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Market Briefing

Adairs' MD on FY17 results and outlook

Interview with Mark Ronan (Managing Director & CEO)

Adairs' Managing Director & CEO, Mark Ronan, discusses the Company's full year 2017 (FY17) results and positive outlook for FY18, including:

- *LFL sales growth improving in the second half with positive momentum into FY18*
- *Product and operational execution underpinning the Company's second half FY17 performance*
- *Focus on consistent retail execution driving growth into FY18*
- *Inventory increase as store rollout continues*
- *Growing store network in Australia and New Zealand*
- *Evolving competitive landscape*
- *Positive outlook for FY18*

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1. ***Adairs' FY17 result delivered continued revenue growth that was underpinned by new store openings. While like for like [LFL] sales were down 1.4% on FY16, have there been signs of a turnaround in the business?***

Mark Ronan

The FY17 result came in towards the top end of our revised guidance range provided with our half year results last February. We said that it would not be until February / March that we would know whether the actions taken to address the missteps in some of our product categories, particularly fashion bedlinen, would be successful. Pleasingly, they were, and we saw LFL sales improve over the second half finishing with a fourth quarter LFL sales at 3.8% on the back of a strong June month.

With our focus on delivering excellence in product and operational execution, fashionable quality products at a compelling price, and an engaging retail experience, the recent momentum has continued. LFL sales grew 13% in the first eight weeks of FY18, and while still early into the new financial year, this is a pleasing sign that our product is working and our growth momentum has started to return.

While LFL sales over FY17 were negative, our revenue was up as we added new stores to our national network in Australia, as well as continued to expand in New Zealand. Further we saw more

promotional activity and discounting to clear underperforming inventory impacting our gross margin, which fell to 59.2% [from 61.0%] over the full year. However, with our more balanced range improving performance in the second half, gross margin was stabilised finishing at 59.1%, from 59.3%.

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2. *Is the recent growth in LFL sales growth sustainable?*

Mark Ronan

Having identified the range issues in our fashion linen category in October 2016, we worked through the issues, clearing poor performing inventory and re balancing the range to improve the product in store. As we highlighted at the time, it took time for this to work through our business, and we are confident that we have put in place processes to mitigate the risk of these issues recurring.

The return to growth in LFL sales in the fourth quarter of FY17, has continued into the early weeks of FY18, with the first eight weeks performing well. The improved sales gives us increased confidence that we are on the right track, and that the changes we have made to our product offer throughout 2017 are gaining traction with our customers. However, given it is early in the year, it would be imprudent to extrapolate these results to a full year sales expectation at this stage.

Although we continue to see variability in sales across product categories and geographies on a week to week basis, we are confident that the performance of the Adairs business has been sustainably turned around, and LFL sales over FY18 are expected to grow.

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3. *Adairs has been focused on getting its business right over the second half of FY17. What was done to deliver this turnaround?*

Mark Ronan

We went back to basics in the second half of FY17. We focused on operational execution and analysing what we as a team could learn from the mistakes that had occurred. I believe we have gained valuable learnings over the last 12 months that will put the Company in a better position to deliver on its initiatives and deliver growth in shareholder value.

The 'fashion miss' that we experienced at the start of FY17 was a result of numerous controllable factors within our business that have since been rectified. We understand the issues and why they occurred and took decisive actions to correct them and mitigate the risk of them happening again.

By sticking to the basics, we understood what our customers wanted, and the designs that resonated with our broad customers base, creating a more balanced range. We went back to 'It's about the customer always' and made sure they formed a key part of our design process.

We are always focussed on moving poor performing stock, so we continued to clear inventory throughout FY17 by increasing our promotional and discount activity. As the new fashion linen started to arrive instore we saw this resonate well with our customers, driving a return to growth in LFL sales in the fourth quarter of FY17 that has continued into FY18.

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4. ***Why was there a build-up in inventories over FY17? Will you have to mark down prices to move excess inventory?***

Our inventory position increased \$6.7 million during FY17 due to three reasons. Firstly, we opened 13 stores and upsized 4, and needed to grow inventory to support these stores. Secondly, we needed the increased inventory in our New Zealand warehouse to support our growing presence in New Zealand. Finally, we made a conscious decision to build selected inventory lines to support sales through July and August 2017. We remain committed to managing our inventory in line with our trading and believe the current inventory position will support the ongoing sales growth of the business.

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5. ***Your store rollout slowed during FY17, what are your objectives for growing your footprint in Australia and internationally?***

Mark Ronan

We remain committed to our Australian store roll out program, which is part of our long-term growth strategy. With a clearly planned store rollout strategy focused on capitalising on premium locations, we opened nine new Australian stores in FY17, having opened eight in the first half.

While we are focused on growing the business, this does not mean we will open new stores just to grow store numbers. We will only open new stores if the financial metrics are favourable, and only stores that deliver a profit will be kept within our portfolio. Looking forward, even with continued retail sector headwinds, we plan to open six to eight new stores in FY18 and are targeting up to six further stores to be upsized across both our Regular and Homemaker formats.

Our store mix continues to evolve as we focus towards our higher performing, higher margin Homemaker store format. The Homemaker format allows our customers to browse a significantly wider selection of home furnishings in a setting that allows us to showcase the entire look, making the product come to life for the customer.

FY18 will see us focus on our core store formats whilst we continue to develop the emerging store formats of Adairs Kids and Urban Home Republic to ensure that they can generate the necessary return on capital employed. Over the past two years we have opened a number of these stores now giving us sufficient scale to fully assess their roll out potential. Over FY18 we will make changes to the product mix as we continue to enhance the offering in these stores to drive store profitability.

Our international expansion into the New Zealand market has been progressing to plan. We opened four new stores on the North Island, and all have been performing to expectation. With our New Zealand customer base sharing many of the same fashion trends and market characteristics as the domestic Australian market, we have been able to resonate with the New Zealand market and increase brand awareness.

The expansion into New Zealand has provided Adairs with its first opportunity to build a long term international growth platform. We have a dedicated New Zealand team on the ground and we are very encouraged by these results and excited with our international expansion to date.

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6. *When do store numbers reach maturity and will you begin to start slowing down new store rollout?*

With 156 stores in Australia and 4 stores in New Zealand, Adairs still has a significant runway for growth supported by consumer demand for fashion linen and home furnishings. Australia is a 'house-proud' market where the inspired home decorator continues to want to create aesthetically pleasing living, entertaining and functional spaces. This trend combined with our omni channel strategy will support our rollout program which we envisage reaching around 200 stores in Australia and up to 18 stores in New Zealand.

Our store numbers are not the only thing driving our growth. We continue to refurbish and move towards our 'upsized' Homemaker category, which will drive further growth in revenue through our expanded product range.

Key international markets remain a largely untapped growth opportunity for Adairs, with our first market, New Zealand, performing to plan. We will assess further opportunities to expand to other countries if we deem there is sufficient scope and scale to develop a profitable territory.

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7. *The home furnishings segment has been changing over the past 12 months. How has Adairs responded to these market dynamics and increased competition?*

Mark Ronan

The changing face of retail means that we must always look at how we can enhance the business. Whilst this is the case, we need to remain focused on providing the best possible product at a compelling price that provides the customer with real value. Innovation and design remains the focus of developing our product range as we deliver differentiated products with the highest quality of instore or online experience.

Our website has been re-platformed and our online store continues to grow strongly, with our new ecommerce platform enabling a more streamlined and user- friendly experience. Our online store currently accounts for 9.0% of sales, and we see this increasing to greater than 12% by FY19. Our focus remains on a true omni channel strategy that positions us well for growth, as we enable the customer to shop where they want, when they want.

Adairs prides itself on its fashion approach with this being a key to our differentiation strategy. We seek to innovate and lead on fashion trends in home decoration, buoyed by the popularity of home design and the Australian 'house-proud' culture. By constantly providing high quality fashion at a compelling price combined with excellent service, we believe we can continue to grow in the face of a changing retail landscape and evolving competitive dynamics.

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8. *Since the second half of FY17 has been a turnaround period for Adairs, what can we expect in FY18?*

Mark Ronan

FY17 was a tale of two halves, with a greatly improved last quarter positioning the business to return to growth in FY18. The previous ranging issues across some of our product categories have been addressed, gross margin has stabilised, and over the past three months we have delivered like for like sales growth. With confidence in our product execution restored, and delivering our customers what they want, there is renewed momentum within the business.

We will continue to execute on our proven strategy to drive sales and earnings growth. FY18 sales growth will be driven by a return to like for like sales growth, further new store roll outs in Australia and New Zealand, and ongoing growth in our online channel. The sales growth, together with a more stable gross margin rate and annualised impact of the cost saving initiatives undertaken in FY17, will see our earnings grow in FY18.

Reflecting the operational initiatives being pursued in FY18, and consumer sentiment remaining at current levels, the Board of Adairs provided the following guidance for FY18:

	FY18 FORECAST
Year End Stores	166 – 168
Sales (\$m)	285 – 300
Gross Margin %	59% - 60%
EBIT (\$m)	33 – 37
Capital Investment (\$m)	9 – 11

We look forward to a better year ahead and returning the business to growth.

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Thank you, Mark.

For further information, please contact +61-3 8888 4500, or visit www.adairs.com.au

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