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Wednesday 10 June 2015

STW Communications Group Limited – Strategy Update

STW Communications Group Limited (ASX:SGN), Australasia's leading marketing content and communications group today provided an update on its strategic and operational review.

STW's Chief Executive Officer, Michael Connaghan, said: "STW Group has constantly evolved with the market to meet the needs of our clients. A thorough review has identified a number of initiatives to improve performance which are all underway."

Key highlights of the strategy update include:

- Creation of new management structure to drive deeper engagement with each of our businesses coupled with stronger STW Group finance management of operating companies to instil greater financial discipline and deliver cost efficiencies
- A number of business mergers, consolidations and divestments as part of a strategy over time creating fewer, bigger and better businesses to drive organic growth
- A range of immediate cost out initiatives currently underway to deliver annualized cost savings of approximately \$7 million and a continuing program to identify and deliver additional cost savings and operating efficiencies
- Improved terms of STW's bank covenants to deliver immediate and materially greater covenant headroom (pro forma 2.5x Net Debt/ EBITDA at Dec 14 versus covenant of 3.0x) and a clear path to return to internal target gearing ratio of less than 2.0x Net Debt/ EBITDA by December 2016
- No change to STW's target dividend payout ratio of 60-70% of underlying net profit with DRP to be maintained

STW's Chief Financial Officer, Lukas Aviani, said: "STW Group has today agreed new covenant definitions providing immediate and materially greater headroom in our bank covenants."

Mr Connaghan said: "We are confident in our strategy. The new initiatives will allow us closer oversight, enable better optimisation of group resources and importantly help us to drive organic growth and deliver value to all stakeholders. STW Group is well placed for future growth."

The investor presentation is attached and the briefing will be accessible online via a live webcast at <http://webcast.openbriefing.com/2108/>. The briefing will commence at 10:00am today.

ENDS.

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STRATEGY UPDATE
JUNE 2015

STW 2015 STRATEGY UPDATE

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POSITIONING AND STRATEGY

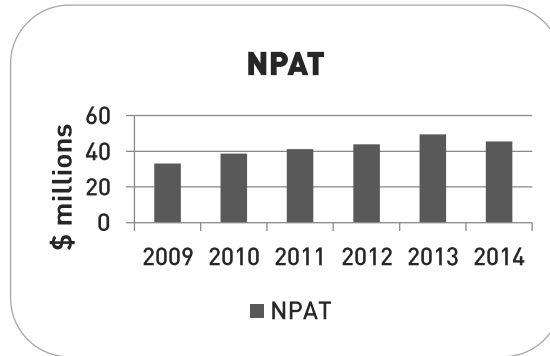
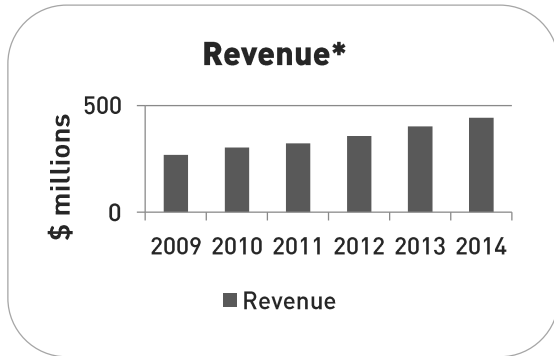
STRUCTURAL AND OPERATIONAL INITIATIVES

BALANCE SHEET AND CASH FLOW

PROGRESS TO DATE

CHANGE - REMAINS A CONSTANT

- 2014 = TOUGH YEAR. First negative NPAT and EPS growth year since GFC
- We have acknowledged need for faster change
- Change is a process – we have always been one step ahead – in 2014 we fell behind
- New business win/loss record not up to our standard
- We were too slow in responding to performance issues and intervening in some businesses
- We have picked apart our strategy – we’ve benchmarked global best practice – we have consulted clients – we have checked in with our partners – we have sought external views



*Proportional

REFINING OUR STRATEGY FOR GROWTH

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“OWN 100% OF A CLIENT'S
ADVERTISING BUDGET”



“OWN 100% OF A CLIENT'S
MARKETING BUDGET”



“OWN 100% OF A
CLIENT'S CUSTOMER
EXPERIENCE BUDGET”

The world is moving fast forward. No single company, no single client, no one individual can possibly predict what is next.

STW Group has the scale, longstanding client relationships, pool of talented people and unrivalled knowledge of the local market to take advantage of rapid change, to meet client needs and grow shareholder value.

We must and we are constantly evolving to protect and strengthen our competitive position, improve performance and deliver value to our clients, shareholders and employees.

We are a variable cost base business and are not exposed to structural challenges of single market businesses.

Customer experience investment continues to grow.

We operate across the full spectrum of the economy.

We should win more than our fair share of the revenue opportunities!

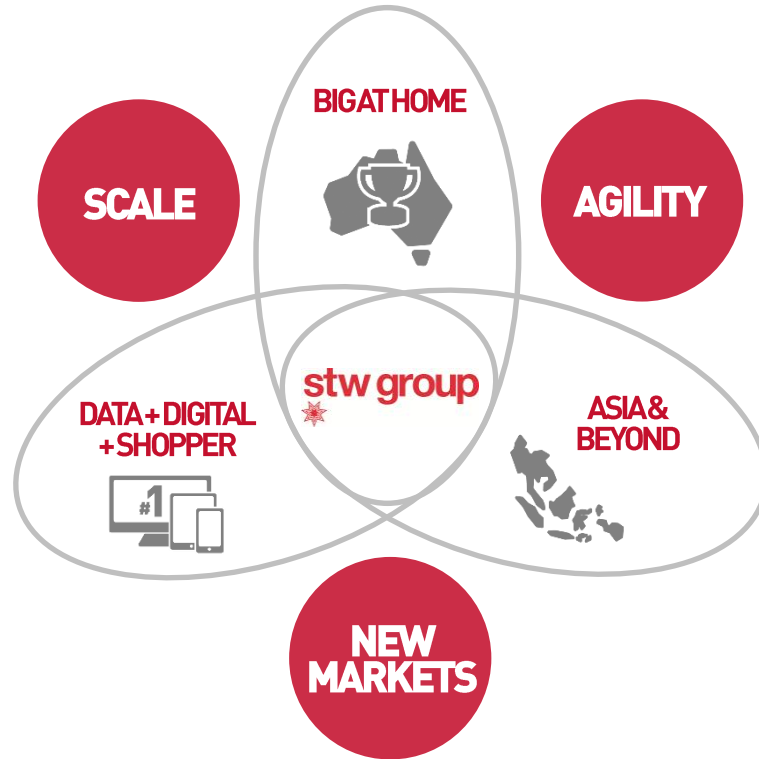
STW GROUP BUILT ON SOLID FOUNDATIONS

- Best in class local agency brands
- Leading international partners
- On the ground/local oversight
- Group has continually evolved and diversified → followed the money
- One eye firmly delivering on the present: One eye looking firmly into the future
- Balance of local and global blue chip clients
- The marketing environment has never been more complex – the complexity plays to our strength
- More money being spent on marketing communications and customer experience than ever before

BENEFITS OF SCALE AND DIVERSIFICATION

- The scope of the STW portfolio allows us to secure productivity and growth opportunities that are not available to our competitors. It also provides the basis for superior economic returns.
- Our model allows us to create opportunities through:
 - Leveraging scale and benefits
 - Capturing scope advantages from existing and new clients
 - Bringing together multi-disciplinary teams to assist clients across their total customer experience needs
 - Incubating and innovating new companies and services
- We are refining and changing our operating model continually in an environment of rapid and fundamental change.
- We must be better at capturing the opportunities inherent across our client portfolio.

STRATEGY TO CONTINUALLY EVOLVE





Drive growth out of our leadership positions in Australia and New Zealand.

- Strong competitive position in these home markets - recognised brands, extensive knowledge of the local market, enduring client relationships, diversified service offering across the entire communications services value chain
- Room for growth in home markets - STW's market share is below 10%. We are a leading player in a very large market – no impediments to growth
- Ability to consolidate knowledge and insights to benefit all group companies
- Allows us to provide clients with total solution to current and emerging communications needs



Continue to future proof the business by growing and diversifying our service offering.

- Client marketing spend will continue to evolve and STW will continue to evolve its service offering
- Advertising budget to marketing budget to customer experience budget
- STW has a well established digital offering. Market leading stand alone brands and integrated digital offerings within our large traditional agencies
- Build Data-Hub, coordinating STW data resources and leveraging 'big tech' partnerships in concert with STW Group clients
- Leverage tools and insights from international partners
- Consolidate STW Shopper offer to build scale in Australia – making STW by far the most important and powerful shopper business in the region



Take advantage of the opportunities afforded by South East Asia and beyond in exporting our businesses and skills into fast growing markets and gaining efficiencies back into Australia & New Zealand through low cost markets.

- Platform for growth established in South East Asia
- Looking to organically export home bred companies and IP to the region driven by client opportunities
- Low cost production and services remain a medium term focus
- Build Asia's pre-eminent digital network led by aleph&edge
- Solid base in place – now positioned to leverage assets and increase return on investment through organic growth

ACKNOWLEDGING OUR EVOLVING COMPETITIVE LANDSCAPE	TACKLING THE COMPETITIVE PRESSURES	OWNING THE FUTURE
<ul style="list-style-type: none">• Clients insourcing• More project work• Consultants/Big 4 Accounting Firms going digital• More desperate 'not for profit' competition• Frenemies – Google + Facebook• Programmatic buying• Automation	<ul style="list-style-type: none">• Creative excellence• Use Group scale to offer clients more holistic solution• OutCreate/OutHire/OutThink• Existing clients – best source of new business• No. 1 Player = partnership model• Help clients build their own• Own the automation tool – feed the machine	<ul style="list-style-type: none">• Be where the money is going to be• Content• Scale• Efficiency• Brilliance of execution• ROI• Partner with best clients, best tech, best global• Innovation culture• Talent magnet

**CONTINUING TO BUILD AN AGILE, DIVERSE,
SCALED, SUSTAINABLE AND GROWING BUSINESS**

**RIGHT STRATEGY.
BETTER EXECUTION!**

RIGHT STRATEGY. BETTER EXECUTION.

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- a) **CLOSER/DEEPER OVERSIGHT:** New Executive Council (EXCO) Structure
- b) **ORGANIC GROWTH DRIVE:** New organizational design allows better capture of available revenue
- c) **PORTFOLIO RATIONALISATION/OPTIMISATION:** Gain efficiencies and better leverage inherent scale of group
- d) **FINANCIAL INCENTIVISATION:** New reward structure to better leverage opportunities across Group companies
- e) **TALENT PROGRAM:** Acquisition/retention – a big opportunity. Appointment of a Chief Talent Officer
- f) **COST OUT PROGRAM:** Consolidation of back office/procurement advantage/head office recalibration
- g) **MAXIMISE FREE CASH FLOW:** Improved cash flow conversion
- h) **DEBT REDUCTION PLAN:** Clear path to return to internal leverage targets by December 2016
- i) **IMPROVED DEBT COVENANTS:** Revised definition increases head room

**A NEW LEADERSHIP STRUCTURE
TO ENABLE CLOSER OVERSIGHT,
DEEPER ENGAGEMENT AND
BETTER LEVERAGE ACROSS
THE GROUP.**

THE EXECUTIVE COUNCIL (EXCO)

- Leadership now provided by a newly formed (EXCO)
- Every company reports to an EXCO member
- STW's new operational structure results in closer, deeper oversight of the companies
- This will allow us to better leverage our scale and result in far better synergies across the Group
- Every EXCO member has a day job – ie. no extra overhead
- EXCO incentivised by performance based scheme funded out of growth
- Every EXCO member has deep knowledge and expertise in that company's discipline and provides guidance and thought leadership
- Close Financial Management provided by STW Group Finance over operating companies

THE EXECUTIVE COUNCIL (EXCO)

MIKE CONNAGHAN, CEO



MICHAEL CONNAGHAN	ROSE HERCEG	DAVID FOX	STEVE HARRIS	JAMES PIKE	KIERAN MOORE	SVEN BAKER	ALEX CAMPBELL	GAVIN DUNN	JUSTIN DI LOLLO
STW Advertising & Media	STW Data & Digital Labs	STW Shopper & Activation	STW Production & Content	STW Insights & Research	STW Public Affairs	Strategic Design & STW New Zealand	STW Asia & Technology	STW Talent & Training	STW Internal Communications & Government Business

FINANCE PARTNERS – DOMAIN EXPERTS REPORTING TO LUKAS AVIANI, CFO



THE EXECUTIVE COUNCIL (EXCO)

EXCO MEMBER	FOCUS AREA	DAY JOB
Mike Connaghan	Agencies (division)	STW, Chief Executive Officer
Rose Herceg	Data & Digital Labs (growth area)	STW, Chief Strategy Officer
David Fox	Shopper & Activation (growth area)	Ogilvy, Chief Executive Officer
Steve Harris	Production & Content (growth area)	The Brand Agency, Chief Executive Officer
James Pike	Insights & Research (growth area)	Added Value, Managing Director
Kieran Moore	Public Affairs (growth area)	Ogilvy Public Relations, Chief Executive Officer
Sven Baker	Strategic Design & STW New Zealand (growth area)	Designworks, Chairman & Chief Executive Officer
Alex Campbell	Asia & Technology (growth area)	STW, Business Director South East Asia
Gavin Dunn	Talent & Training	Phuel, Managing Director
Justin Di Lollo	Internal Communications & Government Business	Hawker Britton, Director
Lukas Aviani	Services (division)	STW, Chief Financial Officer
Chris Rollinson	Investor Relations & Shared Services	STW, Company Secretary
Rob McLachlan	Shared Services	STW, Finance Director Research Division
TBC	Chief Revenue Officer	TBC

REVENUE GROWTH

- STW Group client list is second to none
- Big Local – Best International
- Organic growth with existing clients remains a massive opportunity
- New EXCO structure designed not only for closer/deeper oversight – but to better enable existing client revenue capture
- Appointment of Chief Revenue Officer
 - Hunt sizeable new opportunities – broaden group client touch points
 - Build bespoke teams in response to client demand

PORTFOLIO RATIONALISATION

- Solid progress already achieved toward our goal of fewer/bigger/better businesses
- Taking full advantage of talent/scale/insights/tools we believe bringing select STW Group companies closer together represents a significant growth opportunity
- Aleph/Edge in South East Asia – region’s largest digital native business
- Creation of Ikon Sydney Group – merger of Moon/Shift in to Ikon creating media led powerful new full service agency
- Divestments of non core assets
- Creation of STW Shopper Agency offering
- Four more projects in progress – announcements imminent
- Combination of consolidation of big agency brands and optimization/merger of others means by end FY15 portfolio = <50 opcos

NEW INCENTIVE PROGRAM TO MAXIMISE GROUP OPPORTUNITY

- STW 'touch points' growth from existing clients has relied on business sense and goodwill
- As we have grown and diversified we believe now is the time to better align rewards to incentivise all levels of the organisation to farm opportunities for other group companies

Implementing a new incentive structure to drive delivery of group scale and diversification benefits:

- EXCO member and individual company programs
- EXCO incentives will be equity based with retention obligations
- Payment of incentives will be subject to overall group performance (ie appropriate sharing of out-performance with shareholders and STW performers)
- Alignment between rewarding our people for group contribution and delivering for shareholders is key

STW: A PEOPLE BUSINESS

- Talent: Retention and development a major battle ground
- Chief Talent Officer: Appointment of Gavin Dunn. Key role in EXCO structure
- Circa 3,500 employees group wide
- Annual employee cost base = \$250m
- Will reduce STW's significant recruitment, training and severance costs
- STW Group is a collection of many businesses from different sectors – complex task but the opportunity is significant
- Centralise recruitment
- Induction and On Boarding Program
- Market mapping and benchmarking our internal talent with the external market
- Evolve STW 'Spur' Training Program to STW Business Communications School
- Further invest in STW High Performers and Graduate Program
- Establish platform to better utilize resource capacity across STW Group
- Freelance/contractor accreditation program

FINANCIAL OBJECTIVES



5 key financial objectives:

1. **Immediate cost out:** Identified and substantially implemented
2. **Operational efficiencies:** Extracting economies of scale, ongoing cost efficiencies
3. **Operating cash flow:** Converting earnings into cash flow
4. **Financial strength:** Debt covenants revised and near term deleveraging
5. **Dividend policy:** Balancing shareholder returns and debt reduction

1. IMMEDIATE COST OUT – AREAS OF FOCUS

Immediate focus of strategic review covered following categories:

- **Operational efficiencies:** Cost reductions and other initiatives identified within individual business units.
- **Property rationalization:** Consolidation of property footprint and co-location of selected business units into Campuses.
- **Back Office Consolidation:** Consolidation of duplicated operating infrastructure between business units.
- **Streamlined Head Office and Shared Service Centre:** Opportunities for savings through the restructure of head office resources.

1. IMMEDIATE COST OUT – SIGNIFICANT SAVINGS IMPLEMENTED

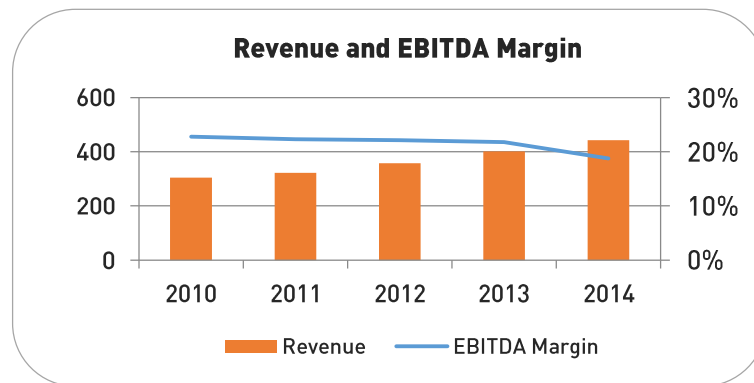
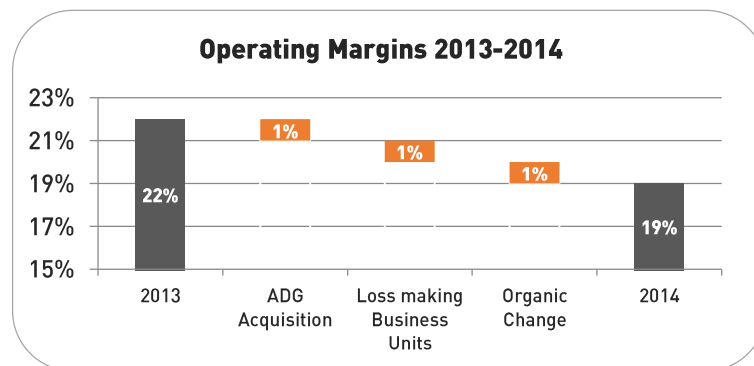
Action underway to reduce costs targeting \$6.9 million in annualised pre-tax savings - one-off implementation pre-tax costs of \$6.2 million

Cost Category	One off Cost to Implement pre-tax (\$ million)	Annualised Savings pre-tax (\$ million)	Status
Operational Efficiencies (within business units)	\$1.3	\$2.0	In progress – 80% complete. To be completed in Q2 15
Property Rationalisation	\$2.5	\$1.1	Identified and to be delivered H2 2015
Back Office Consolidation	\$1.2	\$1.7	Identified – to be implemented in Q2/Q3
Streamlined Head Office and Shared Service Centre	\$1.2	\$2.1	Identified – 80% implemented. To be completed in Q2
TOTAL	\$6.2 pre-tax	\$6.9 pre-tax	

- All one off costs to implement the restructure will be incurred in 2015 with the majority of costs expected to impact 1H 2015.
- Savings will commence in 2H of CY2015. Full run rate benefit from 1 January 2016.

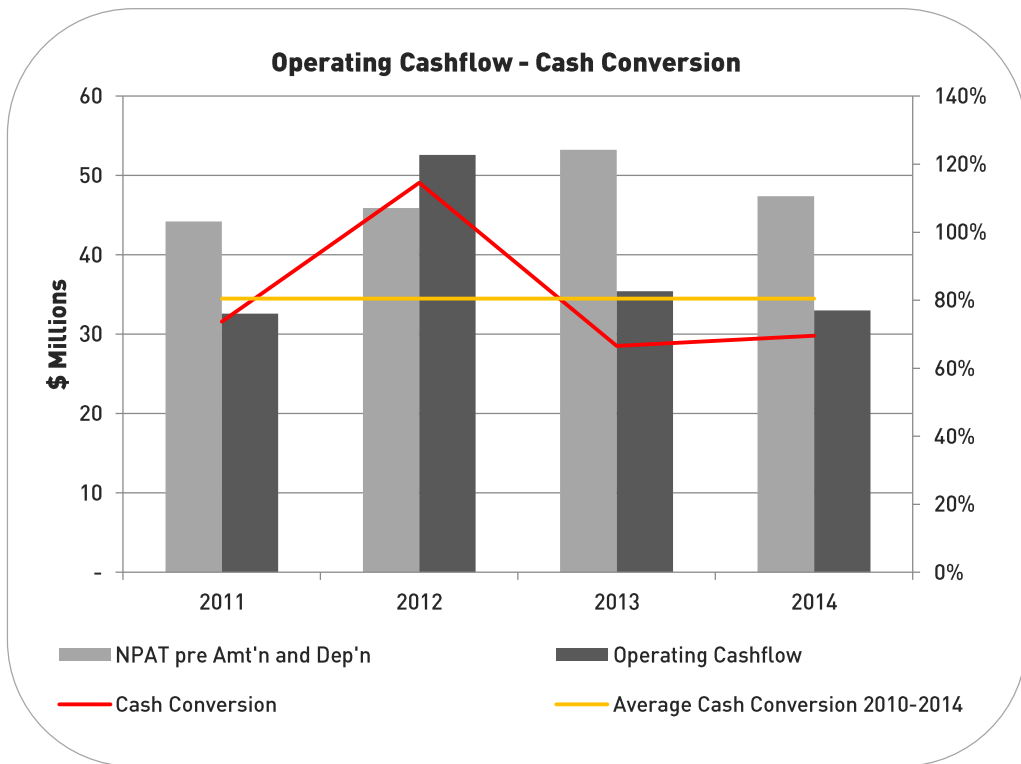
2. OPERATIONAL EFFICIENCIES – SUSTAINING STRONG MARGINS

- Operating margins of 19% in CY2014 reflecting the impact on business mix from the acquisition of Active Display Group, loss making business and client and competitor pressures
- Our focus is on maintaining strong operating margins and ongoing cost efficiencies
- Ongoing initiatives include:
 - Increased oversight from finance to deliver direct margin objectives
 - Real time information systems and controls driving better decisions
 - Structure – fewer, bigger businesses delivering scale efficiencies
 - Offshore low cost delivery of production and back office functions
 - Improvement of underperforming entities margin
 - Increased focus on procurement efficiencies delivering greater value from our scale
- STW total cost base is circa \$350 million



3. OPERATING CASH FLOW: CONVERTING EARNINGS INTO CASH FLOW

- Targeting improved cash conversion (operating cash flow / NPAT pre depreciation and amortisation) closer to 100%
- Cash conversion was 70% in CY2014 mainly due to the loss of a number of media accounts
- Improvements in cash conversion driven by
 - Real time reporting on debtors and days sales outstanding
 - Better management of payables through leveraging scale
 - Closer oversight of client receivables through empowerment of finance team
 - Cash collections and working capital management becomes a whole of business focus area
 - Finance partners to drive top level overview

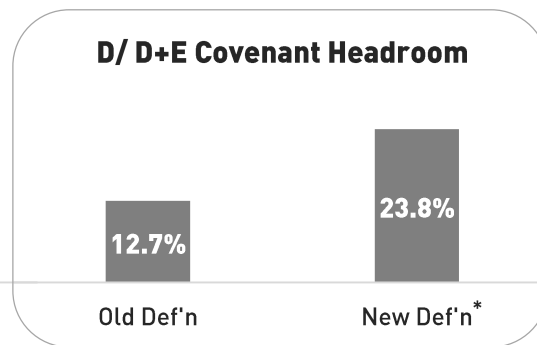
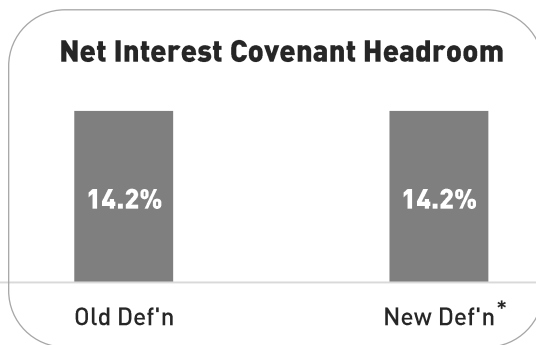
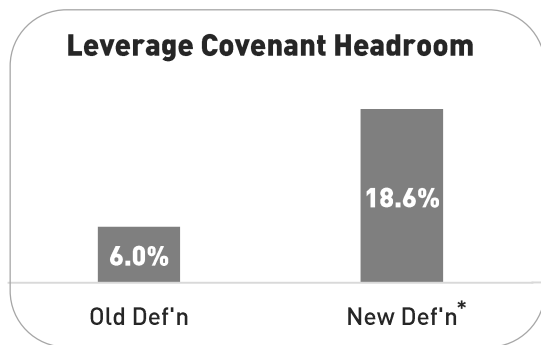


4. FINANCIAL FLEXIBILITY – COVENANTS

We have agreed new covenant definitions with our banks to better reflect current market practice

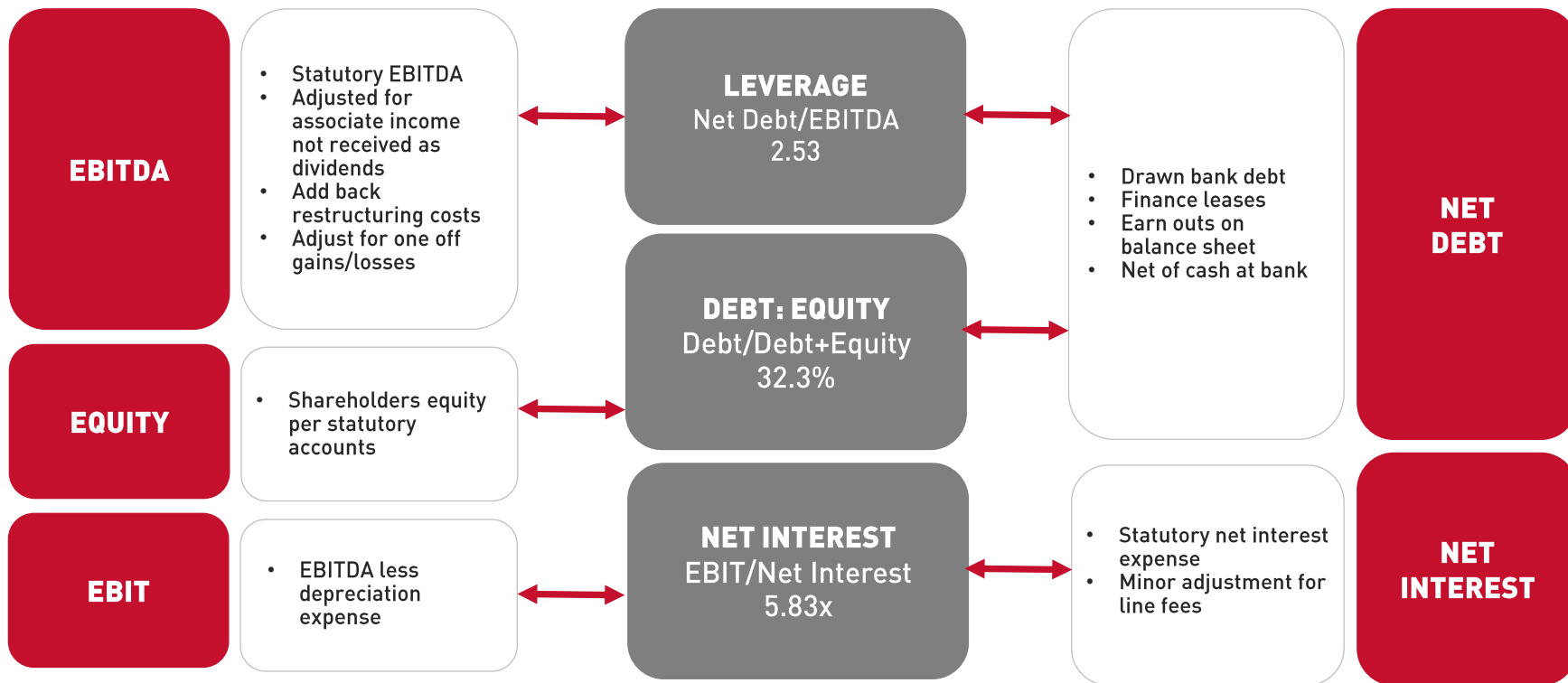
- Definition of Debt now excludes off balance sheet property guarantees (\$14.5m - Dec 14)
- Definition of Debt now measured on a net of cash basis (Cash balance \$19.9m - Dec 14). Previously Debt was measured on a gross basis
- One off and restructure costs are excluded from definition of EBIT and EBITDA for covenant calculations
- Impairment charges are excluded from definition of EBIT and EBITDA for covenant calculations

	Calculation	Covenant	Dec 14 As Reported	Dec 14 Pro-forma Adjusted
Leverage	Debt/EBITDA	< 3.0 times	2.83x	2.53x
Interest Cover	EBIT / Net Interest	> 5.0 times	5.83x	5.83x
Debt: Equity	Debt / Debt + Equity	< 40.0%	35.5%	32.3%

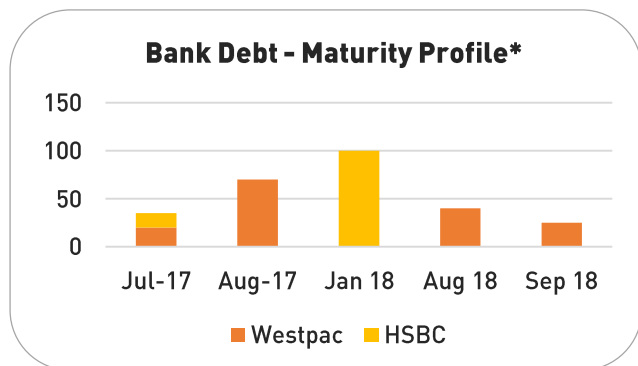
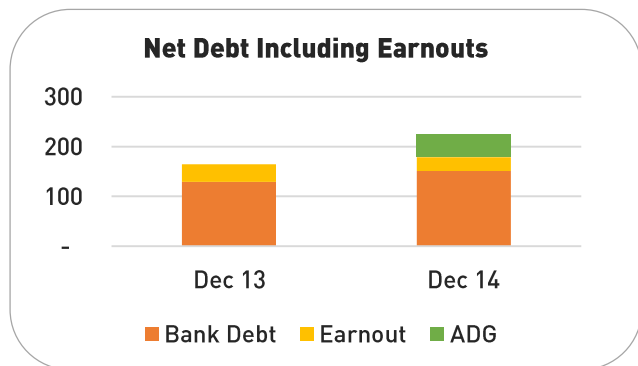


*Based on 31 Dec 2014 pro forma position

4. FINANCIAL FLEXIBILITY – EXPLAINING HOW OUR NEW COVENANT DEFINITIONS WORK (PRO FORMA DEC 14)



4. FINANCIAL FLEXIBILITY – DEBT FACILITIES



*Maturity profile on basis of termed out Aug 2016 facility

Debt Facilities

- Core debt facilities of \$270 million (excluding bank guarantees, leases)
- Debt facilities increased in 2014 to fund the ADG acquisition
- Internal target leverage ratio of 1.5 to 2.0 times Net Debt / Statutory EBITDA. At 2.5 times as at 31 Dec 2014, reflecting ADG acquisition.
- Weighted average maturity of 27 months (31 months post term out)
- Net debt includes earn outs of \$31.7 million at 31 Dec 2014 – subject to earnings performance
- Looking to implement receivables finance facility during 2015

MATURITY	\$M
August 2016	\$70 *
July 2017	\$35
January 2018	\$100
August 2018	\$40
September 2018	\$25
Total Group Facilities	\$270

* Debt of \$70 million maturing in August 2016 has a term out option to extend the maturity of the debt for an additional 12 months to August 2017.

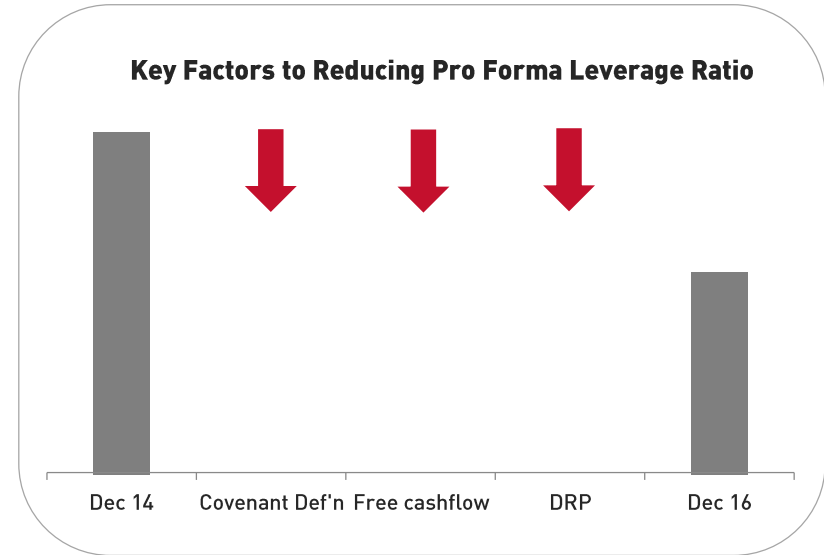
4. FINANCIAL STRENGTH – CLEAR PATH TO DELEVERAGING

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- Internal target leverage ratio of 1.5 to 2.0 times (Net Debt to statutory EBITDA)
- Objective is to be sub 2.0 times by Dec 16.

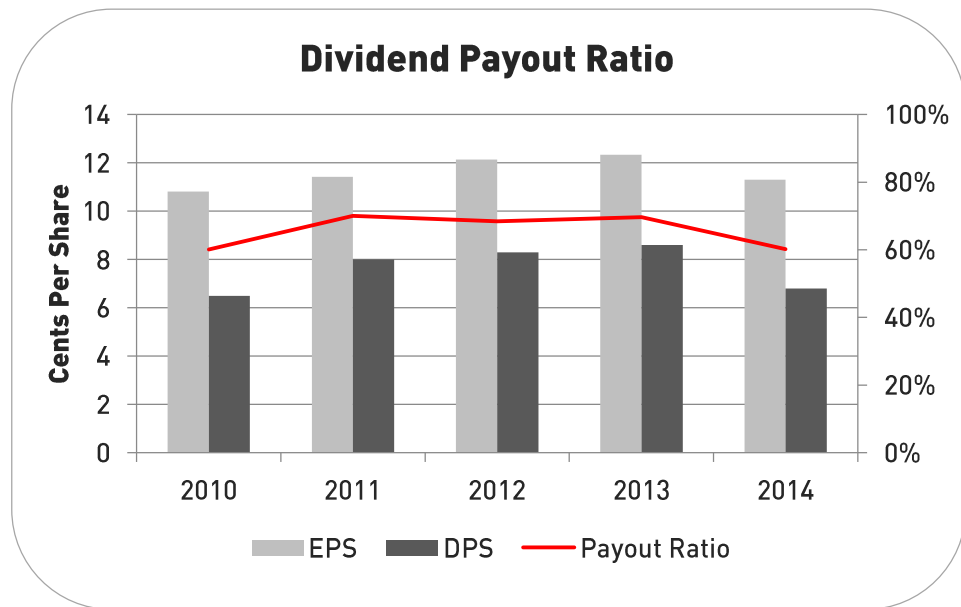
Key assumptions of the plan to return the leverage ratio to within the target range:

- Maintain dividend payout ratio of 60%-70% of net profit after tax
- DRP in place at current discount of 2.5%
- No net new acquisitions
- Emphasise organic business performance
- Fixed asset renewal at <80% of depreciation
- Focus on free cash flow and reducing working capital



5. DIVIDEND POLICY : BALANCING SHAREHOLDER RETURNS AND DEBT REDUCTION

- STW's target dividend payout ratio is 60%-70% of earnings
- Dividend reinvestment plan to remain in place at the current discount of 2.5%
- Historical take up of the DRP has been circa 50% of total shares on issue
- Board will balance dividends against actual results, outlook and need to reduce debt




PROGRESS



**RIGHT STRATEGY.
BETTER EXECUTION.**

**A GROUP FIT FOR TODAY'S
REALITY AND TOMORROW'S
POSSIBILITIES.**

SCORECARD: PROGRESS TO DATE

CLOSER/DEEPER OVERSIGHT OF GROUP COMPANIES	<ul style="list-style-type: none"> • Creation of EXCO • Deeper engagement, better leverage • Stronger STW Group finance management of operating companies (freedom within a framework) 	
CAPITAL MANAGEMENT/DEBT	<ul style="list-style-type: none"> • Agreed improved banking covenants • Free cash flow maximization program • No net new acquisitions • DRP maintained • Target dividend payout ratio maintained • Clear path to return to internal leverage targets by December 2016 	Underway
\$6.9 MILLION IMMEDIATE COST OUT/ANNUALIZED SAVINGS	<ul style="list-style-type: none"> • Clear dead wood • Operational efficiencies • Property rationalization • Streamlined head office and shared service centre • Further opportunities beyond immediate initiatives 	Underway
FEWER, BIGGER, BETTER BUSINESSES	<ul style="list-style-type: none"> • Close/divest non-core assets • Aleph/Edge Asia consolidation • Creation of Ikon Group Sydney – Shift/Moon/Ikon • Further opportunities in Design/Production/Shopper 	Underway
APPOINTMENT OF STW TALENT OFFICER	<ul style="list-style-type: none"> • Reboot SPUR – creating STW Business School • Focus on talent retention/acquisition/development • Develop platform to drive cost efficiencies in recruitment 	Underway
REVENUE GROWTH FOCUS	<ul style="list-style-type: none"> • EXCO – capturing more Group revenue opportunities • Chief Revenue Officer • Focus on growth sectors – shopper, data, offshore 	Underway
NEW GROUP WIDE INCENTIVE SCHEME	<ul style="list-style-type: none"> • Promotion of partnership focus across group companies • Client revenue capture and leverage group resources • Growth funded 	WIP

THE WAY FORWARD

RIGHT STRATEGY

DIVERSITY

SCALE

SHOPPER

DATA

OFFSHORE

RIGHT EXECUTION

LEVERAGE
GROUP
SCALE

EXCO

COST OUT

BALANCE
SHEET
RENEWAL

PORTFOLIO
RATIONALI-
-SATION

IDEAS **S** 
CREATE **T**
GROWTH **W**