grays ecommercegroup Market Eye

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Market Briefing

Grays eCommerce Group CEO on H1 FY16 results and outlook

Interview with Mark Bayliss (CEO & Executive Director)

In this Market Briefing interview, Grays eCommerce Group's CEO & Executive Director, Mark Bayliss, discusses the company's 2016 first half results and strategic outlook including:

- *Financial performance over the 6 months ended 31 December 2015 [H1 FY16]*
- *Sale of the Fixed Price Retail [FPR] assets*
- *Strategies in place to drive growth in the Business to Business [B2B] division*
- *Key balance sheet items*
- *Growth outlook for H2 FY16*

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Grays eCommerce Group's first half results showed solid revenue growth, an increase in earnings from continuing operations, however an overall loss. What were the key drivers for this half year result?

Mark Bayliss
Over the first half, Grays has been transformed from a mix of online retail and auction businesses to a predominantly B2B auction focused business. This saw us deliver on our B2B growth strategy, refocus the remaining profitable B2C auction business and exit the FPR business with its sale to MySale.

The financial result for this half needs to be looked at carefully to understand how the underlying B2B and B2C auction businesses performed, which was actually quite well.

To better understand the half year result, we have split the financials into continuing operations – consisting of our core B2B and B2C auction businesses – and disposed operations relating to the FPR business.

Our B2B division continued to grow strongly, with revenue up 21% to just over $36 million reflecting strategic initiatives undertaken in the key segments of Auto, Mining and Transport, partially offset by a weaker Banking, Insolvency and Finance [BIF] market due to the delay of some contracts into the second half of the 2016 financial year. Diverse revenue streams are a strength of our B2B division where the weaker BIF result was offset by 30% plus growth in our core vertical markets.

Traditionally skewed to the first half, BIF is expected to grow strongly in the second half given current contracts and pipeline."

Our continuing B2C operations generated 14% lower revenue to $26.1 million as we re-weighted our stock levels to match key B2C categories and some major event sales from the first half of the 2015 financial year were not repeated during the first half of the 2016 financial year.

EBITDA from continuing operations grew 9.3% to $8.1 million driven by cost savings from our B2C auction business, which more than offset increased investment into B2B resources to support growth initiatives. B2C cost efficiencies centred around outsourcing, warehousing and logistics, producing a saving of $4.4m.

In relation to our disposed B2C operations, revenue was up 32% to $52.5 million and a loss of $7.9 million EBITDA was generated. This compared to a loss of $1.7 million in the first half of the 2015 financial year, which only included seven weeks of trading. The increased loss was also driven by a controlled inventory sell-down and increased variable costs, as we exited the business following the sale of its goodwill and customer lists to MySale.

Our Net Loss After Tax of $22 million is inclusive of just under $25 million of significant items relating to the sale of FPR. Splitting the significant items into cash and non-cash, there was a cash positive $1.7 million of significant items with a negative $26.7 million of non-cash items.

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Could you explain the strategic rationale behind the sale of FPR? Are you planning to exit the B2C business entirely?

Mark Bayliss

The sale of our FPR business last November to MySale was a pivotal move allowing the group to focus on what it does best and leverage its competitive advantage in online auctions.

Given the competitive dynamics and high fixed costs of the online FPR market, we believed the best outcome in terms of shareholder value was to dispose of these operations and focus on our core assets. The sale of FPR also allowed us to reduce the fixed cost base of our total business.

Our remaining B2C auction business is growing and profitable. We undertook several strategic initiatives over the first half that focused on reducing costs, optimising warehouse space and the management of volume seasonality to produce a leaner business. Other strategic initiatives put in place included new sourcing strategies to increase the supply of quality goods and increase average sale prices.

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It's clear that the B2B division is the growth driver of the group. What initiatives were put in place to drive future growth?

Mark Bayliss

Our B2B division continues to be our growth driver and we successfully implemented a number of key initiatives including integrating DMS Davlan, expanding into the South East Asia market and investing in infrastructure and staff across key segments. There are multiple segments where we see

attractive opportunities for Grays to differentiate itself and build scale, including agriculture, automotive, mining and transport. We have made investments to position ourselves to benefit from underlying market demand in these areas.

We are pleased by the results of initiatives taken in B2B, particularly in our strongest segments of Auto, Mining and Transport, which achieved 30% plus growth in revenue in aggregate during H1 FY16. We also expect an improvement in our EBITDA margins in the second half.

While it is still early days, we are seeing a strong pipeline of potential sales activity from our expansion into the South East Asia market, assisted by our joint venture with Iron Planet, an alliance providing us with access to a huge and growing international market.

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What was responsible for the $25 million of significant items during the first half and what was the cash impact of those significant items?

Mark Bayliss

The $25 million of significant items related to our strategic decision to exit FPR and focus on our profitable auction businesses.

The largest component of the significant items was the $16.1 million non-cash writedown of goodwill given the sale of FPR involved the goodwill and customer lists of our B2C FPR businesses. In total there was $26.7 million of non-cash significant items, with the other major item being the non-cash loss incurred on recognition of onerous lease contracts, relating to excess warehouse space at our Lidcombe facility.

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Having sold your FPR business during the half, why is inventory so high at $10 million? How much FPR inventory is left following the sale of the business and what loss can we expect to see in H2 FY16 to liquidate the remaining inventory?

Mark Bayliss

Our inventory position at 31 December 2015 needs to be considered in light of the transformation of Grays that has occurred over the half.

In terms of our continuing operations, inventory levels increased from $3.6 million at 30 June 2015 to $8.4 million at 31 December 2015 as we restocked our more popular B2C auction products – for example, power tools and outdoor furniture - to allow us to benefit from seasonal growth during the second half of the financial year.

In relation to our disposed operations, FPR inventory reduced from $11.6 million at 30 June 2015 to $1.6 million at 31 December 2015 as we exited that business. This will be reduced to nil during the second half, and there will be no significant delivered margin loss as the inventory liquidation has already been provided for and included in significant items for the first half. As the FPR business did not cease trading until the end of January 2016, we expect further operating losses (pre-tax) in the second half in the range of $1.5m to $1.7m.

The overall impact of the FPR inventory liquidation has been to reduce the amount of working capital required and allow us to redeploy funds into more profitable and strategic growth segments.

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Grays' net cash position decreased by $2.6 million over the half. What was the driver of the reduction in cash?

Mark Bayliss

The reduced cash level essentially reflects the $2.7 million cash paid for DMS Davlan. In terms of our continuing operations, they generated $5.7 million of operating cashflow, and we also saw a $7.8 million reduction in working capital for the group as a result of the sale of FPR inventory.

During the half year we received $3 million from the sale of FPR, with the balance of $2.2 million received in early February 2016. This final payment was of course not included in our first half cash flow numbers.

The solid cash position allowed us to continue investing in our continuing operations to better position Grays for growth in the second half.

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Do you plan on acquiring more B2B businesses?

Mark Bayliss

We are very focused on optimising the existing business, expanding our core businesses into segments where we have a competitive advantage, and growing into new areas where we can utilise our talent and experience. The acquisition of DMS Davlan allowed us to strategically expand into the Agricultural segment, a market that is a natural extension for our online B2B auction business.

While we have a number of attractive organic growth opportunities, we continue to keep watch for potential acquisition opportunities that bring scale and/or capabilities to the group.

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Finally, can you update us on the second half growth outlook for the Company?

Mark Bayliss

Having sold FPR, built an efficient and scalable auction platform and delivered EBITDA growth from our B2B and continuing B2C divisions during the first half of the 2016 financial year, we are well positioned to grow over the second half compared to the second half of the 2015 financial year.

While still early, being only seven weeks into the second half, it has been a promising start, with continued growth in our Auto, Mining and Transport segments. Our BIF business has also performed well over the start of the second half, with a strong pipeline of multiple opportunities and a number of projects being undertaken that were deferred from the first half.

Overall, we are excited by the growth opportunities available to Grays. As we said at our AGM in November last year, and have reaffirmed with this result, we expect our Continuing Operations EBITDA in FY16 to comfortably exceed that achieved during FY15.

We now have a very lean and focussed business with exceptional talent and infrastructure in place that will underpin long term growth in shareholder value.

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Thank you, Mark.

For further information, please contact +61-2 9112 9440 or go to www.graysonline.com.au or www.graysecommercegroup.com.au