

# OPERATING AND FINANCIAL REVIEW



TOP-TOY's revenue totalled DKK 3,365.5 million in the 2016/2017 financial year, which were below the expectations. The decrease was primarily driven by challenges following the launch of our new ERP system at the end of March 2017 and the fact that the implementation of the new system occupied many key resources both before and after go-live. Poor weather in the Nordic region during the summer 2017 also had a negative impact on sales of outdoor products. Finally, the all-important Christmas season was slightly disappointing due to competition and the fact that TOP-TOY did not benefit fully from increased online demand.

The implementation of a new ERP system brought a number of challenges which affected our operational performance in 2016/2017. Customers, who used our web shops after go live experienced significantly limited search capabilities, lack of promotional pricing and poor checkout flow. Many customers start their search online even when they intend to make their purchase in a physical store. So, this problem also had an impact on our physical stores. In addition, poor performance in our supply chain as a result of the new system meant that customers who visited our online and physical stores found a less attractive assortment – often without the products they intended to buy. Due to ERP system challenges store employees also focused more on internal issues like stock counting than on purely serving the customers.

The operational issues with the ERP system will be solved in 2017/2018. However, there will still be an impact on Q1 in the new financial year. The focus is on ensuring all areas of operation are fully up to speed before the 2017 Christmas season.

The main business impact on our financial performance was a significant decline in revenue during Q4 of our financial year (April – June 2017). Furthermore the gross margin was negatively affected as weak sales lead to price reductions to reduce inventories of seasonal goods. OPEX also increased during Q4 of our financial year due to the need for stock recounts and manual order handling.

The Board of Directors and the Executive Management view the overall operational and financial performance in 2016/2017 as unsatisfactory.

We have launched several initiatives to improve short and mid-term performance. Key initiatives are centred around achieving positive same-store sales growth, this includes attractive prices and promotions as well as a good store service level to enhance the customer experience and making a visit to our stores appealing. This also includes proactive introduction of category initiatives such as the launch of Babies"R"Us in selected test stores.

Another focus area is to reduce costs and make the company more agile in order to react faster to changes in consumer demands and market trends. Unfortunately this meant that we in August 2017 had to say goodbye to a number of employees across our office locations.

One of the key areas to improve our performance is to excel in online sales. From autumn 2017, we have strengthened our price offering by increased use of "price matching" and "everyday low prices", supported by the introduction of a "price crawler" which constantly checks competitor prices. We have also invested significantly in an up-to-date online platform to improve the customer experience and agility of our online offer. This new platform will go live in Q4 of 2017.

### Revenue development

Total revenue for 2016/2017 was DKK 3,365.5 million, which were below the expectations. This was mainly driven by a decrease in same-store sales, as the opening of new stores almost sets off the impact of store closures.

The decline in same-store sales was largely caused by issues with our new ERP system. However, the underlying consumer preference for online sales clearly poses a challenge to our physical stores. Consumers are increasingly doing their shopping online, which globally is changing the purpose and need for shopping experience in the physical stores – a challenge TOP-TOY has taken on board.

### Development in earnings

The gross margin was 52.4%, which was below our expectations. It was impacted by significant inventory inefficiencies due to implementation of the new ERP system. Increasing price competition, especially on branded goods like LEGO, also had an impact on earnings.

Operating costs were DKK 1,623.9 million, representing 48.3% of revenue. The target is to reduce operating costs as a percentage of revenue – both in individual stores and administrative functions.

EBITDA before special items amounted to DKK 138.9 million impacted by the low operational result after ERP going live. Operating result and result for the year showed a loss at DKK -16.0 million and DKK -38.7 million respectively. The result is positively affected by changes in exchange rates. The effect is DKK 40.3 million, hereof DKK 24.4 million from loans in foreign currency.

### Free cash flow and net interest-bearing debt

Net working capital increased due to the go-live of the new ERP system. This was due to a decision to fill up inventories before go-live on 27th of March. Due to payment terms, most were paid for before year end.

Cash flow from operating activities was DKK -107.4 million. This was mainly driven by changes in working capital, which are expected to

be improved in the current financial year, and the higher interest expenses, which will continue in the years ahead.

Cash flow from investing activities was DKK -124.3 million. The main asset acquired was the new ERP system, which has been fully capitalized and started to be amortised at go-live. From 2017/2018, investment activities will be more normalized and primarily focus on store openings and upgrades.

The interest-bearing debt increased from DKK 1,349.4 million in 2015/2016 to DKK 1,563.1 million in 2016/2017. TOP-TOY has after the balance date entered into a committed loan facility agreement of DKK 250 million with the shareholders who hold 5% or more of the share capital. TOP-TOY is in dialogue with the owners and Lenders about the future finance structure.

### Outlook for 2017/2018

In 2017/18 revenue and operating result before special items are expected to grow despite continued uncertainty due to the new ERP system.