FINANCIAL **CAPITAL**

OUR GOAL: Ensure efficient utilisation of financial capital to compete and enable growth

FOCUS AREA	PRIORITIES	ACTUAL PROGRESS FY18 (last year)	FY19 (this year)	FY19 Progress
Financial resilience	Maintain financial flexibility through strong capital management			• Reduced gearing from 25.3% in FY18 to 13.6% in FY19 reflects working capital focus and lower capital expenditure due to increased capital allocation discipline • Access to committed bank debt facilities of $180m (undrawn at balance date) in addition to a $50m seasonal credit facility • Headroom provides ability to invest for growth above maintenance capital expenditure.
Total Shareholder Return	Reward shareholders with a consistently strong return on investment			• Strong capital growth in the share price over the course of FY19 of 12.8% (FY18: -4.2%)[1] • Total Shareholder Return (inclusive of dividend) of 20.2% (FY18: 3.3%)[2] • Dividend policy of 75% to 85% of adjusted Net Profit After Tax • Return on Funds Employed of 23.5% (FY18: 16.9%)[3].
Allocation of capital	Optimally invest in our business to retain relevance in a dynamic retail landscape			• Greater discipline around our capital expenditure in FY19 • The recently established Investment Review Committee assesses each business case and applies internal hurdle rates to ensure propositions 'stack up' from a financial perspective • Reduction in capital expenditure from 121% capex/depreciation in FY18 to 104% in FY19 due to focus on transformation and development of strategic initiatives.
Access to capital	Maintain access to diverse capital sources			• The Group maintains three primary sources of capital in operating cash flow, debt and equity • Operating cash flow has significantly improved in FY19 due to working capital initiatives • Access to debt is through multi bank bilaterals and an NZX listed bond • Market capitalisation increased from $704m in FY18 to $794m in FY19.

Key initiatives

In FY19, inventory management and improved supplier terms were a key focus of our transformation initiatives. In line with comments made throughout the financial year, we have begun to realise some of the benefit from these undertakings with a meaningful reduction in working capital. Consequently, the business has generated sufficient free cash flow over the course of the year to increase the dividend paid to shareholders to 17 cents per share, while repaying $63.7m of bank debt and funding capital expenditure of $62.1m. The current low level of gearing is helping to build capacity in advance of expected future investment in planned transformation and growth initiatives.

Increased discipline around the allocation of capital has resulted in capital spend this year below guidance.

There were also transformation initiatives that were originally planned to land in FY19 which are now expected to occur in the first half of FY20. Of the capital expenditure, 39% was on stores and distribution centres, 40% on information systems and digital initiatives and 21% on logistics. Investment in a warehouse management system drove the proportion of capital spent on logistics higher than anticipated, the first phase of which has delivered improvement in eCommerce fulfilment metrics. For the purposes of capital planning, we are assuming to have several years of capital spend in the $100m to $120m range. In addition to lifting our capital expenditure versus depreciation, we will be looking to increase our percentage of growth capital spend as we start to execute our growth aspirations.

[1] Capital growth calculated as close price at Financial Year end / open price at the start of the Financial Year.

[2] Simple Total Shareholder Return calculated as (close price at Financial Year end + dividends paid to shareholders during the Financial Year)/ open price at the start of the Financial Year.

[3] Return on Funds Employed calculated as Operating Profit from Continuing Operations as a percentage of average Funds Employed.

ROADMAP TO OUR GOAL (FY20 (next year), FY21, FY22+)	KEY RISKS	MITIGATIONS
Gearing levels not greater than 30%	• Like many New Zealand businesses, the Group is impacted by the performance of the New Zealand economy and indirectly the economic performance of New Zealand's major trading partners. Economic downturns may result in a deterioration of financial performance. • Offshore retailers may enter or increase existing footprint in New Zealand, altering the retail sector's competitive landscape and creating direct business competition.	• The Group's established New Zealand brands and diversified product offering can alleviate performance pressure from market downturns • Maintain access to diverse and quality sources of capital • Tightly manage our property portfolio to balance location security with flexibility to manage individual store performance. • Maintain our unparalleled footprint in the New Zealand non-food market across physical and online channels • Remain dedicated to providing the best retail experience for our customers • Continue to create and develop appealing and new ways to shop, such as TheMarket.
Target 17%+ Return on Funds Employed	• Downturn in international and domestic financial markets may impact on the share price of The Warehouse Group.	• Develop trust with shareholders through delivering a high level of financial reporting and transparency • Maintain our commitment to consistently deliver value to our shareholders through a balance of dividends and capital growth.
Targeting increased proportion of capital spend on growth initiatives	• Erosion of the asset base from under-investment due to deferral of spend or lack of strategic direction • Under-investment in growth initiatives that are core to delivering exceptional customer retail experiences. • Underperformance of investments relative to initial expectations.	• Refine our maintenance capital expenditure programme to ensure our infrastructure and customer channels (physical and online) meet or exceed customer expectations. • Use our investment review process to test the robustness of investments from an operational, strategic and financial perspective.
Maintain diversity of funding sources	• Tightening of credit markets and/or local banking regulations and downturn in equity market performance due to local and/or global economic factors causes a rationing of capital.	• Retain our banking relationships and headroom in excess of immediate needs. Supplement our bank funding with an NZX listed bond • NZX listed for nearly 25 years with a founding shareholder that has maintained a controlling stake • Continue our focus on working capital control and conversion of earnings into operating cash flow.

Significance

Financial capital is an enabler that allows the Group to execute on the various initiatives we identify as important for the long-term sustainability of the Group and development of its capital base (financial and non-financial). Current focuses for the Group are completing our detailed transformation plans as well as investing in growth initiatives. The transformation plans are, however, not only associated with financial performance. We are investing in areas of the business where goals are linked to non-financial measures but the ability to develop, implement and achieve them is dependent on the financial resources of the Group. Financial capital is therefore not only about financial results, it is also about delivering results for the betterment of the Group and our stakeholders.

Materiality

'Here for good' is a value within the Group that displays our commitment to our people and our planet and delivering great value to customers with our products. In order to make-good on that commitment, the Group needs to also have a robust financial capital base. The Group has been focused on achieving a strong balance sheet that provides capital headroom to weather potential downturns and fund investment in value-enhancing initiatives and strategies. Financial discipline is of utmost importance to us and is core to making sure that we are here for good and for New Zealanders.

Future focus areas

Our focus in FY20 and beyond will be to:

- Continue with the transformation process through:
  - Investing capital in line with the strategy and delivering shareholder value
  - Focusing on the retail fundamentals to grow the top line while assessing areas to be more cost efficient
- Continue our focus on financial risk management.