 million have bought from a catalogue in the last 7 days. In addition, the research indicates that catalogues are considered as the first or second most useful media for making a purchasing decision in 54% of categories as measured by Roy Morgan.

PMP will continue to participate in industry consolidation when opportunities arise, which remains logical in terms of offsetting these negative industry trends. For example, during FY16 PMP benefited with the exit of Bauer Media from magazine distribution in Australia. Given PMP's competitive advantage in distribution it entered into an agreement with Bauer Media to provide retail magazine distribution for the group. The new contracts are expected to generate circa $300m sales per annum.

PMP's management have identified and have been in long term discussion with a number of significant potential targets. The timing on major acquisitions is uncertain.

An acquisition by PMP could weaken credit metrics and bring execution and integration risks: PMP's stated strategy is to continue to participate in industry consolidation. Credit metrics may deteriorate as cash is used to fund such a purchase. Offsetting this is PMP's strong balance sheet and cashflow, meaning it is coming off a very low leverage base. In our opinion, any increase in leverage should only likely result in a still conservative level. This would also be controlled by the Note and Senior lender's covenant levels. In terms of integration risks, PMP does have a history of successful large acquisitions, including the $80m purchase of Times Printers Australia in 2007 and Adcast software in 2009.

Loss of a number of key customers or a dramatic collapse in volume of catalogues printed: A key risk is the strength of the catalogue business over the life of the bond. A dramatic collapse in the volume of catalogues printed or the loss of key customers would place the company's credit metrics under some pressure. In mitigation, the catalogue business has remained largely resilient in recent years. Further, PMP has a relatively diverse customer base with the top 10 clients contributing circa 20% of FY16 revenue

The strength of the retail market has an impact on marketing spend, including catalogues: While retailing is struggling somewhat, PMP's key customers tend to be more resilient and in the less cyclical part of the market for example supermarkets. Further, the catalogue segment is somewhat counter cyclical with for example, marketing spending on the medium increasing post the GFC in response to slowing economic conditions.

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Appendix 1: Unsecured note structure

The Information Memorandum contains the terms and conditions, including the full covenant package for the offering and investors are strongly encouraged to review it. The following table is a summary only covering the main structural features of the bond issue.

Key bond features	
Issuer:	PMP Finance Pty Ltd
Guarantors:	The guarantors/issuer must as all times represent at least 90% of total assets of the group
Issue amount:	$40m
Maturity date:	17 September 2019
Issuer call option	17 September 2017 at 102% 17 September 2018 at 101%
Coupon:	6.43% fixed rate
Minimum parcel size:	$50,000
Face value of each note:	$1,000
Use of proceeds:	Refinance of existing debt
Ranking:	Unsecured
Covenant structure:	• Negative pledge • Limitations on new refinancing of secured debt • Limitations on total debt incurrence • Dividend restrictions • Restrictions on asset sales and application of proceeds
Event of default	• Non-payment of interest and principal • Cross default and other standard events of default
Change of control:	Investor has option to put the bonds back to the issuer @ 101%

Source: FIIG Securities, Information Memorandum

The covenants offer investor protections in key areas as detailed in the table below.

Protection	Restrictions	Value FY16
Limitation on total net debt (Net debt/EBITDA)	2.25x	0.0x
Limitation on secured debt (Secured debt/EBITDA)	1.75x	0.3x
Limitation on debt (EBITDA/Interest expense)	3.50x	6.5x
Restricted payments to equity (Dividends/NPAT)	100% of NPAT	

Source: FIIG Securities, Investment Memorandum

Appendix 2: Board of directors

Peter George: Chief Executive Officer, BCom, LLB, Date Appointed: 22/10/2012.
Mr George was first appointed to the Board in 2001 and has held Board or management positions since and has been the Managing Director and CEO since October 2012. Mr George is currently also a Non-Executive Director of Asciano Ltd. He was also Executive Director, Strategy and Policy Development Cable and Wireless Optus Ltd from 1998 to 2001, and the Executive Chairman of Nylex Limited 2006 to 2008. Mr 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.

Matthew Bickford-Smith: Chairman, Date Appointed: 2/06/2009.
Mr Bickford-Smith has been an independent Non-Executive Director of PMP since 2009 and has been Chairman of the Board of Directors and Chairman of the Appointments and Compensation Committee since 2012. Mr Bickford-Smith is also a Director of Eastern Agricultural Australia. Mr Bickford-Smith was previously CEO of Ridley Corporation Limited from 2000 to 2007. He was previously with the Man Group and was MD of the Australian operations from 1996 to 2000. Mr Bickford-Smith has extensive commercial experience within finance, manufacturing, risk management and strategy.

Naseema Sparks: Non Executive, BPharm, MPharm (Pharmacol), MBA, GAICD, Appointed: 17/08/2010.
Ms Sparks has been an independent Non-Executive Director and member of the Appointments and Compensation Committee since August 2010. Ms Sparks is currently a Director of Grays e-Commerce Group Ltd, Australian Vintage Ltd, Melbourne IT Limited, Ingogo and AIG. Ms Sparks is also Deputy Chairman of Racing NSW and a trustee of Sydney Living Museums (Historic Houses Trust of NSW). Ms Sparks was previously a Director of Shadforth Financial Group Ltd until August 2014, the Sydney Dance Company and MNZ Ltd (Deals Direct). She has held senior positions in leading agencies in Australia and UK, her most recent being Managing Director of M&C Saatchi. Ms Sparks has a background in strategic consulting, marketing, digital media and applications with over 20 years' experience in the advertising industry.

Peter Margin: Non Executive, BSc (Hons), MBA. Date appointed: 30/01/2012
Mr Margin has been an independent Non-Executive Director since January 2012 and Chairman of the Audit and Risk Management Committee since March 2012. Mr Margin is a Non-Executive Director of Nufarm Ltd, Bega Cheese Ltd, Huon Aquaculture Ltd, Pact Group Ltd, Costa Group Holdings Ltd and was also a director of Ricegrowers Ltd from September 2012 until August 2015. Mr Margin has a strong record of managing large Australian consumer food companies delivering operational efficiency, brand development and profitable growth having served amongst other things as the Chief Executive Officer and Managing Director of Goodman Fielder Ltd, and before that National Foods Ltd.

Anthony Cheong: Non-Executive Director. Date appointed: 04/03/2014
Mr Cheong has been a Non-Executive Director and member of the Audit and Risk Management Committee since March 2014. Mr Cheong is an Associate of the Institute of Chartered Accountants in England and Wales and a Fellow of Institute of Singapore Chartered Accountants. Mr Cheong is the Company Secretary for Fraser and Neave Limited, the holding Company for the Fraser and Neave group and holds directorships on various Fraser and Neave subsidiaries, associated and joint venture entities including Fraser and Neave Berhad on the BURSA Malaysia. Mr Cheong has more than 26 years of varied financial and corporate experience in the packaging, property, printing, publishing, retail and education sectors.

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