# CEO'S REPORT

"At the time of our half-year announcement, our results demonstrated that we were on track with the implementation of our strategy and our far-reaching transformation programme."

**Nick Grayston**
**CEO, The Warehouse Group**

**Strategy stress tested**

The global cataclysm wrought by COVID-19 has stress-tested our strategy, our business and our people far beyond the levels anyone could have expected or desired. Obviously it has not been business as usual this year for anyone, anywhere in the world.

Relative to the experiences of those elsewhere we have been fortunate in New Zealand. Nevertheless, COVID-19's impact has made huge demands at every level of The Warehouse Group. Events during the final months of FY20 required that our teams work in new ways – whether it be store team members fulfilling online orders in-store or our Store Support Office teams supporting the customer engagement centre or working in our fulfilment centre.

Our experience in navigating the uncertainty and restrictions during New Zealand's initial response to the pandemic gave us even greater confidence that the Agile model at our Store Support Office will support the business with speed to market, collaboration, innovation and productivity.

After six months of operating frontrunner tribes to help us define optimal operating models, we moved fully to this way of working in late August. This will enable us to further increase our focus on New Zealanders' needs in a retail environment where the one real constant is the relentless pace of change.

**Learning from adversity**

At the time of our half-year announcement, our results demonstrated that we were on track with the implementation of our strategy and our far-reaching transformation programme.

We experienced some real challenges during Christmas, brought on in part by New Zealand's adoption of heavy discounting as early as Black Friday in November. Additionally, every six years, there is one less week between Black Friday and Christmas, which compresses the selling season and tends to have a profound effect on overall spending – 2019 was one of those years. We did, however, see a late wave of spending at the end of a shorter Christmas trading season which flowed into decent results in January.

Also, we experienced an operational challenge during this period: the self-inflicted wound we sustained from an initiative to centralise fulfilment functions for The Warehouse and Warehouse Stationery and deploy a new Warehouse Management System (WMS).

With the benefit of hindsight, we now know that insufficient user input and early-stage support in the planning and development phase, underpinned by poor quality of data, data architecture and governance, contributed to the issues relating to the WMS project. We regret that this happened and the inconvenience that it caused to our customers.

But we have learnt a great deal from the experience, which underscored that the old-fashioned siloed methods of execution and hierarchical structures are no longer fit for purpose. It also highlighted that 25 years of under-investment in information systems and physical infrastructure is a problem we must address in order to become a nimble, customer-centric company.

We set in place a very purposeful recovery plan. In addition, one of our experienced senior executives - Pejman Okhovat - is now in charge of the integrated supply chain.

We had already planned to shift to an Agile operating model and the WMS experience further validated its introduction. These learnings are all the more important given the huge slate of systems modernisation we have ahead of us.

Our response to the WMS challenge also meant we were much better placed when COVID-19 hit.

The closure of our physical stores and the subsequent permission from the Government to sell essentials online proved to be a quantum leap for our online sales, with 48% of our online purchasers during this period being new eCommerce customers.

We saw exponential growth in eCommerce in just two months from April through to June. While not all this growth has survived lockdown, much of it has and this behaviour shift will have profound effects on legacy retailers, which necessitates the acceleration of our transformation.

The institution of social distancing meant we could only deploy 60% of our people in the fulfilment centre – and that could have crashed the business totally.

However, the benefit of becoming much more Agile was that very quickly we opened up 30 The Warehouse and Warehouse Stationery stores as online fulfilment centres, which took a lot of the pressure off. We also quickly moved to open all 75 Noel Leeming stores as fulfilment centres due to demand.

It was by no means perfect. When stores reopened, there were issues around contactless Click & Collect because we weren't designed to satisfy the volumes ordered, exacerbated by the problems experienced by our delivery service providers.

Yet, by and large, we coped. That would not have been the case in the last months of calendar year 2019. It's a real learning from adversity, and also points into the health of the future.

We still have in front of us a major task in terms of information system and physical infrastructure upgrades. We have an integrated systems strategy and are well placed to begin rolling out improvements. For example, introducing a new finance and inventory system in The Warehouse will enable real-time visibility of inventory that will have a customer-facing benefit.

**COVID-19: Agile adaptation**

In the days immediately prior to New Zealand's initial COVID-19 lockdown, the Group faced considerable uncertainty.

We had to pivot quickly after unexpectedly being told we could not operate our stores or online services during alert levels 4 and 3.

Subsequently it became clear that people needed access to our products so they too could make the necessary adjustments in their work and home lives.

We worked very closely with the Ministry of Business, Innovation and Employment (MBIE), and other government officials. We took great care to do exactly what they asked us to do. We were a participant in National Emergency Management Agency (NEMA), the Police's retail-focused COVID-19 response team, and worked with other retailers and industry in the lead up to and during lockdown.

We were able to provide an important service to New Zealand by supplying essential goods online through The Warehouse, Warehouse Stationery and Noel Leeming.

Our earlier decision to diversify our supply chain by building a direct sourcing business with relationships into factories in China, India and Bangladesh stood us in good stead in terms of continuity of product supply.

In the early stages of New Zealand's COVID-19 response, we were fortunate to have front loaded deliveries from China by early January to account for Chinese New Year. That meant we had three months' insulation in the system. In the end, China reopened fairly quickly, so the impact on our business was more influenced by decisions as to what and how much in terms of orders to cancel in ambiguous circumstances around the impact of COVID-19.

In South Asia, many factories have been working through lockdown because their workers need to continue earning. In an effort to do the right thing, we have tried to keep our contracts going and have also taken additional steps to support our partners. These include distributing COVID-19 safe resource kits prepared by our industry partners to supplier factories. In the case of India, Bangladesh, and Pakistan, we have contacted factories directly to confirm and track their COVID–19 management practices, and to ensure that they were meeting all payment obligations to their workforces and operating in accordance with any government guidelines.

**Delivering value across our brands**

Revenue for The Warehouse in FY20 increased marginally to $1.7b, with gross margin down 70 basis points.

It was pleasing to see the continued increases in quality and value perception, and to reap the benefits of greater acceptance of our Every Day Low Prices strategy, which also drove further productivity improvements.

We are very proud of the resilience that our people demonstrated in coping with extremely uncertain circumstances as a result of COVID–19 and the work the fulfilment team has done to meet the surge in online demand.

Noel Leeming had another record-breaking year – exceeding $1b revenue for the first time, with operating profit up 20.8% to $46m this year. Operating margins also improved 50 basis points from 4.1% in FY19 to 4.6% this year.

The continued execution of services and growth into the commercial business gives us a platform to build into B2B. Services delivered significant growth with a 19% increase year-on-year. Other milestones included the successful launch of our new Protection service plans; the growth of Consultation which delivered over $2.2m this year; and the introduction of our free Tech Solutions helpdesk, which has helped over 18,000 customers.

The successful introduction in November of our new digital team member – Nola – at our Westfield Newmarket store marked a further leap in innovation. Nola is one of the first human-like interfaces backed by artificial intelligence in a New Zealand retail store, and is positioned to help shoppers navigate the store and answer questions they may have. She is now working in our contact centre helping customers there too.

We have done some hard yards in Torpedo7. Revenue was up 10.7% to $191m on last year but there was an operating loss of ($14.7m). The loss was caused by continued correction of inventory profiles and the impact of not being able to trade during lockdown and resulting inventory imbalances.

While we are not there yet on the results, Torpedo7 is expected to deliver. We are confident that we are making progress towards profitability and will see a quantum leap in performance in FY21.

The recruitment of Simon West, who became Torpedo7's CEO in August 2019, has provided the steady, experienced and dedicated leadership required to lift the brand's performance. We are starting to see evidence of progress with changes to merchandising, the product mix, improved skill sets in stores, and steps taken to grow distribution and fulfilment capabilities.

Warehouse Stationery continued to build on the momentum of its positive performance in FY19. Retail sales were up 0.1% with 50 basis points lift in gross margin. Operating profit also increased from $16.7m in FY19 to $22.8m this year.

There were seven further integrations of The Warehouse and Warehouse Stationery stores, taking the total number to 17. These Red and Blue store integrations are delivering the performance benefits we had sought, and we continue to assess further opportunities to bring stores together across our portfolio.

TheMarket.com more than proved its reason for being during COVID–19 alert levels 4 and 3. It was an extraordinary achievement by the team to go live in August last year, and to do so under budget. We have seen good growth, with the number of merchants choosing to participate on TheMarket.com platform reaching over 650 by the end of July 2020.

We have learnt a great deal about the drivers and cost metrics of engagement and acquisition. The focus now is to grow TheMarket.com's offerings further and keep leveraging Group strengths to benefit customers. While we know there is still a lot of work to be done, TheMarket.com has had a very good foundational year and is meeting planned performance targets.

As stated earlier, Group online sales accelerated well beyond expectations due to the impact of rapid changes to our customers' shopping options and habits during the COVID–19 lockdown.

We knew before COVID–19 that our digital strategy and expanded online offerings were a critical component of our future growth. This year's results validate continued investment in developing our online channels.

**Here for good**

In December 2019, the Group's Chief Sustainability Officer David Benattar and I attended COP25 (The Conference of the Parties – the supreme decision-making body of the United Nations Framework Convention on Climate Change) in Madrid. As part of the New Zealand delegation led by Minister for the Environment James Shaw, we participated in panel discussions and meetings between government, non-government organisations (NGOs), scientists and business on the collective global effort to combat climate change.

After moving to become a carbon neutral business last year, we were honoured to attend and share our perspectives.

While the conference itself ultimately had a disappointing result, with no global agreement to Article 6 which regulates the international trade of carbon emission credits, the summit was full of valuable insights.

In particular, we saw how the engagement of the private sector is essential to addressing the climate crisis, in ways that governments and NGOs cannot do. Companies are stepping up globally and taking action on sustainability because they think it is the right thing to do and because the customer is requiring it. They are moving faster than governments which have, so far, failed to deliver the mechanisms for achieving the Paris Agreement commitments.

COVID–19 will not slow down our commitment to increasing the element of sustainable product quality and materials, packaging and consumption that we supply.

We have dedicated our efforts to marrying sustainable attributes with affordability so customers do not have to pay more. We now have over 6,000 products with sustainable attributes in our stores. We are doing much more to tell our customers about those products, having just launched our 'Sustainable and Affordable' campaign to educate our customers around the fact that a value-based offering doesn't necessarily require compromise, in terms of sustainability.

The Group takes seriously its role in helping to upskill New Zealand's workforce. For the hundreds of young people participating in our youth and gateway programmes, like P-TECH and Red/Blue Shirts in School.

We worked with our partners to move swiftly to provide laptops for students needing them, and to support curricula and programme redesign so that learning could be moved online. In-store training for our Red Shirts in Communities programme with the Ministry of Social Development was paused as a result of COVID–19 restrictions.

We have an increasing focus on equality and diversity. In July 2020 we joined other major businesses which signed the 'NZ Retailers Against Racism Pledge' to confirm an ongoing commitment to address racism proactively, along with a refusal to tolerate other forms of abuse at work.

Approximately one in four New Zealanders lives with a physical, sensory or learning disability, mental health or other challenges. We partnered with Accessibility Tick, a pan-disability provider, to make the Group's workplaces more accessible and inclusive for our team members and customers with disabilities. In December 2019, we became the first retailer to achieve the Accessibility Tick.

In September, we announced our Retail Wage commitment, entitling employees at The Warehouse with at least a year's worth of service to receive a pay increase to $21.15 per hour in 2020.

We have also started to trial a new programme aimed at rewarding our customers and providing them a way to support the causes they are passionate about. Called 'Giveit', the programme enables customers to access exclusive offers and rewards, via The Warehouse app and through scanning a QR code in store. Every time a customer shops with us through their Giveit account, The Warehouse gives back to a local cause of their choice.

**Responding to an uncertain trading environment**

COVID–19 caused some major customer changes – particularly the shift to online. Although peak online numbers dropped after we reopened our stores, they remain around double the level prior to the COVID–19 lockdown. It is a change that looks set to stay.

The sustained shift online causes some specific challenges to our business model and raises questions about the need for quite so many physical store locations.

Good retailers should be assessing the suitability of their network continuously. Value for money has never been more important to our customers. We can deliver that if we manage our costs and run our business efficiently.

That is why we have accelerated some changes around in-store operations and the location of some of our stores in response to our uncertain trading environment.

It is not just about closing stores. It's about evolving our store network – and that has seen us open new stores at Lunn Ave in Auckland, Westfield in Newmarket, and Northlink in Christchurch.

We have also confirmed and signalled the closure of several stores including The Warehouse Birkenhead (Auckland), Dunedin, Johnsonville (Wellington), Whangaparāoa, and Noel Leeming Takapuna (Auckland), the Palms and Papanui (Christchurch), Tokoroa, Henderson and St Lukes Clearance Centres and Warehouse Stationery Te Awamutu. Our Dunedin Central store will become a 'dark store' to serve our customers' online orders.

The result of all these changes could see a reduction of approximately 320 full-time equivalent roles across the business.

We have made these changes to weather the effects of the varying economic conditions and customer habits with strength, and help us to continue to be there for our team of more than 11,000 as well as for our customers and communities. Very specifically, the growth of online, both customer direct and via Click & Collect as well as changing shopping times requires us to redeploy our workforce, in many cases altering their rosters.

During the year we welcomed some talented new people to our executive leadership team.

**"We have dedicated our efforts to marrying sustainable attributes with affordability so customers do not have to pay more to do the right thing."**

**Nick Grayston**
**CEO, The Warehouse Group**

Edwin Gear, our Chief Information Officer, brings a wealth of retail information services experience. Most recently, he was the Chief Information Officer of Metcash Australia, and has held prior roles in New Zealand with Mitre10 and Foodstuffs. Alongside this, Edwin has extensive operational and broader business experience together with a strong track record of delivering change and building and leading teams.

Richard Parker stepped up to become Acting Chief Human Resources Officer, following Evelyn Ross' resignation from the role in January 2020, and has now been appointed in this role effective 31 August 2020. Previously, Richard held a number of senior human resources and corporate legal roles at some of New Zealand's leading organisations including Fletcher Challenge, Telecom (now Spark) and TVNZ.

There have been two other departures from the team. Mark Yeoman, who became Chief Operating Officer in April 2018, played a key role in the transformation of the business over the past five years. Mark left the business in May 2020.

Post-balance date, our Chief Logistics Officer Chris Foord also departed. Chris had led all aspects of our logistics and fulfilment across the Group, including The Warehouse, Warehouse Stationery, Torpedo7 and Noel Leeming.

Evelyn Ross, Chief People Officer, also left the company during the financial year.

We wish Mark, Chris and Evelyn all the best in their future careers.

**Maintaining momentum**

As we look ahead to FY21, we cannot afford complacency.

We saw a significant lift in sales after our stores reopened. However, the forecasts for New Zealand's economy indicate that there is a significant contraction ahead. While headline unemployment data in early August was considerably better than expected, those not participating in the labour force rose by 37,000 in the June quarter. By the end of July, around 21,000 people were receiving the COVID–19 Income Relief Payment. There is much uncertainty about the flow-on effects when this subsidy ends.

Consumer confidence remains below the historical average. We do not expect the recent wave of sales optimism to continue, particularly in light of the re-emergence of community transmission of COVID–19 in August and the potential for more lockdowns or disruption to occur.

The Group is taking a conservative approach and expects the coming year to be tough.

In spite of the challenging business environment, we will continue to make the changes necessary to protect and grow our brands. We will invest in our key infrastructure. We will refine our operating model further as we embrace the principles of agility. And we will continue to eliminate inefficiencies that impact on our productivity.

There is more work to be done.

**Nick Grayston** – CEO