



Smiths City

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**Smiths City
Annual Shareholders Meeting
The Tannery, Woolston
Christchurch
5 September 2018 10:30am**

Chairman Alastair Kerr

I have been on the Smiths City Board for a little over 8 months. I agreed to join because I saw a company that enjoyed a significant opportunity to build on a legacy that now spans more than 100 years.

I saw a company that - over several generations - had retained the goodwill and loyalty of its customers, particularly those who live in heartland New Zealand. They trust Smiths City for the quality of our products, the value we offer and - as detailed in this year's annual report - the commitment of our staff.

Smiths City was successfully embracing the shift to digital marketing and operated a highly successful online store. Although we do not break out detailed figures on this channel, the Smiths City website now ranks in the top echelon of our store network and it is growing sales strongly.

Smiths City also had a national footprint and rightly sought to be recognised for these good qualities in the upper North Island, the country's largest and most important market.

But even before I joined the company it was clear that Smiths City was not making the most of its potential.

I am passionate about retail.

I have held senior executive roles with retailers such as Marks and Spencer, Mothercare, Virgin and The Body Shop among others. As an independent non-executive director this has continued with companies such as Steamer Trading, a UK based kitchenware retailer, Fuller Smith and Turner, a brewer operating in London and the South of England; and Paper Plus, the New Zealand book retail co-operative.

Since joining the Smiths City board in December, I have found a company that has the potential to benefit from many of the disciplines that these companies take for granted.

But the company has been thwarted in its ambitions by underinvestment. Most notably, it has underinvested in information systems and in the store network. In some areas it has also lost touch with its customers.

Rightly it has rationalised its national footprint with the closure of a network of underperforming appliance stores. And it has more clearly defined its proposition as a national furniture and appliance retailer.

But it is clear we need to do more to reward customers for the loyalty they have shown over many years. And we need to do more to bring in the next generation of customers.

The transformation programme of the last few years has taken some important steps in the right direction. But it has not been sufficiently focussed on delivering on our goal to help our customers to Live Better. Additionally, the pace of change has not been fast enough to meet changing market conditions.

Many of our stores have not kept pace with expectations on how products should be displayed and sold. We have not been selling the products customers want and we have not been making the most of the customers that walk in the door.

Our patchwork of legacy systems - at best - results in delays in answering customer queries and processing transactions. At worst, it disappoints them with inaccurate information or results in poor customer fulfilment. Our current systems also give us little insight into what is driving customer behaviour.

Smiths City also needed to take some hard decisions; to recognise that some stores, despite the company's best efforts, would never deliver a profit.

2018 has been a remarkable year for the company.

On the one hand Smiths City achieved the milestone of 100 years in business. Yet on the other hand, this celebration coincided with a financial performance that can only be described as among the worst in recent history.

It is a year in which many of the problems I have just mentioned have come home to roost.

However, I am pleased to say that positive change is occurring at all levels of the company.

Reflecting the need for new perspectives, Smiths City has refreshed its board.

And I am confident the board has the skills and experience to provide the necessary oversight and assistance to the management team. Ben who joined the board with me in December is Chief Executive of Fishpond, one of Australasia's most successful home-grown online retailers.

Meanwhile, Tony joined the board in June and brings to Smiths City a successful career in retail and property. He is now a corporate adviser to a number of listed and private retail and property companies in Australia.

These new directors along with Tony Allison, who joined the board in 2016, and the Smiths City leadership team share an understanding of the change that is needed at the company. I am also delighted to say that we can see we are making progress.

This year's recognition of the onerous nature of several store leases and the resulting provisions of \$4.9 million are further tangible evidence of the change. This board and management team understands that we must first acknowledge the problems we face if we are to resolve them.

There is more work to be done. Roy and Tony will shortly provide more detail on the initiatives they have underway.

What I want to make clear is that this is not going to be a quick fix, nor is it going to come cheap. Significant investment in the basic infrastructure of the business is required.

We need to continue to refresh our store formats and implement modern information systems. In addition to ensuring up to the minute oversight of the business, these systems increasingly are becoming important to our service proposition. We also need to continue to invest in the product range and the training and development of our people.

In June, in light of these demands, the board decided that it was prudent not to declare a full-year dividend.

Our view on the dividend is unchanged. It is our firm intention to resume paying dividends, but we will only do so when the company is growing and sustainably generating cash in excess of its investment requirements.

I would now like to hand you over to Roy who will address these points in more detail.

Chief Executive Roy Campbell

Thank you, Alastair and good morning ladies and gentlemen.

It is a pleasure, indeed an honour, to be addressing you as CEO of Smiths City in the year it celebrates its centenary.

It was an important occasion that we celebrated with staff at the Colombo Street store – where the company first opened its doors in 1918. To acknowledge the founder Henry Cooper Smith we also invited his grandchildren.

In preparation for the event, we reflected on how we had achieved this significant milestone. The answer was clear – this company was founded on a simple principle; the value of the business is determined by the strength of its relationship with its customers.

Henry Cooper Smith started the business in the belief that Christchurch needed a grain and produce auction house. However, he realised there was an opportunity to offer more and quickly moved to selling and auctioning livestock and reconditioned farm implements.

From that moment on, Smith City's growth was fuelled by generations of Smiths City team members doing the same – recognising, and then bringing to life, opportunities to help customers Live Better.

On the day of the centenary we announced significant improvements to staff terms of employment.

We chose to do this because we wanted to emphasise the extent to which we value the team and recognise the pivotal role they played in carrying the company through to its centenary.

Customers are the reason we exist, but they represent only one side of the equation.

We are determined in this - our new century - to not only recognise the contribution our people make to the success of Smiths City but also work with them to develop a culture of service that sets Smiths City apart from its competitors.

Celia will cover the 2018 financial results in detail shortly, so I will just make some broad observations.

The retail sector has faced a difficult trading environment with a continuation of the easing in

demand and intense competition we first signalled in the first half of the 2018 financial year.

Soft demand led to heavy discounting, often to unsustainable levels, and the expansion of interest-free credit terms to periods rarely seen in the industry.

These trends were most pronounced in Christchurch and Auckland, where we operate our largest outlets and generate a significant proportion of our total sales.

These challenges were made worse by store refurbishments and closures, election-year trading uncertainty and in some areas an insufficient focus on our customers. Meanwhile, trading at our Auckland stores did not meet expectations.

We took some important steps in the year to address these issues, continuing the programme of transformation we started more than three years ago. But on reflection we didn't move fast enough.

We rolled out the new Live Better store format, first with our Hastings store followed by Whangarei and just before Christmas we rolled the format out to our Auckland stores. We also continued to refine and rationalise our product offer in those stores.

The Auckland stores are now benefitting from new management and more localised marketing support. We recognise the benefits to the group of achieving a strong presence in Auckland and we are intensely focussed on achieving success in the country's largest market.

As Alastair noted, our online channel, which we relaunched this year, is growing strongly and we see plenty of potential to further develop the site in the coming year.

We have endeavoured to protect our margins, refusing to offer prices that are over the longer-term unsustainable.

These changes follow on the closure of our appliance-only stores, the rationalisation of group distribution and administration centres, stock rationalisation and refreshment, merchandising improvements, and staff changes.

We have made some ground. We were for instance, delighted this year to be named the best furniture and appliance retailer in the Roy Morgan customer satisfaction awards.

However, as Alastair noted, the challenging trading conditions exposed our weaknesses. They showed we need to inject new energy into the programme and continue our drive towards exceeding customers' expectations.

Since our centenary celebrations we have been reflecting on our vision, mission and strategy and how well they will sustain us into Smiths City's new century.

As you can imagine, it has prompted robust debate among the team. It is still a work in progress and we will communicate more as we set it in stone.

However, I want to share with you the core elements of our thinking.

We want to become New Zealand's first call for furniture and appliances. We want customers to know they will simply be unable to find a better package of price, quality, trust and fulfilment.

We will use every point of customer engagement as an opportunity to build an enduring relationship. Customers should feel that we care.

We will build trust through integrity and transparency and by being experts in our products and categories. Our team will help people to Live Better by advising them on the products that best meet their needs and wants. Not what is on special, but what the customer truly wants.

We will make sure we have what customers want – by offering an outstanding product range that is desirable and affordable. We will give our customers many choices.

We will focus 100 percent on our customers, by listening to them and putting their needs first. Because at Smiths City, it's not just about making a sale, it's about building an enduring relationship.

From our mission there emerges several strategic priorities. Tony will talk to you shortly about our merchandising strategies.

Operationally we have work to do on all our systems and processes, which as Alastair noted, are badly in need of an overhaul.

We need a point of sale system that is linked end-to-end through the business.

We need to overhaul our finance and logistics systems to deliver seamless ordering, invoicing, payroll, reporting, tracking and communicating with our customers.

We need to introduce greater functionality into our online ordering system, make better use of our social media platforms and make our finance business friendly to mobile devices.

These changes will help us to better understand our customers and their needs and enhance service.

We need to continue our store refurbishment programme and refine the Live Better proposition. While we believe the brand proposition is the right one, it is clear it needs to be flexible enough to respond to local conditions.

Metropolitan stores inevitably must deliver a different experience and range to regional stores and we must be able to meet the needs of specific markets. Stores in Auckland for instance must meet the needs of a highly-urbanised population.

We must continue to invest in our people. As I mentioned we want to deliver a service culture at Smiths City that sets us apart from our competitors. The first step to achieve that goal is remunerating our team fairly.

During our centenary celebrations we announced we would pay our staff at least the equivalent of the 2018 living wage. We offered them an extra day's holiday as a birthday gift. We also announced the introduction of a well-being day for all staff, allowing them to use a day's accrued sick leave each year for whatever purpose they wished.

This is just the beginning of our engagement with staff. As we detail in the annual report we are rolling out a broad range of initiatives for the team including: training; engagement and succession and development programmes. The aim as I said is to create a leading service culture.

Finally, I want to address our capital management plans.

As Celia will detail shortly the recognition of onerous leases on several underperforming stores weighed heavily on our results. We continue to review all our leases and will not hesitate to exit stores that do not meet our performance expectations.

We will also continue to work hard to manage working capital.

We continue to believe our strong reputation coupled with a national store network, a more compelling finance proposition and a strong online presence offer the company a unique opportunity.

The challenge before us, and it is a long-term challenge, is to make the most of the traffic through our stores by leveraging our strengths and by delivering continual improvements to the customer experience.

I would now like to hand you over to Tony Kingston, General Manager Merchandise, to discuss the changes we are making to our product range and in store.

Tony Kingston, General Manager Merchandise

Thanks Roy and good morning everybody.

Our centenary celebrations highlighted our roots, where we have come from, how we have contributed and how we have served and enhanced the lives of New Zealanders. We have a proud history built on delivering good value and quality products that Kiwis can trust.

Over the last 100 years, the types of product we have sold have changed for many reasons including advancements in technology, changes to lifestyles and growing diversity in the populations we serve - to name a few.

With these changes there has also been a change in customer expectations, their needs, wants and desires.

To meet these changes, we must adapt all parts of the way we retail. It is not just about product although product is key. It's also about, Price, Promotion and the in-store experience.

Let me touch on each of these individually.

We need to be innovative. We need an offer that is relevant to our customers. It needs to be on trend, have the right look and design. Personalisation has become very important to our customers, so our offer must suit an individual's needs.

Advancements in technology, especially over recent years, have led to convergence. Apps have automated homes. Consumers can now control their TVs, lights, security systems, heating, washing machines and fridges all through one device such as a phone, a tablet or a notebook.

To fully meet our customers' needs, it is not just about selling a single product, it is about selling a solution tailored to them. We need to stock complementary products that allow us to deliver those solutions.

For us, the next 100 years is about staying relevant, being forward thinking, and successfully anticipating changes in trends, designs and technology.

Our products need to be constantly changing and evolving, not only to enhance the lives of our existing customers, but also to attract new customers, new generations of shoppers and people from all walks of life.

So how will we do this? By constantly reviewing our ranges and by analysing category performance and life cycle.

In the past we have been slow to exit products and categories, we need to be decisive to allow us to exit the old quickly, and reinvest in the new.

Our ranges while mostly consistent across all stores will also have an element of product that suits the individuality of local customers. We need to be “more local than local”. We need to offer a range that is personalised to specific communities.

Moving to price. Never before has price been more accessible, in the past to compare a product’s price it would involve a customer travelling from store to store. It was a lengthy and time-consuming process. But with technology a price can be compared in a blink of an eye.

Our focus is on value. We will remain true to our customers, offering them a quality range of products at competitive prices all day, every day, seven days a week, but we will still make a margin.

Traditional advertising media: the press, radio, TV and mailers have become much less relevant.

People now read the news through a web browser, watch TV on demand, or stream their favourite programmes. Mailers have become very expensive relative to their probable return.

Instead consumers look to different media – email and social media such as Facebook, Instagram, and Paid Search.

While we should not turn away from traditional media we will reduce our reliance on them in the future.

Via email we currently target over 80,000 registered customers to support our weekly promotional activity. Our Facebook/Instagram channels talk to a highly-targeted audience.

They are designed to entice and engage our brand with inspirational, aspirational advertising, which can be tailored demographically, geographically and behaviourally to personalise the offer and the customer experience.

Social Media helps drive awareness and customer engagement. It’s a less formal and it can adjust to changes in the market and personal preferences on a daily basis.

Google Search involves paying for both search words and shopping campaigns that actively target customers.

All of these new media are the result of technology enhancements, which give customers the freedom to choose and personalise the way they shop.

The internet has changed customers’ expectations.

Online shopping is convenient and comfortable. With a click of a button, orders are placed and within a few days, the product will arrive often from around the globe.

For Smiths City to compete, we need to be truly Omni-channel. We need to allow our customers to shop how and when they like, while always delivering on our customer promise, vision and values. All parts of our business need to reflect this commitment, from our website, to delivery, service, and in our stores.

Whether it is our sales team, tickets, signage or display solutions, our stores need to be inviting, exciting and fun. It’s about the atmosphere, the theatre. It’s about the emotive experience a customer will receive when they enter our stores.

All of these four pillars – price, product, promotion and the customer experience - are crucial to our success. We cannot look at any one pillar in isolation.

My team, and it is a new, dedicated and enthusiastic team, are committed to delivering on these promises.

They are committed to reviewing our products' relevance, introducing innovation, exciting our customers with new ranges that are on-trend, modern, solutions-based and personalised to them.

We must always be competitive with our pricing, but this will not come at the expense of profit.

Our promotions will be targeted and again need to be personalised to what our customers are looking for. The whole experience no matter how, where or when our customers shop should live up to this promise.

I will now hand you over to Celia to take you through our financial results.

Chief Financial Officer Celia Mearns

Tony, thank you, and good morning everybody.

You would have received our annual report, so I am not going to dwell on the detail. Instead we decided it would be useful to focus on the main drivers of these results.

As both Alastair and Roy noted Smiths City faced a tough trading year, revenue was down just over 5% or \$11.5 million.

We held operating expenses steady, with consistent results in the finance business partially offsetting the loss in the retail operations, however with one-off abnormal adjustments of \$6.9 million, we posted a loss before tax for the year of \$9.9 million.

These adjustments included a \$4.9 million provision for the leases on stores that on review offer little chance of delivering a profit for the company. They also included a \$1.5 million provision related to the Employment Court's May ruling.

Cash outflow from operating activities, relative to the reported loss, was a modest \$1.4 million, reflecting the weaker trading performance. However, the cash demands on the business grew.

We invested just over \$10 million. This included investment in the store network and growth in the group finance book. We also paid out \$1.9 million to cover the final dividend for the 2017 financial year and an interim dividend for 2018.

The net cash outflow was covered by a reduction in cash reserves and a \$7.6 million increase in borrowings.

The balance sheet is strong, with \$6.2 million cash on hand and \$33.9 million retained earnings, however the company requires further investment to build sustainable earnings momentum.

Net interest-bearing debt stood at \$54.7 million at the end of the financial year and all of this was covered by finance company receivables.

Meanwhile, finance company receivables exceed finance business borrowings by \$7.3 million.

Gearing as measured by net debt to total assets has risen from 30.1% to 40.4%.

We continue to drive improvements in our balance sheet with working capital down by \$5.8 million.

This reduction includes a \$6.1 million fall in inventory and the increase in liabilities, principally reflecting the provisions I mentioned earlier.

I will now hand you back to Alastair.

Chairman Alastair Kerr

Celia, thank you.

So, to summarise, we have endured tough trading conditions in the 2018 financial year, but we are working on new initiatives to drive trading improvements in the current financial year including investment in brands and systems, people and training.

The aim of this investment is to improve the customer experience in store, online and after sale; and to continue to build a high-performance culture in the organisation.

This is not a quick fix. We have the foundations in place, but the company must be growing and sustainably generating cash in excess of its investment requirements before we will consider a resumption of dividends. And at present we cannot speculate on when this might be.

Trading in the first four months of the year has been volatile and the housing market, a key driver of demand, remains muted despite rising housing affordability.

That said we have been lifted by the success of our centenary celebrations and the recent strong growth in our online channel. We are also seeing some green shoots of evidence that our performance improvement initiatives are delivering results, particularly in the Auckland area.

We will provide an update when we release our half year results in late December.

Before we move to shareholder questions I believe it is appropriate to acknowledge the contribution made Craig Boyce, Gary Rohloff and Sheena Henderson who all retired from the board this year. Craig, in particular, gave 30 years of service to the company.

Finally, on behalf of shareholders and the rest of the board, I would like to thank Roy, the senior management team and indeed the broader Smiths City team for their work over the last year.

Significant change is needed at Smiths City, but I believe, there is understanding among the whole team of the task we face and a commitment to getting it done.

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About Smiths City:

Smiths City Group (NZX.SCY) was founded in Christchurch in 1918 and has a proud tradition as one of New Zealand's oldest and largest retail chains. The company floated on the stock exchange in 1972 and operates 35 stores (including 3 clearance centres) nationwide. The group comprises Smiths City Retail, Smiths City Finance and Smiths City Commercial. On the web: www.smithscity.co.nz and www.smithcitygroup.co.nz