

# chief executive officer's review



## A warm welcome to all stakeholders of The Warehouse.

I am pleased to present my first Annual Report as Chief Executive Officer.

The Warehouse Group achieved an audited tax-paid profit for the twelve months ended 31 July 2001 of \$60.8 million.

This profit result is \$9.7 million (13.8 percent) below the \$70.5 million achieved for the corresponding period ended 31 July 2000.

Total group operating profit before interest, unusual items, goodwill amortisation and taxation for the period

was \$122.1 million. This is \$10.8 million (9.7 percent) above that achieved for the corresponding period in the 2000 year.

### Overview

The year ending 31 July 2001 was a challenging one for The Warehouse. We aggressively grew the retail space in New Zealand, in both The Warehouse New Zealand and Warehouse Stationery, and we also took ownership of the Australian operation of Clints and Solly's, now called The Warehouse Australia. Most of the year's challenges were due to the repositioning and transforming of The Warehouse Australia from a bargain store to a discount variety business, similar to the New Zealand Warehouse concept, while still managing continued growth in New Zealand.

During the year, sales rose 54.8 percent to \$1,665 million, having reached \$1 billion only last year, while New Zealand same-store sales and operating profit increased. Group operating margins as a percentage of sales decreased in the year owing to The Warehouse Australia's negative contribution, the competitive New Zealand market, weaker Australasian currencies and changes in merchandise mix in Warehouse Stationery. The Group result was also impacted by a \$3.5 million pre-tax expense for unusual items such as investment writedowns. This compares with a \$1.8 million pre-tax benefit in the previous year.

Below is a more detailed discussion of the results of each main business comprising The Warehouse Group.

The Warehouse New Zealand	2001 \$000s	2000 \$000s	INCREASE %
Sales	1,166,728	1,012,266	15.3%
Operating profit	117,127	106,331	10.2%
Operating margin %	10.0%	10.5%	

### The Warehouse New Zealand

The Warehouse New Zealand's sales continued to grow strongly. The operating margin dropped slightly to 10.0 percent (from 10.5 percent last year). This change is caused largely by the compression of gross margin owing to heavy promotional activity undertaken in the fourth quarter combined with the weakness of the New Zealand dollar during the year.

In February 2000 with my move to CEO, David Wilson joined us as General Manager - The Warehouse New Zealand. David was most recently head of store operations at Target Australia. He is a very experienced retailer and is already making a very valuable contribution to our New Zealand business.

Growth in store numbers and retail space continued to be aggressive. During the year The Warehouse opened nine new stores (including three replacements), extended nine and relaid two others. This increased retail space 20.9 percent to 306,838 square metres across seventy-five stores. This increase in retail space of 53,121 square metres was the largest single-year increase in floor space in the history of The Warehouse.

Our customers have responded well to the increase in store numbers and floor space and this is confirmed by other indicators including:

- A 5.1 percent increase in same-store sales.
- The Warehouse accounting for \$154 million or 82 percent of the \$188 million growth in the New Zealand department store retail sector during the year.
- A 2.9 percent increase in The Warehouse's share of the total department store retail sector to 43.6 percent.
- Weekly paying-customer count up 11.4 percent to 825,000 compared with 740,000 last year.
- An increase in customer's average basket size to \$27.20 compared with \$26.07 last year.

### Warehouse Stationery

Warehouse Stationery continued its exceptional growth with a 48.3 percent increase in sales. The reduction in margin - to 7.0 percent compared with 7.9 percent last year - is attributable to a planned change in the stores' sales mix. That is, a higher proportion of Warehouse Stationery's sales are now comprised of business machines such as computers, facsimiles and printers. It's a large and important market category - essential to the Warehouse Stationery's growth and success - but it customarily has lower margins than those for general stationery items.

Warehouse Stationery	2001 \$000s	2000 \$000s	INCREASE %
Sales	93,525	63,083	48.3%
Operating profit	6,505	5,005	30.0%
Operating margin %	7.0%	7.9%	

Warehouse Stationery's operating profit was also affected by a significant infrastructural investment required to support the nine new stores added during the year. It takes up to two years for a new Warehouse Stationery store to become profitable which means the

recent Warehouse Stationery store rollout programme creates a temporary drag on operating margins that will take up to two years to reverse.

Confirmation that sales growth is not confined to the store rollout programme is confirmed by same-store sales that were up 25.4 percent. The nine new store openings during the year increased Warehouse Stationery's retail space 26.5 percent to 36,775 square metres. A continuing programme of store refurbishment to maximise efficiencies and more new store openings, lead us to be confident of a restoration of operating margins on a larger sales base in our traditional stationery market. However, a planned initiative focusing on the business stationery market (touched on later in this report) is expected to have a negative impact on overall Warehouse Stationery operating margins for the next two to three years.

### The Warehouse Australia

The former Clints and Solly's retail stores - which are progressively being transformed and renamed The Warehouse - achieved sales of \$404.5 million. This figure represents an estimated increase of 8.8 percent over the same period last year allowing for the removal of wholesale tax in Australia and the introduction of GST.

The Warehouse Australia	2001 \$NZ000s
Sales	404,496
Operating profit	(1,537)
Operating margin %	-0.4%

The Warehouse Australia's operating margin for the year was an unsatisfactory -0.4 percent. While macroeconomic conditions in Australia were not supportive for the retail sector generally, much of our weak result in Australia reflects execution difficulties with our format transition, which were further compounded by our decision in April 2001 to quit excess inventory.

When the Australian business was acquired we indicated that it would take two to three years before the business would produce material positive returns to the group. During that time the Australian business would be repositioned to a format similar to The Warehouse in New Zealand. We continue to have confidence in this strategy and there are a number of positive signals that confirm this view:

- As new stores are opened, and as the merchandise range is enlarged and improved, we are seeing a

move towards destination shopping and increased weekend trading - visiting The Warehouse for its own sake with faith in the merchandise quality and range - as we experience in New Zealand.

- Customers have responded above our expectations to the new store format. We opened ten new or replacement stores in the period, eight of them in new locations - all are trading significantly ahead of budget.
- New stores will be in the 2,500 to 3,500 square metre range meaning the average store size in Australia will double in the next three years.
- The average sale per customer in Australia ranges from only \$A10.70 in the old stores to \$A14.73 in the new format stores; that compares with \$A22.58 in The Warehouse New Zealand.
- The new format stores are achieving rental to sales costs of between 1 to 1.5 percentage points lower than old format stores. This gap will widen as the new stores grow in coming years.

### The Warehouse Group

The consolidation of these figures for The Warehouse New Zealand, Warehouse Stationery and The Warehouse Australia results in the following:

The Warehouse Group	2001 \$000s	2000 \$000s	INCREASE %
Sales	1,664,749	1,075,349	54.8%
Operating profit	122,095	111,336	9.7%
Operating margin %	7.3%	10.4%	
Tax-paid profit	60,753	70,459	
Tax-paid profit margin	3.6%	6.6%	

While sales rose 54.8 percent and operating profit increased 9.7 percent over the previous year, operating margin as a percentage of sales fell to 7.3 percent for the various reasons described above. Comparing only the New Zealand result against last year, the New Zealand operating margin fell slightly from 10.4 percent to 9.8 percent

### Details of store openings during the year

A tangible expression of growth is the increasing store numbers and the subsequent increase in retail space. The following is a detailed list of store openings during the year in review.

### The Warehouse New Zealand

Between August 2000 and July 2001 The Warehouse

New Zealand opened nine new stores.

- **New stores in new locations** Six stores in new locations: Queenstown, Rangiora, Belfast, Auckland Airport, Hillcrest and Dannevirke.
- **Replacement stores** The other three were replacement stores in Glenfield Mall, Eastgate and Whangaparaoa.
- **Extensions** Nine stores (Petone, Invercargill, Tauranga, Te Awamutu, Manukau, Pukekohe, South City, Nelson and Paraparaumu) were extended.
- **Total store numbers** At the end of the 2001 financial year The Warehouse retail chain in New Zealand consisted of 75 stores representing 306,838 square metres of retail space, an increase of 20.9 percent compared with the end of July 2000.
- **Future plans** During the next financial year The Warehouse plans to open four new stores, three in new locations (Wainuiomata, Motueka and South Dunedin) and one replacement store (Alexandra). We also expect to extend up to five existing stores.

### Warehouse Stationery

- **New stores in new locations** Between August 2000 and July 2001 Warehouse Stationery opened nine new stores: Pukekohe, Taupo, Paraparaumu, Timaru, Blenheim, Linwood, Downtown Auckland, Chartwell and St Lukes.
- **Total store numbers** At the end of the 2001 financial year the Warehouse Stationery chain comprised 33 stores representing 36,775 square metres, an increase of 26.5 percent compared with the end of July 2000.
- **Future plans** Warehouse Stationery expects to open up to six new stores during the next year.

### The Warehouse Australia

Between August 2000 and July 2001 The Warehouse Australia opened ten new stores.

- **New stores in new locations** Eight of these new stores were in new locations: Loganholm (Qld), Toowoomba South (Qld), Villawood (NSW), Townsville (Qld), Dromana (Vic), Epping (Vic), Deception Bay (Qld) and Woden (ACT)
- **Replacement stores** The other two were replacement stores in Mordialloc (Vic) and Griffith (NSW).

- **Extensions** In addition three stores (Queanbeyan (ACT), Tuggeranong (ACT) and Northcote (Vic)) underwent major extensions.
- **Total store numbers** At the end of the 2001 financial year The Warehouse retail chain in Australia consisted of 117 stores representing 149,766 square metres of retail space.
- **Future plans** During the next financial year The Warehouse Australia plans to open sixteen stores in new locations and two replacement stores.

#### **A change in Australian management**

I am pleased to welcome Paul Hutchinson to the role of chief executive for The Warehouse Australia, a position he assumed in October 2001. Paul has had seventeen years in the financial services sector, working with Bank of New Zealand, National Australia Bank and Westpac. His experience has been in retail banking roles involving training, large scale sales management, corporate and business strategy and business integration.

Dave Rickards, the former chief executive, remains a director of The Warehouse Group Limited and an executive director of The Warehouse Australia, based in Australia.

#### **Other highlights of the year**

Other significant achievements during the year include:

- Continuing success in the apparel market where sales at The Warehouse New Zealand stores increased 30 percent after having increased by the same percentage last year.
- Healthy growth in the sporting goods sector in which The Warehouse New Zealand increased its sales by 30 percent. Other category increases include Green gardening which enjoyed a 27.5 percent increase in sales.
- The installation of a new automated apparel sortation system in the Wiri distribution facility to support the growth in apparel sales.
- The successful launch of the leading Sanyo brand in New Zealand during October 2000. In every category to which we added Sanyo to our merchandise range we have seen a consequent lift in sales across that category including house brands.

- Reduced shrinkage at The Warehouse New Zealand, Warehouse Stationery and The Warehouse Australia.
- New checkout installations in twenty-one The Warehouse New Zealand stores leading to a 30 percent reduction in checkout transaction times.
- The completion of the standardised store layout plan in all Warehouse Stationery stores.
- The introduction of the leading Hewlett-Packard brand of computers and printers to Warehouse Stationery and a generally enhanced range of business machines.
- The latest 'People First' survey showed 88 percent of team members agreed that The Warehouse is 'Where People Come First'.

#### **The future**

##### **Trading since balance date**

Since 31 July 2001, the New Zealand group has experienced varied trading conditions. While Warehouse Stationery continued to register record sales in August, with a 49.7 percent increase over the previous year, activity in The Warehouse New Zealand was more subdued with turnover up 6.3 percent over August 2000.

The Warehouse Australia's sales in Australian dollars for August 2001 were 14.6 percent ahead of the same month last year.

The tragic events of 11 September 2001 had an immediate effect on consumer confidence and business activity around the world. Trading in Australia and New Zealand was depressed for the two to three days after the event. However, trading since then has reverted to normal patterns.

##### **Financial Services**

The Warehouse New Zealand and WestpacTrust currently operate The Warehouse Card which has more than 200,000 card holders. On 24 May 2001 The Warehouse and WestpacTrust announced a new joint venture called The Warehouse Financial Services Limited to provide retail financial services through The Warehouse New Zealand's nation-wide chain of seventy-five retail stores.

The venture combines the expertise and creditability of New Zealand's largest bank with the distribution success of the country's largest general merchandise

retailer in order to meet growing customer demand for retail financial products and services, and flexibility in accessing them.

At first the joint venture will offer a new range of credit card products as well as a number of insurance products. Other financial products will be added over time.

### **A new venture for Warehouse Stationery**

Warehouse Stationery launched in September 2001 a new business-to-business (B2B) stationery venture directly targeted at commercial customers and small to medium size enterprises. Warehouse Stationery does not currently compete in this sector which means its entry into this market requires significant up-front investment. As a result we do not expect an immediate profit from this new business - negative earnings are being budgeted for the first two years - although potential earnings are high as this sector spends between \$600 - \$700 million per year on stationery and related office supplies.

The new B2B business will use multiple channels to service its customers (internet, call centre and sales representatives) with order fulfilment undertaken at The Warehouse Wiri distribution centre.

### **Next year**

The year ahead will be full of new challenges and initiatives. Besides the extensive property programme mentioned earlier, there are a number of planned initiatives in merchandising including a television advertising campaign featuring the Jo Seagar 'Seal of Approval' for a range of housewares. This promotion is designed to lift both the profile and the offer of consumables and housewares.

The merchandise team is also adding new brands such as Hanes, Rio and Hey Sister to the apparel offer while the Head brand (racquets) will be added to the sporting department. In the operations area customers will benefit when another eighteen stores are refitted with the new 'sprint' checkouts that reduce checkout times by up to 30 percent.

Meanwhile the operations team has identified forty projects to improve in-store operations with the focus on improving customer interaction and service.

### **A farewell to Neil Plummer**

At the end of this year Neil Plummer, who has been with The Warehouse for nearly twelve years, and has

been our merchandise director since 1994, is stepping down from that role. I would like to add a personal note of thanks to Neil. He has been wonderfully supportive of me during the transition from Stephen Tindall. Additionally, he has been a tower of strength and inspiration in Australia. During the last year he has spent most weeks there, helping us transform the business. My very sincere thanks to Neil and his wife Judith for helping build the platform for growth. While Neil will be missed, he leaves behind the best buying team in Australasia, uniquely positioned to keep delivering the bargains.

### **Conclusion**

Despite the reduced margins and profit reported in this the company's seventh annual report, the foundation of future sustainable growth of sales and profits, in both New Zealand and Australia, continues to be laid.

The investment in Australia is based on a three-year strategy which we are certain is well-founded and now requires sound execution for real benefits to accrue. We were all disappointed with the early executional mistakes that disrupted our first 6 to 9 months in Australia. However, the situation has been well recovered and I offer my sincere thanks to the Australian management team for their support and significant efforts over the last 6 months. Meanwhile the New Zealand retail operation continues to remain the chief value driver of the group and is a long way from reaching saturation.

I am most appreciative of the support and efforts of our directors, our management teams and the 11,500 team members across Australia and New Zealand.

Finally a huge thank you to Stephen for the opportunity to lead this exciting business and for his unflagging enthusiasm, passion and ongoing support.



Greg Muir  
Chief Executive Officer