SPECIALTYFASHION | GROUP

ASX Announcement – Media Release

24 February 2015

Specialty Fashion Group Announces Half Year Results

Specialty Fashion Group Limited (ASX: SFH) (the **Group**) revenue for the half year ended 31 December 2014 was $413.0 million, 27.4% higher compared to the Previous Corresponding Period (PCP). This increase reflected underlying comparable store sales growth (CSG) of 5.7% for the Group during the half, excluding Rivers.

The Group delivered Earnings Before Interest Taxation Depreciation and Amortisation[1] (EBITDA) of $22.6 million, which includes a loss of $11.2 million attributed to Rivers, compared with EBITDA for the PCP of $31.2 million, which included a discount on the Rivers acquisition of $4.6 million. Gross margin was 60.2% for the half compared to 63.6% for the PCP. Net profit after tax for the half year was $5.9 million compared with $16.2 million for the PCP, and as at 31 December 2014 the Group had net cash of $5.0 million.

As outlined at the AGM in November 2014, several legacy issues still need to be addressed before the Rivers integration process is completed and the brand contributes to the Group's profitability.

At this stage and given present market conditions, the Board has determined it would be prudent to retain cash reserves and to not declare an interim dividend.

> Gary Perlstein, Specialty Fashion Group's CEO, said: *"Apart from Rivers, the overall performance of the Group has been pleasing, especially in an environment where discretionary expenditure has been under pressure.*
>
> *The Group has successfully delivered on a number of key strategic objectives, particularly the turnaround of Millers, our international expansion, supply chain transformation and a significant uplift in digital/online retail sales.*
>
> *Given the Group's track record of acquiring brands and delivering operational improvements to extract value, we are confident that we will be successful in rebuilding and integrating the operations of the Rivers brand into the Group.*

[1] EBITDA is adjusted for fair value revaluation of derivative financial instruments through profit or loss. A reconciliation of EBITDA to profit before tax is provided in the appendices of the investor presentation, also announced 24 February 2015.

Notable recent achievements as part of the Rivers turnaround have included:

- *encouraging performance of the first Rivers' womenswear category relaunched under the full control and influence of the Group since acquisition; and*
- *progress to reduce ongoing marketing spend and align future Rivers marketing efforts with our digital strategy.*

However, continued discounting activity, whilst crucial to accelerate the improvement of the Rivers business in the medium term, has had a significant negative impact on our margins in the short term. Nevertheless, we remain confident that Rivers will make a meaningful contribution to the Group's profitability in future years alongside our other brands."

Financial Overview

Specialty Fashion Group ended the half year with net cash reserves of $5.0 million at 31 December 2014 (PCP $22.6 million).

The Group's capital expenditure was $10.7 million for the half year (PCP $13.1 million), with the opening of 24 new stores. A continued focus on Millers' brand rejuvenation and the integration of Rivers required ongoing investment in headcount and infrastructure, as the Group implemented highly experienced teams to support these key growth initiatives.

The Group also remains focused on its omni-channel growth strategy across all brands, with the continued roll out of "click & collect" initiatives underpinning strong online sales growth, an uplift of 73.2% on the PCP.

The Group's cost of doing business, as a percentage of sales during the half, amounted to 54.7% (PCP 54.9%). Despite underlying annual inflation in wages and rentals of between 2% and 4%, cost savings were achieved by reducing base rentals of renegotiated leases and underperforming stores.

Subsequent to 31 December 2014, the Group renegotiated an extension of the bank loan facilities to mature in November 2016.

Continued Business Improvements

The Group continues to deliver business improvements as part of its strategy to be an omni-channel retailer.

<u>Omni-channel Operations</u>

During the half, a number of new store opportunities materialised that offered attractive investment returns to the Group. Consequently, the Group's physical store portfolio grew to 1,105 stores at 31 December 2014, following the opening of 24 stores and closure of 14 stores (net increase of 10 stores).

The Group has adopted a measured approach in its pursuit of new store opportunities in markets beyond Australia, with six new stores opened in the USA during the half.

The Group's online sales grew to $24.6 million for the half year – an increase of $10.4 million or 73.2% on the PCP. Online sales now represent 6.0% of total revenue.

Continued online sales growth is expected, following the successful completion of "click & collect" rolled out to all Australian stores during the half.

<u>Transformation of Supply Chain</u>

The Group's supply chain transformation to a design and direct sourcing model supports underlying gross margins. However, continued aggressive discounting by Rivers to clear excess levels of inventory, which was anticipated and flagged in the FY2014 results, did have negative impacts on short term profitability.

Nevertheless, ongoing supply chain transformation initiatives will assist the Group in protecting margins against the decline in the Australian dollar exchange rate. The Group is currently hedged through to the fourth quarter of FY2015.

During the half, the Group commenced the implementation of its replenishment inventory model, with a view to ensuring optimum levels of correctly sized core product lines are delivered and replenished to stores quickly. This has resulted in a noticeable reduction in merchandise stock outs and contributed to lower markdowns.

<u>Leverage Customer Relationship Management (CRM) Capabilities</u>

Investment in a dedicated in-house customer insights team and CRM platform continued to drive results in customer engagement during the half. Email campaign responses increased to well above industry standards, as more sophisticated customer segmentation was adopted. We continue to grow the database with focused in-store activities aimed at signing up new customers, whom we can engage and monitor directly through email. The Group's total customer membership database has grown to 8 million members.

Three Pillar Growth Strategy

Specialty Fashion Group has a three pillar strategy for growth through: rejuvenation of existing brands across the Group; transformation of Rivers; and measured expansion into new markets beyond Australia for City Chic.

1. <u>Millers' Brand Rejuvenation</u>

Millers is the Group's largest and most mature brand, and continues to perform strongly under its new leadership team, which has been tasked to upgrade every facet of the brand's operations. New in-store and online branding efforts and initiatives have been favourably received by the Millers customer, which has contributed towards the success of the brand's rejuvenation.

Millers experienced positive CSG sales and margin growth during the first half. This positive trend is expected to continue over the remainder of FY2015.

2. Rivers' Transformation

Considerable progress has been made to transition and integrate the business into the wider Group. When acquired, Rivers was a business that had been adversely affected by aggressive discounting, excessive marketing expenditure and significant levels of inventory accumulation. The Group was aware of these issues and the challenges they presented, and throughout 2014 we implemented strategies to address these issues and turn the Rivers business around. However, when compared to our expectations at acquisition, some of these strategies are taking longer than initially anticipated to have a positive impact on Rivers' profitability.

By successfully liquidating inventory inherited on acquisition in half the expected time frame, the business will ensure Rivers' long term brand equity is maximised, albeit with a negative impact to the Group's margins over the next 12 to 18 months.

The Group remains confident that with the continued successful execution of the focused strategies and initiatives, the Rivers business will deliver a meaningful contribution to the Group's profitability in future years. To transition and integrate Rivers, the Group has been focused on initiatives across five key areas of the business:

(i) Product Management

The excessive levels of inventory inherited on acquisition have been reduced significantly during the past year through aggressive discounting and promotions. While the Group expected that clearance of this old product would take two years, this outcome has been achieved within a shorter period to avoid the deterioration of Rivers' brand equity – this should ensure a positive long term outcome for Rivers and the overall Group.

New systems to overcome legacy issues relating to inventory purchasing and critical path management have now been successfully implemented through the new Rivers buying team, leveraging the expertise of the Group's core team to positively influence product design (thereby lifting sales), and to secure alternative suppliers (thereby lowering costs).

This is evidenced by the encouraging response to the Rivers' womenswear category, which was the first Rivers category relaunched under the full control and influence of the Group since acquisition.

(ii) Staffing

As indicated in August 2014, following the closure of the Rivers' Melbourne office, an entirely new team needed to be rebuilt and trained, a task that was completed on schedule during the first half. Rivers' stand-alone buying, planning and marketing teams are now fully operational.

(iii) Marketing

Reducing Rivers' marketing spend was identified early as a material cost saving opportunity in the business.

With Rivers' stores being destination sites located, typically, in non-retail locations, expensive national and regional above-the-line advertising was previously utilised to drive customers to these locations.

A less costly digital strategy, as already adopted by the Group's other brands, will be an important lever to reduce marketing spend. Considerable progress has already been made to build the Rivers database system and integrate legacy systems.

A key focus has been to clean up the database, and we are now in a position to start testing and trialling email offers directly to customers. We have a database of 750,000 Rivers customers. Digital marketing is a significantly more effective and potentially cheaper option than the previous TV, print catalogue and above-the-line campaigns that Rivers conducts.

(iv) Supply Chain Management

The process to fully leverage Rivers to the Group's existing supply chain infrastructure in order to drive down costs is continuing. This has translated into improvements in product pricing and reduced delivery lead times, with a view to enhance flexibility in replenishment of core product lines into stores.

(v) Store Performance

The Group intends to expand the number of Rivers store sites once the brand has been returned to profitability. A new store format and design is being scoped. Once trialled, successful elements of the design will be rolled out in existing stores.

3. <u>City Chic's Expansion into the USA and South Africa</u>

Following an assessment of the performance of stores opened in markets beyond Australia over recent periods, the Group continued the expansion of the City Chic brand into the USA and South African markets. During the half, we opened the first City Chic stores in the USA, with six new stores in California. There are two City Chic stores in South Africa. The performance of new stores will continue to be assessed as further site opportunities are explored in these markets.

City Chic's USA wholesale business, predominantly to Nordstrom's, continues to expand with 60 Nordstrom stores now being supplied by the brand.

Outlook

The Group has performed within expectations since the start of the second half of FY2015, in accordance with plan, and the focus for the remainder of the year is to continue:

- Millers' brand rejuvenation program, which has underpinned the strong result of the Group (excluding Rivers);
- Rivers' transformation into a profitable and growing brand for the Group; and
- Assessment of further expansion of the Group's store portfolio, both in Australia and abroad.

We anticipate that our core strategies of continual business improvements and omni-channel growth will ensure ongoing benefits to the Group.

We strongly believe the key to success will be to compete for increased sales and improved margins through product differentiation and customer engagement of our brands rather than discounting prices. The Group will also focus on potential growth opportunities for our brands through measured entry into certain retail markets beyond Australia.

ENDS

INVESTOR ENQUIRIES:
Gary Spreckley
Chief Financial Officer
Specialty Fashion Group
(02) 8303 3435

MEDIA ENQUIRIES:
John Gardner / Matthew Gerber
MAGNUS Investor Relations + Corporate Communication
(02) 8999 1010

About Specialty Fashion Group

Specialty Fashion Group is the largest specialty retailer of women's fashion in Australasia, through Millers, Katies, Crossroads, Autograph, City Chic and Rivers. The Group operates 1,105 stores in Australia, New Zealand, USA and South Africa and its brands' products are also available online at www.millers.com.au, www.katies.com.au, www.crossroads.com.au, www.autographfashion.com.au, www.rivers.com.au, www.citychic.com.au, and in the USA at www.citychiconline.com.