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Lodgement of Market Briefing**

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Market Briefing

Adairs MD on FY15 results and outlook

Interview with David MacLean (Managing Director & CEO)

In his first Market Briefing interview, Adairs' Managing Director & CEO, David MacLean, discusses the company's maiden full year results as a listed company, and its outlook, including:

- *Results for the 52 weeks ended 28 June 2015 [FY15] exceeding Prospectus forecast*
- *Continued earnings growth underpinned by focused retail execution*
- *Strong like-for-like sales growth through increased transaction numbers*
- *Strong balance sheet with comfortable gearing to support continued growth*
- *Positive start to FY16 with momentum continuing in the first eight weeks of trading, ensuring the company is well positioned to achieve its FY16 Prospectus forecast.*

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1. Adairs' FY15 results exceeded Prospectus forecast. Key measures include total sales up 25.6% to \$210.9 million, gross profit up 25.9% to \$130.7 million and EBIT up 51.8% to \$33.1 million. What has underpinned this growth?

David MacLean

We are very pleased with the growth that has been achieved by the company over FY15 that saw us exceed Prospectus forecast. Our focus on retail execution has driven strong growth in transaction numbers, allowing us to achieve 31 consecutive months of growth. We were especially pleased with Q4 trading, which was stronger than assumed in the Prospectus forecast.

The strength of Adairs' business model can be seen in like for like sales growth of 21.6% across all of Adairs' store formats over FY15. The performance of our online sales was particularly pleasing, with 35.2% sales growth for FY15.

While driving growth in the top line, we have also focused on operational improvements by leveraging economies of scale. As a result, our cost of doing business [CODB] reduced from 46.5% of sales in FY14 to 44.1% of sales in FY15. With strong top line growth and reducing CODB percentage, we were able to grow earnings faster than revenues over FY15.

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2. How important is the online sales channel for Adairs?

David MacLean

Our online sales channel continues to grow, at levels we believe are above overall market growth for this channel. Over FY15 online sales grew by 35.2% from FY14, with the second half of FY15 seeing growth of 48.3%. This channel now accounts for approximately 5.6% of Adairs' total sales.

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3. How sustainable is your current growth rate going forward, particularly like for like sales growth?

David MacLean

We believe we can continue to grow at levels above the overall growth rate for our category given the strategy we have put in place that focuses on retail execution and on trend product differentiation. The level of like for like sales achieved in FY15 was exceptional. Cycling strong like for like sales is always challenging, but we believe we are well positioned to achieve the FY16 Prospectus sales growth.

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4. Whilst strong sales growth was achieved, gross profit margins were slightly down on Prospectus forecasts, with a margin of 62.0% versus a forecast of 62.7%. What is behind this, and what are the expectations for gross margins moving forward?

David MacLean

Off the back of significant sales growth, gross margins remained at very healthy levels for FY15 despite some minor headwinds. Due to the strong growth in sales, we had to put more volume through the Distribution Centre which increased distribution costs.

In addition, we decided to take a particularly pro active approach to ensure a clean inventory position towards the end of the financial year to improve stock turn. This reduced the margin on some of our products but had the benefit of reducing total working capital investment.

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5. How is Adairs responding to the movements in the dollar and its impact on profit margins?

David MacLean

Exposure to foreign currency fluctuations, in particular the Australian Dollar/US Dollar is common for all of our competitors. However, we believe Adairs is better placed than most to address foreign currency movements given our vertically integrated model.

Our private branded products, particularly our fashion and decorator products, are more capable of supporting price increases because of their proprietary design. Early indications following recent

price increases indicate an acceptance by customers given sales volumes do not appear to have reduced.

Reduced import duty rates from 10% to 5% have partially offset increased costs as a result of the declining Australian Dollar. It's important to note that currency is not a competitive advantage for any competitor in the medium term as 'net prices' tend to adjust relatively quickly in our category.

We continue to implement strategies to mitigate the impact of foreign currency movements. These include implementing pricing changes and altering our promotional strategies. We are also working closely with our suppliers to achieve cost reductions. Lastly, we continue to take foreign exchange cover in line with our internal policy to insulate the business from short term volatility in the Australian Dollar.

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6. Your capital expenditure in FY15 increased slightly to \$6.9 million. What is the likely business as usual capex level going forward?

David MacLean

In FY15 we invested \$5.2 million in 5 new stores and 3 concession stores, as well as refurbishing or relocating 9 stores. The balance of our investment was in our ERP and other projects, with the main roll-out of store POS on track for completion in the second half of FY16. We believe the current anticipated level of investment of between \$7 million to \$9 million is appropriate going forward based on our existing plans, including our stated roll out and refurbishment objectives.

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7. Given you only opened a net 4 new stores in FY15, what are your store roll-out plans and will you be able to achieve the Prospectus forecast of 11 new stores in FY16?

David MacLean

In relation to FY15, it's important to note that in addition to the 4 net new stores, we also opened 3 Urban Home Republic Myer concession stores that were not part of the FY15 forecast. So you could say we actually opened up 7 net new stores in FY15 (which includes one store closure).

We have been very busy planning and executing our new store roll-out programme and are well on track to achieving the Prospectus forecast of 11 new stores in FY16. We are now 8 weeks into the financial year and we have opened 2 new stores, one Adairs Homemaker and an Adairs Kids store. We have also finalised 3 leases for new stores, and are at an advanced stage of negotiation on a further 3 new stores. In addition we have finalised deals to upsize 4 Adairs Homemaker stores.

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8. Can you provide an update on Adairs' international expansion plans?

David MacLean

We are constantly assessing new growth opportunities to further build the Adairs business, and this includes evaluating the potential for international expansion. Our international growth plans will be measured and would commence with a small number of trial stores.

We are yet to finalise our decision on which market we may enter, with further diligence currently being undertaken on both the New Zealand and South African markets.

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9. Are you looking to grow via acquisition and if so are you pursuing any M&A opportunities?

David MacLean

Our current focus is on retail operational excellence and organic growth, and extracting further efficiencies from our recent investments in the business. We have multiple attractive organic growth opportunities available to us and if we can execute them well, this will continue to grow shareholder value.

That being said, should attractive M&A opportunities arise we will assess them in terms of their potential to further add shareholder value.

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10. How has Adairs' performed so far in FY16, and what are your expectations for the remainder of this new financial year?

David MacLean

Adairs has in place very solid foundations and is well positioned for further growth. We are only eight weeks into FY16 and while it is premature to provide detailed comment on the company's performance to date, I can say that we are positive on the Company's outlook.

There has been significant investment in the business and we expect to leverage the benefits of these over FY16. Our new ERP will enhance customer experience through improved delivery channels, faster transactions and a more integrated loyalty program. We are also enriching our online experience and reallocating marketing spend to higher performing more targeted channels such as our loyalty program 'Linen Lovers', email and search as well as developing our social media strategies.

Our emerging formats, Adairs Kids and Urban Home Republic, are an exciting growth opportunity and we are recommencing the roll out of these stores given the improving performance metrics of Adairs Kids and the current trial of Urban Home Republic concessions.

We have an exceptional team in place, a strong retail and distribution infrastructure, unique products and a differentiated customer proposition. Coupled with a clear growth strategy, we are well placed to grow shareholder value and achieve our FY16 Prospectus forecast.

We look forward to keeping shareholders updated on the year ahead as further developments come to hand.

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Thank you, David.

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

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