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Lodgement of Open Briefing**



Skilled Group Limited  
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**Record of interview:**

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Skilled Group Limited reported a net profit increase of 78% to \$17.5 million for the half year ended 31 December 2004, including an \$11.2 million profit from divestment of non-core businesses. To what extent has the Skilled structure changed and what is driving your strategy?

**MD & CEO Greg Hargrave**

This is a transitional year for Skilled. Our strategy is to be the market leader in a specific area, that is staffing services, so over the past year we've purchased Origin Healthcare and divested Communications, Power, and Yallourn Mechanical workshops; businesses that are not staffing services. We've divested these businesses because they're highly cyclical and they don't share the management synergies and capabilities of our core staffing services.

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To what extent can you extract positive synergies across the three business units of Workforce Services, Customer Contact Services and Origin within Managed Labour Services?

**MD & CEO Greg Hargrave**

Our real focus is sales and margin growth as we leverage our fixed cost base. We're the largest staffing services business in this country and we have the scale and depth of expertise to leverage a common IT platform, common management & HR platforms, common sales, common training and capability platforms across

these businesses. As I stated earlier, our focus is to be the market leader in the staffing services arena. As these businesses all share similar characteristics we have the opportunity to extend management capability across them.

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Managed Labour Services increased EBITDA, excluding non-recurring items, 38.5% to \$15.9 million from \$11.5 million. EBITDA to sales margin rose to 4.2 percent from 4.1 percent. What target returns are achievable as your strategy matures?

**MD & CEO Greg Hargrave**

We're targeting EBITDA margins in excess of 5 percent in the next twelve to eighteen months.

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How is the shortage of skilled workers affecting your business?

**MD & CEO Greg Hargrave**

The lack of skilled workers is not a new phenomenon. Our clients are finding it increasingly difficult to source people and they realise they can't deal with smaller suppliers that can't deliver. Large clients have started to consolidate their supply from many small suppliers to either just one or at the most four. As such we are seeing more and more customers turn to us as their primary source of supply. Conversely employees are turning to us to deliver employment with greater flexibility.

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Within Managed Labour Services, Workforce Services' sales rose 22% to \$316 million or 74% of total group sales. Can you elaborate on the sectors that underwrote that growth?

**MD & CEO Greg Hargrave**

Revenue growth was strong across the broader industrial economy particularly mining and energy, primary manufacturing, automotive, transport and logistics; the sectors that reflect a strong economy. For Skilled, there were market share gains across the board. State-by-state we saw mining strongly impacting on WA. In South Australia, there has been very strong growth from the automotive sector. Across the Eastern States there was a strong pick up across the manufacturing and logistics space.

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Occupational Health and Safety (OH&S) is the subject of a continuous improvement programme within Skilled. What has been your OH&S performance recently and how does it impact Skilled's business?

**MD & CEO Greg Hargrave**

If we look at the major measure of occupational health and safety performance, the Lost Time Injury Frequency Rate (LTIFR), our performance since 1997 has been a 97 percent improvement. Over the past year alone there's been a further 50 percent reduction. We are now not just the industry leader, but a leader in

safety across the broader economy. Our outstanding safety record provides us with increasing sales opportunities with like-minded clients. Also employees turn to an organisation they can trust to look after their safety.

For shareholders it positively impacts our financial performance. The reduction in our LTIFR year on year has helped to reduce workers' compensation costs as a percentage of wages.

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Customer Contact Services' revenue increased 52% to \$32 million, 7.5% of total group sales. What has enabled you to achieve this level of growth and what is the outlook for the business?

**MD & CEO Greg Hargrave**

Again there's been a strong focus at management level on leveraging the capabilities of our broader business in both training and workforce management skills. This is delivering benefits for clients and subsequently our value proposition has improved.

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To what extent is Customer Contact Services dependent on the Telstra relationship?

**MD & CEO Greg Hargrave**

As the largest player in Australia in the customer contact or call centre markets Telstra is a large client of ours. All our major competitors are suppliers to Telstra in this area because they are so large. Our business with Telstra is under a range of contracts with different business units, including Telstra retail and Telstra mobile and the wholly owned Sensis division. This is balanced with a range of work across a broad base of other clients, including business and government in Australia and New Zealand.

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Origin Healthcare's revenue was \$35.2 million, 8% of total group sales - a level below your expectations at the time of the acquisition. Why are sales below expectations, how do they compare with the pre-acquisition performance and what measures have you taken to lift performance?

**MD & CEO Greg Hargrave**

We have been cautious and have taken extensive time to fully understand the business, including extensive market research across both clients and the nursing workforce. We are currently implementing productivity and management changes to lift performance. Revenue has been relatively flat. Some of the issues include: our inability to optimise the placement of scarce nursing resources to meet client requirements, the general difficulty sourcing nurses and industry structural issues in healthcare. There have been structural issues within the public health sectors in a few of our primary markets and also a lack of management depth within the business. The industry capacity to meet the level of demand for skilled nurses has been a constraint.

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At the time of the Origin acquisition you forecast EBITDA of \$8 million for FY05. What is the likely result this year?

**MD & CEO Greg Hargrave**

It will be significantly lower, but competitive pressures don't allow me to give you a number. I will say that earnings will be consistent with the lower sales. However, a number of steps have been taken to address this and we expect to see the benefit of these in 2005/06.

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Skilled paid \$57 million for Origin in February 2004. What was the rationale for the acquisition and does it remain valid given the underperformance to date?

**MD & CEO Greg Hargrave**

Origin is a market leader in the healthcare space and clearly fits our strategy. As we've stated, so far it has underperformed our expectations, but the acquisition rationale remains valid. It is an important component of our staffing services portfolio.

Overall market demand in healthcare remains robust and nursing skills continue to be in high demand. The market is competitive, but fragmented with many small suppliers operating. We believe this presents a significant opportunity for us as hospital operators rationalise suppliers and rely on larger, national providers, such as Origin. Nurses will also benefit from the larger operators who can provide a wider choice of work options.

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The Origin acquisition is currently having a negative impact on earnings per share. How long will it take for your strategy to be reflected in positive financial returns?

**MD & CEO Greg Hargrave**

We expect Origin to have a positive EPS impact in the '06 financial year.

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Can you explain the factors behind the \$1 million negative cash flow in the latest half year compared with a positive \$7 million in the previous half?

**MD & CEO Greg Hargrave**

On a like for like basis the cash flows for the halves were similar. Our divestments distorted the way cash flow was reported in the Appendix 4D. We've had to show \$22 million in cash proceeds, including some \$8.8 million of working capital, from the divestment of businesses in the Cash Flow From Investing Activities section. The \$8.8 million of positive cash flow would normally have been shown as Cash Flow From Operations as Receipts from customers.

In addition, the strong sales growth that we've experienced in the recent half compared with the same period last year has increased investment in working capital. Our receivables, an indicator of growth, were \$8 million higher at

December '04 than December '03 after adjusting for divestments. Also, due to differences in the pattern of tax instalment payments, we've paid an extra \$2.5 million in income tax in the latest half.

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Group depreciation and amortisation charges of \$7.3 million more than doubled from \$3.6 million. What is the source of the much higher depreciation and amortisation charge and what level of depreciation and amortisation would you anticipate in future periods?

**MD & CEO Greg Hargrave**

The Origin acquisition increased depreciation and amortisation by \$2.8 million. We also had \$1 million of additional goodwill amortisation relating to businesses divested.

With our current portfolio of businesses we expect depreciation and amortisation of about \$6 million in the second half and somewhere in the order of \$9 million to \$10 million in the year to June '06 as we adopt the new accounting standard.

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What is the destiny of your remaining non-core business, SEM?

**MD & CEO Greg Hargrave**

We've rebranded SEM so as not to confuse it with our core Skilled brands. It's a strong, standalone business with a dominant market position in its field, the manufacture of emergency vehicles. It has a low risk profile, a low capital requirement and a very large market share. SEM generates positive returns exceeding the cost of capital. It makes a positive contribution to our business and does not distract senior management. We'll continue to operate it and assess it's future as we go.

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Are you on track to achieve your previous net profit guidance of \$25 to \$26 million for the full year, including profits from asset sales?

**MD & CEO Greg Hargrave**

We've reviewed our expectations for the full year and anticipate that the full year net profit outcome will be in a range of \$24 million to \$25 million. This has been primarily influenced by the divested businesses not achieving the trading results we expected, the earnings contribution from Origin is lower and we've incurred additional business development costs as we invest for longer term growth. These have been partially offset by the positive out-performance by our Workforce Services business.

Included in our full year forecast is an \$11.2 million net profit on divestments which is in line with our earlier guidance.

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Thank you Greg.

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