



**26 June 2019**

**ARQ GROUP (ASX: ARQ)**

**Arq Group – Investor Update - Broadcast Details**

Attached is a Transformation Update and Full Year Outlook announcement from Arq Group.

The Company advises that the Transformation Update and Full Year Outlook will be presented by the CEO, Mr Martin Mercer, via webcast at 10am on Wednesday, 26 June 2019.

Investors will be able to access the webcast to listen to the update from the CEO, Mr Mercer, via this URL link, <http://www.openbriefing.com/OB/3367.aspx>

**Or by dialling the below**

Participant toll: 02 9007 3187 (AU)

Participant toll-free: 1 800 558 698 (AU)

**Conference ID: 1000975**

An archive of the event will also be placed on the Investor Announcements page of our corporate website after the event.

**Anne Jordan**

Company Secretary

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**ENDS.**

**About Arq Group**

Arq Group, previously Melbourne IT Group, is Australia's leading digital solutions partner.

Arq Group is the dynamic space for smart thinkers. Creating unforgettable experiences, solving complex challenges, and providing seamless, end-to-end solutions – from design thinking to customer solutions, leading mobile, cloud and analytical insights, digital marketing to web design - Arq Group powers the growth of businesses, big and small.

Founded in 1996, Arq Group has evolved from the leading Australian domains and hosting business to a leading digital services partner. Today, the company builds and manages innovative channels to market for many of the country's largest enterprises, whilst simultaneously supporting half a million small businesses throughout their online journey.

Arq Group currently has approximately 850 employees, and offices in Melbourne, Sydney, Brisbane and Auckland.





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**ARQ GROUP (ASX: ARQ)**

## **Arq Group: Transformation Update and Full Year Outlook**

### **Transformation Update**

Arq Group is 12 months into an 18-month transformation from Melbourne IT. The rebranding to Arq Group in May 2018 was the beginning of a change programme that will progressively consolidate ten existing brands into two; Arq Group, the company's premium digital services brand servicing the mid-market and above; and Netregistry, a provider of complete online solutions to the small business market.

Today, as part of this merging of brands, the company is announcing an evolution of the Company's organisational structure. This includes a flattening and broadening of the current leadership that will bring us much closer to our customers, streamline decision making, improve execution, and create a scalable organisation design that will support future growth. Two senior roles have not been carried to the new structure, with those executives leaving the business.

### **Full Year Outlook**

Today the Group is also providing an update on the outlook for the remainder of the financial year, and guidance for the contribution from the Core operations.

At the beginning of this year the Group provided a new degree of disclosure on its historical results. Specifically, it split its P&L into two, one for the "Core Operations" and one for the "Non-core Operations" (essentially the Indirect part of its SMB division).

This presentation was a response to the considerable uncertainty about the future contribution from the Non-core Operations. This uncertainty was due to the pending sale of approximately half the Indirect business and the anticipated loss of a major customer contract in the remainder of the Indirect business – which was disclosed in August 2018, with the quantum and timing of the loss still uncertain in February 2019.

By presenting its results in this way, the Group wanted to help investors to better understand the historical contribution from the Core or ongoing operations, and the historical contribution from that part of the business that was going to reduce materially for the reasons set out above.

Today the Group is providing guidance for the Group and for the Core Operations.

The Group is forecasting underlying EBITDA in the range of \$22.0m to \$25.5m for FY19.





## **Core Operations**

The Core Operations are expected to generate between \$15.5m and \$18.5m of underlying EBITDA in FY19.

The SMB division is exceeding expectations and forecast underlying EBITDA will be in the range of \$9.7m to \$10.7m in FY19. This performance is the result of consistent growth in new solutions revenue and cost improvements from productivity initiatives.

The Enterprise division has fallen short of expectations in the first half and forecast underlying EBITDA will be in the range of \$12m to \$14.5m. This is due to execution issues in Melbourne and unexpected delays in turning on revenue from new contracts.

This is a temporary challenge. The recovery plan is well advanced for Melbourne and we are seeing the first signs of improving performance. In addition, revenue from delayed contracts will shortly start coming online. As a result, growth in Enterprise in H2 FY19 is forecast to be at least 45% higher than H2 FY18.

The Group has also provided an update on the progress of a number of cost reduction initiatives that are expected to deliver savings of \$4.1m in 2019 and annualised savings of \$7.8m.

## **Non-Core Operations**

The contribution from the Non-core Operations has become more certain following the sale of the TPP business and increasing certainty about the contribution from the remainder of the non-core operations. The Group expects that the non-core operations will contribute between \$6.5m and \$7.0m in EBITDA in FY19.

## **Debt and Dividend**

While our net leverage ratio is outside the desired range, we continue to operate within covenants.

Due to the lower than expected earnings in H1 FY19, the Group will not be declaring an interim dividend. The full-year dividend will be reassessed at December 2019 in line with Arq Group's stated dividend policy of returning between 55% to 75% of full year underlying NPAT to shareholders.

## **Conclusion**

The organisational changes implemented today will support future growth. Our recovery plan for Enterprise is also well advanced and, we're seeing improvements in Melbourne. We also expect the revenue from delayed contracts to come on stream in the Q3. Together with the ongoing recovery in SMB, the Group is expecting a stronger H2 FY19 performance.

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**ENDS.**





# **TRANSFORMATION UPDATE AND FY19 OUTLOOK**

## **INVESTOR PRESENTATION**

26 June 2019

**ARQ**  
group



# **Arq Group**

**Core Operations**

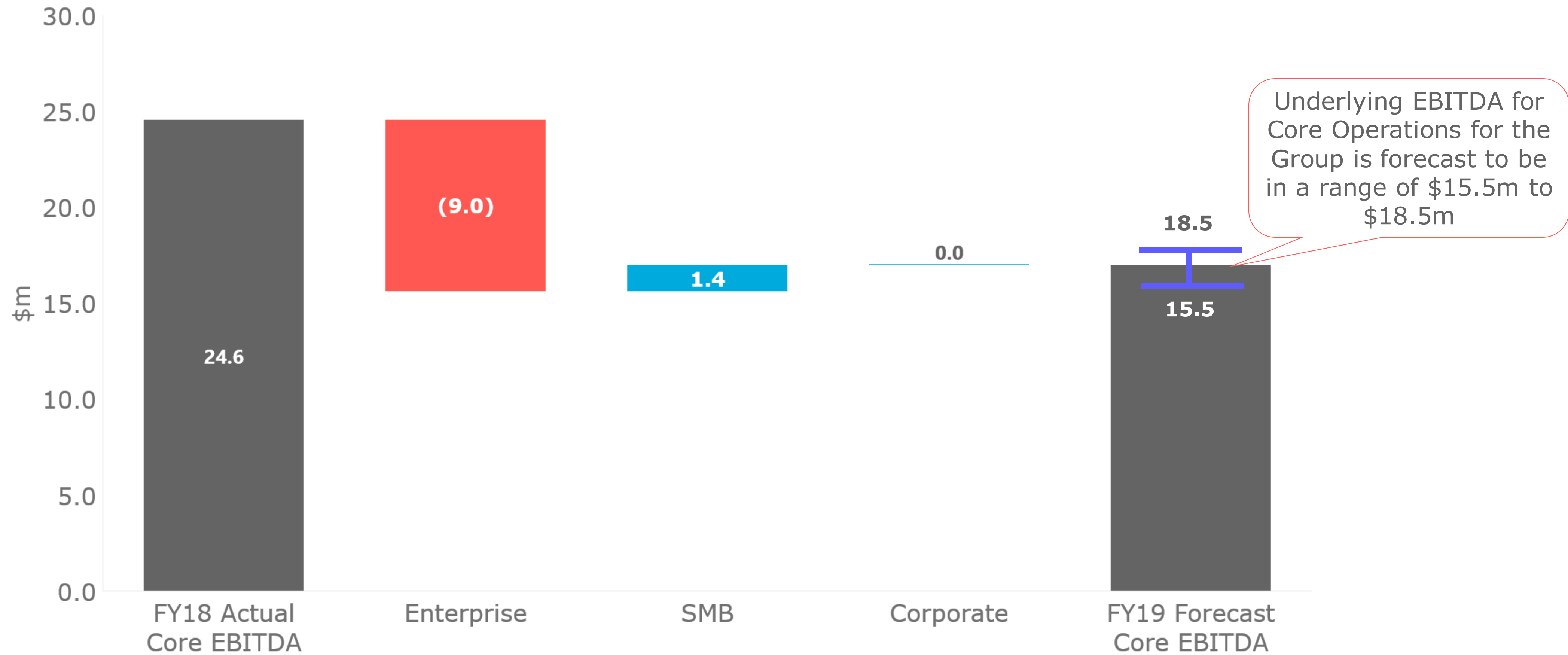


# Overview

- We are 12 months into an 18-month plan to transform the business into Arq Group. Some parts of the business are on track and others are not.
- The forecast underlying EBITDA for the Group for FY19 is expected to be in the range of \$22.0m to \$25.5m.
  - this consists of \$15.5M to \$18.5m from the Core Operations and \$6.5m to \$7.0m from the Non-Core Operations
- The forecast underlying EBITDA from the Core Operations for FY19 has been revised down to a range of \$15.5m to \$18.5m;
  - the forecast underlying EBITDA from the Core Operations for the first half is expected to be ~\$0.6m
- The SMB division is exceeding expectations and forecast underlying EBITDA will be in the range of \$9.7m to \$10.7m in FY19 (cf \$9.5M at May\*);
  - consistent growth in new solutions revenue and cost improvements from productivity initiatives
- The Enterprise division is falling short of expectations and forecast underlying EBITDA will be in the range of \$12m to \$14.5m in FY19 (cf \$24.2M at May\*);
  - unexpected delays in turning on revenue from new contracts and executional issues in Melbourne, that are being addressed.
- Cost reduction initiatives are expected to deliver savings of \$4.1m in 2019 and annualised savings of \$7.8m.
- Organisational changes are also being implemented that will bring us closer to our customers, improve execution, and create a scalable model to support growth
  - as a result of this re-organisation 2 senior executives will be leaving the business
- Our net leverage ratio is outside of our desired range, but we continue to operate within covenants.
- Due to the lower than expected earnings during H1 FY19, the Group will not be declaring an interim dividend;
  - the full-year dividend will be reassessed at December 2019 in line with Arq Group's stated dividend policy of returning between 55% to 75% of full year underlying NPAT to shareholders.

\* The company provided an update on the outlook for each of Enterprise and SMB at the AGM in May, these underlying EBITDA numbers could be inferred from that outlook statement

# Group Core Underlying EBITDA: FY18 vs FY19



Underlying EBITDA for Core Operations for the Group is forecast to be in a range of \$15.5m to \$18.5m

The chart above presents the expected movement in Underlying EBITDA for the Core Operations from FY18 to FY19. Movements for forecast periods presented above reflect the midpoint of the expected range of outcomes for the FY19 outlook.

# FY19 Outlook: changes from May outlook

The changes to May forecast assumptions and their impact are set out in the table below.

| Description  | EBITDA impact (\$m) | Notes   |
|--|---------------------|---|
| <b>ENTERPRISE</b>  |                     |   |
| <b>Previous Enterprise (Core) Underlying EBITDA forecast</b> | <b>24.2</b>         | Low double digit growth on FY18 – per outlook at May AGM  |
| Unexpected delay to starting new contracts                   | (3.0)               | \$12m of revenue from new contracts delayed by three months   |
| Slower recovery in Melbourne than forecast                   | (4.3)               | \$11m revenue impact at an average margin of ~40%   |
| Revenue mix change impacting margin                          | (1.1)               | Unfavourable revenue mix due to slower than anticipated growth in higher margin Mobile services.          |
| Average daily rate for Mobile lower than forecast            | (2.6)               | 6% reduction in average hourly rate due to proportionally more revenue coming from larger mature accounts |
| <b>Current Enterprise (Core) Underlying EBITDA forecast</b>  | <b>13.2</b>         | Revised forecast following changes above  |
| <b>SMB</b>   |                     |   |
| <b>Previous SMB (Core) Underlying EBITDA forecast</b>        | <b>9.5</b>          | Low single digit growth on FY18 – per outlook at May AGM  |
| Cost savings   | 1.0                 | Productivity initiatives delivering more cost savings than forecast                                       |
| Solutions revenue  | 0.2                 | Growth in solutions sales in H2 ahead of forecast   |
| <b>Current SMB (Core) Underlying EBITDA forecast</b>         | <b>10.7</b>         | Revised forecast following changes above  |

The table above presents the expected Underlying EBITDA for the Core Operations in FY19. Underlying EBITDA for forecast periods presented above reflect a point within the range of outcomes for the FY19 outlook.



# Core Operations: underlying EBITDA (half-on-half)

| Core Operations | 2018           |                | 2019          |                | Comments   |
|-----------------|----------------|----------------|---------------|----------------|--|
|                 | H1             | H2             | H1            | H2             |  |
| SMB             | \$2.7m         | \$6.6m         | \$4.9m        | \$5.8m         | <p><b>2018:</b><br/>H1 F18 earnings were negatively impacted by lower than expected new Solutions sales (and the compounding effect on subsequent renewal sales).<br/>H2 FY18 earnings growth on the previous half was driven by savings in operating costs.</p> <p><b>2019:</b><br/>H1 FY19 earnings are expected to be higher than the prior comparative period as a result of the savings in operating costs, partially offset by the compounding impact on renewal sales of the decline in 2018.<br/>H2 FY19 is forecast to beat H1 as the recovery plan for Solutions sales builds increasing momentum in new Solutions sales (and resultant subscription revenue).</p>   |
| Enterprise      | \$13.4m        | \$8.8m         | (\$0.9m)      | \$14.1m        | <p><b>2018:</b><br/>H1 FY18 earnings was (positively) distorted by an exceptional customer contract, providing \$15.3m in revenue at higher than budgeted margins. This contract ended at the beginning of H2 FY18. H2 FY18 earnings were impacted by a decrease in utilisation in the Mobile practice in the third quarter, due to the time taken to reassign staff returning from the exceptional project to other projects.</p> <p><b>2019:</b><br/>H1 FY19 earnings are down on the prior comparative period due to the absence of the exceptional customer contract as well as unexpected delays in turning on revenue from new contracts, a disappointing sales performance in the Melbourne, and an adverse change in revenue mix to lower margin services as a result of the delay in turning on higher margin revenue.<br/>H2 FY19 earnings are forecast to rebound as delayed contracts are turned on and performance in Melbourne improves.</p> |
| Corporate       | (\$4.1m)       | (\$2.8m)       | (\$3.4m)      | (\$3.5m)       | Corporate costs are unchanged year-on-year.  |
| <b>Group</b>    | <b>\$12.0m</b> | <b>\$12.6m</b> | <b>\$0.6m</b> | <b>\$16.4m</b> |  |

The table above presents the expected Underlying EBITDA for the Core Operations from H1 FY18 to H2 FY19. Underlying EBITDA for forecast periods presented above reflect a point within the range of outcomes for the FY19 outlook.

# Update on Cost Initiatives: FY19 and annualised

Our business plan contains a number of initiatives that reduce costs and in some cases deliver additional benefits. In addition to the initiatives that were already in the plan we have today implemented a major redesign of our operating model. This redesign is consistent with our strategy of moving to two brands; Arq Group and NRG. It brings us much closer to our customers, improves execution, and creates a scalable model to support growth.

As a result of today's reorganisation two senior executives will be leaving the business.

The savings expected to be realised in FY19 (and on an annualised basis) are set out in the table below.

| Description                          | FY19 Cost Saving (\$m) | Annualised Cost Saving (\$m) | Other Benefits   |
|--------------------------------------|------------------------|------------------------------|--|
| Data Centre Rationalisation          | 0.3                    | 0.5                          | None - cost reduction only   |
| Automation of Cloud Managed Services | 0.4                    | 0.7                          | Scalable infrastructure allowing future growth at minimal incremental cost   |
| Productivity Improvements in SMB     | 2.5                    | 2.5                          | None - cost reduction only   |
| Enterprise Reorganisation            | 0.9                    | 0.9                          | Enhanced customer focus underpinning cross sell, speed to market, clearer accountability and faster decision making. |
| Streamlining Leadership Team         | -                      | 1.2                          | Removing a layer of senior management speeds up decision-making, enhances accountability, and drives collaboration   |
| TPP Reseller Stranded Cost Removal   | -                      | 2.0 <sup>1</sup>             | None - cost only   |
| <b>Total Estimated Savings</b>       | <b>4.1</b>             | <b>7.8</b>                   |  |

1. Stranded costs associated with the divestment of the TPP Reseller business are anticipated to be removed over a period of 2.5 years, with approximately 20% of costs removed in each of the first two years, and the remaining 60% of costs removed in the six months following.

# Net Debt and Dividend

- **Net Debt:** Following the sale of our TPP reseller business, net debt will be reduced to \$50.3m (1.94× net debt/EBITDA), which is within covenants and with headroom in the existing facility.

Net debt has temporarily increased beyond the desired range (1.25× - 1.75×) due to the impact of the following significant outflows;

- fit out costs associated with expanding our footprint in Melbourne and Sydney
- one off costs incurred in rebranding, and
- higher than expected earnout payments as a result of strong performance of the InfoReady acquisition.

We expect the net debt/EBITDA ratio to return to within the desired range in early 2020.

- **Dividend:** Due to the lower than expected earnings during H1 FY19, we will not be declaring an interim dividend. The full-year dividend will be reassessed at December 2019 in line with Arq Group's stated dividend policy, which is to aim to return between 55% to 75% of full year underlying NPAT to shareholders.

# Arq Group Core: summary

- We are 12 months into an 18-month plan to transform the business to Arq Group. Some parts of the business are on track and others are not.
- The forecast underlying EBIDTA from the core operations has been revised down to a range of \$15.5m to \$18.5m.
- The downward revision is due to the performance of Enterprise and is driven by execution issues (in Melbourne) and an unexpected delay in turning on revenue from new contracts. This is regrettable but we are confident that this is a temporary setback;
  - the recovery plan is in progress
  - the business experienced a similar set back in SMB last year and the recovery plan is working – the outlook for SMB has been revised up
  - growth in Enterprise in H2 FY19 is forecast to be at least 45% higher than H2 FY18.
- Significant organisational changes have been implemented to address issues with execution and to move to an organizational structure that is aligned with our strategy.
- Cost reduction initiatives are expected to deliver savings of \$4.1m in 2019 and annualized savings of \$7.8m.



# **Enterprise**

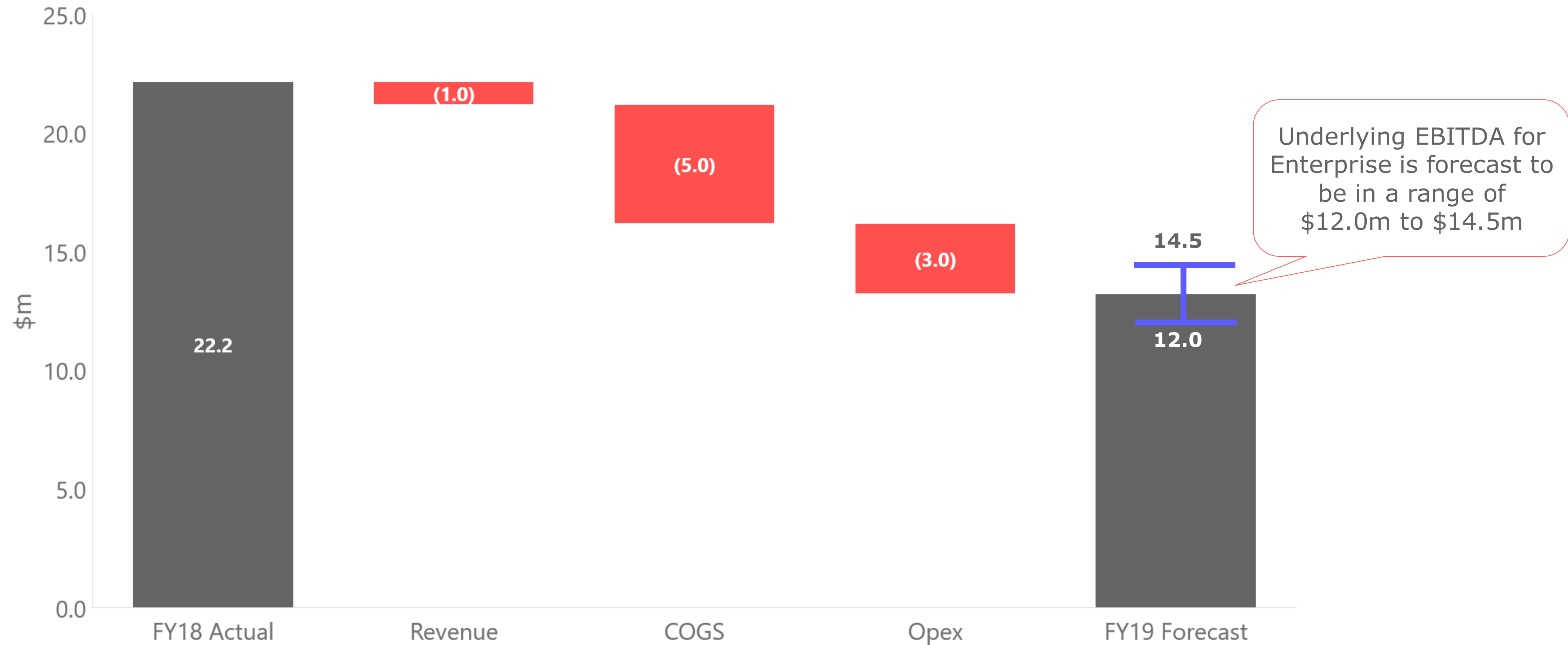
## **Core Operations**



# Enterprise Core: summary

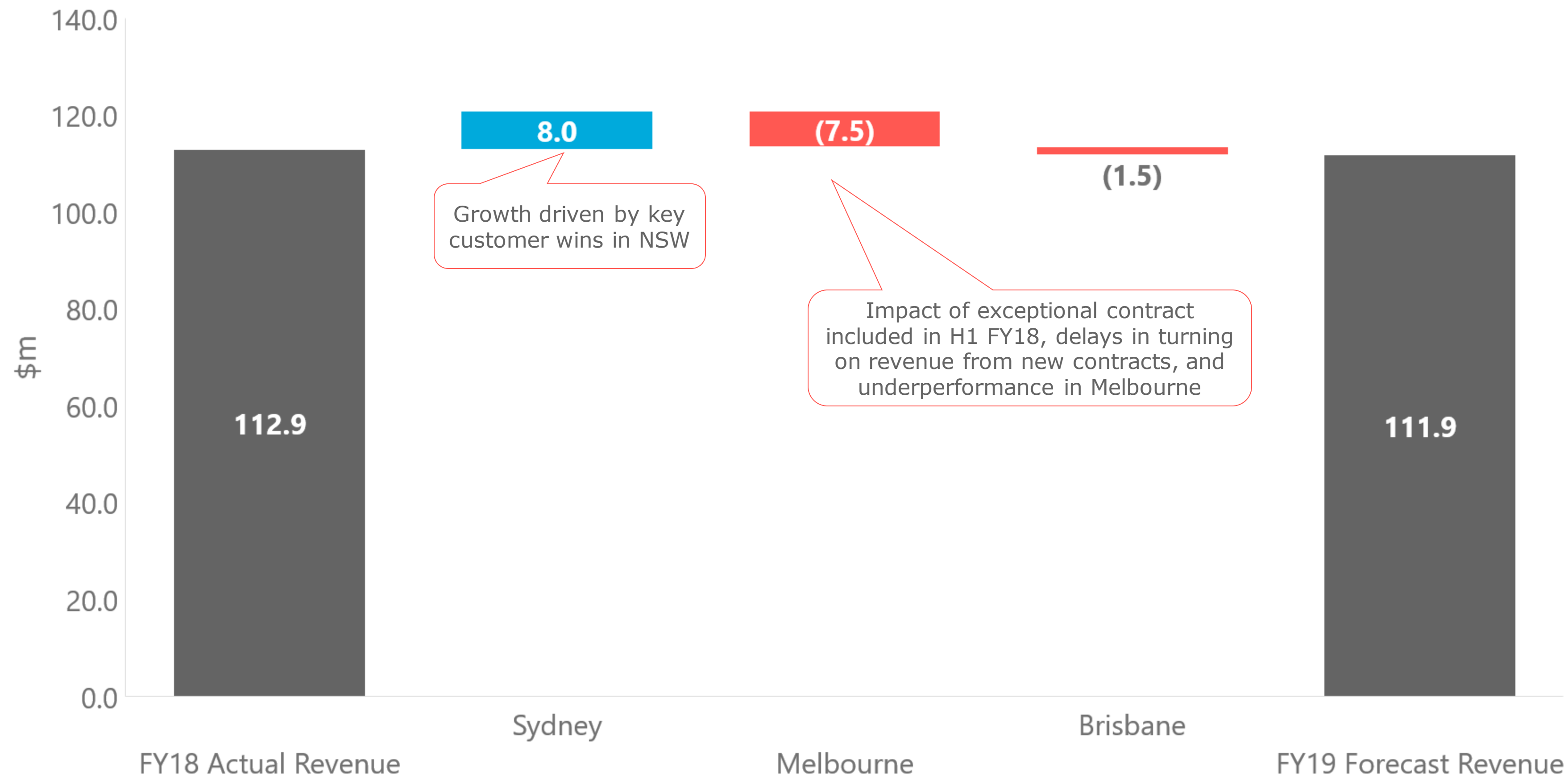
- Underlying EBITDA for the Enterprise division is forecast to be in the range of \$12m to \$14.5m.
- The forecast YoY decline in the Enterprise division is a function of flat revenue growth against the backdrop of increasing costs (both COGS and operating expenses);
  - more than half the increase in COGS is due to temporary factors
  - the forecast increase in operating expenses is largely driven by the move into new accommodation and is a one-off increase
- The Enterprise result is a story of two cities, Sydney is growing strongly (forecasting ~40% growth YoY) while Melbourne is declining (forecasting ~15% decline YoY).
- The relative under-performance in Melbourne was due to poor execution;
  - a depleted sales team wasn't addressed quickly resulting in delays in signing new customers
  - headcount wasn't managed well resulting in delays in turning on new work
- The recovery plan is underway;
  - a new sales leader is in place in Melbourne and the team has been rebuilt
  - billable headcount is now growing and new work is being resourced
- Cost reduction initiatives will contribute to a reduction in operating expenses of \$1.6m in FY19 and an annualised impact of \$2.7m.

# Enterprise Core FY19 Outlook: underlying EBITDA



The chart above presents the expected movement in Underlying EBITDA for the Core Operations from FY18 to FY19. Movements for forecast periods presented above reflect the midpoint of the expected range of outcomes for the FY19 outlook.

# Enterprise Core: revenue by geography (FY18 vs. FY19)



The chart above presents the expected movement in Underlying revenue for the Core Operations from FY18 to FY19. Movements for forecast periods presented above reflect the midpoint of the expected range of outcomes for the FY19 outlook.





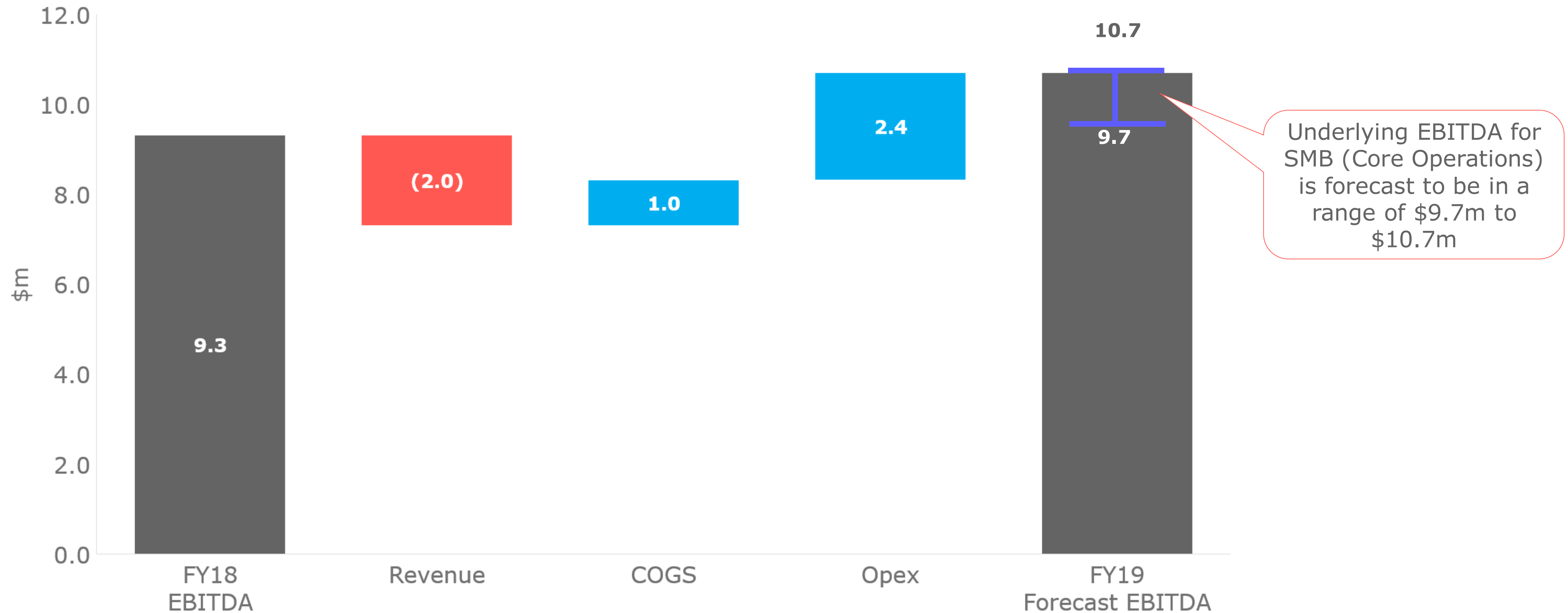
**SMB**  
**Core Operations**



# SMB Core: summary

- Core underlying EBITDA for the SMB division in forecast to be in the range of \$9.7m to \$10.7m.
- The upward revision to the forecast for the SMB division is a function of consistently growing sales of new solutions services and sustainable productivity improvements.
  - the solutions recovery plan is delivering
- The turn around in solutions revenue is driving a significant improvement in revenue performance on the prior year;
  - improvements in both solutions and components revenue performance in FY19 leading to a significant improvement on FY18 – revenue expected to shrink ~3.5% in 2019 compared to ~14.0% in the prior year
  - consistent month-on-month improvement in solutions revenue will see H2 FY19 solutions revenue exceed H2 FY18 by ~10.0%.
- A focus on cost optimization is contributing to a material improvement in the performance of the SMB division;
  - \$2.5m of annualised cost savings realised from productivity improvements

# SMB Core: underlying EBITDA



The chart above presents the expected movement in Underlying EBITDA for the Core Operations from FY18 to FY19. Movements for forecast periods presented above reflect a point within the range of outcomes for the FY19 outlook.



# **Appendix 1**

## **Non-core Operations**



# Arq Group Non-core: SMB Indirect

## TPP Reseller Divestment:

- Arq Group has sold its TPP reseller business to CentralNic plc.
- Total transaction funds is \$24.4m<sup>1</sup> on an implied multiple of 4.2x FY18 EBITDA.
- Arq Group will receive an upfront cash payment of approximately \$21.3m and deferred cash payments of \$3.1m (\$2.3m in 1 year and \$0.8m in 2 years).
- The completion date for the transaction is 30 June 2019<sup>2</sup>;
  - the acquirer has secured the necessary financing for the sale to complete
- The TPP reseller business contributed revenue of \$17.0m and EBITDA of \$5.8m to Arq Group in FY18. As at the transaction date (20 May 2019), the Group estimates the TPP reseller business will have contributed approximately \$2.3m of EBITDA to the YTD 2019 Group result.
- The Group anticipates that approximately \$2.0m of additional ('stranded') costs associated with the Indirect SMB business will be removed over the course of the next three years (skewed towards the back end of the three-year period).

## Large Customer:

- The large customer that makes up the remainder of the Non-Core operations has advised us of the timetable for turning off services
  - we understand that services will be turned off progressively over the final quarter of FY19
  - on this basis we expect that the large customer will contribute between \$4.3m to \$4.8m of EBITDA in FY19
- The Group is still in negotiations with this large customer to resolve a dispute around the calculation of amounts being charged in relation to the contract for these services.

1. Arq Group will receive fees associated with the separation of approximately \$3.1m as part of a Transitional Services Agreement (TSA) over the next two years.

2. The completion date is conditional on the acquirer securing appropriate financing.

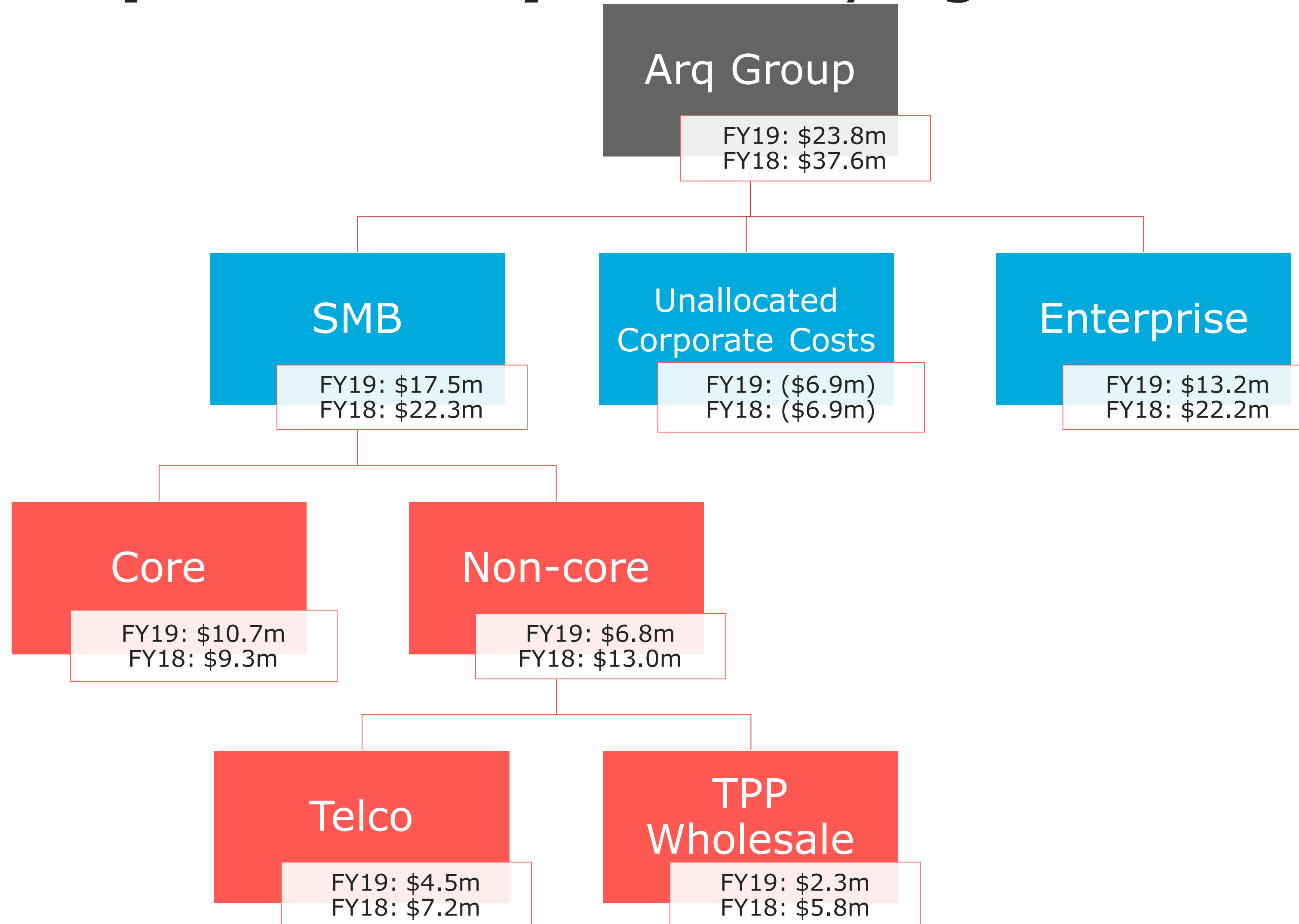


# **Appendix 2**

## **Arq Group Summary**



# Arq Group Summary: Underlying EBITDA



The chart above presents the Underlying EBITDA in FY18 and expected Underlying EBITDA in FY19. Underlying EBITDA for forecast periods presented above reflect a point within the range of outcomes for the FY19 outlook.