adairs

Release to the Australian Securities Exchange

2016 Annual General Meeting

Chairman's address delivered by Michael Butler

Good morning, Ladies and Gentlemen. My name is Michael Butler, and I am Chairman of the Board of Directors of Adairs Limited.

It is now 11:00am, the appointed time for holding Adairs' 2016 Annual General Meeting. I am advised that a quorum is present. I, therefore, have pleasure in declaring this, the very first Annual General Meeting of Adairs as a publicly listed company, open. Thank you for attending.

Before proceeding with the formal business of the Meeting, I would like to introduce my colleagues:

- David MacLean, Executive Director and retiring Managing Director & CEO
- Michael Cherubino, Executive Director, Property and Business Development
- Trent Peterson, Non-Executive Director and chair of our Remuneration Committee
- Kate Spargo, Non-Executive Director and chair of our Audit and Risk Committee
- David Briskin, Non-Executive Director; and
- Mandy Drake, our new CFO and Company Secretary.
- Mark Ronan, our COO and incoming Managing Director & CEO

We are fortunate to have attracted Directors to your Board of a very high calibre with a good mix of relevant industry experience, and broader corporate governance, operational experience and independence.

Members of our Senior Leadership Team are also with us today. I ask them to stand and identify themselves. They are:

- Jenny Hides, General Manager of Product and Design
- Paul Randall, General Manager of Retail Operations
- Utadi Murphy, General Manager of Marketing and eCommerce

Also present Ash Butler, partner with the Company's Auditor, Ernst & Young. Ash will be available to answer questions on the accounts at the appropriate time. We also welcome the team from the Company's Share Registry, Link Market Services Limited, who will assist as required in the counting of votes in respect of all resolutions to be put to the meeting.

The agenda for today's meeting is that following my introductory remarks, David MacLean, retiring Managing Director & CEO, will present his review of the Company's activities during FY16 and then Mark Ronan, COO and CEO-elect will review the company's recent trading update and business strategy. We will then proceed with the formal business of the Meeting to vote on the Resolutions. At the conclusion of the meeting, we invite you to join the Board and senior management for light refreshments.

The 2016 financial year was a period of substantial growth for Adairs, with extensive work undertaken by the Executive and Board to build a sustainable platform for growth.

It was a solid year for our Company, which is testament to the hard work and dedication of all our team. During FY16, the Company:

- Outperformed its prospectus forecast and market guidance;
- Generated 11.7% like-for-like sales growth, cycling two consecutive prior years of double-digit like-for-like sales growth; and
- Delivered record results with $247.4 million revenue, $44.4 million EBITDA and $26.1 million net profit after tax.

Superior retail execution has always been the focus of our team, and this ensured Adairs could deliver the strong FY16 results amid a competitive retail environment. We aim to deliver above-market growth, underpinned by a combination of product and range differentiation and our omni-channel strategies.

The company's FY16 performance, that David will take you through in detail shortly, clearly shows the strength of our business model given the above market growth it has historically generated.

Adairs has the capital structure in place to support its continued growth. We have a strong and conservative balance sheet with net debt of $27.1 million at 3 July 2016. Reflecting the Company's strong balance sheet, financial performance and growth opportunities, your Directors were pleased to announce and pay fully franked dividends for the year of 11.5 cents per share.

The long-term industry fundamentals remain, and underpin attractive future growth opportunities for Adairs. The company is positioned well to focus on the execution of its core activities and growth strategies.

As announced on 7 September 2016, David MacLean is retiring from the position of Managing Director & CEO effective today and Mark Ronan, the current Chief Operating Officer, will follow David into the role of Managing Director & CEO this transition reflects the successful succession plan that was put in place a few years ago.

David has been a key contributor to the growth of Adairs over the past 28 years. Under his leadership, Adairs has grown from a business with just 7 stores in Victoria, to a business with 150 stores in Australia and New Zealand. We are delighted that David will remain on the Adairs Board as a Non-executive Director.

Mark has been with the business for more than 9 years and is extremely well regarded within the industry. We are very pleased that he has been elected CEO effective today and look forward to further growth under his leadership.

The results achieved over the 2016 financial year would not have been possible without strong leadership across every function of our business. On behalf of the Company's Board I would like to thank these leaders, along with all of our team for their daily pursuit of retail excellence and ongoing commitment to our business.

We recently released a statement to the ASX about the poor performance of the company in the first four months of the current financial year, and of our efforts to remedy what we believe to be the underlying causes of the weak trading. Mark Ronan will elaborate on this topic in his presentation.

I will now hand over to David MacLean to discuss Adairs' performance in FY16 in more detail, which will then be followed by Mark Ronan providing a review of the company's outlook and business strategy. Thank you.

CEO Presentation - David MacLean

In my presentation today, I will provide an overview on the business operational and financial achievements of FY16.

Mark will then talk to the trading performance for the first four months of the current year and provide you with commentary on our strategy and future outlook.

As touched on by Michael earlier, the FY16 year was a period of substantial growth for Adairs. Our continued focus on superior retail execution saw the company outperform the Prospectus forecast and upgraded earnings guidance.

Our proforma results on a 52 week basis showed strong growth across all key measures:

- Like-for-like sales growth up 11.7%, while cycling strong prior periods (noting we delivered 21.6% growth in FY15)
- In fact FY16 was our 3rd consecutive year of LFL sales growth greater than double digit.
- Sales were up 17.3% to $247 million (7.1% above Prospectus Forecast)
- Gross profit was up 15.5% to $151 million (6.3% above Prospectus Forecast)

Our earnings showed continued strength:

- With EBITDA increasing by 17.8% to $44.4 million (6% above Prospectus Forecast)
- EBIT rose 18.4% to $39.2 million (6.7% above Prospectus Forecast)
- NPAT grew 18.9% to $26.1million (7.1% above Prospectus Forecast)

Our balance sheet is in excellent shape with conservative gearing of 0.6 times LTM EBITDA which provides us with a platform to capitalise on growth opportunities. Further we were able to pay a full year maiden dividends totalling 11.5 cents per share fully franked.

So to the numbers in a bit more detail:
We have achieved exceptional growth in revenue and EBIT over the past four years and further we expect to continue to grow the business over the longer term.

This growth in revenue has been underpinned by above market like for like sales growth which has been driven by a strong growth in transactions with a small growth in average basket size. The growth in transactions has been delivered by more Australians making Adairs their preferred retailer of choice for our sector of home furnishings.

So where did the growth come from?
We continued to take share from our competitors both department stores and specialty retailers.

We continued to benefit from tailwinds from both housing construction and strong housing turnover that is Australians up and down sizing their homes. Further, the Australian householders interest in redecorating and investing in their home remains strong as evident by the continued popularity of TV series like 'The Block' and 'House Rules'.

Importantly, our omni channel strategies continued to deliver 'above market' growth with online sales growing at 63%; just under 8% of sales.

To our new store rollout – we opened 13 new stores and closed 1 store in FY16. From the 13 new stores opened - 8 were core format stores including 5 new Homemaker stores and 5 emerging format stores including 4 new Adairs Kids stores.

In addition to this, we fully refurbished 9 existing stores; consistent with our philosophy to reinvest in the health of our existing store portfolio.

Our GM Rate finished at 61%, down 100bp on prior year; heavily impacted by a falling AUD. On a constant currency basis, the impact of the devaluation of the AUD was approximately $7.2 million pcp, with $5.2 million of that impact felt in the second half.

We continue to work with our suppliers to reduce product costs, review our retail pricing and seek to better manage our promotional pricing.

Our CODB% improved by 100bp reducing to 43.1%; largely driven by the leverage of strong LFL sales. The combination of these financial inputs again delivered an EBIT margin above 15%.
With an unrelenting focus on superior retail execution, Adairs is well positioned strategically and financially to capitalise on a number of attractive growth opportunities and ultimately grow our shareholder returns.

Before I handover to Mark to present our 4 month trading update, strategy and outlook, I'd like to take a couple of moments to thank the Adairs team for making my past 27 years so rewarding. Firstly, to my parents John & Alwyne MacLean who laid the foundations of this great business. My father in particular taught me the importance of having a clear vision, preparedness to take a risk and the need for resilience and grit. My mother helped round my skills and drove the values of respect and fairness to all.

I have also been fortunate to work with a number of outstanding past board members who have supported myself and our executive teams through good and bad times. In particular I would like to thank Terry Stanley, Peter MacLean, John Barr and Michael Napthali.

Over the last decade, I and the business have received enormous support from Brett Blundy and Trent Peterson from Catalyst who have both been majority shareholders and remain our 2 largest shareholders. Your faith, encouragement and guidance has been steadfast and unwavering.

Next I would also like to acknowledge our current board led by Michael Butler for their guidance through what was foreign territory for the executive team in listing Adairs on the ASX 17 months ago. I look forward to my ongoing role as a non-executive director of the board.

Finally, my greatest thankyou goes to the team members of Adairs; both past and present. We have a great heritage of team members staying with the business for the long journey. You have inspired and motivated me every day in our business. For a long time the mantra of our business has been and will remain ‘It’s about the customer, always’ but the true secret or recipe of our success is our leadership and behaviours. In reflection our internal mantra is more like ‘It’s about our team, always’.

In conclusion, I would like to state my absolute confidence in Mark Ronan’s leadership and along with the experience, personal attributes and professional skills of Michael Cherubino, Jenny Hides, Paul Randall, Utadi Murphy, Mandy Drake and their respective teams has Adairs in great hands! Thank you

I now invite the new CEO and Managing Director of Adairs Mark Ronan to address the gathering.

COO & CEO Elect Presentation - Mark Ronan

Thank you David

I will start by walking through the recent trading update provided to the market on the 2nd of November which stated that trading through the first four months of the 2017 financial year had been below company expectations, particularly in the key bed linen product category leading to a flat like for like sales result over this period.

With bedlinen representing approximately 40% of the business the like for like sales result in bedlinen of -8% significantly impacted the business over the first four months of the year.

The key driver of the underperformance in bedlinen related to missed opportunities in fashion linen. Whilst we correctly interpreted this seasons trend which were softer, plainer and more muted colours we did not cater to another segment of our customer base who wanted more colour and design in their products. Our efforts to meet these customers missed their expectations through design issues, such as prints that didn't appeal, and gaps in the range that we know our customer consistently seeks, particular colours and styles, and reinterpretations of our ‘known winners’.

As a consequence of the poor range, our transaction value and gross margin rate decreased as we cleared inventory to ensure we managed our stock levels.

The positive out of the first four months was the result of the "Other" product categories that are performing in line with our expectations with 5% like for like growth. A good result given we were cycling exceptionally strong like for like sales over this period in the prior year.

Further the like for like transaction count continues to grow showing that we continue to attract a larger customer base but over this period due to our poor range we have had to offer them better value to move our key bedlinen products.

Whilst this was an unfortunate error for which the company takes full responsibility, we have now addressed this issue and look forward to achieving stronger sales in calendar year 17.

Over the same period we completed three major projects:

- We re-platformed the website and still delivered 15% sales growth despite a temporary pull back in online marketing during the implementation phase of the new website;
- The POS rollout is complete, with all stores now operating on the same system; and

- The New Zealand expansion strategy is underway with the opening of our Sylvia Park store and our New Zealand web store.

These projects provide the business with a strong platform for growth and will allow the business to focus on the execution of our core business activities and growth strategies.

Whilst it has been a difficult first four months the business is in good shape to return to growth in the second half.

We finished October in a ‘clean’ inventory position with problem bedlinen being cleared as we work through the season. Reflecting the broader success of our business, our non-bedlinen categories are all performing well and in line with expectations, delivering like for like growth over the first four months.

We believe we have identified the issues in the bedlinen range and that these have been remedied. This won't happen immediately it will gradually occur throughout the second half with the business expecting the improvement to commence in February as the newly designed product starts to arrive in store.

Our growing transaction count continues to tell us that customers are happy to shop with us and that we can keep growing our customer base.

The currency headwinds that we are facing in the first half neutralise in the second subject to the US dollar exchange rate remaining stable.

Nothing has changed as far as our strategy to roll out stores across Australia and New Zealand is concerned, we are continually targeting a pipeline of new store opportunities, and we will continue to open stores over the balance of the year, subject to successfully negotiating lease terms.

We have put a number of steps in place to make sure our performance in the second half moves back to a growth trajectory with a combination of like for like sales and store rollout driving the ongoing growth of the business.

To support this growth I would like to highlight our key growth drivers over the coming years and note that the change in management won't see a change to our growth strategies.

Firstly, our product differentiation strategy, which has underpinned our success in recent years – this strategy is driven by our fashionable ranges, innovative fabrications and new products, as well as being fast to market with new home decorator trends.

This is about fortnightly drops of new product and fashion into store and maintaining a strong value for money proposition for our customers. The first four months shows how important this strategy is to the business and the critical focus the business has on ensuring we provide a differentiated product offering.

Next, our category range extension strategy, is about growing the customer shopping experience, making our stores a more interesting place to shop and building upon our ability to furnish more of our customers living, entertaining and functional spaces.

Our success in the last five years and indeed future years, is linked to this range expansion and the growth of our homemaker store format. We believe this strategy has long terms benefits for the business as we enter new and aligned product categories.

Thirdly, the upsizing of our store formats. To support our category range expansion strategy we are committed to increasing the size of our stores and will look to upsize selected stores as leases expire or centre redevelopments provide an opportunity to do so.

From a trial perspective, we have tested a new Mini Homemaker format in three shopping centres. The mini Homemaker store is 350 to 500 sqm and allows us to introduce a larger product range, including an extended range of homewares and occasional furniture driving an improved shopping experience and increased sales. All three stores are recently fitted out to cater for the extended ranging and are trading well.

Fourth, as per prior year we expect an accelerated rollout of new stores in Australia in FY17. We have consistently outlined that we expect to open 8-12 stores per annum but with 8 stores to be opened in the first half we are confident that store openings are going to be at the higher end of this scale.

To our omni channel strategies. Our customer data base of which our loyalty program, Linen Lovers, is central, is driving frequent customer engagement and continues to grow strongly as do our various social media platforms.

Customer research identifies our Linen Lover customer shows a greater propensity to research online then shop online or in store – with instore providing the touch and feel element and a heightened level of customer service and advice.

By broadening our product offer online, commencing online in new international territories, adding click and collect in CY17 and continually improving the customer user experience, we believe that our online store will continue to grow as a percentage of our total sales.

And finally to international expansion -

Adairs recently opened its first international store in Sylvia Park with the first four weeks of trading being very positive.

We will open our next store on the 8th of December and have secured 2 further sites on the North Island secured for opening in the second half.

Across our core store formats we currently believe there is potential for up to 18 stores in New Zealand in the medium to long term.

We also began trading online in New Zealand in-line with the opening of the Sylvia Park store. Planning for entering the New Zealand market has been detailed and we remain confident that New Zealand will be a successful first international market.

Based on current forecast we expect to generate an EBIT loss in NZ of up to $1m AUD in FY17 which will be dependent upon how quickly we can build customer loyalty and awareness

As you can see we have a number of strategies that we see continuing to deliver growth over a number of years.

On the back of the trading update we have updated our outlook for FY17.

As stated previously our store roll out strategy remains on target and we expect to continue to rollout stores in line with our previous guidance of 160-165 stores.

Given we delivered flat LFL sales in the first 4 months we have lowered our guidance to 'low single digits' and as a consequence we have lowered the sales range by $10m.

Because of the actions that we have taken to keep our inventory clean, you can see that we have lowered our gross margin expectations by approximately 150 basis points. We still believe the sustainable gross margin of the business to be 60 - 62%.

In regards to capex – the major reduction has come from identifying stores where it was not essential to refit this year and those where centre redevelopments have been delayed to reduce the anticipated refit capex requirements of the business.

Based on our re forecast we see FY17 EBIT falling approximately 15% as compared to FY16.

Finally I would like to take this opportunity to thank the Adairs team for all their efforts. They are a great team and I am honoured and privileged to work with and now lead such a great group of people. I look forward to leading the business through our next phase of growth.

Thank you

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