SERVCORP LIMITED
ABN 97 089 222 506

CHAIRMAN'S ADDRESS
2018 ANNUAL GENERAL MEETING

ADDRESS BY MR BRUCE CORLETT AM

CHAIRMAN, SERVCORP LIMITED

15 NOVEMBER 2018

Ladies and Gentlemen,

As you are doubtless aware, the flexible workspace industry (as it is now known) has seen unprecedented change over the past two years. This disruption in the commercial real estate market has impacted Servcorp's short term performance in some markets; the upside is, that what historically was a niche market is now very much a mainstream market.

These changes are challenging, but we feel we have a unique opportunity to capitalise on them as the overall market will grow, but with orientation to flexible workspace. We believe there will be a growing demand for business-oriented space and related quality services, and given our positioning as the premium business provider we are confident there will be more opportunity after the initial period of disruption.

Results

Revenue for the year was $314.4 million, a decrease of 5% on 2017. Net profit before tax was $32.1 million, a decrease of 33%. Net profit after tax was $10.1 million, resulting in earnings per share of 10.2 cents.

Net profit before tax was impacted by more than $5 million of one-off expenses incurred relating to strategic initiatives. In addition to this, net profit after tax was also affected by a one-off, non-cash $13 million adjustment relating to the USA deferred tax asset. Excluding these significant, one-off items, which do not reflect the real operating performance of our business, underlying net profit before tax and net profit after tax were $37.9 million and $28.9 million respectively.

Servcorp's financial strength underpins its success. During the 2018 financial year, the business generated strong net operating cash surpluses of $50.1 million. Cash and investment balances at 30 June 2018 were $104.8 million, a decrease of 12% on 2017; $97.1 million of this balance was unencumbered and the Company has negligible debt.

These cash balances were after significant cash outflows during the year, including:

- more than $5 million for strategic initiatives, which I will discuss later in my address;
- $7.3 million on a share buy-back program conducted in the second half of the financial year, during which the Company acquired 1.6 million shares; and
- approximately $18 million invested in modernising our current fit-outs to incorporate coworking as an integral piece. This is an ongoing investment program and there has been continued upgrading of more floors since June 2018.

Unencumbered cash balances as at 14 November are approximately $73.0 million.

In October, the Company paid a final dividend of 13.0 cents per share, franked to 25%, bringing total dividends for the 2018 financial year to 26.0 cents per share; resulting in a payout to shareholders of approximately $25.4 million.

Industry Strategic Review

In response to the emergence of new and well-funded disruptive players in flexible office workspace, we undertook a major review and carried out restructuring initiatives in the 2018 financial year. These initiatives included a comprehensive industry review that identified the new trends, and considered the future implications for both service providers like Servcorp and for major global commercial property owners. The review included assessment of our extensive operating system platforms for property management, communication services and related infrastructure, and for the communities already existing within the Servcorp client base. The review identified significant competitive and valuable capabilities relevant for both our existing business and for the new direction of this changing market sector.

In conjunction, we considered the ability of selected regional areas to be ready for future transactions possibly involving external parties, and we carried out a series of internal tasks to substantially improve our ability to be agile and ready for new initiatives.

We undertook this strategic work to improve our future readiness; the related costs have been expensed in the 2018 financial year results.

The US Operations

The US is challenging, and we continue to work hard to achieve a stable operating performance. We must respond to the shifting market dynamics and be focused and diligent in our customer facing activities. We have a new leadership team in place who are working to improve office utilisation levels and the delivery of our range of services.

We have been conservative and prudent in writing off the related deferred tax assets and will continue to be conservative as we take a longer-term view to this market. This is a not an easy task and needs time and care.

Marcus Moufarrige and Taine Moufarrige

Last week, the Company announced the resignations of Marcus Moufarrige and Taine Moufarrige as Executives. Taine has also resigned as a Director of Servcorp Limited.

They are leaving to further develop their careers, and we wish them both all the best with their future endeavours.

The Board thanks Marcus and Taine for their invaluable contribution over more than 20 years. Marcus has had leading roles in the business, most recently in the USA, and has been largely responsible for design of the workspace platform and Community that support Servcorp's business; Taine has played a key role in building Servcorp's business, especially across the Middle East, and in other regions.

Marcus and Taine have left a skilled and competent management team in place in their regions, and our strong team of global General Managers covering Australia, Southeast Asia, Japan and the Middle East have all been with Servcorp for in excess of 15 years.

The CEO will take a more active role in the business operations in the USA and the Middle East.

Outlook

This takes me to the outlook for the 2019 financial year.

When we released our 2018 financial year results in August, we forecast that net profit before tax would be between $34 million and $40 million in the 2019 financial year. New floor operating losses are included in this forecast and are expected to be between $4 million and $5 million. We are committed to sound commercial practice, including generating regular and recurring net operating cash flow, which in the 2019 financial year is expected to exceed $50 million.

Trading for the first quarter of the current financial year is generally in line with expectations.

Accordingly, we confirm our 2019 financial year guidance of net profit before tax between $34 million and $40 million, subject as always to currencies remaining constant, global financial markets remaining stable and no unforeseen circumstances.

Modernisation

As I have mentioned, the flexible workspace industry is undergoing unprecedented change and the commercial real estate landlords are also facing significant disruption.

As a leader in the workspace industry, Servcorp is transitioning with these changes. Our investment in reshaping our global portfolio to modernise current fit-outs and enhance our coworking offering is progressing. We have completed, or are in the final stages of completing, more than 80 locations at a total cost of $32.0 million and have continued our investment into the 2019 financial year.

This new flexible coworking space category is already selling well and has created an important new revenue stream. Given this success, we have accelerated the modernisation program, and in the past month approximately 20 additional floors have been identified for modernisation with more floors being evaluated. Depending on the final selection of floors, we estimate an additional investment of between $10 million and $20 million over the next 12 months.

In addition to modernisation, Servcorp has committed to spend approximately $22.0 million in opening new floors and to the expansion of current floors; new floors include Osaka (which opened in August 2018) and three large floors in Riyadh, Tokyo and Berlin.

Dividends

I now turn to dividends.

At the time of the release of our 2018 full year results, Directors anticipated the level of dividends for the 2019 financial year would be 26.0 cents per share, representing 13.0 cents per share in each half.

Having strong cash balances positions Servcorp to take advantage of opportunities should they arise, particularly in disrupted markets. Accordingly, having committed to additional investment in modernisation, which so far has shown promising returns, and recognising the importance of a strong financial position, the Directors consider it commercially prudent to reduce the anticipated dividend payment that shareholders will receive with respect to the second half of the 2019 financial year (payable in October 2019).

This will enable Servcorp to continue to reinvest in the long-term future of this business. It will also provide greater flexibility to weather the heightened competition and take advantage of our many strengths.

Directors anticipate an interim dividend of 13.0 cents per share in respect of the first half of the 2019 financial year, and a final dividend of 8.0 cents per share in respect of the second half of the 2019 financial year. At this stage, franking levels are uncertain.

Dividend projections are always subject to unforeseen circumstances, and we will continue to assess our position over the coming years, whilst always ensuring we retain strong net cash balances.

Close

On behalf of the Board, I want to acknowledge the outstanding efforts of our CEO, Alf Moufarrige, and our leadership group and all the Servcorp team members for their dedication and commitment during the past year that has been challenging.

We remain optimistic due to our unique strategic positioning, global reach, technology platform, longstanding track record, impressive cash generation and strong net cash position. These all reinforce our confidence in Servcorp's potential to drive long-term returns for our shareholders, and maintain our position as the world's premium provider of Workspace Solutions.

We thank you, our shareholders, for your continuing support. We look to the future with optimism.