

CHAIRMAN'S ADDRESS TO SHAREHOLDERS OF SMITHS CITY

27 AUGUST 2013

INTRODUCTION

Before moving to the formalities of the meeting I would like to talk to you as shareholders and investors about the general economy, Christchurch in particular, and the company itself.

THE ECONOMY

After a period of pick up through 2012 based around buoyant rural conditions and prices, the retail market went flat as we moved into 2013 especially in the South Island rural areas and lower North Island. We saw the best farming conditions for 50 years in 2012 with strong prices and favourable grass growing weather, quickly decline and confidence with it. Prices to farmers fell rapidly due to the weakened European markets and the NZ\$ remained very high. On top of that a serious drought on the east coast and upper north island took hold through the summer of 2012-2013 and with farming cash flows under pressure it was inevitable for rural spending to slow.

Since 2010 real GDP across New Zealand has been around 2% with real uncertainty as we head through 2013 – we have only seen the GDP numbers for the first quarter of 2013 and that was below economists’ expectations at only .3%. There is no “bounce” in the economy and this is reflected at retail. The latest retail statistics were released last week to the headline “Strong Core Retail Sales for the June Quarter”. But if you dig deeper into the numbers a different picture emerges – like food and beverage, DIY and motor vehicles up but most of this happening in the Auckland and Waikato markets. Growth in the Wellington region is flat and in the South Island in decline.

As I have said before to Rick economic downturns in New Zealand, other than that caused by a financial crisis, have always been preceded by a drought.

GROWTH AND THE CHRISTCHURCH REBUILD

The expectations of bureaucrats and economists for 4%+ GDP for New Zealand growth as recently as 2010 have proven to be wrong. I said at last years AGM that we plan our business around there being no improvement but perhaps an upturn in Christchurch when the rebuild begins and have, so far, been proven right. The Christchurch rebuild is frustratingly slow to

gather momentum although we are seeing increases in whiteware and floorcovering sales – this goes with the refurbishing stage of the recovery.

It was encouraging to get the news last week the EQC and Fletchers expect to bring forward completion of the under \$100,000 per property repair phase of the rebuild by a year – in effect to finish the 90,000 jobs by the end of 2014. This will be a huge effort as only 40,000 have been completed to date in over two years; however, more “opt out” settlements may allow residents to get on with it themselves. We all know that the over \$100,000 per property repair and reinstatement jobs requiring insurance company settlement have been very slow to get started but this work must begin soon.

The building of new homes has been slow to start. Residential building figures released at the beginning of August covering the year to June tells a real story. In the five years up to 2008 residential consents averaged 27,000 new homes each year. In the following five years to 2013 the annual consents averaged 15,000 – over 40% less. It is generally accepted that New Zealand needs about 25,000 new homes a year so a housing shortage was inevitable and will take years to correct. The number has started

to increase with 2013 up to 18,500 but this is still 25% below the required level and half what was consented in 2004.

In Christchurch consents have started to happen with the 2,500 approved for the six months to June 2013 being 25% up on a very low number for last year – but it still only represents 500 more houses than last year over that six month period – we need a lot more than that to replace the homes lost which we know are at least 10,000. The picture out front is clearly for significant home building and that means more retail sales – the question is when?

Besides this specific demand for home building, growth will come from the incomes relating to the overall Christchurch road and water infrastructure and major projects rebuild with much of it funded from overseas insurance proceeds. The massive earthquake repair and rebuild now being talked about as \$40B around 20% of New Zealand's annual GDP will eventually kick in. Some companies have geared up for this rebuild too early and suffered as a result. We wait patiently.

SMITHS CITY

Behind us at Smiths City over the last year is:

- Most of the Earthquake insurance claim and settlement activity.
- The repair and re-establishment of our Christchurch stores and, in the case of our seriously damaged Colombo Street operation, back to two thirds of the retail space we traded in before. Planning continues for the rest of the Colombo Street rebuild.
- The restructuring and new funding for Smithcorp Finance, our consumer finance operation. This brought substantial cost saving to us but did require almost \$10million in cash investment to cover off the new equity levels and the “break fee” penalty cost of Fisher & Paykel Finance, our previous funder.

BOARD AND MANAGEMENT

The Board’s role is to agree the Strategy and oversee that it happens.

- That there is a clear business plan both for the existing businesses and for the growth strategy.
- That we have good cash flow and relationships with those providing our funding lines.

- Support for management in their business improvement program and maintaining the strength of our market position and brands.

I want to, again as I did last year, acknowledge the efforts of management team and all 700 staff. It has not been easy for them working in this highly competitive retail sector.

STRATEGY

The Smiths City plan as outlined in the yellow book is for continued steady growth in sales from existing stores and through the North Island store rollout into areas where we are under represented, based around our "full service model".

In the last couple of years we have built sales growth on our furniture, flooring and bedding sales levels emphasising the higher margin business that we enjoy in these products. In addition, our kitchen and whiteware product offering has expanded with good sales growth. These have cushioned to some extent the decline both in sales prices and volumes in the consumer electronics and digital products. In these commodity product areas further decline is inevitable and we will continue to adjust the operations to match the changes

Shareholders may ask why it is we continually look for growth – the answer is that retailers that don't grow go backwards, particularly where the products being sold are subject to deflation, as most appliance and electronic goods have been in recent years.

The one thing that does not stop is the increase in our costs although areas such as wage costs, bad debts and interest costs have moderated and are under strong control. Our insurance costs last year were close to \$1million more than in 2010 before the earthquake and property costs continue upward.

After Rick's address

OUTLOOK

There will be no real lift in the markets over the next year except in Christchurch. Much depends on how quickly the residential sector starts to complete significant new and refurbished homes. The ongoing infrastructure recovery will provide support for good employment levels. The rural areas will remain subdued until prices for the pastoral sector improve and the Wellington region we expect to remain flat.

Sales in the first quarter to end July 2013 are below budget and down on last year. Some of this is understandable in places like Greymouth, Dunedin, Gore and Invercargill where actual or threatened job losses have hit the community. So far this month sales have improved but strong promotions are the norm and credit based promotions are not as popular as in the past. Price deflation in electronic goods continues to erode sales but the furniture, flooring and whiteware sales price points are steady with good margins. In Christchurch during this year a number of our competitors reopened following the rebuild of premises and the number of retail stores in our sector is back almost to where it was pre earthquake.

We are hopeful that the improved trading we have seen this month will continue but the outlook is more uncertain than this time a year ago. What we do know is that the Christchurch rebuild is yet to get started and that we are ready for it.

SMITHS CITY GROUP

ANNUAL MEETING TUESDAY 27 AUGUST 2013

MANAGING DIRECTOR'S ADDRESS

Market Overview

Market conditions in the product segments in which we operate are always competitive – nothing changes there!!!!

In the electronics category prices have continued to fall, albeit at a slower rate than previously. Whilst there has been some offset through growing markets such as tablets and smartphones (where I saw one recent article which said there are more smartphones in the world than toothbrushes), the market continued to be “market share driven” with high discounts and ever longer interest free terms the norm.

The furnishings category is not as volatile from a price viewpoint as the electronics market, but it is an easily deferrable purchase and the Department of Statistics retail figures show that the overall market continues to show little or no growth.

Geographically the four regions in which the company operates showed different trends.

The South Island market was our strongest region as a result of a strong rural sector. Christchurch still awaits the post-earthquake rebuild but is starting to show some signs of life.

The two North Island regions faced more difficult trading conditions as the Bay of Plenty region suffered from the drought conditions and the Wellington region from the overall contraction of spending in the public sector.

Review of Operations

Management's key drivers for the 2013 year were:

- To finalise a new funding arrangement/structure for Smithcorp where

by funding costs would be reduced but at the same time autonomy in the company's management of its operations would be retained.

- To get those Christchurch retail operations that remained closed back up and running plus deal with the myriad of insurance issues relating to 2011.
- To complete a full review of the Colombo Street property and to produce a plan that maximised retail sales from the central, southern and eastern sides of Christchurch whilst at the same time taking into consideration the requirement for an administration/Group office.
- To further develop the Group omni-channel retail offering.
- To maximise returns from the current retail stores before looking for further geographic expansion. In particular, to improve returns from the lower North Island region.

All this had to be done whilst keeping service levels up and costs down.

So how did we go?

- We did get funding arrangements for Smithcorp finalised;
- We did get all the Christchurch retail stores reopened;
(Moorhouse Avenue photo)
- The plans for the Colombo Street retail offering were completed, although these are now held up by the well documented problems with the Christchurch consent process;
(Colombo Street ex Street photo)
(Plan for repairs)
(Photo of the "Crack House")
- We did get the Smiths City Internet site up and running although we are yet to see huge sales increases coming through;
- Looking at the returns across all our stores the lower North Island has been a "thorn in our side" and needed a radical overhaul. So:

- In March we closed the Upper Hutt store (where sales fell consistently once the Lower Hutt store opened).
- We centralised local management for L V Martin, Smiths City and all support functions under one regional manager. This has led to better in-store service and a much more streamlined “back end” to the business.
- In August we opened a new store on Kapiti Coast.

(Photo of Kapiti x 2)

- And we negotiated out of the existing Smiths City Porirua store and to move into a much higher profile Porirua store for Smiths City. This is due to open in November 2013.

Management is now very confident in its lower North Island footprint.

Priorities and Outlook

The trading environment continues to change rapidly, particularly in the technology area. This applies to both the style of product we are selling and the way customers are buying.

We are very confident in our brand and our strategy. We must continue with our commitment to selling quality brands through the provision of excellent customer service at all times in all locations.

Management does not expect to see trading conditions change significantly. As a result, whilst the company prides itself on its commitment to providing superior service levels than its competitors it must continue to meet the promotional offers in the market.

In line with the Board’s strategy the priorities for management are:

- Continue to be aggressive in the market place, ensuring that we gain sustainable increases in market share in those products that we see as being core to our future success – consumer electronics, kitchen appliances, beds and furniture – and sustainable increases in sales levels in all towns in which we operate.

- To this end top quality buying is essential. Our Christchurch based buying team work constantly – including spending considerable time overseas – to ensure we have the right product at the right price.
- Finish the Wellington restructure and take advantage of the Christchurch rebuild in both the retail and commercial market sectors.
- Make use of our lower cost of funding to expand the profit opportunities our finance operation gives to us.
- Continue the development of the omni-channel strategy.
- Complete a full logistics review and at the same time continue to micro manage both stock and receivables.

People

I have noted over many years how our staff throughout the country continue to “step up to the plate”.

We know very well how the Christchurch staff have reacted to the earthquakes over the last two years and now we are seeing other parts of the country having to “step up” as well.

Their loyalty and support is appreciated and never taken for granted.