Lynch Group Holdings Limited

2024 AGM – Chair/CEO address

22 November 2024

Chair's Address

Introduction

FY23 witnessed the post COVID bounce back in Australia with normalising supply and logistics driving a recovery in margin. China had a much more volatile period having been through drastic social measures to contain the virus in the first half before these were suddenly abandoned in the second. The initial post lockdown spending burst petered out by June as macroeconomic factors became a drag on earnings in China.

FY24 was, in large measure, a continuation of these factors. Australia continued to experience a normalisation of both product availability and supply costs. Air freight remains elevated compared to pre COVID levels, but other measures have seen nearly a full restoration of margin. Our supermarket customers continued to grow their overall market share proving the resilience of both the product and the channel. End customer confidence in product quality when married with the convenience and value offered by the supermarket channel is likely to drive penetration rates closer to overseas markets. The Group also supplies the florist and general wholesale channel which was impacted by slowing consumer spend.

China has not recovered from the economic headwinds evident late in FY23. Whilst the property crisis has likely bottomed, a continued lack of consumer confidence and demand persists. The government continues to search for means to stimulate demand and recognises that increased domestic consumption is needed to rebalance the economy. No tangible progress however is evident.

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 more than 28% over the last 5 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.

The Group continued to optimise its merchandising system, to further improve merchandiser productivity and allow the business to capture increased sales opportunities whilst minimising in-store 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. Like prior years, growth in SOR store revenue was ahead of core store growth (where ordering and display are managed internally by the supermarket customer).

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 from season to season and supply chains are prone to disruption. The Group continues to focus on increasing sea freight as an alternative to air where quality can be maintained. This has the potential to make a material difference to the landed cost of product as well as reducing our carbon emissions.

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 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 Sydney, Brisbane, Adelaide and Perth, 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. We continue to look at opportunities to expand our Markets footprint.

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 in China had 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 quickly. 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 distribution and bouquet making facilities located in Shanghai and Guangzhou.

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. Our products are distributed across China through wholesalers, online and offline retailers, florists via our webshop, and a small but growing B2C business. Export markets include Australia, Japan and south-east Asia.

The poor trading conditions experienced towards the end of FY23 persisted throughout the whole of FY24. Weak conditions domestically, impacted by the prolonged property downturn, higher unemployment levels for younger Chinese, and low levels of consumer confidence and spending, meant realised pricing remained weak and below the prior year's levels across the financial year. Given China is an emerging market for discretionary spending on the floral category, we see a different picture to the more mature market in Australia where the category has proven to be resilient up and down economic cycles.

China has been further complicated by the addition of new supply. In addition to the Group's own greenhouse expansion over the last three years a number of new large-scale projects have been established. We believe that we have a competitive advantage in growing and remain the lowest cost producer of scale. This means that we continue to generate positive cashflow from operations whilst many of our competitors will have significant cash deficits. Rose prices fell 18% on the prior year and 32% on FY22. The fixed cost nature of growing means the Group is well leveraged to the upside when prices recover. This is likely to happen from a combination of capacity withdrawal, increased penetration rate of floral products and a general improvement in consumer sentiment. In the meantime, we have paused our growth capex until we see a sustained improvement in operating conditions.

We continue to value add our product to reduce the correlation with market pricing. This includes expanding the retail channel including SOR stores, increased production of bouquets in Shanghai and Guangzhou, and the establishment of an online B2C business "Farm Flowers". Expanding our distribution footprint beyond Kunming, Shanghai and Guangzhou will support improved selling price and achieved margin.

<u>Closing</u>

We would again like to recognise and thank our staff for the incredible role they played in our business 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

Introduction

Today I will talk to you about our performance over financial year 2024, update you on the execution of our current growth strategies, outline the Group's progress on sustainability, and provide a trading update and outlook for the current financial year.

Across FY24, our committed teams delivered outstanding operational execution whilst continuing to advance our strategic initiatives across the business. In China, our Group faced a challenging operating environment, with consumer sentiment remaining low during the year translating to low pricing on key products. In Australia, margin recovery initiatives and revenue momentum delivered a strong uplift in EBITDA with year-on-year improvement of 50%.

The Group's full year results finished in line with the updated guidance provided to the market in early June at both Revenue and EBITDA. The results reflect continued recovery in margins in our Australian operations, and a decline in China's performance due to ongoing weakness in consumer confidence and demand, impacting realised pricing across our sales channels.

Our FY24 results reflect 1% growth in Group Revenue year on year, 2% when adjusted for an additional week of trading in our Australian segment in the prior year FY23. Australian customer demand remained resilient across the year, with the bulk of our demand generated in the supermarket channel, where we again achieved particularly strong performance from our sale-or-return store network. Australian revenue growth was adversely impacted by declines in our wholesale markets channel which predominantly services florists. China revenue declined across the year off the back of weaker domestic and export pricing, on higher production volumes. Subdued economic conditions, impacted by the prolonged property downturn and low consumer confidence and spending, meant pricing remained weak and below last year's levels across the financial year.

Group EBITDA of $39.6 million, fell short of last year's result by 7%. Australia's EBITDA result improved by 50%, with margin recovery initiatives across procurement, freight and labour delivering the strong rebound in earnings. China's earnings decline reflected persistently weak trading conditions, with real caution in consumer spending having a significant impact on realised pricing. The strength of our operating platform and team, and the quality and reliability of our products enabled an $8.6m EBITDA contribution, set against extremely challenging market conditions.

The Group recorded a non-cash impairment charge against China's carrying value of goodwill of $30.1m at the half year of FY24. The Group's confidence in the positive medium to long term outlook for the China floral industry remains unchanged.

FY24 Australia

For the year ended 30 June 2024, the Australian operations achieved Revenue of $329.6m, 3% up on FY23, when adjusted for an additional week of trading last year. FY24 EBITDA of

$31.0m, 50% up on the same period last year, reflected ongoing margin recovery initiatives, and the moderating international freight rates across the first half of the year.

Customer demand for supermarket floral products remained robust across the year, despite increasing pressures on consumer confidence and household spending. Sale-or-return store growth continued to outperform core store growth across the year. Our key second half supermarket events across Valentines Day and Mother's Day were delivered in full and achieved very pleasing sell through rates in store for our customers. Demand from other wholesale and florist customers remained subdued but stable across the year, with florists in general facing challenging trading conditions.

Australian EBITDA margin recovery initiatives progressed to plan across the year. Steady improvement to overall buying rates via reductions in freight, ongoing range management initiatives, and greater labour availability, combined to deliver improved EBITDA performance. The bulk of international air freight reductions were realised in the first half of the financial year, with rates on key supply geographies remaining steady across the second half but elevated compared to pre pandemic rates.

FY24 China

China achieved Revenue of $85.4m, 12% down on FY23, with EBITDA of $8.6m down 61% on FY23. China's revenue decline resulted from a combination of strong farm production volume growth which tracked at around 10% across the full year, material declines in domestic pricing which saw average pricing on our key rose products fall by around 18%, and export pricing declines reflecting the pass through of reduced export freight rates to Australia. The FY24 farm development program takes our total greenhouse space in production to 84ha.

Weakness in local China floral pricing continues to be driven by very low levels of consumer confidence and spending, which is largely being impacted by the prolonged property market downturn and higher unemployment levels for younger Chinese. Discernible volumes available on market via auction have also been elevated around key event windows. Operational execution across growing, processing, sales and distribution continues to be managed efficiently and effectively, delivering a solid volume uplift over the year, with costs well controlled.

Strengthening our downstream distribution capabilities remains a key strategic focus for us in China, allowing us greater opportunity to value-add our products, and reach a larger universe of customers across all market channels. In this vein, we successfully commissioned our second east coast production facility in Guangzhou early in the second half, which has immediately provided additional sales reach in this large market across our wholesale, retail and webshop channels.

Sustainability

We are pleased to have issued the Group's second annual Sustainability report – Flourish – as part of our FY24 annual report. This report provides detailed insights into the Group's investment, activities and focus areas across our environmental, social and governance (ESG) initiatives. Across FY24, the Group's multidisciplinary sustainability team focused on establishing visibility, baselines and processes that underpin our ESG platform. Some foundation achievements of this team include the establishment of six material sustainability pillars that constitute the framework for our longer-term ESG roadmap. These are waste, carbon emissions, water, packaging, biodiversity, and people and community. Our team also formalised processes to approve and fund proposed ESG projects and initiatives, and formulated and released the Group's public Sustainability policy.

We are proud to have entered two important flora conservation partnerships with the Botanic Gardens of Sydney and the Centre for Ecological Restoration in Kenya. The Botanical Gardens of Sydney is custodian of three significant botanic gardens in New South Wales and our support extends to the Garden's mission to protect and preserve Australia's native flora through research, land and habitat restoration. The Centre for Ecological Restoration in Kenya is a recently established, not-for-profit organisation in Kenya that has a core mission of restoring biodiverse ecosystems by engaging people, sharing knowledge and conserving local native flora.

We continue to closely monitor and manage our emissions and energy consumption following the establishment of baseline emissions data in the previous year. Recognising that a material contributor to our scope 3 emissions is airfreight into Australia, we are investing in and have commissioned primary research and trials to examine the feasibility of enhanced sea freight capabilities.

Waste reduction and management stands as a foundation of our sustainability efforts, reflecting our commitment to efficient resource utilisation and environmental stewardship. Encouraging high staff engagement in our waste management activities has had significant positive internal cultural impacts and provides the model for rollout to a broader selection of sites.

We launched our internal People Plan, a three-year working strategy to meet the business' long-term goals with focus areas including diversity and inclusion, health, safety and well-being, development and succession, talent acquisition, engagement and retention, and management and compliance. The health and safety of our people remains a key priority for the Group, with ongoing investments made during the year in our WHS roadmap to continue to support and protect our people.

Following the recent developments on Australian Sustainability Standards, we are in the process of determining the nature and form of disclosures required under AASB Sustainability Standards and our future reporting and disclosures are expected to evolve to achieve ASRS S1 and ASRS S2 compliance by the relevant adoption date.

Trading Update and Outlook

In August, we updated the market on performance and outlook, noting consistent margins in Australia, and China margins continuing to be impacted by low domestic pricing. Current trade settings for first half FY25 are as follows.

In Australia:

- Ongoing stable floral demand trends with our major supermarket customers, with revenue growth expected to be around 4% for the first half
- Demand for lower priced supermarket floral products continues to be positive with new brands launched during the first half delivering positive sales momentum
- We are expecting stronger revenue growth across the second half, driven by planned volume increases for the key Valentines Day and Mother's Day events with our major customers
- Potted products continue to underperform relative to floral, reflecting a downward reset in consumer demand for these lines following the peak demand years across COVID
- Australian EBITDA margin has remained in line with last year levels across the first half
- The SAP system upgrade is now well progressed with the project's first phase expected to complete within FY25 with costs in line with August guidance of c.$1.5m

In China:

- We note the Chinese Government has announced policies designed to support economic growth and improve consumer confidence
- To date, consumer confidence and spending remains weak for discretionary items with no discernible change in conditions or sentiment during the half
- China revenue is expected to increase on the first half of FY24 from additional tulip and export volumes, offset by declines in domestic rose ASP of around 5%
- Seasonal pricing improvements are evident heading into the winter season, with higher demand expected through the 2H major events commencing with Chinese New Year
- Operational execution across growing, processing, sales and distribution in line with expectations with costs continuing to be well controlled

Group Outlook

The first half group financial outlook is for:

- Group Revenue growth of around 5%
- Underlying Group EBITDA in the range of $16-17m (excluding the impact of SAP project costs), reflecting stable margins relative to 1H FY24 in Australia, and China margins below 1H FY24 impacted by domestic rose pricing

Closing

In closing, the Board and I would again like to recognise and thank our teams across Australia and China for their ongoing energy, effort and dedication across the year. Their commitment to deliver quality, innovation and service for our customers remains our biggest strength.

Authorised for release by the Board of Lynch Group Holdings Limited

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