Lynch Group Holdings Limited

2023 AGM – Chair/CEO address

24 November 2023

Chair's Address

Introduction

Last year we reported on a successful first full year as a listed enterprise against a backdrop of COVID related lockdowns and other restrictions, including navigating significant disruption to global supply chains. These challenges continued into FY23, albeit largely tailing off by the end of the December quarter.

Australia had returned to more normal operating conditions by the start of FY23, but the hangover of tight labour markets and elevated international freight rates persisted, creating a continued drag on margin. Several initiatives were implemented to mitigate these impacts, including pricing, product range optimisation and a focus on driving labour productivity. With labour markets easing and freight rates starting to normalise, margins recovered strongly in the second half.

China, which had managed through successfully for much of the pandemic, began to see increased infection rates from the end of FY22, increasing exponentially by December 2022. The government's adherence to its zero COVID policy caused ongoing disruptions to operations, particularly in local and export logistics, as well as to market demand and pricing, materially impacting the first half result. The sudden and immediate abandonment of the policy in early December 2022, allowed a rapid return to normal operations by January 2023, with a strong rebound in demand boosting sales through the major events across the second half. Other macroeconomic issues, however, resulted in a consumer spending slump from early June, and average selling prices fell sharply relative to the prior corresponding period. We believe these impacts to be transitory and remain enthusiastic about the growth potential of our China business and its ability to consistently deliver high returns on growth capital expenditure.

Australia

The core of the Australian business is the national supply of floral and potted product to our supermarket customers. Whilst the Group has been supplying the Australian supermarket channel for over 30 years, the supermarket floral category continues to have significant long term growth potential. In the UK for instance, more than 50% of all floral products are sold through supermarkets. In Australia, that share has grown from 19% to 28% over the last 4 years, as the quality and value proposition of supermarket floral products has resonated with customers, and as value added bouquets, arrangements and potted products continue to drive gifting demand, particularly during key events.

Our scale, innovation, worldwide sourcing capability and continued investment in our instore merchandising teams, have greatly changed the perception of supermarket flowers, providing key support to our supermarket customers as they drive increasing share of the overall floral industry. With availability and cost greatly impacted by COVID related supply disruptions, the Group successfully navigated this period applying a combination of price increases, recipe and sourcing changes, and a pivot to higher value lines, to deliver a record revenue year under extraordinary circumstances.

The Group continued to optimise its new merchandising system that improves merchandiser productivity and allows the business to capture increased sales opportunities whilst minimising instore waste. The Group, with one of the largest independent merchandising teams in Australia, derives approximately 40% of its sales from Sale or Return (SOR) stores where the Group heavily influences in-store range, volumes and presentation, in conjunction with our supermarket customers. Growth in SOR store revenue was strongly ahead of core store growth (where ordering and display are managed internally by the supermarket customer) for the year, demonstrating the appeal and resilience of the category. Some volatility was experienced in core sales across the first half, as a major supermarket customer implemented an auto replenishment system to the floral category for the first time.

The value the Group brings to its supermarket customers is our ability to plan and manage a complex category. We trade in a highly perishable seasonal product that is sourced from Tier 1 growers in Australia and from around the world. Growing conditions can often vary season to season and supply chains are prone to disruption. The Group's ability to switch sourcing, substitute climate-controlled sea freight in some instances for airfreight, and modify recipes, enabled a near perfect record of delivery in full and on time to our customers. Whilst the Group was successful in implementing price increases across its range, the speed of change in the logistics market meant that not all the additional costs could be recovered, and margin was lower than achieved historically. As these cost pressures abated in the second half, margin recovered strongly.

Labour market conditions improved through the year as labour availability returned to more normal levels. This enabled the company to operate efficient rosters, reducing the requirement for excessive overtime levels, particularly in the ramp up for major events. The move to a purpose-built facility in Ingleburn (NSW) was another major milestone which, through improved environmental control and facility design, has seen an improvement in both delivered quality of product and workforce productivity. Ingleburn is now the prototype for new facilities to be rolled out in other major markets.

Our in-house quality team works closely with Australian Biosecurity to ensure that imported product is effectively treated and screened to protect Australia from damaging pests and disease. We work actively with government authorities in each of our major countries of origin to achieve world's best practice in bio-security process design and execution, minimising rejection rates in Australia and building confidence in the quality of imported product. The

Group's three Australian farms support the Group with orchid and foliage plants, and Australian wildflowers that are difficult to otherwise source at required specification, quality and volumes. This vertical integration of supply (including our farms in China) is a competitive advantage in maintaining consistency of service to our customers. We continued to invest in our Australian facilities to enhance our supply of key potted lines.

The Group is the largest importer of floral product into Australia. Our Markets sites distribute locally sourced products alongside imported lines to other wholesalers and florists. With our hub operations in Flemington and Brisbane, and two satellite sites in Newcastle and Canberra, our Markets operation leverages our procurement scale, and provides additional flexibility in how we manage product flow. Additionally, the Markets business provides important real time market intelligence on price and product availability which feeds back into our supermarkets business.

China

Due to historical product quality issues associated with a fragmented and developing grower base, coupled with multilayer ambient product distribution networks, the consumer market for floral products has been slow to develop. Today, the floral market in China is many times the size of most western markets, and consumer buying trends centred around self-consumption and gifting, particularly during key event periods, are emerging rapidly. Per capita spend rates on floral products remains low on a comparable international basis. The Group's China operation is the largest grower of premium flowers in the country, with four farms and a processing facility located in Yunnan province, and a distribution and bouquet making facility located in Shanghai.

The Group's access to premium floral genetics, investment in advanced growing infrastructure and systems, and direct distribution via its own contracted cool chain logistics, provides year-round supply of a high quality and unique product range to Chinese retail and wholesale customers at competitive prices. A large proportion of our farm production volume is sold to various retail platforms including supermarkets at fixed prices, suppressing the volatility of market prices, and allowing flexibility to maximise pricing opportunities in high demand festival windows across the year.

China's operating performance was a tale of two halves. The first half was severely disrupted with increasing COVID infection rates and the zero COVID policy response of the Chinese government. Whilst our four farms and processing facility remained operational throughout the half, quarantine restrictions and lockdowns shut down various essential components of the supply chain at different times. We were successful in selling all our product albeit at significantly reduced year on year pricing in the December quarter. As the government abandoned its strict zero COVID policy and the economy opened from the end of the first half, demand for floral products rebounded strongly from January, and we experienced strong customer activity levels across the major events in the second half. Weaker economic conditions from June saw a fall in consumer sentiment and spending. This coincided with peak summer supply and a resulting fall in product pricing. Farm production rates were well ahead of plan and offset some of this weakness in pricing.

Closing

We would like to recognise the incredible role played by our staff during the year. Their continued ability to find innovative solutions to problems, create beautiful designs and produce year-round quality product makes the Group a global leader in floral supply.

CEO's Address

FY23 Summary

Today I will talk to you about our performance over financial year 2023, update you on progress on our current growth strategies, outline the Group's progress on sustainability, and provide a trading update and outlook for the current financial year.

Across FY23, our committed teams delivered outstanding operational execution whilst advancing our strategic initiatives across our business. Our Group faced a very challenging first half operating environment, which included extended COVID lockdowns in China, a continuation of higher freight costs for our international logistics, as well as a tight labour market in Australia.

The Group's full year results finished in line with the upgraded guidance provided to the market in early June, with significantly improved second half trading performance in both Australia and China. In general, we experienced more stable and improving operating conditions in both countries across the second half of the financial year.

Our FY23 results reflect 8% growth in Group Revenue year on year, 7% when adjusted for an additional week of trading in our Australian segment. Australian customer demand remained resilient across the year, with the bulk of our demand generated in the lower-priced supermarket channel, and we were pleased with particularly strong performance from our sale or return store network. In China, revenue growth was supported by higher volumes from prior period farm production footprint expansion works, with FY23 pricing generally lower than FY22 levels, particularly across the first half during the height of COVID restrictions.

EBITDA performance across the second half demonstrated a significant improvement in both Australia and China, bringing the full year Group result to $42.7 million. Second half Australian margins strengthened off the back of margin improvement initiatives, good execution of our key Valentines Day and Mother's Day events, moderating international freight rates, and improving labour availability. In China, a general recovery in trading conditions following the abandonment of COVID-zero policies in December, enabled improved pricing, with strong customer demand in China's key event window from Chinese New Year through to Mother's Day in May.

FY23 Australia

For the year ended 2 July 2023, the Australian operations achieved Revenue of $324m, 5% up on FY22, with Pro-forma EBITDA of $21m, 11% down on 2022. Second half EBITDA was up 54% on the same period last year, reflecting ongoing margin recovery initiatives, and moderating international freight rates.

Customer demand for supermarket floral products remained resilient across the second half, despite quoted pressures on household spending. Price increases were implemented with our customers across the financial year to partially mitigate broad based cost inflation, with no discernible impact on end-consumer demand. Previously highlighted first half core store order volatility with a major customer was resolved early in the second half, reestablishing stability in our weekly order volumes, also allowing better control of our floral buying and labour spend across the second half.

Our key second half events were delivered in full, with minimal disruption from previously experienced supply chain pressures or labour availability, and achieved very pleasing sell through rates in store for our customers. On the cost front, we experienced improving capacity availability and rates on our key international freight channels for both air and sea across FY23. In broad terms, we experienced a steady decline from peak rates experienced in March 2022 by financial year end.

Labour shortages experienced over much of calendar year 2022, eased markedly at the beginning of the second half, enabling our Australian operations to manage overtime levels more effectively.

We commenced operations at our new NSW facility in November and have now run three major events out of the site. Key benefits include improved product quality, enhanced labour efficiency, more efficient product handling during peak volume events, as well as the added capacity benefits for long term growth.

FY23 China

China achieved revenue of $97m, 12% up on 2022, with EBITDA of $22m, down 12% on FY22. Second half EBITDA was up 21% on the same period last year. Revenue growth was primarily driven by increased farm production volumes, with significantly increased rose and tulip volumes from our expanded producing greenhouse footprint. The FY23 development program takes our total greenhouse space in production to 82ha.

We continue to control more of our downstream distribution to control quality, maximise margin, and insulate the business from the volatility of market pricing. The Shanghai distribution hub positions us closer to our customers and allows us to increase value add through the production of bouquets and arrangements. A further hub is planned to be opened in Guangzhou in early 2024.

Operations across our farms, processing facilities and sales channels were well managed across a highly disruptive year. All sites experienced periodic and partial closures across the COVID lockdown period, whilst also managing impacts to our domestic and international logistics. Despite this, all farm production volumes were able to be sold, packed and shipped across this period.

Pricing remained below FY22 levels for most of the financial year, with first half performance adversely impacted by broad based COVID restrictions, followed by a strong rebound in pricing after the easing of restrictions in December. Pricing across the second half tracked close to FY22 levels across the major festival events from Chinese New Year to Mother's Day in mid-May.

Market conditions weakened post Mother's Day, with deteriorating levels of consumer confidence impacting demand and pricing. China remains early in its post COVID recovery, with its economy being impacted by major disruptions in its property sector which is continuing to drag on domestic consumption.

Sustainability

We are pleased to have issued the Group's inaugural Sustainability report in October. In the report we introduced FLOURISH, our sustainability initiative which is now integral to the way the Group operates, and which is strongly aligned with our longstanding core values.

The report provides detailed insights into the Group's investment, activities and focus areas across our environmental, social and governance initiatives. Across FY23, the Group's ESG committee made substantial progress in building processes, awareness and acceptance of shared responsibility, to foster and deliver improved ESG outcomes within our business over the long-term. The annual Sustainability Report will present an opportunity for the Group to examine and reflect how well the past year's ESG initiatives have contributed to its sustainability goals and FLOURISH will emphasise ESG's role in our future business decisions.

The report follows the launch of our sustainability journey in FY22 with a dedicated sustainability team and a multifaceted ESG materiality assessment project guided by an external consultant. The outcome of this materiality assessment informed and underpinned a series of ESG research and data collection initiatives in FY23 and, going forward, will form the basis of our ESG strategy development, in parallel with the Group's broader organisational strategy. This year, we have reported our baseline position based on the research outcomes of the materiality assessment workstream, and a sustainability review of our operations and processes. During the year we collaborated with an expert environmental data analysis team from Western Sydney University and the outcome has been to establish baseline data points to understand our current environmental performance and reporting.

In November 2022 we relocated our Australian head office and NSW operations to a purpose-built facility in Ingleburn NSW. The short time since this move has delivered increased efficiency and environmentally focussed operational processes. We have made notable progress in sustainable packaging of floral product including ongoing discussion with customers to present sustainable options that are reusable or recyclable, as well as adding recycle logos to selected floral and potted packaging.

Our enhanced internal systems and procedures ensure the continued ethical sourcing of product and the management of human rights risks including modern slavery. The health and safety of our people remains a key priority for the Group, and during the year we developed and implemented an upgraded, proactive work health and safety program to continue to support and protect our people.

We also launched our first graduate program based in NSW, and continued to invest in training and development initiatives to offer career progression scope and opportunity through our Emerging Leaders Program.

The Group is fully committed to a strong governance regime to ensure we meet and exceed the standards required from our stakeholders, including compliance with obligations under relevant legislation. We operate an in-depth risk management process, internal audit procedures and are committed to transparency of reporting and communication with stakeholders.

<u>Trading Update and Outlook</u>

In August, we updated the market on performance and outlook, noting improving margins in Australia, and soft consumer spending in China. Current trade settings for first half FY24 are as follows.

<u>In Australia:</u>

- Recent floral demand trends have remained stable with our major supermarket customers, and Australian revenue growth is expected to be around 4% for the first half. Demand for lower priced supermarket floral products remains consistent amidst moderating consumer spending. Demand from florists remains weak, impacting sales through our wholesale markets channel
- SOR store sales performance, where range order volumes are controlled by the Group, continue to perform strongly
- International freight rates have moderated further in 1H FY24 with improvement in key middle Eastern routes
- Labour availability remains stable

In China:

- Consumer confidence and spending remains weak amidst softening macroeconomic conditions, particularly for more discretionary items. We currently expect a China revenue decline of around 10% for the half, reflecting lower pricing on higher volumes
- China domestic pricing has remained below last year levels across the half. We are seeing early signs of price improvement in late Autumn, and expect higher market demand through the major events commencing with Chinese New Year
- Farm production volumes continue to track up based on prior year production footprint expansion, and we continue to tightly manage production costs across our operations. We have added a further hectare of production space across the half to support our tulip program, and have delayed further expansion works until we see market conditions improve and stabilise. We remain confident in the medium to long term outlook for the floral market in China

- We have secured a site for a second Tier-1 city production facility in Guangzhou, which we expect to have operational early in the new calendar year, which will allow for further development of our customer channels

Group Outlook

The first half group financial outlook is for:

- Group Revenue growth of 2-3%, with Australia ahead of prior year, and China adversely impacted by soft domestic pricing linked to weak consumer sentiment and spending
- Group EBITDA in the range of $15-16m, reflecting margin improvement initiatives and a moderation of international freight in Australia, and China margins adversely impacted by weaker domestic pricing. The majority of first half EBITDA is expected to be generated from Australia, with China remaining profitable across the half

In closing, the Board and I recognise and thank our staff for their ongoing dedication and effort across the year. Their passion to provide our customers with the best possible product remains our biggest strength. Our teams in Australia and internationally continue to innovate, solve problems and provide exceptional customer service.

Authorised for release by the Board of Lynch Group Holdings Limited

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