Annual Results 2018

The Warehouse Group Limited

21 September 2018

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Presentation outline

'FY18 was a challenging year. To deliver a result above guidance is pleasing.'

Joan Withers

Chair

Group Chair – Joan Withers

Chair’s Introduction

Chair's Introduction

- FY18 produced an encouraging full year performance with Adjusted NPAT of $59.0m, in a year of significant change. This result is above market guidance of $50-$53m given in March 2018.
- FY18 has been about implementing and accelerating our strategic plan. We fundamentally changed the pricing strategy in The Warehouse and embarked on a two year transformation programme to accelerate our strategy of fixing the retail fundamentals and investing in our digital future.
- Our Reported Continuing NPAT was $27.3m, which was 61.4% down on FY17 and included a non-cash impairment of goodwill in Torpedo7. NPAT Attributable to Shareholders was up 12.0% to $22.9m.
- A final dividend of 6 cents per share will be paid, making the FY18 total dividend 16 cents per share.
- Group Short Term Incentive (STI) has been triggered. If the result is normalised for the impact of the STI, Adjusted NPAT would have increased 1.6% year on year.
- During FY18 we welcomed new local and international talent to our management and leadership team.
- Sir Stephen Tindall has decided to take a further 12 months leave of absence from his directorship of The Warehouse Group due to his current workload which includes the hosting of the 2021 America's Cup in Auckland, his ongoing work with The Tindall Foundation and investment vehicle K1W1. Robbie Tindall will continue to act as his alternate on The Warehouse Group board.
- We are in the process of finalising a new Board Director appointment whose skills and knowledge base will be complementary to the existing skills of the Board and strategically relevant to the evolution of the business.
- The Board is looking forward to realising the significant benefits of the transformation programme over the next 24 months and beyond and driving results both for customers, our shareholders and wider stakeholders.

CEO – Nick Grayston

Group Performance Review

Group Performance Review

Our shared purpose

Helping Kiwis live better every day

Our shared values

- Take the lead
- Create the way
- Be the experience
- Here for good

We're on!

This year we launched our new Group shared values.

Our purpose is to help Kiwis live better every day

We're on for New Zealand, our customers, our employees, our shareholders and communities.

Group Performance Review

- FY18 has been a foundational year of change for the business. Each year sees new and stronger competitive challenges to our business and 2018 is no exception. We remain a profitable business that creates value for New Zealand, both as an employer and as a corporate citizen.
- This year we launched a transformation programme to fix our retail fundamentals. The transformation focuses on store performance, merchandise, logistics, central functions, non-trade spend, capital, information systems and most importantly, creating a high performance culture.
- FY18 was a particularly big year for The Warehouse as we changed our pricing strategy from Hi-Lo to Every Day Low Prices (EDLP). Customers have responded well to this change and we are pleased that sales declined less than originally expected, and we saw an uplift in volumes sold.
- Other significant shifts in the business include:
  - Integration of the Centres of Excellence with our brands under our new matrix management operating model. One example of this is the consolidation of our Marketing function, where we moved from having 7 separate media planning and buying agencies down to one.
  - We integrated The Warehouse and Warehouse Stationery both operationally and legally into one entity.
  - We opened 3 ‘Store within a Store’ concept stores for Red and Blue, bringing the total to 4.
  - FY18 also saw a new sourcing office opened in India and further growth of our direct sourcing capability.
  - Investment in a new Warehouse Management System (WMS) to further improve our fulfilment and delivery capability.
  - Other highlights include the growth of our online sales to $221.1m. Online sales makes up 7.4% of total group sales. The Warehouse shopping app helped to drive this growth, where we saw a revenue increase of 275%.
  - This year we made efforts to increase our level of transparency in reporting and have produced our first Integrated Report.

Group Financials

FY18 Annual Result

Year ended 29 July 2018

$ million	2018	2017	Variance
Retail Sales	2,994.6	2,980.8	0.5%
Retail Gross Profit	991.2	971.9	2.0%
Gross Margin %	33.1%	32.6%	50bps
Retail CODB	899.7	864.1	4.1%
CODB %	30.0%	29.0%	100bps
Retail Operating Profit	91.4	107.8	(15.2)%
Operating Margin %	3.1%	3.6%	(50)bps
Continuing NPAT (Reported)	27.3	70.7	(61.4)%
Continuing NPAT (Adjusted)	59.0	68.2	(13.4)%
NPAT (Attributable to Shareholders)	22.9	20.4	12.0%
Operating Cash Flow	107.9	128.1	(15.8)%
Ordinary Dividend (cents per share)	16.0 cps	16.0 cps	(0)cps
Total Dividend	55.5	55.5	0.0%

- Group sales up 0.5% with Noel Leeming delivering a strong result and The Warehouse transitioning well under EDLP.
- Group Gross Profit up 2.0% influenced by Noel Leeming's performance and positive Gross Profit Margin lift in the Warehouse under EDLP.
- Cost of Doing Business increased 4.1% reflecting higher costs in Noel Leeming, Torpedo7 and The Warehouse.
- Reported Continuing NPAT of $27.3m, down significantly due to a number of one-off items including restructuring costs, non-cash impairment of goodwill and a gain on property disposals (further details slide 12).
- Adjusted NPAT from continuing operations (excluding Financial Services) was $59.0m, which is less than last year but above guidance.
- NPAT Attributable to Shareholders increased 12.0% from $20.4m to $22.9m.

Group H1 vs H2

For the Year ended 29 July 2018

$ millions	H2			H1		
	2018	2017	Variance	2018	2017	Variance
Retail Sales	1,396.5	1,406.9	(0.7)%	1,598.1	1,573.9	1.5%
Retail Gross Profit	468.7	452.9	3.5%	522.5	519.0	0.7%
Gross Margin %	33.6%	32.2%	140bps	32.7%	33.0%	(30)bps
Retail CODB	435.7	415.0	5.0%	464.1	449.1	3.3%
CODB %	31.2%	29.5%	170bps	29.0%	28.6%	40bps
Retail Operating Profit	33.0	37.9	(12.9)%	58.4	69.9	(16.5)%
Operating Margin %	2.4%	2.7%	(30)bps	3.7%	4.4%	(70)bps
Continuing NPAT (Adjusted)	21.3	23.2	(7.8)%	37.7	45.0	(16.4)%

- FY18 was a period of significant internal change. The stability of Retail Sales and increase of Retail Gross Profit of $468.7m from $452.9m during a challenging H2 is a very pleasing result in the context of internal changes made.

Adjusted vs Reported results

For the Year ended 29 July 2018

$ million	EBIT		NPAT	
	2018	2017	2018	2017
Adjusted Earnings	91.4	107.8	59.0	68.2
Gain on property disposals	0.2	11.5	0.2	11.5
Goodwill impairment (Torpedo7)	(25.6)	-	(25.6)	-
Restructuring costs	(8.7)	(12.1)	(8.7)	(12.1)
Income tax	-	-	2.4	3.1
Continuing Reported Earnings	**57.3**	**107.2**	**27.3**	**70.7**
Discontinued Operation (Financial Services)			(4.4)	(50.3)
NPAT Attributable to Shareholders			**22.9**	**20.4**

- To improve the understanding of underlying business performance, the Group adjusts profit for unusual and non-operating items. Unusual items include profits from the sale of assets and losses associated with adjustments in carrying values of assets, M&A activity, and restructuring costs.

Balance Sheet

As at 29 July 2018

$ millions	2018	2017	Variance
Inventory	523.8	487.3	36.5
Trade and Other Receivables	79.8	75.6	4.2
Trade and Other Payables	(279.0)	(267.3)	(11.7)
Provisions	(88.0)	(69.1)	(18.9)
Working Capital	**236.6**	**226.5**	**10.1**
Fixed Assets	272.9	273.3	(0.4)
Held for Sale	3.7	71.7	(68.0)
Funds Employed	**513.2**	**571.5**	**(58.3)**
Tax Assets	32.0	45.9	(13.9)
Derivatives	16.4	(19.3)	35.7
Goodwill and Brands	81.0	106.6	(25.6)
Capital Employed	**642.6**	**704.7**	**(62.1)**
Shareholders Equity	479.4	485.5	(6.1)
Minority Interests	0.9	0.9	-
Net Debt	162.3	218.3	(56.0)
Capital Employed	**642.6**	**704.7**	**(62.1)**
Gearing	25.3%	31.0%	(570)bps

- Inventory is slightly higher than expected, taking into account higher sales volumes. We're comfortable with the current level of inventory and the transformation initiatives that will lower inventory in FY19.
- Diners Club NZ finance book classified as held for sale and recorded as discontinued operations.
- Transformation initiatives will focus on improving working capital through inventory management and supplier trade terms.
- The mark-to-market valuation of the Group's foreign exchange derivatives are 'in the money' due to the fall of the NZD against the USD.
- Impairment of Torpedo7 goodwill $25.6m.
- Net debt decreased from $218.3 to $162.3m due to the sale of Lunn Ave and discontinued Financial Services business.
- Capital structure remains stable and we will look to continue to reduce debt over the next few years.
- Target gearing between 20-40%, current Group gearing is 25.3%.

Cash Flow

For the Year ended 29 July 2018

$ million	2018	2017	Variance
Trading EBITDA	**151.1**	**166.2**	**(15.1)**
Working Capital	(5.9)	21.7	(27.6)
Taxes Paid	(14.1)	(27.5)	13.4
Interest Paid	(9.3)	(16.0)	6.7
Discontinued EBITDA	(3.5)	(6.7)	3.2
Other items	(10.4)	(9.6)	(0.8)
Operating Cash Flow	**107.9**	**128.1**	**(20.2)**
Capital Expenditure	(70.2)	(70.6)	0.4
Divestments	74.7	79.7	(5.0)
Acquisitions	-	(1.0)	1.0
Dividends Received	0.3	0.3	-
Dividends Paid	(55.8)	(52.5)	(3.3)
Other	(1.0)	(2.7)	1.7
Net Cash Flow	**55.9**	**81.3**	**(25.4)**
Opening Net Debt	(218.3)	(299.6)	81.3
Closing Net Debt	(162.3)	(218.3)	56.0

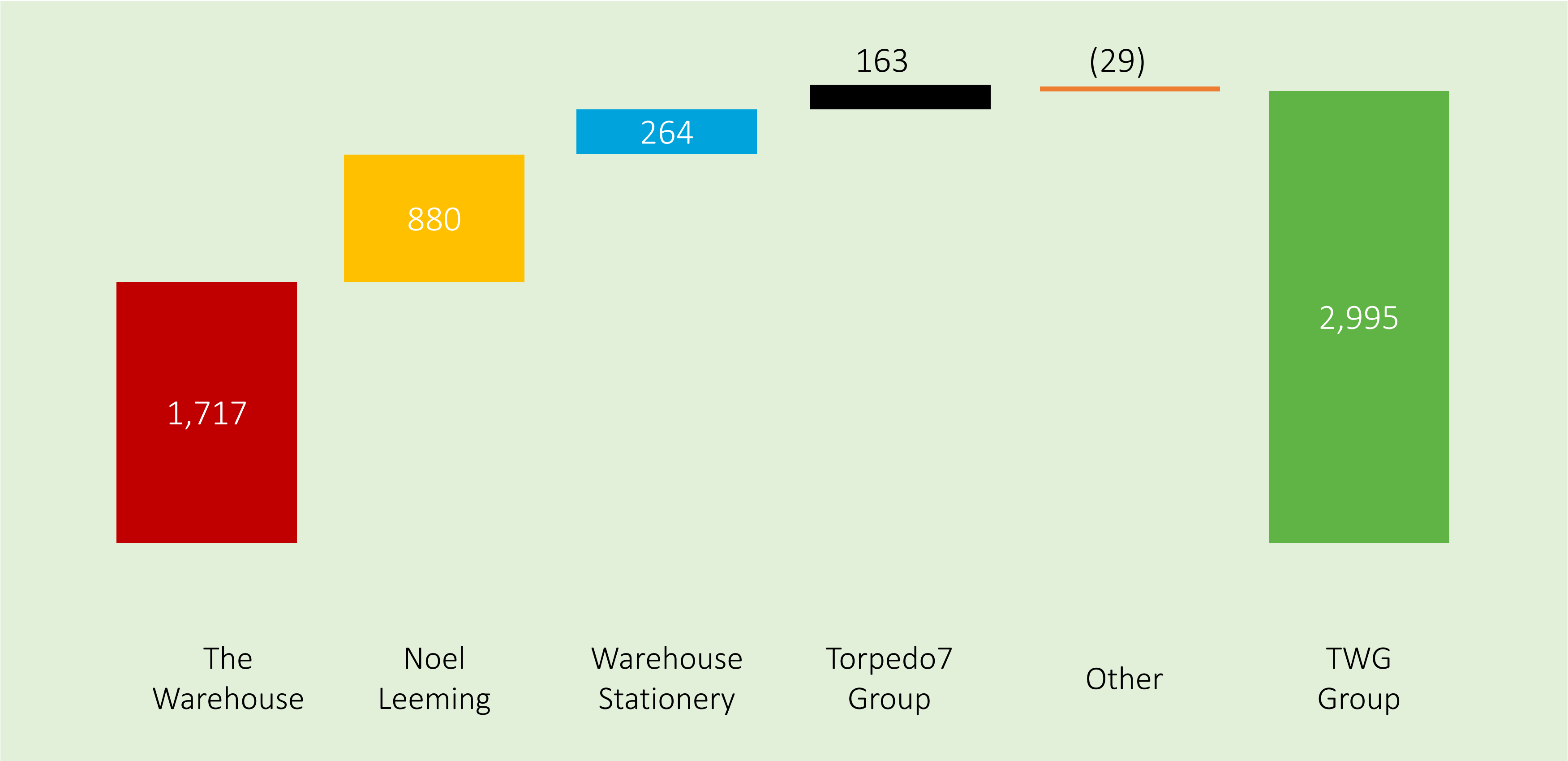
- Higher inventory, increased payables and provisions are the key components of the changes in working capital. Overall net movement is a increase in working capital.
- Capex excluding property and discontinued capex increased from $53.8m in FY17 to $60.2m in FY18, driven by the investment required to deliver transformation.
- Cash flow from divestments include disposal of Lunn Ave and The Warehouse Financial Services.

Divisional Revenue Summary

Divisional Revenue summary

FY18 Revenue by brand

($million)



The Warehouse Performance

For the year ended 29 July 2018

$ million	2018	2017	Variance
Retail Sales	1,716.6	1,761.4	(2.5)%
Same Store Sales	-3.0%	1.2%	(420)bps
Retail Gross Profit	642.4	648.9	(1.0)%
Gross Margin %	37.4%	36.8%	60bps
Retail CODB	571.0	564.4	1.2%
CODB %	33.2%	32.0%	120bps
Retail Operating Profit	71.4	84.5	(15.5)%
Operating Margin %	4.2%	4.8%	(60)bps
Capital Expenditure	41.4	36.4	5.0
Stores	93	92	1

- FY18 was a year of significant reset for Red under EDLP.
- Retail sales down 2.5%. The drop in revenue was expected and due to the transition to EDLP.
- A positive lift in Gross Margin from 36.8% to 37.4%.
- Under EDLP we observed:
  - A lift in unit sales volume by 6.6%
  - Simplification of private label portfolio from 136 to 30 labels
  - SKU reduction by 9.8%
  - Marketing savings of $5.0m from reduction of mailers
  - A reduction of clearance goods at higher margins
  - Store labour productivity increase of $1.6m through reduction in manual price re-ticketing
  - Dollar Deals in Grocery increased 14% YOY
  - Apparel rose 2.8% YOY driven by growth across Childrenswear, Menswear and Womenswear.
- FY18 saw one new store opening at the Balmoral Clearance Centre.

Warehouse Stationery Performance

For the year ended 29 July 2018

$ million	2018	2017	Variance
Retail Sales	263.8	278.2	-5.2%
Same Store Sales	-6.0%	-0.3%	(570)bps
Retail Gross Profit	104.7	108.6	-3.6%
Gross Margin %	39.7%	39.0%	70bps
Retail CODB	94.1	92.9	1.3%
CODB %	35.7%	33.3%	240bps
Retail Operating Profit	10.6	15.7	-32.7%
Operating Margin %	4.0%	5.7%	(170)bps
Capital Expenditure	1.5	3.9	(2.4)
Stores	70	69	1

- It was a disappointing year for Blue. We experienced a weaker result in FY18 due to internal systems integration issues and an industry segment that is facing challenges due to changes in customer buying behaviour.
- Sales fell 5.2% from the previous year to $264m in FY18.
- Operating profit decreased from $15.7m to $10.6m, with a corresponding operating margin reduction from 5.7% to 4.0%.
- Careful management of CODB through the year led to an increase of 1.3%.
- The first half of the year was particularly challenging and saw a 7.1% decline in sales compared to H1 FY17. In H2 we reduced our deficit to 3.3%.
- The pilot scheme for Store within a Store continues.
- Warehouse Stationery remains number one in the Back to School category.
- FY19 will focus on repositioning the business ahead of structural changes in the industry. This will see dedicated resource to the B2B segment of the business and growth in shoulder categories.
- Three stores were combined into Red stores, two new stores (Glenfield and Rolleston) and one relocated store (Fraser Cove). One store closed in Mt Wellington.

Noel Leeming Performance

For the year ended 29 July 2018

$ million	2018	2017	Variance
Retail Sales	880.5	810.7	8.6%
Same Store Sales	5.7%	6.4%	(70)
Retail Gross Profit	198.9	171.5	16.0%
Gross Margin %	22.6%	21.2%	140
Retail CODB	167.7	152.2	10.2%
CODB %	19.1%	18.8%	30
Retail Operating Profit	31.2	19.3	61.8%
Operating Margin %	3.5%	2.4%	110
Capital Expenditure	11.3	10.4	0.9
Stores	74	77	(3)

- Noel Leeming had a stand out year and continues to benefit from advantages of scale and the expertise offer through the assisted sales model. Purposeful strategy has been well executed.
- Noel Leeming delivered an 8.6% increase in revenue to $880.5m.
- Retail Operating Profit up 61.8%, from $19.3m to $31.2m
- Sales growth was driven from category growth in audio visual 22%, computer accessories 13%, and communications (cellular and wearables) 12% YOY.
- Noel Leeming Tech Solutions in over 40,000 NZ homes p.a. Services now makes up 2.7% of all sales, up 2.5% YOY.
- Over 50% of MyTechSolutions product purchases have used some feature of the service plan within the first year.
- High customer experience rating for Tech Solutions, NPS of 86%.
- 2 new stores opened in FY18 (Royal Oak in Auckland and Rolleston in Christchurch). 5 Built-in Cooking Centre Stores incorporated into their respective main stores to simplify operations (St Lukes, Wairau Park, Sylvia Park, Napier and Moorhouse).

Torpedo7 Performance

For the year ended 29 July 2018

	2018	2017	Variance
Retail Sales	163.4	157.7	3.6%
Same Store Sales	1.3%	5.6%	(430)bps
Retail Gross Profit	39.3	38.4	2.2%
Gross Margin %	24.0%	24.4%	(40)bps
Retail CODB	40.7	35.7	13.9%
CODB %	24.9%	22.7%	220bps
Retail Operating Profit	(1.4)	2.7	-154.1%
Operating Margin %	-0.9%	1.7%	(260)bps
Capital Expenditure	2.9	0.6	2.3
Stores	14	12	2

- It was a year of further investment and repositioning for Torpedo7.
- Sales increased by 3.6% and Retail Gross Profit of 2.2%, however we faced high margin pressure and realised a Retail Operating Loss of $1.4m.
- Loss caused by difficult trading conditions, on-going challenges with sub-scale operation and internal disruption connected with relocating parts of the business operations.
- In August 2018 we impaired the remaining goodwill of Torpedo7 of $25.6m attributed to business acquisitions in 2013 and 2014.
- The future cash flows, which reflect an investment in store expansion programme towards being an omnichannel retailer, no-longer supported the valuation of goodwill.
- We sold Shotgun Supplements, folded the No. 1 Fitness business as a category in T7, and scaled back the Australian online business.
- In FY18 we opened our flagship store in Westgate (Auckland), Porirua and Remarkables Park (Queenstown). One store closed in Penrose.
- In the next 3 months Torpedo7 will open 4 new stores and plans to open further new stores during FY19 in order to bring the scale required to deliver profitability.

Strategy and Transformation Update

Our Strategy

- Our purpose: Helping Kiwis live better every day
- Strategic pillars: Fixing the retail fundamentals | Investing in the digital future
- Our priority: Transformation
- Our enablers: Technology | Culture | Shared values

- Transformation focus
  - Store Performance
  - Merchandise
  - Logistics
  - Central Functions
  - Non-Trade Spend
  - Capital

Our People

Our Senior Executive Team

Nick Grayston
Group CEO

- **Evelyn Ross** – Chief People Officer
- **Jonathan Waecker** – Chief Marketing Officer
- **Jonathan Oram** – Chief Financial Officer (from 1 October 2018*)
- **Mark Yeoman** – Chief Operating Officer
- **Pejman Okhovat** – CEO of The Warehouse and Warehouse Stationery
- **Tim Edwards** – CEO of Noel Leeming and Torpedo7
- **Scott Newton** – Chief Transformation Officer

*Mark Yeoman is the current Group CFO and will focus on his role as COO from 1 October.

Transformation Timeline

1,000+

Ideas generated

250+

Initiatives actively worked on

↑ EBIT

Earnings uplift

Culture

Building a sustainable and high performance culture

JANUARY FY18

Independent Assessment

MARCH FY18

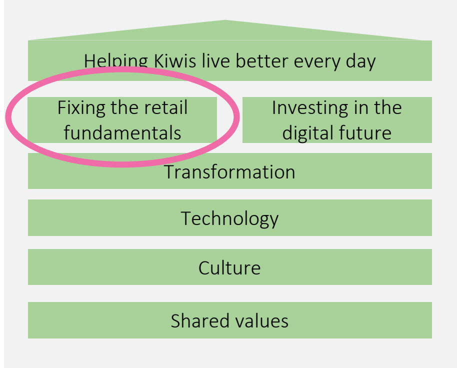
Transformation Planning

JUNE FY18

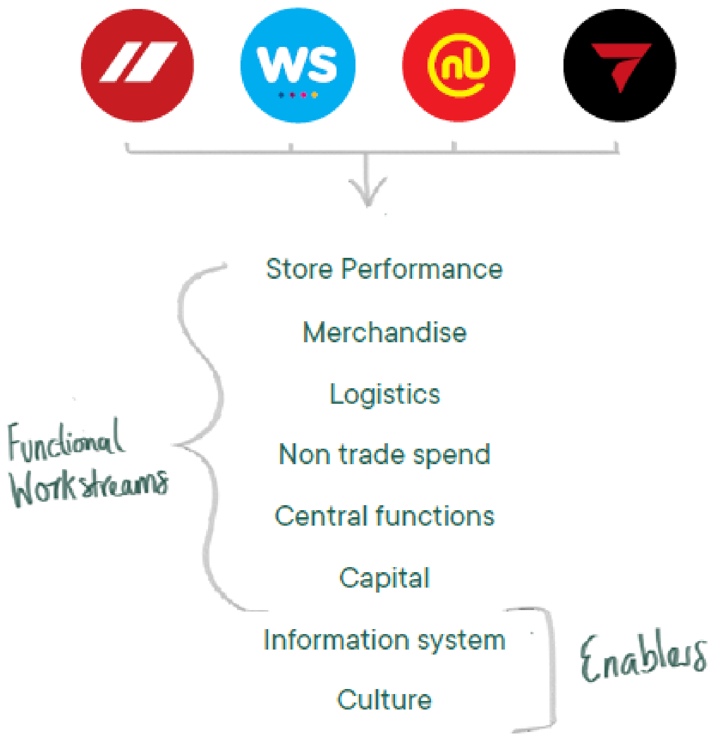
Implementation Kick off

TRANSFORMATION ON GOING (2 YEARS)

Our Transformation



Our transformation Workstreams



- Our transformation is focussed on fixing our retail fundamentals
- 12 workstreams (8 functional, 4 brands)
- 250+ initiatives
- 200+ team members involved
- We estimate the capex for FY19 to be between $80m to $100m.
- Largest capex demands over next few years are directed towards technology and store improvements.
- Transformation in favour of projects with payback horizons between 12 to 18 months.
- Skill and capability development in execution, negotiation, pricing optimisation and data analytics.
- Embedding a culture change to adopt an ‘Owner’s mindset’
- Weekly cadence set by Transformation Office, with support of our transformation partners.
- 55% growth vs 45% cost initiatives

Investing in the digital future

- While we are focused on fixing the retail fundamentals through our transformation programme, we are also investing in our digital future to get ahead of the curve.
- In FY18 we boosted our digital capability and did a lot of work to bring our core IT infrastructure up to standard. This included:
  - moving our IT system to IBM cloud
  - introducing chat bots to improve customer service experience
  - digital marketing to launch personalised product catalogues on Facebook
- In FY19 we will continue to invest in building a competent fulfilment capability and improving our infrastructure, systems, supply chain, and distribution process, setting the foundation for our future.
- New Warehouse Management System (WMS) will provide greater visibility, allow dynamic allocation of orders, and help decisions based on real-time information. We anticipate this will save approximately $5.4m from FY20.

Our focus on this strategy is to:

- Create a mobile first platform to build digital capabilities and ecosystems to respond to customer needs
- Create effortless, personalised and seamless customer experience and interaction across multiple brands and omnichannel
- Create innovative ways to engage and reward customer loyalty, and enhance value added service offerings.

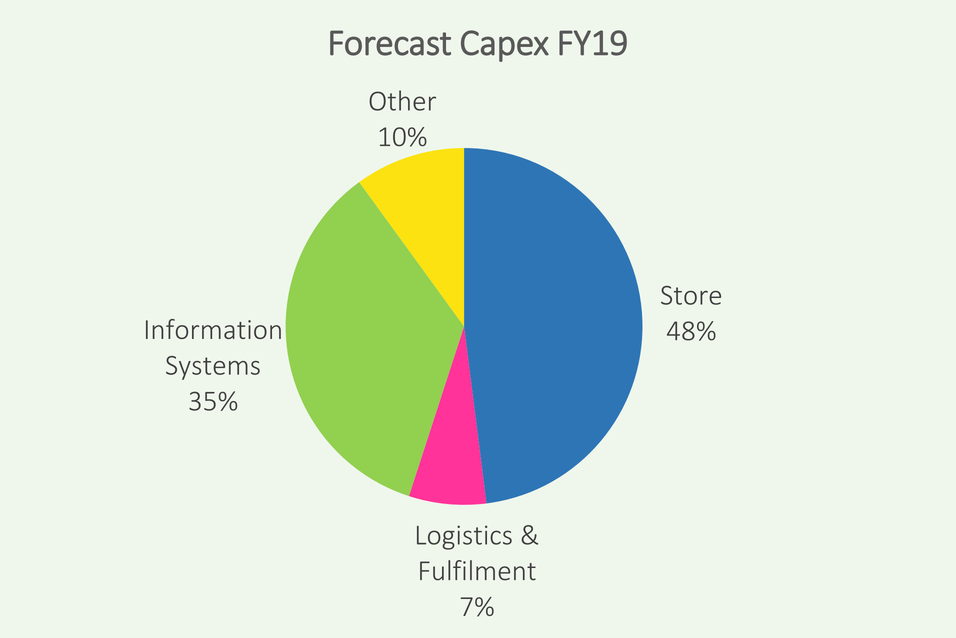
‘An efficient and frictionless offering is no longer a differentiator.’

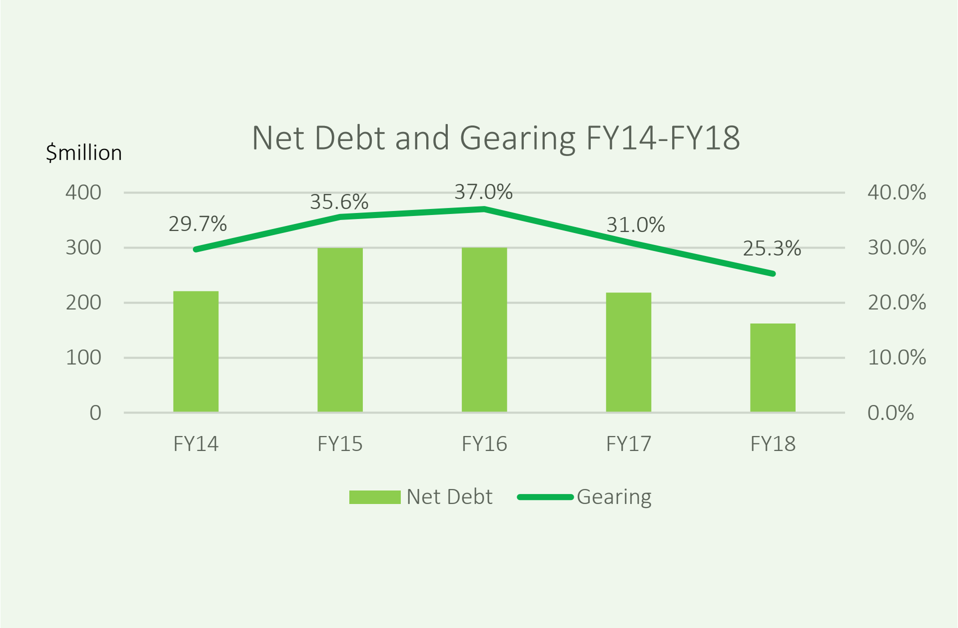
Nick Grayston

CEO

Group Outlook

Capital requirements for Transformation





- Capex increased from $64m in FY17 to $72m in FY18, driven by investment required to deliver transformation.
- We estimate capex for FY19 to be in the range of $80m to $100m.
- Transformation will favour projects with payback horizons of between 12 to 18 months.
- Largest capex demands over next few years are directed towards technology and store improvements.
- Our transformation can be accomplished within the existing capital investment envelope for the business because most initiatives are focussed at improving business processes and supported by targeted technology investments.

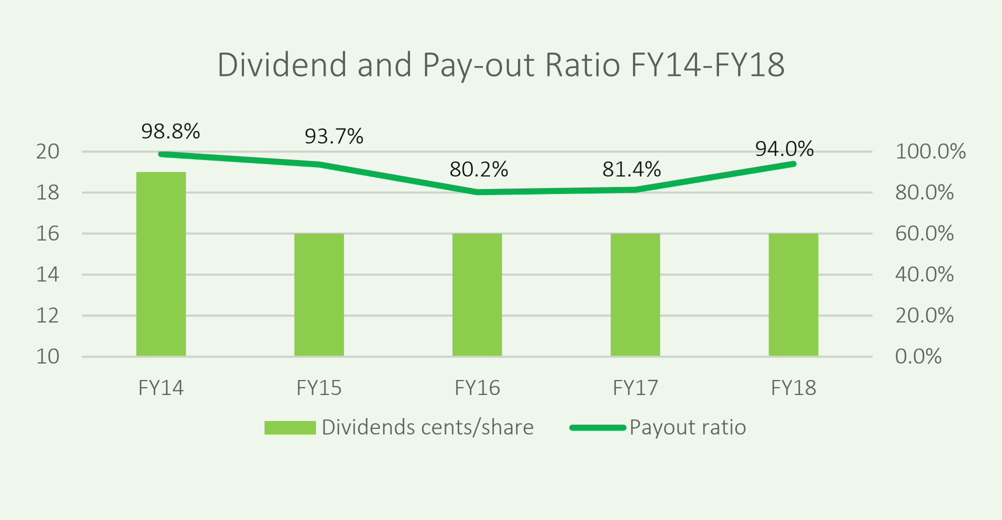
Outlook for FY19

We expect FY19 to be a year of continued investment to deliver the benefits of our transformation.

- With some execution risk in front of us and increased transformational operational expenditure, we expect a modest increase in profitability.
- We expect non-recurring transformation costs and fees related to the transformation to be between $20-$30m, which equates to approximately 1% of Revenue.
- A significant part of performance improvement is expected to be through the continued realisation of benefits under EDLP in The Warehouse. We have cycled through our clearance activity related to the introduction of EDLP and we expect trading improvements through FY19 as we optimise our operating model. We expect the investment made into the transformation will be more fully realised in FY20. We remain committed to the objective of improving our EBIT margin to 7% over time.
- We expect some headwinds in FY19 from currency movements and increases in labour and fuel costs.
- The earnings outlook in FY19 will be dependent on the critical Christmas trading period. Earnings guidance for FY19 will be given at the end of the second quarter.

Dividend

- Dividend policy remains unchanged with a dividend pay-out ratio of 75%-85% of Adjusted Net Profit After Tax.
- In light of the transformation programme we will revisit capital structure and dividend policy as appropriate. A further update on dividend policy will be made at Annual Shareholder's Meeting.
- The Directors are pleased to confirm the final dividend for FY18 of 6.0 cent per share. This brings the total dividend for FY18 to 16.0 cents per share fully imputed.
- Total Dividend pay out represents 94.0% of the Group Adjusted NPAT and is above our dividend policy, which reflects the Board's confidence in Group strategy.
- Dividend Record Date: 23 November 2018
- Payment date: 6 December 2018



Thank you

Q&A