Photon Group

FY11 EBITDA downgraded by 10%

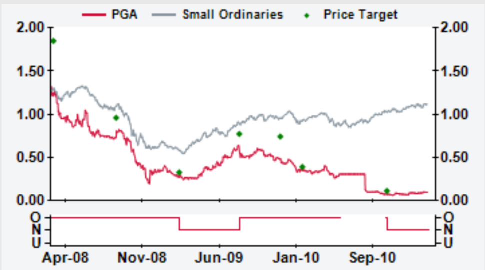
AUSTRALIA

PGA AU		Neutral
Price 15 Feb 11		A$0.10
Volatility index		**Very High**
12-month target	**A$**	**0.10**
12-month TSR	**%**	**+5.3**
Valuation - Sum of Parts	**A$**	**0.06-0.10**
GICS sector		**Media**
Market cap	**A$m**	**146**
30-day avg turnover	**A$m**	**0.3**
Number shares on issue	**m**	**1,541**

Investment fundamentals

Year end 30 Jun		2010A	2011E	2012E	2013E
Revenue	m	378.6	351.1	340.9	352.4
EBIT	m	54.0	46.9	45.5	48.1
Reported profit	m	-87.6	-30.6	18.2	23.5
Adjusted profit	m	21.0	13.2	18.2	23.5
Gross cashflow	m	42.3	27.1	32.2	37.6
CFPS	¢	7.5	2.4	2.1	2.4
CFPS growth	%	-42.9	-68.1	-12.5	16.6
PGCFPS	x	1.3	4.0	4.5	3.9
PGCFPS rel	x	0.10	0.39	0.55	0.52
EPS adj	¢	3.7	1.1	1.2	1.5
EPS adj growth	%	-50.1	-70.0	5.8	29.4
PER adj	x	2.6	8.5	8.1	6.2
PER rel	x	0.12	0.55	0.71	0.63
Total DPS	¢	0.9	0.0	0.0	0.0
Total div yield	%	9.4	0.0	0.0	0.0
Franking	%	100	nmf	nmf	nmf
ROA	%	6.7	6.1	6.5	6.7
ROE	%	7.9	4.5	5.5	6.7
EV/EBITDA	x	3.1	5.2	5.4	5.1
Net debt/equity	%	99.3	31.5	24.4	18.0
P/BV	x	0.2	0.4	0.4	0.4

PGA AU vs Small Ordinaries, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, February 2011

(all figures in AUD unless noted)

Alex Pollak
+61 2 8232 3172 alex.pollak@macquarie.com
Derryn Chin
+61 2 8232 4203 derryn.chin@macquarie.com

17 February 2011

Event

- The company reported 1H11 EBITDA of $32.9m, which was down 12% on the pcp (or down 7.6% after adjusting for adverse currency movements). 1H11 EBITDA includes the contribution of the businesses which were sold to Salmat at the end of December.
- Although this is an improvement from the 28% decline in 2H10, the 12% rate of decline for the half implies a sharp deterioration during the second quarter given that the 1Q11 trading update saw EBITDA in line with the pcp.
- All up, after backing out a non cash fair value gain on deferred consideration of $11.4 million (net of $4.7 million tax), this gives 1H11 adjusted NPAT and EPS of $5.9 million or 0.6cps (versus $9.7 million and 6.2cps in the pcp).

Impact

- As a result of the declining run rates in the business over the fourth quarter of calendar 2010 and better clarity from the now disclosed revenue and EBITDA half splits by segment, we have downgraded our FY11 EBITDA estimate to $61 million, a decrease of 10% from our previous number.
- After factoring in the amended earnings number and the debt pay down from the Salmat proceeds, we have also downgraded our valuation to 10cps at the high end from 11 cps previously.
- Put simply, in order for the company to qualify for an Outperform recommendation, the market needs to gain confidence in its earnings forecasts given the history of downgrades throughout the GFC.
- Although current CEO Jeremy Philips has certainly taken some very positive steps in reducing the number of businesses from 45 to around 26, the complex mix of businesses means visibility in this regard is limited and as such we prefer to remain conservative on earnings growth forecasts.

Earnings and target price revision

- FY11E EPS: -35% to 1.1cps from 1.7 cps previously
- FY12E EPS: -29% to 1.2 cps from 1.7 cps previously

Price catalyst

- 12-month price target: A$0.10 based on a Sum of Parts methodology.
- Catalyst: Potential for asset sales could be an upward catalyst for valuation.

Action and recommendation

- With the stock already closing at 9cps yesterday and the earnings outlook uncertain, we maintain our Neutral rating.

Analysis

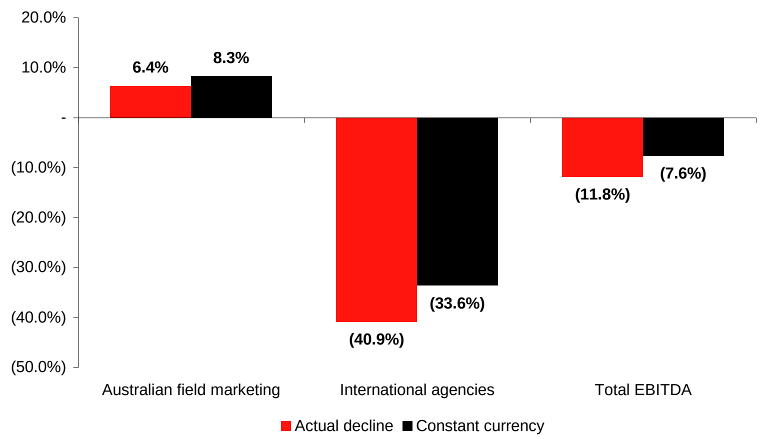
Fig 1 1H11 EBITDA was down 12% compared with the pcp

$m	1H10	2H10	1H11	2H11E	FY09	FY10	FY11E
Revenue summary							
Australian agencies	73.2	75.8	69.0	58.0	161.9	149.0	127.0
Australian field marketing	63.3	55.2	65.0	57.0	133.5	118.5	122.0
International agencies	56.1	44.0	48.2	39.8	114.5	100.1	88.0
International - US search marketing	3.7	7.4	5.9	8.1	30.7	11.1	14.0
Total sales revenue	**196.3**	**182.3**	**188.1**	**163.0**	**440.6**	**378.6**	**351.1**
Other	0.3	0.5	0.2	0.6	1.2	0.8	0.8
Total revenue	**196.6**	**182.8**	**188.3**	**163.5**	**441.9**	**379.4**	**351.8**
% chg on pcp	(11.4%)	(16.9%)	(4.2%)	(10.6%)		(14.1%)	(7.3%)
Costs	159.3	145.0	155.4	135.4	349.0	304.2	290.9
% chg on pcp	(12.3%)	(13.4%)	(2.4%)	(6.6%)		(12.8%)	(4.4%)
EBITDA							
Australian agencies	16.3	15.7	14.5	9.5	31.3	32.0	24.0
Australian field marketing	11.0	9.5	11.7	10.3	25.1	20.5	22.0
International agencies	13.7	11.5	8.1	8.6	25.6	25.2	16.7
International - US search marketing	2.1	4.4	0.8	1.6	19.6	6.5	2.5
Other	(5.8)	(3.2)	(2.3)	(1.9)	(8.6)	(9.0)	(4.2)
Total EBITDA	**37.3**	**37.9**	**32.9**	**28.1**	**92.8**	**75.2**	**61.0**
% chg on pcp	(7.4%)	(27.9%)	(11.8%)	(25.9%)		(19.0%)	(18.9%)
Total EBITDA margin	**19%**	**21%**	**17%**	**17%**	**21%**	**20%**	**17%**

Source: Company data , Macquarie Research, February 2011

- By division, the decline was driven mostly by international agencies (-41%) and Australian agencies (-11%), offset in part by savings in head office costs (which more than halved) and some growth in the field marketing division. With the 1Q11 trading update in line with the pcp at both the revenue and EBITDA lines, the 12% decline in the half suggests the second quarter EBITDA was down as much as 20%. This was attributed to unsettled incentive structures at Naked which is hampering the International Agencies, weakness at The Leading Edge and recent senior hires which also crimped the EBITDA margin. Additionally, the Australian agencies division was cycling a tough comp which is set to get even harder given the cyclical uptick in advertising during 2010. The company indicated that the US search business is set to be sold, but we have left the segment in our numbers until confirmation of this occurs.
- With regards to the full year FY11 outlook, the second half excludes the four businesses which were sold to Salmat, which explains a chunk of the 26% decline. On a like for like basis, when these businesses are stripped out, the EBITDA decrease is approximately 15%. We prefer to remain prudent on our earnings estimates until we are more certain that the rate of earnings decline in 2Q10 has adequately slowed. Ongoing AUD strength will also be another headwind.

Fig 2 Declines in the half were exacerbated by strong Australian dollar



Source: Company data, Macquarie Research, February 2011

The numbers

Fig 3 1H11 adjusted NPAT of $5.9 million was down 39% versus the pcp

	1H10	2H10	1H11E	2H11E	FY09	FY10	FY11E
Sales revenue	196.3	182.3	188.1	163.0	440.6	378.6	351.1
Other revenue	0.3	0.5	0.2	0.6	1.2	0.8	0.8
Total revenue	**196.6**	**182.8**	**188.3**	**163.5**	**441.9**	**379.4**	**351.8**
%chg on pcp	(11.4%)	(16.9%)	(4.2%)	(10.6%)		(14.1%)	(7.3%)
Costs	159.3	145.0	155.4	135.4	349.0	304.2	290.9
%chg on pcp	(12.3%)	(13.4%)	(2.4%)	(6.6%)		(12.8%)	(4.4%)
EBITDA	**37.3**	**37.9**	**32.9**	**28.1**	**92.8**	**75.2**	**61.0**
%chg on pcp	(7.4%)	(27.9%)	(11.8%)	(25.9%)		(19.0%)	(18.9%)
Depreciation	4.0	3.9	4.0	3.0	9.1	7.9	7.0
Amortisation	6.3	6.9	4.5	2.5	11.4	13.2	7.0
EBIT consolidated	**27.0**	**27.1**	**24.4**	**22.6**	**72.3**	**54.1**	**46.9**
Non recurring EBIT (1)***	(8.9)	(108.4)	(41.3)	-	(7.9)	(117.3)	(41.3)
Associate contribution	(0.1)	-	-	-	0.1	(0.1)	-
Total reported EBIT	**18.0**	**(81.4)**	**(16.9)**	**22.6**	**64.5**	**(63.4)**	**5.6**
Interest expense incl PV	12.4	12.1	15.3	10.5	27.3	24.5	25.8
Interest income	0.2	0.2	0.3	0.1	0.7	0.4	0.4
Net interest expense	**12.2**	**11.9**	**15.0**	**10.4**	**26.6**	**24.1**	**25.4**
Reported PBT	**5.8**	**(93.3)**	**(31.9)**	**12.2**	**38.0**	**(87.5)**	**(19.8)**
Recurring tax	4.9	3.8	3.6	4.8	16.7	8.7	8.5
Non recurring tax (1)***	(2.1)	(6.0)	2.5	-	(1.1)	(8.1)	2.5
Total reported tax expense	**2.8**	**(2.2)**	**6.1**	**4.8**	**15.6**	**0.6**	**11.0**
Net profit	**3.0**	**(91.1)**	**(38.1)**	**7.3**	**22.4**	**(88.1)**	**(30.7)**
Reported MI	0.1	(0.6)	(0.1)	(0.0)	1.0	(0.5)	(0.1)
Reported NPAT	**2.9**	**(90.5)**	**(38.0)**	**7.3**	**21.4**	**(87.6)**	**(30.6)**
MI NRI adjustment		(0.7)				(0.7)	
Adjusted NPAT	**9.7**	**11.2**	**5.9**	**7.3**	**28.2**	**21.0**	**13.2**
EFPOWA	156.0	181.0	916.6	1,540.1	101.6	168.5	1,228.3
Adjusted EPS(2)* **	**6.2**	**6.2**	**0.6**	**0.5**	**27.7**	**12.4**	**1.1**

*** (1) Includes adjustments to remove the non cash impairment charge of $36m and the loss on sale of subsidiaries of $19.2m (net of $2.2m non cash deferred tax benefit). This is offset in part by the non cash benefit from the deferred consideration revaluation of $11.4 m (net of $4.7 m tax liability).
*** (2) Adjusted EPS numbers in prior years above do not include a dilution factor which explains the variance with EPS numbers on the front page.
Source: Company data, Macquarie Research, February 2011

Fig 4 Valuation downgraded to 10cps on the high end valuation

EV/EBITDA Valuation		**FY11E**	**Low Multiple**	**High Multiple**	**Low Value**	**High Value**
Group EBITDA	**$m**	**61.0**	**5x**	**6x**	**304.8**	**365.7**
Target EV	**$m**				**304.8**	**365.7**
FY11E net debt	$m				101.5	101.5
Deferred consideration	$m				114.7	114.7
Equity value	**$m**				**88.5**	**149.5**
EFPOWA	m				1,540.1	1,540.1
Value per share	**$**				**0.06**	**0.10**

Source: Macquarie Research, February 2011

Photon Group Limited									
Year End 30 June		**1H10A**	**2H10A**	**1H11A**	**2H11E**	**2010A**	**2011E**	**2012E**	**2013E**
Profit & Loss									
Sales									
+ Sales Revenue	$m	196.3	182.3	188.1	163.0	378.6	351.1	340.9	352.4
+ Other Revenue	$m	0.3	0.5	0.2	0.6	0.8	0.8	0.8	0.9
Revenue	**$m**	**196.6**	**182.8**	**188.3**	**163.5**	**379.4**	**351.8**	**341.8**	**353.3**
Operating Costs	$m	159.3	145.0	155.4	135.4	304.2	290.9	282.1	291.1
Operating Surplus	**$m**	**37.3**	**37.9**	**32.9**	**28.1**	**75.2**	**61.0**	**59.7**	**62.2**
- Depreciation	$m	4.0	3.9	4.0	3.0	7.9	7.0	7.1	7.1
- Other Amortisation - Ex Goodwill	$m	6.3	6.9	4.5	2.5	13.2	7.0	7.1	7.1
Consolidated EBIT	**$m**	**27.0**	**27.1**	**24.4**	**22.6**	**54.1**	**46.9**	**45.5**	**48.1**
+ Share of associates net profit	$m	(0.1)	-	-	-	(0.1)	-	-	-
EBIT including associates	**$m**	**26.9**	**27.1**	**24.4**	**22.6**	**54.0**	**46.9**	**45.5**	**48.1**
+ Non-recurring EBIT	$m	(8.9)	(108.4)	(41.3)	-	(117.3)	(41.3)	-	-
Total EBIT	**$m**	**18.0**	**(81.4)**	**(16.9)**	**22.6**	**(63.4)**	**5.6**	**45.5**	**48.1**
- Net Interest Expense	$m	12.2	11.9	15.0	10.4	24.1	25.4	16.7	12.9
Pretax Profit	**$m**	**5.8**	**(93.3)**	**(31.9)**	**12.2**	**(87.5)**	**(19.8)**	**28.8**	**35.1**
- Tax Expense on ordinary activities	$m	4.9	3.8	3.6	4.8	8.7	8.5	10.7	11.7
- Tax Expense on NRIs	$m	(2.1)	(6.0)	2.5	-	(8.1)	2.5	-	-
Profit before minorities	**$m**	**3.0**	**(91.1)**	**(38.1)**	**7.3**	**(88.1)**	**(30.7)**	**18.1**	**23.4**
- Minority Interests	$m	0.1	(0.6)	(0.1)	(0.0)	(0.5)	(0.1)	(0.1)	(0.1)
Reported Profit	**$m**	**2.9**	**(90.5)**	**(38.0)**	**7.3**	**(87.6)**	**(30.6)**	**18.2**	**23.5**
Adjusted Profit	**$m**	**9.7**	**11.2**	**5.9**	**7.3**	**21.0**	**13.2**	**18.2**	**23.5**
Gross Cashflow	$m	20.1	22.1	14.3	12.8	42.3	27.1	32.2	37.6
Adj. EPS*	**¢**	**6.2**	**6.2**	**0.6**	**0.5**	**12.4**	**1.1**	**1.2**	**1.5**
% Growth	*%*	*-30%*	*-68%*	*-90%*	*-92%*	*-55%*	*-91%*	*6%*	*29%*
CFPS*	¢	12.9	12.2	1.6	0.8	25.1	2.2	2.1	2.4
DPS*	**¢**	**3.0**	**-**	**-**	**-**	**3.0**	**-**	**-**	**-**
EFPOWA	m	156.0	181.0	916.6	1540.1	168.5	1228.3	1540.1	1540.1
*Per share metrics in FY10 are before application of dilution factor									
Year End 30 June		**1H10A**	**2H10A**	**1H11A**	**2H11E**	**2010A**	**2011E**	**2012E**	**2013E**
Cashflow Analysis									
EBITDA	**$m**	**37.3**	**37.9**	**32.9**	**28.1**	**75.2**	**61.0**	**59.7**	**62.2**
- Increase in Working Capital	$m	(11.7)	67.1	(10.5)	(1.3)	55.4	(11.8)	(5.0)	-
- Net Interest Paid	$m	9.0	9.6	9.8	6.4	18.7	16.2	9.7	8.9
- Tax Paid	$m	11.9	5.3	4.6	6.1	17.2	10.7	9.7	11.2
+ Other	$m	(11.5)	63.4	(20.7)	(5.0)	51.8	(25.7)	-	-
Gross Operating Cash	**$m**	**16.6**	**19.1**	**8.3**	**11.9**	**35.7**	**20.2**	**45.3**	**42.1**
+ Proceeds from Sale of PP&E	$m	0.2	0.5	0.3	-	0.7	0.3	-	-
- Capex	$m	2.1	2.2	2.7	2.3	4.3	5.0	5.0	5.0
- Acquisitions & Investments	$m	77.8	53.9	30.2	10.1	131.6	40.3	15.8	13.3
+ Other	$m	-	(4.9)	(3.0)	(3.0)	(4.9)	(6.1)	(6.1)	(6.1)
Net Cash Used in Investing	**$m**	**(79.7)**	**(60.4)**	**(35.6)**	**59.8**	**(140.1)**	**24.2**	**(26.9)**	**(24.4)**
- Dividends Paid	$m	8.2	5.5	-	-	13.7	-	-	-
+ Equity Movements (inc. DRP)	$m	114.7	-	102.5	-	114.7	102.5	-	-
+ Debt Movements	$m	(31.8)	43.2	(65.9)	(75.3)	11.4	(141.2)	(10.5)	-
+ Other	$m	(6.7)	(1.3)	(10.9)	-	(8.1)	(10.9)	-	-
Net Cash from Financing	**$m**	**67.9**	**36.4**	**25.7**	**(75.3)**	**104.3**	**(49.6)**	**(10.5)**	**-**
+ Net Exchange Rate Differences	$m	(1.3)	0.6	-	-	(0.7)	-	-	-
Net Cash movement	**$m**	**3.6**	**(4.4)**	**(1.6)**	**(3.6)**	**(0.8)**	**(5.3)**	**7.9**	**17.7**

			2010A	**2011E**	**2012E**	**2013E**
Trading Information		**Balance Sheet**				
Share Price ($)	**$0.10**	Cash	22.8	17.5	25.4	43.1
Shares on Issue (m)	1540.0	Debtors	92.9	67.0	76.9	79.5
Market capitalisation ($m)	**146.3**	Other current assets	21.4	104.6	104.6	104.6
		Total current assets	**137.1**	**189.1**	**206.9**	**227.2**
		Fixed Assets	18.0	14.3	14.3	14.3
		Other	15.8	0.2	0.2	0.2
		Intangibles	662.6	491.4	484.3	477.2
		Total Assets	**833.4**	**695.0**	**705.7**	**718.9**
		Creditors	76.1	62.0	76.9	79.5
		Short Term Debt	45.5	3.0	3.0	3.0
		Deferred consideration and other	98.4	52.5	52.5	52.5
		Total current liabilities	**220.0**	**117.5**	**132.5**	**135.0**
		Long Term Debt	241.5	116.0	105.5	105.5
		Other long term liabilities	105.7	138.9	127.1	114.2
		Total Liabilities	**567.2**	**372.5**	**365.0**	**354.8**
		Shareholders' Funds	266.2	322.5	340.7	364.2
		Minority Interests	0.6	0.5	0.5	0.5
		Net Assets	**266.2**	**322.5**	**340.7**	**364.2**

Source: Company data, Macquarie Research, February 2011

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand
Outperform – return >3% in excess of benchmark return
Neutral – return within 3% of benchmark return
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie First South - South Africa
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada
Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA
Outperform (Buy) – return >5% in excess of Russell 3000 index return
Neutral (Hold) – return within 5% of Russell 3000 index return
Underperform (Sell)– return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.
* Applicable to Australian/NZ/Canada stocks only

Recommendations – 12 months
Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:
Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*
ROA = adjusted ebit / average total assets
ROA Banks/Insurance = adjusted net profit /average total assets
ROE = adjusted net profit / average shareholders funds
Gross cashflow = adjusted net profit + depreciation
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 December 2010

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	46.38%	62.62%	52.17%	44.99%	67.57%	50.90%	(for US coverage by MCUSA, 13.59% of stocks covered are investment banking clients)
Neutral	37.68%	18.58%	34.78%	50.61%	28.83%	35.48%	(for US coverage by MCUSA, 15.22% of stocks covered are investment banking clients)
Underperform	15.94%	18.80%	13.04%	4.40%	3.60%	13.62%	(for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)

Company Specific Disclosures:
The Macquarie Group acted as financial advisor to Photon Group Limited in respect of is capital structure review as announced on 9 June 2010. Within the last 12 months, Macquarie Group has received compensation for investment advisory services from Photon Group Limited.
Important disclosure information regarding the subject companies covered in this report is available at www.macquarie.com/disclosures.

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Research

Heads of Equity Research

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John O'Connell (Global Co – Head)	(612) 8232 7544
Matt Nacard (Australia)	(612) 8232 4017

Consumer Staples

Food & Beverages

Greg Dring	(612) 8232 3104

Consumer Discretionary

Media

Alex Pollak	(612) 8232 3172

Retailing

Greg Dring	(612) 8232 3104

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Adrian Wood	(612) 8232 8531

ESG

Aimee Kaye	(612) 8232 9772

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Email addresses

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