2 March 2018

1H18 Results & Business-wide Review Update

Key Points

- Underlying net profit after tax of $24.7m, down 31.8% on the prior corresponding period (PCP), reflects disappointing performance in challenging trading conditions.
- Significant aspects of business-wide review complete, resulting in:
  - Strategic business model reset to focus on the quality of the domestic franchise business;
  - Decision that c.160-200 domestic outlets will be closed by end of FY19, predominantly due to unsustainable rent and declining shopping centre performance;
  - c.$10m targeted in annualised operational savings through the restructure of RFG's existing shared service corporate model;
  - c.$1.5m investment to bolster capability within enhanced franchisee field service model.
- The planned store closures, recent trading performance, and a re-assessment of near-term trading prospects, resulted in non-cash impairments and write-downs, and provisioning, totalling $138.0m, being recognised in the 1H18 result, including:
  - Brand System impairments of $84.0m;
  - $35.7m arising from closure program; and
  - $18.3m for PP&E and inventory write-downs, loss on real property disposals and miscellaneous matters.
- Contributed to 1H18 statutory net loss after tax of $87.8m.
- Dividends suspended to support balance sheet following strategic reset.
- Net debt as at 31 December 2017 was $259.7m:
  - RFG in compliance with all banking covenants at this date.
- $150m debt facilities extended into longer maturities.
- Agreement with senior debt lenders to reset financial covenants.

Retail Food Group Limited (RFG, the Company or Group) today announced an underlying Net Profit after Tax (NPAT) of $24.7m for the six months to 31 December 2017, down 31.8% on PCP, following a difficult period influenced by persistent challenging trading conditions.

The recent operating performance, a re-assessment of near term prospects, and a decision to implement the initial recommendations arising from the Company's strategic business-wide review, have resulted in non-cash impairments and write-downs, and provisioning, totaling $138.0m in RFG's 1H18 result, contributing to a 1H18 statutory net loss after tax of $87.8m.

This comprehensive business-wide review was initiated in response to poor trading results which were impacted by ongoing challenging retail market trading conditions, especially within increasingly competitive shopping centre locations, and to better leverage RFG's diversified growth platform, support franchisee sustainability and improve shareholder value. Key recommendations to come from the work completed to date focus on the simplification of RFG's business.

The Company's strategic focus is on improving performance and growing a stronger balance sheet now and into the future. Dividend payments have, therefore, been suspended with immediate effect, and the Company's dividend payout ratio will be reassessed by the Board at an appropriate time in the future.

Persistently tough retail conditions and the cumulative impact of 2H17 and 1H18 domestic outlet closures, combined with onerous lease conditions and internal challenges in the management of RFG's business model, particularly evident in a sharp decline amongst domestic franchise sales and renewals, contributed to RFG's 1H18 results.

Recognition of new international licence fee revenue early in the 2H18, following a brief timing delay regarding conclusion of these arrangements, also influenced the 1H18 results.

Significant items recorded in the Company's 1H18 accounts comprised:

- A non-cash write-down, and provisioning, totaling $35.7m, arising out of the network analysis and closure program;
- Non-cash impairments against the book value of Michel's Patisserie ($45.0m), Pizza Capers ($4.5m) and Coffee Retail Division CGU ($34.5m); and
- A non-cash write-down, and provisioning, of $18.3m on account of PP&E and inventory write-downs, loss on real property disposals and miscellaneous matters, following prioritisation of investment in those initiatives better positioned to drive enhanced shareholder outcomes.

Managing Director Andre Nell said RFG was taking decisive action to address the Company's underperformance.

"We have had to make some tough decisions about our business model, our franchise network and the value of some of our assets," he said.

"The key to improving our performance is to simplify what we do. We have all the assets we need to deliver our diversified business strategy – now we need to make sure we make the best use of those assets. The actions we are taking now will secure a sustainable long-term future for the Company and our franchisees' businesses, and drive future value for our shareholders."

1H18 RESULTS SUMMARY

Summary of Results	Reported			Underlying		
	1H17[1]	1H18	Change	1H17	1H18	Change
Revenue	$161.9m	$195.5m	↑ 20.8%			
EBITDA	$55.4m	($100.8m)	↓ 282.1%	$60.5m	$45.7m	↓ 24.5%
NPAT	$32.7m	($87.8m)	↓ 368.4%	$36.2m	$24.7m	↓ 31.8%
EPS	19.2 cps	(49.0cps)	↓ 355.2%	21.2 cps	13.8 cps	↓ 34.9%
Interim Dividend per Share (DPS)	14.75 cps	-				

(1) 1H17 restated – refer Note 21 to 1H18 financial statements

DIVISIONAL PERFORMANCE

Divisional Contribution to Underlying 1H18 EBITDA	1H17[1]	1H18	% Change
Total Franchise (Domestic)	**$37.6**	**$26.7**	**(29.0%)**
Domestic Franchise Operations	$26.6m	$16.7m	(37.2%)
Domestic Coffee Contribution[a]	$11.0m	$10.0m	(9.1%)
Total Franchise (International)	**$10.1**	**$6.3m**	**(37.6%)**
International Franchise Operations	$8.7m	$4.5m	(48.3%)
International Coffee Contribution[a]	$1.4m	$1.8m	28.6%

Total Franchise (Domestic & International)	**$47.7**	**$33.0m**	**(30.8%)**
Coffee Wholesale[(b)]	**$9.1m**	**$5.5m**	**(39.6%)**
Commercial Division	**$3.7m**	**$7.2m**	**94.6%**
Total Underlying 1H18 EBITDA	**$60.5m**	**$45.7m**	**(24.5%)**

(1) 1H17 restated – refer Note 21 to 1H18 financial statements

(a) EBITDA contribution from Coffee & Allied Beverage sales to Brand System franchise/master franchise partners (as the case may be).

(b) Excludes EBITDA contribution from Coffee & Allied Beverage sales to Brand System franchise/master franchise partners.

Franchising Operations

1H18 new outlet commissionings of 43 fell well below budget, contributing to a net contraction of 66 outlets and closing global network population of 2,450 at the end of the period.

Operationally, domestic weighted Same Store Sales (SSS) and Average Transaction Value (ATV) growth of 0.3% and 2.1% represented a disappointing outcome, heavily impacted by the performance of those Brand Systems with significant shopping centre exposure, particularly during a weaker December 2017 trading period. This performance is contrasted with the QSR Division's performance, where credible SSS and ATV metrics of +2.4% and +3.1% were underpinned by disciplined pricing, menu innovation, alignment with delivery aggregators and a focus on operational excellence.

The transition of the Michel's Patisserie network to an instore operating model continued to present challenges. During 2018, the Brand System will implement repositioning, including new menu items, which emphasizes Michel's French café heritage and better responds to changing consumer tastes and demands.

Mr Nell said, "RFG's future profitability and growth is directly linked to the health and sustainability of its franchise network, and it is clear from the review process that RFG needs to reset its business model and enhance its support to franchisees, including accelerating the delivery of initiatives that increase their revenues, reduce operating costs, and provides them with more 'hands-on' assistance in the field."

The Gloria Jean's Brand System has already initiated a significant brand evolution to provide entry into fast casual dining, including an all-day menu and new 'hero' products, underpinned by significant R&D and franchisee, consumer and landlord engagement.

International

During 1H18, RFG made solid progress with its international expansion strategy, entering breakthrough joint venture arrangements with leading UAE based businesses to establish a world class coffee enterprise throughout the Middle East & North Africa (MENA) region and accelerate Brand System expansion within the Gulf.

This outcome was recently supplemented by the grant of international master licenses in early 2H18 for the Donut King and Crust Brand Systems in the United Kingdom, and, in February 2018, Gloria Jean's in Germany, bolstering growth prospects in Western European markets and complementing existing licensed territories which represent a future platform for establishment of a European hub.

RFG now has 84 international licensed territories across 12 Brand Systems and, while many are in the early stages of their development cycle, they are expected to provide growing recurrent revenue streams as territories mature.

Coffee & Allied Beverage (C&AB)

Wholesale coffee contribution to underlying 1H18 Group EBITDA fell 39.6% to $5.5m, influenced by loss of margin in the contract roasting sector on new customer acquisition, lower volumes on existing customer base impacted by retail challenges, and c.$2.0m in non-recurring gains in the 1H17 and losses on sale of assets.

To reinvigorate performance, the Group has implemented a divisional restructure to refocus its sales strategy, better align capability and leverage RFG's strong coffee credentials. Leading this initiative is Darren Dench, who has been appointed to the role of Global Head of Coffee. A proven sales and marketing leader within the FMCG industry, Mr Dench has previously held key positions in organisations such as Ferrero and LaVazza.

RFG will ultimately exit its existing low-margin capsule operations, following non-renewal of the Group's domestic capsule supply agreement and a failure to achieve adequate business for the professional machine program, which has been significantly impacted by technical and manufacturer related issues.

Commercial

1H18 Commercial Division performance was consistent with expectation, contributing $7.2m to 1H18 underlying Group EBITDA, a 94.6% increase on PCP reflecting the full period contribution of FY17 acquired assets.

Investment in sales and management capability has driven a 9.5% increase in foodservice customers since 30 June 2017, and new business secured for Dairy Country, largely commencing in the 2H18. New product innovation and customer acquisition also drove growth in Bakery Fresh throughput to c.2.3m kg for the period.

BUSINESS-WIDE REVIEW RECOMMENDATIONS

Domestic Outlet Analysis & Consolidation

A comprehensive domestic outlet network analysis has been undertaken, referencing three-year quantitative data (including sales, lease & performance information) and qualitative store-by-store assessment.

Following this analysis, the Company has determined that c.160 to 200 of its existing domestic outlet network is unsustainable on a long-term basis. Subject to moderation of landlord rental requirements, due to unsustainable or above market rent expectations and declining shopping centre performance, these outlets will either be closed or lease renewal not sought on expiry, on or before 30 June 2019. Approximately one third of these outlets are corporate sites.

RFG is seeking to renegotiate improved rental outcomes, where possible, to minimise closures, and will work constructively with impacted stakeholders.

Organisational Enhancement

In recent years, RFG has experienced rapid growth through acquisitive activity. This growth delivered many benefits, but also led to a complexity which impacted focus on RFG's franchise business, and resulted in an increasingly inefficient head office and shared service resource, diminishing organisational effectiveness.

A key focus of the business-wide review is reduction of duplication and inefficiency, better integration of support structures, and improving alignment of the Company's resources with core revenue drivers.

The review targets c.$10m in annualised operational savings, of which c.$4.8m has been realized to date, the full impact of which will be felt in FY19. Further efficiencies will be delivered in the 2H18.

The Company will also invest c.$1.5m to bolster capability within an enhanced franchisee field service model.

CAPITAL STRUCTURE

RFG's net debt as at 31 December 2017 was $259.7m.

The Company was in compliance with all banking covenants as at this date.

During 1H18, RFG's three year debt facilities of $150m were extended, with $100m maturing January 2020, and a further $50m maturing December 2020. As well, the Company reduced its existing five-year facilities maturing December 2020 by $25m. As at 31 December 2017, the Company's total senior debt facilities represented $319m.

Subsequent to the half-year end, the Company has been in negotiations with its senior debt lenders, to reset financial covenants attaching to the Group's debt facilities. Agreement has been reached between the Company and its lenders, subject to formal documentation of amendments to the debt facility agreements, to reset covenants effective 2 March 2018 for covenant testing periods commencing 1 January 2018. Key terms of the reset include:

- Operating Leverage ratio (debt/EBITDA) increased for 12 months to 3.0x, from 2.5x, reverting to 2.5x thereafter;
- A minimum underlying FY19 EBITDA budget of $90m;
- Introduction of a financial covenant on actual quarterly underlying EBITDA performance to budget, with a 20% variance trigger;
- Loan amortisation of $12.5m to occur by 2 March 2019;
- 60% of net proceeds of any asset disposal (unless agreed) to be applied to repayment of debt;
- Pricing adjustment to incorporate increased Operating Leverage limit; and
- No change to current tenor of facilities.

OUTLOOK

1H18 had been a challenging period for the Group and its franchisees, requiring a strategic reset and decisive actions being taken to address underperformance to secure a sustainable long-term future for the Company's and its franchisees' businesses.

Mr Nell noted that RFG's Board is confident in the strength of the Company's underlying business operations and the Group's ability to support its Brand Systems and their franchisees. However, it recognises that retail trading conditions, especially in shopping centres, will remain challenging for the foreseeable future and RFG needs to improve the support it provides to its franchisees as a consequence.

"As the Company progresses its business-wide review, consideration will be given to further structural improvement to better ensure RFG is applying resources more effectively. This includes further review of our broader brand strategy and portfolio".

"This process will ultimately drive a simpler business model underpinned by a leaner and more agile support structure," he said.

Key executive appointments, including Richard Hinson as Chief Executive – Australia and Darren Dench as Global Head of Coffee, have been made to further support the business and fast-track initiatives identified in the business-wide review.

Given RFG's ongoing business-wide review and the decisive action being taken by the Group, it is difficult to predict full year outcomes at this juncture. The Company will keep the market informed of developments.

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For further information, interviews or images contact:
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About Retail Food Group Limited:

RFG is a global food and beverage company headquartered in Queensland. It is Australia's largest multi-brand retail food franchise owner, a roaster and supplier of high quality coffee products, and an emerging leader in the foodservice, dairy processing and wholesale bakery sectors. For more information about RFG visit: www.rfg.com.au