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23 February 2017

Market Briefing

Grays eCommerce Group CEO on H1 FY17 results and outlook

Interview with Mark Bayliss (Chief Executive Officer)

In this Market Briefing interview, Grays eCommerce Group's CEO, Mark Bayliss, discusses the company's results for the six months ended 31 December 2016 (H1 FY17) and strategic outlook including:

- *Financial performance over H1 FY17*
- *Strategic initiatives to drive sustainable growth in EBITDA*
- *Diversity of Grays eCommerce Group's industrial B2B revenue mix*
- *Strategic decision to rationalise B2C division*
- *Outlook for FY17 EBITDA*

Market Briefing
Grays eCommerce Group's H1 FY17 results showed strong growth in revenue, up 14.6% to $71.3 million. However, EBITDA declined 12.4% to $7.1 million. What was the driver behind the earnings decrease?

Mark Bayliss
The Group's strong growth in net revenue was driven by our B2B division, which was up 16.3% to $40.4 million.

Our B2B strategic investment programme is delivering results with strong performances from Auto, Mining and Transport, and increased revenue at higher EBITDA margins generated. This growth in revenue allowed us to invest an additional $5.3 million in people and infrastructure, resulting in EBITDA for the B2B division being up 3.8% to $9.4 million.

The performance of our B2C division was disappointing. Having made the strategic decision to exit the highly competitive and unprofitable fixed price retail segment in FY16, the remaining B2C business was refocused on a narrower range of consumer categories. Further investment was made into the Company's marketing capability by focusing on customer acquisition and engagement, and reviewing the cross-over of customers from B2C to B2B. With sales over the two key trading months of November and December below expectations, B2C net revenue decreased by 9.8% to $15.6 million, and an EBITDA loss of $0.3 million was generated.

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Can you provide some more colour around the investments you are making? When we can expect these investments to deliver EBITDA growth?

Mark Bayliss
Most of the planned investments we made from the second half of FY16 were implemented to position our B2B division for sustainable growth. This investment programme continued in the first half of FY17 and is anticipated to be completed in the second half.

A good example of the investment we have undertaken in B2B is our Auto business. The investment in people and facilities, including additional auto yards, underpinned the growth in numbers of cars sold to 13,500 in H1 FY17 compared to 8,800 in H1 FY16.

We have also enhanced our auto offering to now include a buyers' finance option, which has already seen a strong uptake of 14%, higher than the industry average of 10%. We are currently trialling a motor vehicle warranty option, which we believe is a very complementary addition to our auto offering and assists with gaining and retaining customers.

Over H1 FY17, the total additional business investment made in B2B was $5.3 million in people and facilities. We have already seen incremental H1 FY17 B2B revenue from the investment made in H2 FY16 delivering increased revenues at higher EBITDA margins, and we are confident that this trend will continue.

We continue to expect solid growth in EBITDA from our B2B division in FY17 compared to FY16, reflecting the benefits from the investment programme flowing through.

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How diverse are the revenue streams in the B2B division? Do you believe the current mix is appropriate?

Mark Bayliss
Given the growth opportunities available to us and the depth of our capabilities, we currently have operations in five major B2B categories namely, Mining & Civil, Auto, Transport, Manufacturing/Production and Banking, Insolvency & Finance [BIF]. Our B2B revenue is well diversified across these categories, with no major category contributing more than one quarter of total B2B revenue.

Our BIF revenue grew 18% compared to H1 FY16. This resulted in a slight decline in BIF revenue as a percentage of total B2B revenues from 21% to 20%. While BIF projects often produce substantial revenue for the group, we prefer not to be over-exposed to BIF as revenue tends to be lumpy. Going forward we are targeting a BIF% of total revenue at less than 20% as revenues from other categories grow.

We remain optimistic in relation to our Mining and Civil category, which experienced a 39% increase in revenue and produced 23% of total B2B revenue, up from a 21% contribution during FY16. While there have been fewer receiverships in the mining & engineering services sector in the wake of the recent recovery of commodities, there is still a steady workflow of surplus equipment to be sold as civil construction and infrastructure projects are completed. We believe there are still opportunities for us to grow in this category.

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What opportunities exist from new lines of business like acquisition funding and warranties?

Mark Bayliss

We believe there are opportunities to grow our offering in both acquisition funding, which we have recently started to offer customers, and warranties, which we are currently exploring for our auto business.

We are pleased to have had a strong conversion rate for our buyers' finance product, with 14% of enquiries utilising this option, which compares very favourably to the industry average of 10%. We are also trialling a number of options to enable us to offer a warranty product at competitive prices on eligible vehicles to our buyers.

While buyers' finance and warranty business lines are a natural addition to our auto offering, there may be opportunities to offer these options in other categories as well.

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What was the driver behind the reversal in the performance of the B2C business?

Mark Bayliss

Poor trading over November and December, which are traditionally peak periods in the lead up to Christmas, was the key issue. Grays Home, [which comprises categories including, Art, Jewellery, DIY, indoor furniture, Audio Visual and IT] and Grays Wine both underperformed, as demand weakened and competition intensified in these market segments. We also experienced higher costs during the period as we invested in marketing and our eBay channel to drive sales plus additional warehouse costs for purchased inventory. The overall effect was an EBITDA loss of $0.3 million.

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What actions are being taken to address the underperformance of B2C given the B2C results have steadily declined half on half over the past two years?

Mark Bayliss

Having made the strategic decision to exit the highly competitive and unprofitable fixed price retail segment in FY16, the remaining B2C business was refocused on a narrower range of consumer categories. Further investment was made into the Company's marketing capability by focusing on customer acquisition and engagement, and reviewing the cross-over of customers from B2C to B2B.

The division's underperformance over November and December led to a re-assessment of the longer term strategic relevance of this division in the context of building a growing and sustainable B2B focused business. Following this, and continued poor trading performance in January 2017, we have decided to further rationalise our B2C categories to those that support B2B. An orderly run-down of owned inventories will be undertaken, and the division's fixed cost base will be reduced.

This is the right strategy for B2C. It will minimise future losses in B2C, while also ensuring that shareholder capital and management time is focused on the Company's growth engine, B2B.

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With EBITDA growing over H1 FY17, what was responsible for the decline in Operating Cashflow from $5.7 million in H1 FY16 to $1.9 million in H1 FY17?

Mark Bayliss

Operating cash flow in H1 FY17 was lower due to the timing of B2B activity in the first half. We anticipate that this will improve in the second half as working capital requirements unwind and cash receipts come in this quarter.

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You have revised down your EBITDA guidance for FY17 to a similar level to that achieved in FY16 from Continuing Operations. What has driven this?

Mark Bayliss

We have revised down EBITDA guidance for FY17 due to our decision to rationalise B2C, combined with that division's deteriorating performance. The benefits from investment in the B2B division are expected to continue flowing through in H2 FY17, with continued growth expected in B2B earnings offset by a B2C loss.

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Thank you, Mark.

For further information, please contact +61-2 9112 9440 or go to www.graysonline.com.au or www.graysecommercegroup.com.au