

The Warehouse Group 2023 Annual Meeting

24 November 2023

CEO Address – Nick Grayston

Introduction

Thank you, Joan and good morning everyone.

There is no question that 2023 has been a challenging year for The Warehouse Group. I would like to start my comments today by acknowledging that our annual results for FY23 are disappointing and that we have significant work underway to win back the confidence of analysts and shareholders.

In FY23 while we're proud to have kept the essentials affordable for families and made strong FY23 sales at The Warehouse, the EBIT result was degraded by other factors.

These include our ongoing investment in the transformation and modernisation of the Group's systems and infrastructure which coincided with much weaker consumer confidence. The impact was exacerbated by the significant increase in the cost of living and a shift in spending and disposable income away from big-ticket items to travel and entertainment. These factors, along with material cost inflation to Cost Of Goods Sold, compromised our margin and profitability.

There is plenty of upside to fight for. I will take you through the plan we have put in place from which we are seeing some early progress in key areas. We were pleased to be able to share details of some margin improvements and reduction in our Cost of Doing Business in our latest FY24 Q1 Trading update, which I will also share more about.

Strategic Prioritization

The first half of FY23 was challenging, during which we experienced a raft of headwinds, impacting our margins and profitability. While we planned for an increase in Cost of Doing Business, in particular around information system costs, we faced more pressure on our Gross Profit Margin than expected through promotional activity and cost of goods, while trying to deliver value to our customers.

We made the conscious choice to continue the investment to complete our transformation programme which drove increased CODB, particularly IS operational expenditure and depreciation. The change in accounting principles also meant much of this expenditure hit the bottom line immediately, resulting in this being expensed through the Profit and Loss, rather than being capitalised over 5 or 10 years.

In 2021, coming out of COVID, we recommitted to a strategy that focussed on fixing the retail fundamentals and investing in the digital future. While it is hard to strike the right balance in the best of times, the post-COVID-19 environment and subsequent change in customer shopping habits has caused us to refocus the balance on retail fundamentals.

As a result, we have deferred approximately \$30 million of digital initiative expenditure. We are 30 years underinvested and we are going through a painful time of catch-up. However, it would be inefficient to stop these much-needed key infrastructure projects part way through, versus continuing and finishing these much needed investments.

In response to tougher trading conditions, we undertook a strategic reprioritisation, to focus on the key triggers to improve our financial performance, and improve both our operational efficiency and our customer offering.

- For our financial performance, this means focussing on operational performance by minimising our cost to serve and managing gross profit margin. Looking at initiatives to reduce our cost of doing business and to rebalance our capital and project expenditure.
- Operationally and better to serve our customers, we have integrated TheMarket and Torpedo7 into our Agile brands operating structure. We are focussed on growing grocery in The Warehouse including our own private label Market Kitchen range. And we continue to build our MarketClub membership programme to offer the best deals for our customers and leverage our competitive advantage.

Actions taken to improve performance

As Joan mentioned, while sales increased in FY23, it was a disappointing year as our margins and profitability declined. As part of the strategic reprioritisation – and specifically to improve our financial performance, to minimise our cost to serve, manage gross profit margin, and reduce cost of doing business and project expenditure, we have set the following initiatives:

Reprioritised transformation to concentrate on EBIT delivery:

- We have restructured teams in the SSO which will deliver \$24 million annual benefit;
- We expect TheMarket loss to be less than \$5m this financial year, down from \$16m in the FY23 first half alone;
- We've reduced TheMarket promotional spend close to zero; and
- We have deferred approximately \$30 million digital initiative expenditure until we can afford it.

We continue to reduce store labour costs by driving greater efficiency. As a consequence:

- Total employee expenses have held flat as a percentage of sales in FY23 compared to FY22 – despite wage inflation pressures; and
- The Warehouse cost of doing business decreased as a percentage of sales from 35.9% in FY22 to 33.6% in FY23.

With regards to 1-day, TheMarket and Torpedo7:

- We closed 1-day website, exited 1-day distribution centre, and sold through 1-day inventory;
- TheMarket.com moved to Agile in March 2023 with greater focus on Group Marketplace and we are assessing the future platform direction with a view to further simplification;
- Torpedo7 moved to Agile structure in August 2023. We have a full Torpedo7 review underway of which I'll share more details of in a moment.

In The Warehouse, we are focussed on improving profitability of our grocery offering:

- We increased Market Kitchen range to include 64 different products in FY23, with many more being added;
- We have improved grocery supply chain capability and efficiency;
- We have improved margin management – through real time pricing, reactive pricing to increased cost of product, and reduced handling through distribution efficiencies and the use of bulk stacks; and
- Reduced our SKU-count by eliminating unprofitable SKUs and duplication
- Increased our fresh fruit and vegetables offering to 22 stores.

And lastly, after a couple of years of elevated inventory levels due to supply chain disruptions, we reduced inventory levels which helped reduce working capital:

- Inventory reduced materially between the FY23 half year and year end with closing inventory \$493.3 million compared to \$562.3 million at FY22.
- System projects have commenced which will enable us to improve inventory further once complete.

We know we still have significant work to do. We are committed to improving our performance through controlling our costs, improving our margins, increasing profitability, and growing shareholder value.

Group Performance

We have been through the results and the headline numbers, so I will just briefly touch on the key P&L and Balance Sheet line items.

While sales increased 3.2% over the year, Gross profit margin decreased 190 basis points compared to prior year to 33.4% - and as mentioned this did improve in the second half and we are seeing this improvement continue into the first quarter of FY24 as a result of the implementation of margin management initiatives.

Cost of Doing Business increased in dollar terms, mainly due to significant increases in informational systems, digital costs and depreciation, but decreased slightly as a percentage of sales to 31.6%.

Adjusted NPAT was \$37.5 million in FY23, compared to \$85.5 million in FY22, a decrease of 56.2%.

Reported NPAT was \$29.8 million in FY23, compared to \$89.3 million in FY22 due to restructuring costs and the impairment of Zoom investment.

Balance Sheet

One of the biggest hurdles over the past couple of years was the build up of inventory as we managed uncertain stock flow through COVID supply chain disruptions and port congestions. It was pleasing to see our work result in inventory returning to normalised levels. Our payables balance reduced significantly.

Fixed assets increased due to an increase in store development, notably our new Warkworth stores which opened in May 2023, and investment in core systems and digital platforms, offset by sale of Royal Oak property which reduced capital consumption under a sale and lease back arrangement.

While Net Debt increased from \$41.2 million to \$48.1 million at year end, this was a significant reduction from \$83.4 million at the FY23 half year.

And the year end liquidity of \$421.9 million, is well within the Group's target liquidity range of \$350 million to \$450 million.

Project Expenditure

The nature of new accounting standards and the fact that a significant amount of our project expenditure is now classified as SaaS spend, or "Software as a Service" means that much of it hits us immediately as expense and is taken straight to the P and L. Now we account for total project expenditure rather than just capital expenditure taken to the Balance Sheet.

In FY23, capital expenditure was \$113.2 million compared to \$107.5 million in FY22, while total project expenditure was \$154.4 million on these projects in FY23.

Core Systems investment included the ERP Finance and Inventory, Group Order Management System, Warehouse Management System, Master Data Management, and the delivery of our new people and HR system, Human Capital Management.

Store development continued in FY23, but at a lesser pace than in FY22. New stores included the new Warkworth retail centre including The Warehouse, a Warehouse Stationery SWAS, and a relocated Noel Leeming store. We opened a new Torpedo7 store in Botany and relocated the Torpedo7 Christchurch store to a bigger site. Our SWAS integration programme included the development of a further 5 stores in FY23, bringing the total number of SWAS stores to 40.

Total project expenditure of \$80 million is planned in FY24, with capital expenditure (including prepayments) expected to be between \$60 million to \$70 million.

Torpedo7 Recovery Plan

We have experienced significant challenges with Torpedo7 which delivered an operating loss for FY23 of \$22.2 million and we have seen further sales decline of 25.4% in FY24 Q1.

Decreased consumer demand, consistent with the global decline in the bike market, has continued to impact sales and profitability and exposed other flaws in the Torpedo7 business model.

In FY23, we provided for inventory impairment of \$4.6 million against Torpedo7 to manage excess and aged stock and have put a recovery plan in place.

In October we completed a full end-to-end ERP change in Torpedo7. This has caused some disruption with fulfilment in Q1 and resulted in a period when some customers were unable to have transactions fulfilled both instore and online. Most of these teething issues are resolved now.

Addressing Torpedo7's performance continues to be a major focus for the Group for FY24.

We have major initiatives to improve gross profit margin and, importantly, reduce the cost of doing business and will provide a full update at the FY24 half year.

FY24 Q1 Update

On the 14th of November, we shared with the market our FY24 Q1 trading update.

Group sales for the 13 weeks to 29 October 2023, being FY24 Q1, were \$713.3 million, a decline of 6.7% compared to FY23 Q1.

- **The Warehouse** sales were \$394.2 million, down 4.9%. Grocery category sales continued to grow, with sales increasing 8.2% and making up 22.8% of total The Warehouse sales.
- **Warehouse Stationery** sales were \$54.6 million, down 4.0%.
- **Noel Leeming** sales were \$234.1 million, down 5.1%.
- **Torpedo7** sales were \$27.9 million, down 25.4%.

For context, we were up against a very strong comparative period in FY23 Q1 across all brands, following the easing of COVID-19 restrictions. This saw FY23 Group sales increasing 21.2% and The Warehouse sales increasing 39.0% compared to the FY22 first quarter.

Group gross profit was \$243.4 million in FY24 Q1, down just 1.6% compared to FY23 Q1.

We have seen an improvement in Group gross profit margin percentage of 180 basis points year on year, increasing from 32.3% in FY23 Q1 to 34.1% in FY24 Q1, due to improvement in the management of Cost of Goods Sold.

While online sales have decreased, this has been a normalisation of online sales from peak COVID-19 online trading patterns, down to 8.4% of total sales in FY24 Q1.

Highlights for the quarter include opening new The Warehouse and Noel Leeming stores in Wanaka on 12th October and expanding our fresh fruit and vegetables offering at The Warehouse to 22 stores, up from 12 at year end.

While these results show some margin improvements across our main brands and good progress on lowering our Group cost of doing business, we have a firm focus on the Christmas trading peak and on maximising the opportunity of summer.

Outlook

To recap, looking ahead, and drawing on the improvements we've seen in Q1, we are focused on continuing momentum and on improving our financial performance in FY24.

FY24 has started with softer sales than expected, but with Gross Profit Margin improvements broadly in line with expectations. We remain cautious about the outlook as we approach our busiest time of the year.

The business has planned its cost base and inventory purchasing in consideration of this uncertainty. We will continue to adapt our trading plan to the market conditions as sales build through to Christmas.

Torpedo7 has not made the progress we'd hoped to see, and we have a critical quarter ahead as we focus on driving its performance recovery. It is without question a very challenging situation and we will be reporting on the performance against our recovery plan at half year.

We have planned project expenditure of \$80 million in FY24 with a focus on delivering major projects that are in flight.

We are well positioned as we move into our biggest quarter including Black Friday, Christmas trading, and our summer peak period with good levels of stock across all our brands.

Leadership Squad

And lastly, I would just like to provide you an update with, and introduce, our Leadership Squad.

As Joan mentioned, our Chief Financial Officer Jonathan Oram left the Group last month after five years with the business. But we are thrilled to have the calibre, company knowledge, and financial expertise of Celia join the Leadership team. Celia has been with the Group for nearly 3 years and up to her appointment of Acting CFO, has been leading the financial performance and forecasting teams.

We're thrilled that Mark Anderton will join the Executive Leadership Squad as Chief Sourcing & Sustainability Officer. Mark is based in Shanghai in our international sourcing office. The progress Mark and his team have made with suppliers, ethical sourcing and growing our range of sustainable products has been significant. With our focus increasingly on tackling our Scope 3 emissions, Mark will lead our sustainability approach going forward.

The rest of the team you know, most of whom are here today, and will be available for questions during the Q&A session at the end of the meeting and to meet with you informally after the closure of the meeting.

Close

To conclude, we are very clear about the work to do in front of us.

We remain committed to our strategy and investment in our transformation, however the shift in market conditions and customer spending has put pressure on our business and led to a disappointing overall result for FY23. This has pivoted our focus from transformation to improving our performance.

I would like to thank you as shareholders for your continued support and I wish you a happy Christmas and summer ahead.

I will ask Joan to return to the lectern to conduct the formal part of today's business.

Thank you, Joan.