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Market Briefing

Adairs MD on 1H16 results and outlook

Interview with David MacLean (Managing Director & CEO)

Adairs' Managing Director & CEO, David MacLean, discusses the company's half year results for the period ended 27 December 2015 [1H16] and outlook, including:

- *Continued growth across all key financial metrics*
- *Continued above-market growth in like-for-like sales*
- *Impact of foreign exchange rates*
- *Continued growth expectations for the second half*
- *Expect to outperform FY16 Prospectus forecast - increased FY16 sales and EBIT guidance*

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1. Adairs' continued its growth trajectory with strong growth across all key financial metrics in 1H16. What underpinned the growth in sales by 21.5% to $117.8 million, gross profit by 22.0% to $74.2 million and EBIT by 34.9% to $19.9 million?

David MacLean
The first half of this financial year has delivered another period of growth for the business, reflecting our focus on delivering the very best retail experience for our customers. Strong Christmas retail trading propelled like-for-like [LFL] sales growth of 15.4% across Adairs. The business has now delivered 12 consecutive quarters of like-for-like sales growth.

Reflecting the success of our omni-channel approach, both our store and online channels grew strongly. All store formats continued to deliver above market LFL sales growth while cycling strong 1H15 growth with online being the fastest growing channel, delivering sales growth of 81.7%.

Our Gross Margin rate has benefited from product cost reductions and selective retail pricing increases. The reduced duty rate and lower international freight rates also assisted our gross profit margin result. Our cost of doing business percentage continued to reduce due to operating leverage from LFL sales growth.

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2. How is Adairs responding to the depreciation of the Australian dollar and its impact on profit margins?

David MacLean

The majority of Australian retailers, that source product from offshore, will have been impacted by the recent depreciation in the Australian dollar that has increased the cost of foreign manufactured stock. Adairs continues to take foreign exchange cover to provide a buffer against movements therefore reducing some of the risk of a sudden depreciation in the Australian dollar.

As was the case in FY15, we are actively managing our foreign exchange rate exposure. While the Australian dollar has continued to devalue, we continue to work hard with our suppliers to deliver cost price reductions that partially offset the foreign exchange impact on our earnings.

In addition, we are carefully managing pricing strategies to ensure our product continues to provide a strong value proposition for our customers while also generating appropriate gross margin returns.

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3. Is Adairs' dividend sustainable given the headwinds the retail sector and Adairs face?

David MacLean

The strength of Adairs' business model can be clearly seen in the above-market like-for-like sales growth generated. With a growing store footprint and higher like-for-like sales, earnings continue to grow in a challenging environment.

Growth combined with a strong balance sheet, has enabled the board of Adairs to declare the company's maiden dividend as a public company, a dividend of 5.0 cents per share fully franked. In our half year result, we also reaffirmed the Prospectus dividend expectation of 11 cents per share fully franked in FY16, subject to no significant business change.

Our target payout ratio sits at 55% to 70% of statutory NPAT, and the interim dividend declared is in line with that range as outlined in the Prospectus.

Looking forward, as we continue to pursue growth initiatives, the Board is focused on achieving the right balance in short term and long term shareholder returns and will ensure that the company can continue to invest in growth initiatives while maintaining an appropriate dividend level.

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4. Your FY16 capital expenditures are expected to be above Prospectus forecast. What has driven this increased spend given you are not looking to open more new stores than originally planned?

David MacLean

New site opportunities continue to present themselves as we implement our nationwide store expansion programme. Over the first half we opened 5 new stores as well as undertook 5 refurbishments. We are carefully considering new site locations and based on the pipeline of new sites and we are on track to achieve the FY16 Prospectus forecast of 11 new stores. The increased capital expenditure reflects a change in format mix of new stores with more new Homemaker stores, which are higher returning formats.

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5. The product mix is clearly moving towards your Fashion & Decorator range. Do you envisage this change continuing at the current pace?

David MacLean

Our Fashion & Decorator category continues to grow, in line with our strategy to deliver a higher value, differentiated customer proposition. While we are certainly focused on growing this part of the business, it is the consumer who ultimately decides how fast this shift in product mix occurs, and both our Staples and Fashion & Decorator ranges are growing faster than the overall market.

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6. Six months ago you said you were evaluating New Zealand and South Africa as possible markets to launch Adairs' international expansion. What made you decide on New Zealand as the initial market?

David MacLean

Both South Africa and New Zealand represented attractive new markets for Adairs. However, on balance, we felt New Zealand would be a more appropriate market to undertake our first foray offshore. It is close to Australia, in a similar time zone, and has a number of similar retail market characteristics.

We are currently evaluating a number of sites and have commenced negotiations on a few, with the goal of opening three to four initial stores in the first quarter of the 2017 financial year. This is of course subject to securing appropriate sites and lease terms.

We continue to monitor the South African market for any potential opportunities.

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7. What is the outlook for Adairs for the remainder of this financial year?

David MacLean

In thinking about our second half, it is important to remember that the comparable periods the business is cycling continue to get stronger. As such, our growth trajectory will moderate, but we do expect the business to continue growing given its attractive fundamentals and focused strategy.

Over the past three years, Adairs has been able to drive strong growth given the business' focus on product and range differentiation, with our higher margin Fashion & Decorator category leading the way. We believe the underlying business will continue growing across all our formats as we roll out additional stores, continue to drive positive like-for-like sales, and further improve business efficiencies.

We expect Adairs' underlying business to again grow in the second half of this financial year. However, this growth will be offset by the expected impact of the depreciating Australian dollar on our gross margin rate. While we are doing what we can to mitigate the foreign exchange impact on earnings, we are not immune to its impact.

Based on current market conditions, we expect to outperform our FY16 Prospectus forecast.

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Thank you, David.

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