Experian Half-Yearly Results Bond Investors' Call – 17 November 2010

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1. Introduction

Good afternoon everyone, and welcome to Experian's Interim Results call for our bond investors. I will start today's call with a brief strategic and operational review. I will then take you through the financial performance. Following that, we will take your questions.

2. First-Half Highlights

Overview

In the first half of the financial year, total revenue growth was 8% and organic revenue growth was 7%. This is our best organic revenue performance in four years. EBIT margin was a little better than we expected, progressing by 10 basis points to 24.3% helping deliver continued EBIT growth of 8%. We've delivered double-digit growth in benchmark PBT which increased by 12%, and benchmark EPS was up by 10%. We've increased our interim dividend by 29% to 9 cents, consistent with our new payout policy of approximately 40% of earnings. We have spent a net $1.47m on repurchasing shares in the half. Overall, this was a strong financial performance.

North America

Now let us take a brief look at our strategic progress in each of the regions, starting with North America. North America delivered 6% organic revenue growth. The big story was a return to positive organic revenue growth in Credit Services in the second quarter, ahead of our expectations. The financial services industry is in the early stages of recovery and we're seeing a gradual improvement in credit originations as clients return to modest growth. We've also seen a return to strong growth in our Marketing Services business, much of which relates to the repositioning we've undertaken into digital channels.

Growth in North America Interactive was 9%, driven by strong performance in lead generation particularly in the education vertical. Our Consumer Direct revenue was broadly flat, and in line with our guidance, as we continue to make good progress on the transition to a new marketing brand. Our performance on Consumer Direct is now augmented by the recent acquisition of Mighty Net. The acquisition of Mighty Net provides Experian with two key marketing brands, CreditReport.com and CreditScore.com, and is consistent with Experian's strategy of operating a portfolio of consumer brands which appeal to a broader base of consumers and expand the addressable market for Experian products.

Latin America

Latin American market conditions remain very favourable, and our business grew by 22%, bolstered by exceptional growth in authentication services. Low unemployment and increases in real income are driving further expansion of the middle class. Applications for credit by both businesses and consumers are rising, and the available range of credit products is growing. These factors provide secular support for sustained growth across our businesses. We are also now starting to see the benefits of offering the full-range of Experian products in this huge, fast-growing market with strong growth in Marketing Services and Decision Analytics, although from a small base.

United Kingdom

Here our business has stabilised, with organic revenue improving in the second quarter and flat for the half. The financial services sector continues to bump along the bottom and lending levels remain depressed. However, there are early signs that some lenders are planning for growth next year as the quality of recent credit vintages improves. The situation is very similar to what we experienced in the US six months ago, and as we said in May, we expect to exit the year in positive growth in UK credit services.

In the marketing sector, clients are back spending with greater emphasis on digital media. It is still too early to say how the UK government's austerity measures will play out, but I will remind you that most of our work with the government is aimed at reducing fraud and providing greater efficiencies, so we see good opportunities taking shape in some parts of our business.

EMEA / Asia Pacific

Revenue grew by 4%. Conditions in most Asian markets have strengthened, and we are seeing good demand for Marketing Services as we gain traction across the region. Experian Asia Pacific is on track to deliver $150m in revenue in this financial year.

While other developed markets in Europe remain very sluggish, emerging markets, including South Africa, Russia and Turkey, are growing strongly.

3. Strategic and Operational Review

Secular Drivers of Long Term Growth

Our clients are facing tighter scrutiny, more regulations and a demand for greater transparency about their business processes. These in turn create new business opportunities for Experian centred on our core discipline of data and analytics.

Secondly, the addressable market for our business is expanding. Telecoms, utilities, insurance and other sectors have ever-growing needs for sophisticated segmentation, efficiency and fraud prevention tools. We can satisfy this demand.

Thirdly, there is a growing need for sophisticated risk-management services in emerging markets, which as a global leader, we are well-positioned to provide.

Fourth, Marketing Services' secular shift to digital channels is accelerating, driving a greater need for real-time delivery of data and analytics. We are very well-positioned to lead in this market.

Finally, consumers are becoming more directly engaged in understanding what data is maintained about them, how that data is used and how to best to protect their identity and privacy. This growing consumer awareness creates new opportunities in our Interactive businesses as well as across our other principal activities.

Global Growth Programmes

This is about growing strategically, profitably and consistently within the framework we have previously outlined, focusing on data and analytics and the wise use of capital to drive growth. We are investing both in capex and through the P & L on innovation, on expanding geographically and on maximising opportunities in new consumer segments.

Each of the identified opportunities is material in its own right with an estimated incremental revenue opportunity of up to $100m per initiative over the next three to five years, a minimum requirement for it to be on that list.

We are off to a fast start based on our first-half performance, and we now expect to deliver a contribution to organic revenue of over 2% for the year as a whole.

4. Financial Review

Revenue and EBIT by Geography

Organic review growth of 7% reflected an excellent performance in Latin America, good growth in North America and modest progress in EMEA/Asia Pacific. UK/Ireland made steady progress through the half, to end flat year-on-year. Total revenue growth of 8% translated into EBIT growth of continuing activities of 8%. There was very strong margin improvement in Latin America while the UK margin increased slightly. This helped offset declines in North America and EMEA/Asia Pacific. The overall margin increased by ten basis points to 24.3%.

Organic Revenue Growth Trends by Business Segments

We have seen a marked improvement in Credit Services. Decision Analytics turned positive in the most recent quarter and there are early signs of some improvement in activity. We've seen a significant pick-up in growth in Marketing Services as the re-positioned business demonstrated its ability to exploit the improved market conditions. The growth rate in Interactive has moderated this year as we execute the brand transition of our North American consumer direct business.

Organic Revenue Growth Trends in Credit Services

In underlying sales growth trends in Credit Services, North America, which is the largest region in the segment, turned positive in the second quarter after 11 consecutive negative quarters, dating back to the start of the credit crunch. In Latin America, recent quarters have seen a short-term boost from authentication revenue while underlying growth remains very strong. And while still negative in quarter 2, the UK and EMEA/Asia Pacific have been moving in a positive direction over the last two quarters.

5. Business Segments

Credit Services

Both the total and organic revenue growth was 6%. In North America, there was some recovery in both prospecting and origination revenue as the half progressed. In Latin America, growth reflected greater adoption of value-added products and further penetration of the SME channel. It also reflects a spike in authentication revenue which will not continue into the second half. In the UK, strong performances across new verticals helped offset on-going weakness in financial services. In EMEA/Asia Pacific, origination activity in developed markets was generally weak, but emerging markets, such as South Africa, performed well. Margins held steady at 33.8%. Strong growth in Latin America was offset by the impact of negative operating leverage elsewhere.

Decision Analytics

Total and organic revenue both declined by 1%. Growth in EMEA/Asia Pacific and Latin America helped offset declines elsewhere. Generally, strong demand for analytics helped offset weakness in transaction revenue and software sales. During the half, there was some improvement in activity levels and pipeline strength. The decline in EBIT margin reflects a negative mix effect from the differential analytics and transaction revenue trends.

Marketing Services

Total revenue grew by 15% and organic revenue by 10%. The difference relates mainly to the A-Care Systems and the United Mail Solutions digital marketing acquisitions. We were delighted to have delivered growth across all regions. Improving market conditions and new business wins drove high volumes, and we are benefiting from the mix shift to digital services. These factors drove a margin improvement of 440 basis points to 14.3% and EBIT growth of 70%.

Interactive

Both total and organic revenue grew by 9% in the half. There was a good performance in North America with organic revenue growth of 9%. Consumer Direct was broadly flat year-on-year in line with our earlier guidance. We expect a similar organic trend in the second half as we transition to new consumer brands. There was especially strong growth in lead generation, notably from the education vertical which we expect to moderate as we annualise strong comparatives. In the UK, organic revenue growth was 13%. Margin declined by 220 basis points to 19.9% primarily due to increased marketing spend and a negative mix effect from strong growth and lower margin lead generation activities.

Group Benchmark Earnings

Total EBIT was $484m which represents 10% growth at actual exchange rates. Interest was $34m reflecting lower average debt levels and a net pension credit. The benchmark tax charge in $98m is at a rate of 21.8% of benchmark PBT. The minority interest of $25m primarily relates to Serasa and reflects a continuing strong profitability in the stronger Brazilian real. This brings us down to benchmark earnings of $327m, an increase of 9% on last year. With the weighted number of average shares in issue reduced to 1,008m as a result of the share buyback programme, EPS was up by 10% at 32.4 cents.

Cash Flow

In the traditionally weaker half of the financial year for cash flow conversion, we converted 79% of the EBIT into operating cash. For the full year, we expect to convert our normal 90% or so. In the first half, capital expenditure of $144m was slightly higher than the depreciation charge of $140m. The working capital outflow of $107m reflects the first half impact of bonus and commission payments as well as increased debtors from the pick up in revenue growth which brings us to operating cash flow of $380m. Interest paid in that period was $34m and tax paid was $43m, just under 10% of PBT. Dividends paid to minorities were $25m, bringing us to free cash flow of $278m representing a cash conversion rate of 85% of benchmark earnings.

Net Debt

Closing net debt at the end of the first half was $1.89bn, up by $260m in the half. We started the year with net debt of just over $1.6bn. After free cash flow of $278m, exceptional cash outflow amounted to $18m, largely related to the balance of the cost efficiency programme. Net share purchases amounted to $147m. There was a net outflow of $226 from acquisitions, net of disposals, the majority of which related to the acquisition of Mighty Net. We paid the fiscal year '10 final dividend in the period of $161m. This takes us to net debt of just under $1.9bn at the end of the half.

Net Debt/EBITDA

For the Serasa put option, which increased by $72m to $733m during the half, we ended the period at the top end of our target debt range with net debt to EBITDA of two times. The second half will benefit from the $250m net proceeds from the FARES disposal as well as a seasonally stronger operating cash flow and lower dividend payments.

Capital Strategy

Our objective is to support the growth strategy of the business while maintaining a strong investment grade credit rating. Any surplus capital after meeting these objectives we will look to return to shareholders. We are very pleased that S & P reaffirmed our BBB+ rating recently and revised the outlook from 'stable' to 'positive'. We remain on target to complete the share buyback programme announced in May by the end of this fiscal year. This will amount to $350m, including an estimated $50m to satisfy employee share plans. During the half, there was a net spend of $147m on buybacks. The average price paid for the shares acquired was 621 pence, and we reduced the number of shares in circulation by 13.7m. Our refinancing programme remains on track. In the course of the next six months, we plan to replace our 2012 bank facility, and also to issue a further bond.

Modelling Considerations

We now expect net interest for the year to be in the region of $75m to $85m after small net pension credit. We anticipate a Benchmark tax rate for the full year in the region of 23%. We expect the weighted average number of shares for the full year to be around one billion. We continue to expect capex spend for the year in the range of $340m to $370m reflecting a step up in investment in the second half.

5. Conclusion

We are pleased to have delivered a strong performance in the first half of the year with 7% organic revenue growth and improved margins despite the number of cost challenges. Looking ahead to the full year, we expect similar organic revenue growth similar to the first half and modest improvement in margin despite stepping up investment in the business in the course of the second half.

We'll be happy to take your questions. I'm joined today by Peter Blyth, our Director of Corporate Finance, and Peg Smith from Investor Relations, who will participate in answering your questions.

Questions and Answers

Marco Morandi, MetLife

Good afternoon. You said the UK situation is currently better but you are looking at it as six-months behind the US. How are you looking for that for next year? Are you expecting the UK to come out at a similar pace as the US or is the stability still very low in that regard?

Paul Brooks

It is probably a little early to start talking about next year, and of course the mix of the business is a bit different, but I think it is true to say if we look at the credit related activities in relation to the financial services sector, we have seen a bit of a broad correlation between the behaviour of our US business and our UK business with a six to nine month lag. We have indicated that we expect by the end of this fiscal year, by around March 2011, we do expect to see the UK Credit Services business return to growth like the US Credit Services business has done this last quarter. We do see that as a trend, and I think some of the behaviour we are seeing from the banks in the UK now has some similarity obviously in the US six or nine months ago.

Marco Morandi

Thanks. You are obviously on a positive outlook with the S & P at the moment. Irrespective of what happens with that, is your target still BBB+? Is that fair to say?

Paul Brooks

Our target remains a strong investment grade credit rating, which we interpret as one and three quarters to two times EBITDA including the value of the Serasa put option within the value of net DA.

Marco Morandi

Thanks.

Norbert Ling, BNP Paribas

My question is regarding acquisition strategy. Going forward, do you look at small to mid-size acquisitions or are you looking at large acquisitions? This year's Mighty Net acquisition falls possibly in the small to medium category.

Paul Brooks

Certain acquisitions are part of the strategy but the sort of acquisitions we are looking at we would regard as smallish – certainly nothing transformational. I think the Serasa deal, which is the biggest deal we've done by some way, was really a bit of a one-off; it is a unique asset. There is no other credit bureau remotely that size so I would say, looking at our acquisitions pipeline at the moment, there is nothing enormous.

Norbert Ling

Regarding shareholder return, is there likely to be another shareholder buyback if the results turn out to be as on track as what you plan to be?

Paul Brooks

Obviously we have the residual share buybacks from the programme we announced in May which will take place during the second half to get us up to the $350m for this year. We will then take a view at the year end as to what would be appropriate for fiscal year '12. The things we will take account of are, obviously, the performance of the business and also what possible acquisitions there might be out there at that stage. They will form the decision we take at that point but it is really too early to anticipate that.

Thanks very much everybody for your interest on today's call. We look forward to speaking to you again at the year end. Thank you.