Photon founder defends growth strategy

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Tim Hughes admits he made mistakes at Photon Group, the marketing services company he set up in 2000 and was forced to walk away from a decade later as it struggled to reduce a mountain of debt.

Tim Hughes . . . 'I can't change the past, just learn from it.' **Photo: Tamara Voninski**

Speaking publicly for the first time since he quit as Photon's executive chairman in August 2010, Hughes says events at the company he built from one small advertising agency in Sydney to 50 marketing services businesses here and overseas were "not what I had hoped for".

"We borrowed too much and overpaid for a couple of internet businesses which were hurt by changes in the online ad market.

"But I was the first to put my hand up and take it on the chin," he says, referring to the restructuring and recapitalisation – including the issuing of 1.5 billion new shares at the deeply-discounted price of 10¢ each – Photon undertook during 2010 and 2011 to avoid collapse.

"It's been a real setback, but those mistakes will make me better equipped in the future. I can't change the past, just learn from it."

Hughes says he is not bitter about his forced exit from Photon. "I don't want to blame anyone," he says. "I'm accountable."

But Hughes is not happy about the constant criticism of the company's former strategy by Jeremy Philips, the News Corp executive Hughes hired in 2010 to succeed Photon chief executive Matt Bailey.

Philips, who resigned from Photon in December and left last month, has not criticised Hughes directly in public.

But comments such as telling *The Australian Financial Review* last week that Photon was "an unmanageable mess" when he joined have annoyed Hughes's supporters.

"The attacks on the old Photon and, by implication, Tim, have been disgraceful and unnecessary," says one senior marketing industry executive.

"Of course Tim made mistakes. We all make mistakes. But his critics don't understand that Tim has still has a lot of admirers."

One admirer is Kim Williams, the newly-installed chief executive of Rupert Murdoch's News Ltd.

Williams worked with Hughes and several Photon-owned companies during his previous job as chief executive of pay television company Foxtel.

"Tim has a terrific entrepreneurial spirit," Williams says. "He's very talented and knows the media and marketing businesses very well.

"He's a great observer of trends before they become trends, as demonstrated by Photon's move into experiential marketing and its purchase of [London-based communications planning company] Naked.

"Before Photon, he recognised the potential in the Asian cable TV and telephony sector, taking Macquarie Media Group into Taiwan Broadband Communications."

Hughes's friends and former colleagues say the woes of Photon have obscured his achievements at a succession of companies, including Reg Grundy's TV program production company Grundy Worldwide, Sunshine Broadcasting, RG Capital Radio and Macquarie Media Group.

Southern Cross Media chief executive Rhys Holleran worked with Hughes for 10 years, from the early days of RG Capital Radio in the late 1990s through its takeover of DMG Radio's regional stations to the sale of the combined business to Macquarie Group and the creation of Macquarie Media Group in late 2005.

"Tim is incredibly entrepreneurial," says Holleran, who keeps in regular contact with Hughes and spoke to him last week about a horse they jointly own.

“He can see a small vision and turn it into a big one. He did that with RG Capital Radio, then Macquarie Media Group and then Photon. We built a large business in regional radio, launching a lot of stations from scratch, and then sold the medium to national advertisers and media agencies for the first time.”

During the years he was buying businesses to tip into Photon, Hughes gained a reputation as an inveterate deal maker.

The heads of rival marketing services groups accused Hughes of being obsessed with making acquisitions and creating a patchwork of businesses with one goal in mind: selling Photon to a global marketing group such as WPP or Interpublic.

But Holleran says Hughes is more than a deal maker. “Yes, he’s bought a lot of businesses over the years, but he also built businesses and has operational skills,” he says.

Many of the businesses Hughes built were owned or part-owned by Grundy. Hughes joined Grundy’s Sydney-based production company in 1983 as an accountant. Two years later, he was appointed vice-president of Grundy Investments. In 1987, he was promoted to senior vice-president, corporate development and investment, for Grundy Worldwide.

Hughes moved to Sunshine Broadcasting – a listed regional Queensland TV business that included Grundy, Trevor Kennedy and Sam Gazal on its share register – as chief executive in 1992.

He returned to the Grundy camp in 1995, after Grundy Worldwide had been sold to British media group Pearson for $326 million. Hughes set up a new business, RG Capital, to manage Bermuda-based Reg Grundy’s investments in Australia.

As Grundy’s local money man, Hughes earned a reputation as a canny investor and a skilled networker. His supporters became known as “MOTs”, or “Mates of Tim’s”, and included high-profile brokers and bankers such as Greg Bundy, Geoff Wilson, Chris Mackay, David Paradice and Brett Paton.

The MOTs backed Hughes in businesses such as RG Capital and Photon, and encouraged other investors to join them.

“Tim is highly intelligent and an extremely skilful manager,” Geoff Wilson, chairman of Wilson Asset Management, says.

“Look at his track record at Sunshine, RG Capital and so on; over time, he created significant value for investors. He’s always been prepared to take some strong counter-cyclical views, as an investor and as a business builder.”

Hughes stopped working for Grundy when Macquarie Media Group was set up in 2005. Since then, RG Capital has been managed by Sue McIntosh, who has worked for Grundy since 1981 and has been a Photon director since it was set up.

Grundy bankrolled the launch of Photon and the acquisition of 13 businesses during its first four years.

The expansion accelerated after Photon listed in 2004. Over the following four years, Hughes and the Photon board – including current directors McIntosh and Brian Bickmore – signed off on more than $400 million of acquisitions. By 2008, Photon had about 50 businesses in 13 countries and was one of the 20 largest marketing services groups in the world.

The spending spree was funded by debt and equity, and most deals included earn-out payments linked to the acquired companies’ future earnings.

By the time Philips joined Photon, it had debt of $271 million and about $180 million of deferred payments.

Hughes says Photon could have serviced its debt if its earnings had not been hit by the slowdown in the marketing sector during 2009 and dismal results from its online search engine marketing companies, which were hurt by price increases by Google. (Photon’s earnings before interest, tax, depreciation and amortisation sagged from $93 million in 2008-09 to $75.1 million in 2009-10.)

Hughes and Philips hired UBS and Macquarie Capital Advisors to work on a $103 million capital raising – which was Photon’s third raising in two years – and negotiate new earn-out payment deals.

Photon shares were at $1.02 when they went into a trading halt in June 2010. They were later suspended and did not trade for 10 weeks while Philips and Photon’s advisers and banks worked on a restructuring and recapitalisation plan, including the issuing of 1.52 billion new shares.

The company’s shares have rarely traded above the 10¢ issue price since then. On Friday last week they closed at 4.9¢.

RG Capital spent about $30 million buying new shares in 2010 to maintain its 24 per cent stake in Photon.

Hughes took up about $1.7 million of new shares.

"If anyone saved the company at that time it was RG Capital and the other shareholders who supported the rights issue, and the management under earn-out deals who took scrip and agreed to new earn-out arrangements," Hughes says.

But two small institutional shareholders refused to put more money into the business if Hughes remained.

"The earnings decline [in 2009-10] meant we had to raise $100 million to pay down debt," Hughes says.

"A lot of shareholders were unhappy, which was understandable. I was told a couple of shareholders wanted me to resign before they took up their rights. I didn't want to stand in the way of the company raising the money, so I resigned."

"I certainly didn't abandon the ship. Even though I was no longer a director, I put in $1.7 million in that rights issue. I also lost half my termination payment against future profits which didn't eventuate," he says.

Hughes says Photon was "trapped with too much debt". But he rejects the claim it overpaid for most of its businesses, saying its acquisitions were struck on multiples of 4 to 7 times earnings.

"We did over-pay for a couple of internet businesses, which were greatly impacted by the collapse of search engine pricing and the value of domain names," Hughes says.

"When Photon started to really get off the ground in the early 2000s, I thought that given the transition of media to the internet it was crucial for us to have a large internet presence. Search marketing and domain monetisation was becoming a big business and we invested heavily in the area.

"Naturally, in hindsight it would have been better to stay away from that sector, but it is what it is."

After Hughes left Photon, Philips sold 13 businesses for a total of $233 million – or an average of 7.5 times earnings – and closed or merged another 19 businesses. The group now has 14 businesses.

"Jeremy, the board and its advisers did a good job in terms of selling assets," Hughes says. "To get an average sale price of 7.5 times earnings in a tough market speaks highly about those assets."

Last month Photon said its reported earnings for the December 2011 would crash 61.1 per cent to $12.8 million. Normalised earnings, that is, excluded businesses sold or closed and the loss of the Telstra account by one of its advertising agencies, would be down 7.4 per cent to $7.5 million.

Hughes still owns 30 million Photon shares, or about 1.9 per cent of the company. He welcomes the appointment of Matt Melhuish, the co-founder of the ad agency BMF, which is one of Photon's most successful businesses, as Philips' successor.

"Matt is a good operator and it's great the board appointed a chief executive who has a history of hands-on business experience," he says.

"The businesses left in Photon are great businesses. If Matt can pull them together, they'll do well."

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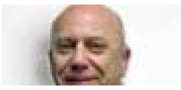

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