

9 May 2018

Trading Update

Greencross announces that it now expects to deliver underlying FY2018 EBITDA of between \$97 million and \$100 million.

In addition, following an operational review, the Company now expects to recognise between \$16 million and \$20 million of primarily non-cash impairments which will be reflected in the FY2018 full year statutory result.

Greencross' new Chief Executive Officer, Mr Simon Hickey, has announced an immediate review of the Company's operating cost base with targeted reductions of between \$10 million and \$13 million in annual operating expenses. This review is expected to be completed and implemented by 1 July 2018. Savings are anticipated to come from back office efficiencies, rebalancing of rosters to provide better customer experience during evening and weekend trading, utility cost efficiencies from new technology and tightening of professional fee discounting policies in the vet business. There will also be a substantial reduction in project costs including consultants as the business enters FY2019. Part of these cost savings will be reinvested into customer facing technology and data analytics to improve customer engagement and in-store experience, enhance subscription capability and better leverage the 1.8 million active members in Greencross loyalty programs.

Current Trading

Greencross provides the following trading update as at week 42:

- Total sales growth 9.0% and Group LFL sales growth 4.5%
- Australian Retail LFL sales growth 4.3%
- Australian Vet LFL sales growth 4.9% (including standalone GP LFL sales decline of 2.8%)
- New Zealand LFL sales growth 4.2%
- Retail Gross Margin 47.2%

Mr Hickey commented that "Since our last update to the market at our half yearly results in February, our retail division has continued to perform well, delivering 4.3% LFL sales growth and stable gross margin despite an increasingly competitive consumer environment. However, our veterinary business has failed to deliver the previously budgeted uplift in second half activity primarily due to disappointing visit numbers in both our standalone GP clinics and in-store clinics. The 4.9% LFL sales in the veterinary division reflects mixed performance across our operations with our in-store clinics posting double digit LFL sales growth and our specialist and emergency centres delivering LFL sales growth in high single digits. However, LFL sales in our standalone GP clinics have decreased by 2.8% as a result of a 4.0% decline in visit numbers. In response, we have put in place a number of measures to increase patronage at our clinics including enhanced retail cross referral programs, increased HPP (Healthy Pets Plus) membership focus, new partnership arrangements with the NSW and Victorian police associations, targeted desexing and seniors campaigns and an uplift in digital marketing. While vet visits in our GP clinics have stabilised, the full impact of these measures is unlikely to be

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realised until FY2019. As a result, the veterinary division is now expected to deliver a \$2.7 million shortfall in EBITDA in FY2018 compared with previous expectations.”

Mr Hickey continued “Despite some short-term weakness in the veterinary division, I remain confident in our integrated petcare model and the medium and long-term outlook for both our retail and veterinary businesses.”

Items impacting underlying earnings

The key factors impacting the revised outlook for underlying earnings are as follows:

	Impact on FY2018 H2 underlying EBITDA (\$m)
Trading update – failure to deliver anticipated improved performance in veterinary division	2.7
Labour cost impact of strategic review of IT projects	4.0
Other items	1.8

Labour cost impact of strategic review of IT projects

Following Mr Hickey’s recent appointment, the Company is conducting a business wide operational and strategic review. The Board has now decided to rescope and refocus a number of projects which have historically contributed high levels of capitalised costs, including projects relating to the “store of the future” and the Company’s retail point of sale system. An additional \$4.0 million of labour costs will now be expensed in FY2018, including labour costs related to staff employed to work on discontinued projects.

Mr Hickey noted “Given structural changes in the pet sector, we need to review our previous capital-intensive model of renewing the physical layout of stores and clinics and instead focus on customer centricity and profitability of the existing fleet. We will continue to backfill veterinary and other services into retail stores in strong catchments and to grow our footprint where we identify synergies with our existing network. However, going forward our immediate focus will shift more towards integrating technology into our existing offering in areas including omnichannel development, digital assets and data analytics, optimising our store and clinic footprint and improving the customer experience. As a result, the previously flagged high capital cost “store of the future” re-fit program is no longer a priority and has been cancelled.”

Other items

In the first half of FY2018, the Company made an onerous lease adjustment to write back a provision previously made in relation to the retail leases for certain Western Australian stores acquired as part of the City Farmers acquisition. The effective impact of that writeback has been to add rental expenses in the second half which were previously unbudgeted. The expected impact on annual rental expense in FY2019 and FY2020 is approximately \$0.6 million per year.

Non-cash balance sheet impairments and provisions

In addition to the items outlined above, which will impact underlying earnings, the Company also expects to recognise between \$16 million and \$20 million of primarily non-cash impairments in FY2018 which will impact its full year statutory result.

Impairment or restructuring cost	Impact on FY2018 statutory EBITDA (\$m)
Impairment of projects	8.0 - 9.0
Provision for slow moving inventory	4.0 - 5.0
Impairment of investments, store assets, store network and incidental provisions	3.0 - 4.0
Provision for restructuring including redundancies	1.0 - 2.0

Impairment of projects

As part of its operational review, the Company has reviewed the carrying value of a number of projects (including projects relating to retail point of sale system, supply chain and logistics) as well as retail software. Following this review, the useful lives of certain projects have been reassessed and the previously capitalised values of some projects have been impaired or written down completely.

Provision for slow moving inventory

As part of its operational review, the Company has also reviewed the carrying value of inventory and, as a result, will make an additional provision of between \$4.0 million and \$5.0 million for slow moving inventory. This includes an increased provision for cat food which was recalled from shelves last year and remains the subject of a claim by Greencross against the supplier.

Impairment of investments, store assets, store network and incidental provisions

The Company has impaired the value of a number of its small investments and written down PP&E in two retail stores and one veterinary clinic which are loss making.

Provision for restructuring including redundancies

Given the decision to immediately reduce its operating costs through headcount reduction and other savings (detailed below), the Company expects to make a provision of between \$1.0 and \$2.0 million for redundancy payments.

Gearing

As at the date of this announcement, the Company has net debt of \$280 million and \$50 million of headroom under its senior debt facilities. The Company has recently completed the refinancing of \$75 million of senior debt. The Company's senior debt facility is not due for refinancing until October 2020. The Company remains in compliance with its banking covenants.

Historically, the Company has utilised a short-term credit facility to effectively extend the terms of supplier payments by up to 60 days. As at the end of the first half of FY2018, approximately \$20 million was drawn under this facility. Given the cost of the facility, this has been repaid and the future use of this facility is under review.

Corporate restructure

Greencross has commenced a review of its head office and operating cost base with targeted reductions of between \$10 million and \$13 million in annual operating costs. Simon Hickey noted “The Company is taking immediate and decisive action to reset its cost base. This drive for increased efficiency will include a streamlining of the existing management structure and a Company-wide review of staffing levels. I expect this review to be completed and implemented by 1 July 2018. The outcome of the review will be released to the market at the Company’s FY2018 full year results announcement in August.”

Outlook

“I am confident that, following this review, Greencross remains well placed to successfully execute our integrated petcare strategy, selectively invest in growth opportunities and deliver improved profitability for our shareholders,” Mr Hickey said.

Mr Hickey added, “While today’s announcement is obviously disappointing for the Company and its shareholders, I firmly believe that Greencross’ portfolio of retail stores, veterinary clinics and grooming salons together with our omnichannel business platform means we are uniquely positioned to deliver long term growth in the Australian and New Zealand petcare markets. With a refreshed strategy, a sharper focus on cost control and a more customer and data centric approach to what we do, we can continue to grow our market leading position in specialty petcare.”

The Company has already identified several key areas to improve performance, including:

- Renewed focus on cross selling across Greencross’ retail and service offerings
- More personalised and effective marketing to our customers, including through digital and social media communications, and leveraging the 1.8 million active members in our loyalty programs
- Better packaging of combined product and service offerings which will deliver superior value to our customers
- Optimisation of store and clinic format and space allocation to maximise returns
- Enhancements to the Group Loyalty program to increase customer engagement
- Improved use of customer data to maximise promotional efficiency and effectiveness
- Expansion of our private label retail offering
- Modernisation of delivery of vet services
- Improved labour efficiencies and cost reductions across a number of areas of the business

Mr Hickey said that prioritising these aspects of the business would enable Greencross to resume earnings growth in FY2019.

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Investor briefing

The Company expects to provide an update to the market on Greencross' corporate strategy at an investor briefing day. Further details will be provided closer to the event.

For further information please contact:

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