FY23 Christmas Trading Update and Interim Results

26 weeks ended 30 October 2022

20 January 2023

THE WORKS

Agenda

Highlights	Gavin Peck	(CEO)
Financial Review	Steve Alldridge	(CFO)
Business Review	Gavin Peck	(CEO)

Highlights

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- Resilient H1 performance against backdrop of challenging consumer environment and residual impact of cyber security incident
- Increased H1 loss, reflecting return to typical pattern and material cost headwinds
- Improved LFLs since end of H1 (+5.7%). Christmas trading was stronger vs. weaker comps, as expected
- Full year expectations unchanged
- Balance sheet remains robust, with c£7m net cash at 30 October 2022
- Expect to announce final dividend, provided full year results in line with expectations
- Good progress made on executing "better, not just bigger" strategy
- Remain positive about medium-term growth opportunities despite short-term uncertainty over consumer spend

	H1 FY23 £m	H1 FY22 £m
Revenue	£118.9m	£116.1m
Revenue growth	2.4%	30.6%
LFL sales growth	0.6%	14.5%
Pre-IFRS 16 Adjusted EBITDA	(£6.4m)	£2.5m
Loss before tax	(£10.7m)	(£1.0m)
Basic loss per share (pence)	(13.9)	(1.4)
Net cash at bank	£7.0m	£17.8m

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Financial Review
Steve Alldridge, CFO

Overview

- H1 FY23 result has reverted to the more usual pattern - whereby The Works typically reports a loss in H1
- EBITDA loss of £6.4m vs. £2.5m profit in H1 FY22. The year-on-year comparison was exaggerated by:
  - Q1 FY23 sales affected by residual effects of cyber security incident
  - Lower gross margin % due to mix, FX & freight
  - Notable cost headwinds from higher NLW and energy prices
  - Comparative in H1 FY22 benefitted from £3.9m rates relief and a post-COVID sales bounce
- Cash cycle also reverted to the expected pattern of an outflow in H1; ended the Period with £7.0m net cash

EBITDA bridge between H1 FY22 and H1 FY23	**£m**
H1 FY22 EBITDA	**2.5**
Additional margin from year-on-year sales increase	2.2
Lower product gross margin percentage	(4.4)
Full business rates charged in H1 FY23	(3.9)
Electricity (inflation)	(0.9)
Payroll (inflation)	(1.6)
Other	(0.3)
H1 FY23 EBITDA	**(6.4)**

[1] Adjusted, pre IFRS 16 basis

Sales

- H1 FY23 LFL +0.6%
  - Q1
    - Store and online sales in May and June affected by residual impact of Mar '22 cyber security incident
    - Store sales strengthened by end of Q1, driven by front list book, outdoor play and back to school ranges
    - Partial recovery in online sales, but not to level expected
  - Q2
    - Positive sales momentum in stores carried into Q2, with back to school season surpassing successful event in FY22
    - Store LFLs slowed in October reflecting unusually early Christmas shopping in FY22 due to customer concerns re: possible stock shortages and further COVID restrictions
- Store numbers broadly unchanged as active refinement of portfolio continued
- Lower effective VAT rate due to increased books mix, which partially offsets lower margin % on front list books
- Focus on rejuvenating loyalty scheme reflected in increased redemption of points

LFL sales growth detail	**Stores**	**Online**	**Total**
Q1	1.4%	(28.6%)	(2.5%)
Q2	5.0%	(8.9%)	2.9%
H1	**3.5%**	**(16.9%)**	**0.6%**
11 weeks ended 15 January 2023	9.7%	(14.0%)	5.7%

H1 FY23 sales analysis	**H1 FY23 £m**	**H1 FY22 £m**	**Var £m**	**Var %**
Store LFL sales	114.7	110.8	3.8	***3.5%***
Online sales	15.1	18.1	(3.0)	***(16.9%)***
Total LFL sales	129.8	128.9	0.8	***0.6%***
Non LFL sales	4.5	3.0	1.6	*53.2%*
Total Gross Sales	134.3	131.9	2.4	*1.8%*
VAT	(14.5)	(15.1)	0.6	*(4.3%)*
Loyalty points redeemed	(0.9)	(0.7)	(0.2)	*28.6%*
Revenue	**118.9**	**116.1**	**2.8**	***2.4%***

Store numbers

2 May 2022	**525**
Opened	7
Closed	(5)
Opened (relocated)	2
Closed (due to relocation)	(2)
30 October 2022	**527**

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Product gross margin

	H1 FY23		H1 FY22			
	£m	*% of revenue*	£m	*% of revenue*	£m Variance	*% Variance*
Revenue	118.9		116.1		2.8	*2.4%*
Less: Cost of goods sold	52.0		47.0		5.0	*10.6%*
Product gross margin	66.9	***56.3%***	69.1	***59.5%***	(2.2)	*(3.2%)*

- Product gross margin decreased 320bps to 56.3%
  - Further increase in sales mix of front list books which achieve lower % margin, as well as branded toys and games
  - Freight costs continued to be high in H1 FY23, although fell significantly towards and after the end of the Period
  - An underlying FX gain was more than offset by a Period end FX creditor translation, expected to be an H1/H2 timing difference
- View of FX and freight costs in FY24
  - Approximately 60% of FY24 US$ purchases are currently hedged
  - Freight costs expected to be lower than FY23 overall and significantly lower in H1 FY24 vs H1 FY23
  - Less favourable FY24 FX rates are expected to be offset by the lower freight costs resulting in broadly neutral margin % impact vs FY23

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Costs included in cost of sales

	H1 FY23		H1 FY22			
	£m	% of revenue	£m	% of revenue	£m Variance	% Variance
Store payroll	23.0	19.4%	21.2	18.3%	1.8	8.5%
Store property and establishment costs	25.2	21.2%	20.8	17.9%	4.5	21.7%
Store PoS and transaction fees	0.9	0.8%	1.1	0.9%	(0.1)	(11.9%)
Store depreciation (excluding IFRS 16)	2.5	2.1%	2.6	2.2%	(0.1)	(3.3%)
Online variable costs	8.2	6.9%	8.1	7.0%	0.1	1.6%
IFRS16 impact	(0.9)	(0.8%)	(2.3)	(2.0%)	1.4	(60.4%)
Adjusting items	0.0	0.0%	(0.1)	0.0%	0.1	(100.0%)
Total	**59.0**	**49.6%**	**51.3**	**44.2%**	**7.6**	**14.9%**
Gross profit per financial statements	**7.9**	**6.7%**	**17.8**	**15.3%**	**(9.9)**	**(55.4%)**

- Store payroll costs increased due to
  - 6.6% NLW increase plus NI increase
  - Limited further opportunity to mitigate directly in stores as most stores operating on minimum hours rota
- Store property and energy costs
  - £3.9m COVID-19 rates relief received in H1 FY23
  - £0.9m increase in energy costs
  - Partially offset by further rent savings
- Online marketing and fulfilment costs level, despite lower sales
  - Adverse sales mix resulted in similar volumes being handled, incurring similar fulfilment costs year on year
  - New automation in fulfilment operation offset higher per hour labour costs due to NLW and higher proportion of agency staff

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Other costs

	H1 FY23		H1 FY22			
	£m	*% of revenue*	£m	*% of revenue*	£m Variance	*% Variance*
Distribution costs	5.0	*4.2%*	4.1	*3.5%*	0.9	*22.8%*
Administration costs	10.9	*9.2%*	11.4	*9.8%*	(0.4)	*(3.8%)*

- Store distribution costs increased by £0.9m
  - Primarily due to inflation in NLW and increase in mix of agency staff (higher hourly rate, less efficient)
- Administrative costs reduced by £0.4m
  - Aggregate of a number of small savings
  - No bonus accrual made in respect of FY23
- Net financing costs reduced by £0.4m to £2.4m mostly due to IFRS 16 calculation reflecting lower rent liability
- Tax
  - FY23 effective tax rate returned to more normal level (FY22 was lower due to a deferred tax credit)
  - No cash corporation tax expected to be due for FY23

Capex

- Total capex for FY23 expected to be approximately £7.5m, per previous guidance
- Spend will be weighted towards H2 FY23 due to
  - Phasing of projects
  - Timing difference relating to new store capital contributions

	H1 FY23 £m	**H1 FY22 £m**	**Variance £m**
New stores and relocations	0.0	0.4	(0.4)
Store refits and maintenance	1.2	0.6	0.6
IT hardware and software	1.3	0.4	0.9
Other	0.0	0.2	(0.2)
Total capital expenditure	**2.5**	**1.6**	**0.9**

Stock

- Stock value grew due to 12% increase in units on hand and 20% average increase in cost per unit
- The pre-Christmas stock build was accelerated to alleviate concerns regarding possible repetition of supply chain disruption
- Targeting FY23 year end stock position broadly in line with last year's, through
  - Stronger sales performance through Christmas 2022 peak
  - Larger/more impactful January sale
  - Careful control of stock intake in Q4

	H1 FY23	H1 FY22	Variance
	£m	£m	£m
Gross stock	46.6	35.2	(11.4)
Less: provisions	(3.2)	(4.4)	(1.2)
Stock on hand, net of provisions	**43.4**	**30.9**	**(12.5)**
Stock in transit	10.2	9.2	(1.0)
Net stock	**53.6**	**40.0**	(13.6)

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Cash

- The Works' typically experiences cash outflow during H1 due to
  - Profile of profit generation through the financial year
  - Build of stock in readiness for Christmas sales season
- H1 FY23 reflected a return to this pattern, plus impact of larger than planned stock build as supply chain disruption did not materialise
- £4m of RCF was drawn during October 2022 (included in £7m net cash figure) and repaid the day following the Period end (31 October)
- £33m total liquidity availability (including RCF headroom) at the Period end

	H1 FY23 £m	H1 FY22 £m	Variance £m
Operating cash flow before changes in working capital	**5.6**	**15.4**	**(9.8)**
Deduct from statutory presentation: rent payments	(14.3)	(16.2)	2.0
Deduct from statutory presentation: loan movements	(4.0)	7.5	(11.5)
Non IFRS cashflow before working capital movements	**(12.6)**	**6.7**	**(19.3)**
Net movements in working capital	3.8	19.7	(15.9)
Capex	(2.5)	(1.6)	(0.9)
Tax paid	(1.5)	-	(1.5)
Interest and financing costs	(0.6)	(0.2)	(0.4)
Cashflow before loan movements	**(13.4)**	**24.6**	**(38.0)**
Drawdown/(repayment) of loans	4.0	(7.5)	11.5
Exchange rate movements	0.3	(0.1)	0.4
Purchase of treasury shares by EBT	(0.1)	-	(0.1)
Net (decrease)/increase in cash	**(9.3)**	**17.0**	**(26.0)**
Opening net cash balance	**16.3**	**0.8**	
Closing net cash balance	**7.0**	**17.8**	

Business Review
Gavin Peck, CEO

Trading Performance

- Resilient H1 performance in light of external trading environment
  - Total LFLs +0.6% (stores: +3.5%, online -16.9%)

- H1 impacted by three key factors:
  - Residual impact of cyber security incident (as we implemented stronger security)
  - Post-COVID shopping trends normalising year on year
  - Trading environment becoming increasingly challenging through the period

- Improved LFLs since end of H1 (including key Christmas trading period), as expected:
  - Total LFLs +5.7% (stores: +9.7%; online -14.0%)

- Encouraged by improved recent trading:
  - New ranges and value proposition resonating well with customers
  - Remain cautious given uncertain outlook for consumer spend

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Our "Better, not just Bigger" Strategy

Our Strategic Pillars

- Develop our brand and increase customer engagement
- Enhance our online proposition
- Optimise our store estate
- Drive operational improvements

Our Strategic Enablers

- Our Colleagues
- Our Systems and Data
- Our ESG Commitments

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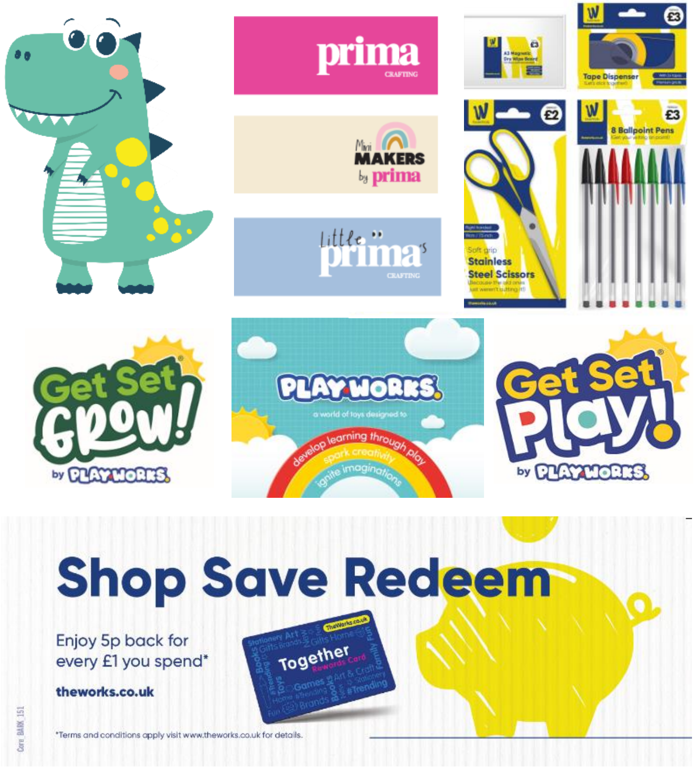
Develop our Brand and Increase Customer Engagement

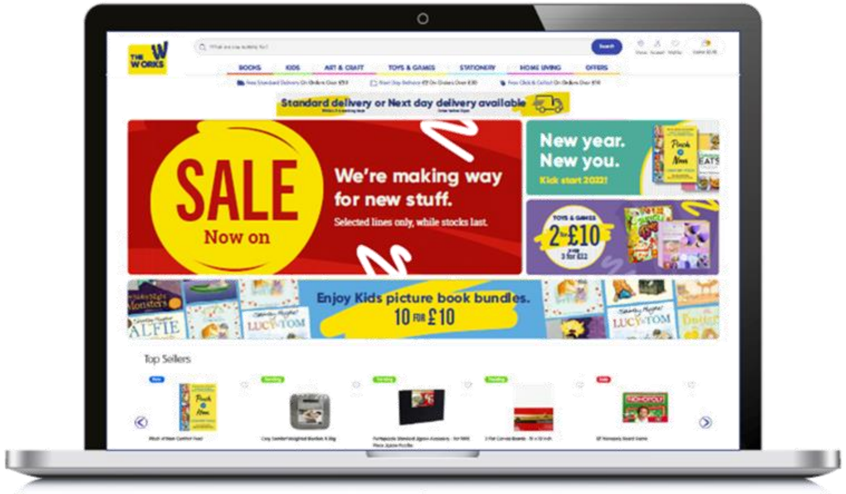
<u>Objective:</u> Reach new customers, increase existing customer engagement and evolve external perceptions of The Works.

<u>Key progress in FY23 to date:</u>

- Launched brand evolution, aligned to new purpose
- Further developed product offer, including:
  - Further development of adult books proposition
  - Revamped kids books proposition
  - Refreshed seasonal ranges
  - Own-brand overhaul planned for CY23
- Relaunched loyalty scheme;
  - 0.3m additional members registered (over 1.1m active members)
  - Customer insight capabilities under development



Enhance our Online Proposition



Objective: Increase awareness of our website and make it a more inspiring destination for our customers

Key progress in FY23 to date:

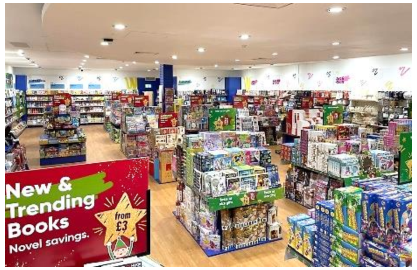
- Increased focus on enhancing online customer experience, supported by
  - Brand evolution applied to website
  - Usability study commissioned
  - Improved analytics and new tooling being implemented in H1 CY23
- In-house Digital Marketing capabilities being developed
- Review of online operation to improve execution of our strategy is underway

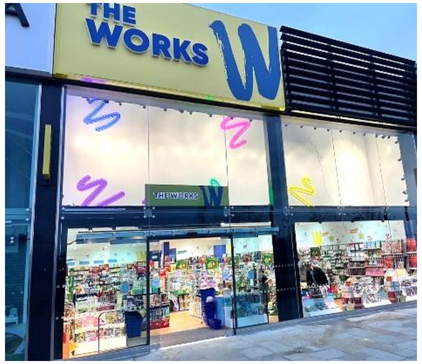
Optimise our Store Estate

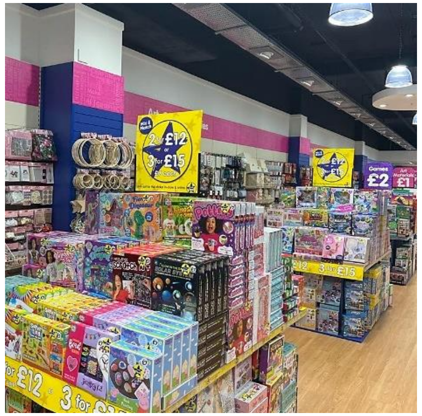
<u>Objective:</u> Create a store environment that can inspire our customers and reflect the communities we serve

<u>Key progress in FY23 to date:</u>

- Improved store look and feel through brand evolution
- Ongoing portfolio management, improving overall estate
    - 7 new stores, 2 relocations, 5 closures by end of H1
- Undertaken 21 store refits (3yr project to bring c130 stores up to "ideal" standard)
- Operational focus on customer service versus "tasking"







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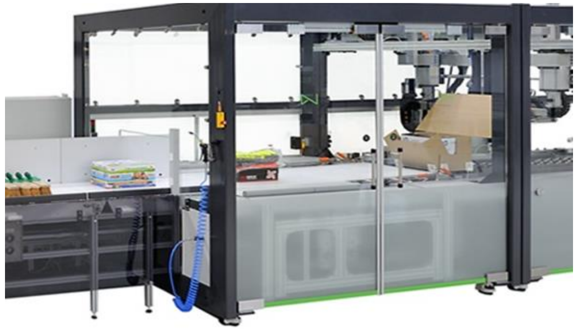
Drive Operational Improvements



Objective: Improve our ways of working to become a better and more modern retailer, whilst ensuring we continue to operate efficiently and in a cost-effective way

Key progress in FY23 to date:

- Continued focus on enhancing end to end stock flows in the business
  - New stock allocation system implemented
  - Internal ways of working review – Merch Planning function being recruited
  - 3rd party partner selected to support with further shaping and delivery of improvement programme
- Developed new EPoS solution – pilot imminent; rollout to all stores pre-peak 2023
- Implemented partial automation for online fulfilment operations
- New DC management team in place, developing plans to improve DC operations

Our Strategic Enablers – Progress Update

Our Colleagues

Placed 12th in Best Big Companies to work for in 2022 (up from 13th)

Launched new Communication and Rewards platform

Launched performance cycle, supported by new "Can-Do Academy" (L&D system)

Our Systems and Data

New EPOS software developed for rollout in CY23

New stock allocation system implemented

New data warehouse under construction – supports improved insight/analysis capabilities

Website development capabilities established in-house

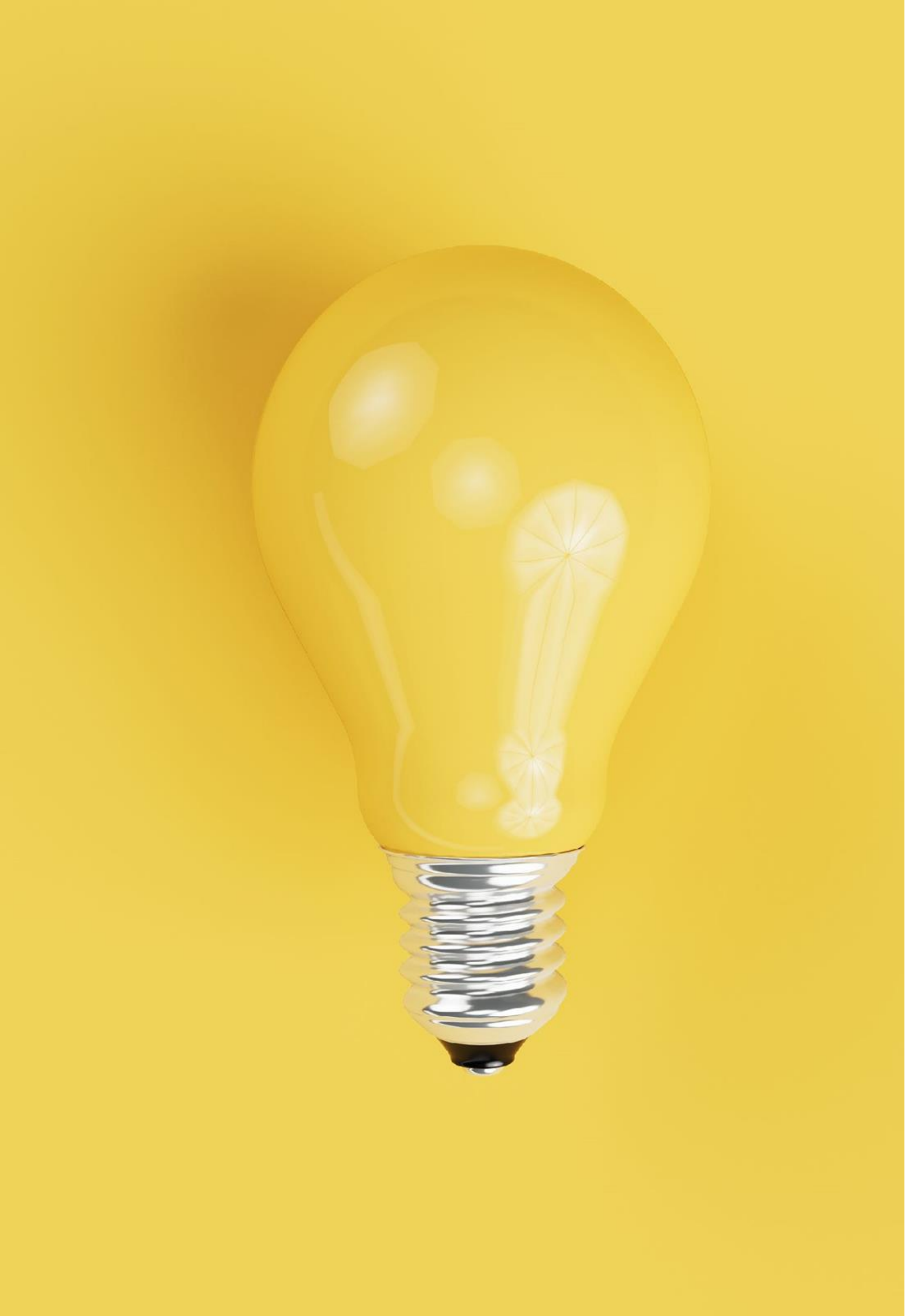
Further cyber security improvements

Our ESG Commitments

Environmental strategy under development with 3rd party

Recruited a Sustainability Manager

External review of D&I across the business completed



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Q&A

Our Purpose

To inspire **reading**, **learning**, **creativity** and **play** – making lives more fulfilled.

Underpinning this Purpose:

We believe in the importance of **FUN & FULFILMENT** and taking time out to do the things you love.

We want reading, learning, creativity and play to be **ACCESSIBLE TO EVERYONE**, affordable, convenient and inclusive.

We want to be the **GO-TO PLACE** to inspire customers to embrace their free time.

Fulfilled by our brand that is:

Fun	**Creative**	**Friendly**
Empowering	**Confident**	**Value-led**

All brought to life by our family of colleagues who are:

Crafty	**Caring**	**Can-do**

Helping us to fulfil our ambition of becoming one of the most loved retailers in the UK – the go-to place for reading, learning, creativity and play.

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