McGrathNicol

MEDIA RELEASE

13 July 2016

The Administrators of Dick Smith, McGrathNicol, today released their Report to Creditors, in advance of the Meetings of Creditors to be held on Monday, 25 July 2016 in Sydney.

The Administrators have received Court approval to issue the Notice of the Meeting to creditors and provide the Report via their website at www.mcgrathnicol.com.

The Report summarises the Administrators activities since their appointment on 4 January 2016. It provides background to the financial performance of Dick Smith, the reasons for its failure, the outcome of the receivership, the likelihood of financial returns to creditors, and the nature of claims that can be pursued, as well as our recommendation that the companies be wound up and liquidators be appointed.

Administrator Joe Hayes of McGrathNicol, said the failure of Dick Smith represents an unfortunate end for one of Australia's iconic retailers. "The collapse was made all the more significant given its speed and scale, just a couple of years after the successful public ASX listing of Dick Smith, as well as the time of year, just following the Christmas period," he said.

The Report outlines the work undertaken by the Receivers and Managers who continued to trade the business with a view to selling it as a going concern. Ultimately, the business could not be sold and was wound down and closed. "The Receivers advised that the losses the business had sustained during 2015, the challenges in obtaining supplier support, the inventory mix in stores, and the low-margin, competitive environment meant potential purchasers did not see value in the network," Mr Hayes said.

"However, employee entitlements have been able to be paid in full for the company's more than 3,300 staff. The work undertaken by employees after the appointment of Administrators and Receivers has been commendable in very difficult circumstances, and demonstrates their great support for the Dick Smith business". The ultimate outcome of the Administration is likely to be a shortfall to creditors in excess of $260 million "The secured Banks would receive a partial return on their exposure, but there is little prospect of any return to unsecured creditors," he said.

Mr Hayes said time will be needed to determine the real causes of Dick Smith rapid demise, and the significant turnaround in Dick Smith's financial position in such a short period required a period of reflection and review.

According to the Report, the reasons for the failure of Dick Smith are complex and inter-related. The business listed in late 2013 after a highly successful IPO which was significantly over-subscribed. The business had achieved strong growth and results pre-float, which were underpinned by an expansion plan and exciting new lines of business.

"In that environment, Management were very focussed on increasing revenue and generating profitability. This ultimately came at the expense of sustainable growth and the business struggled to maintain performance," Mr Hayes said.

The Report suggests that Dick Smith struggled to compete in the fast-moving office sector where customer preferences rapidly change, and began to lose market share. Its expansion plans and store growth utilised all its surplus earnings and required significant borrowing.

"These expansion plans went unchecked during early to mid-2015, and major inventory purchasing decisions meant Dick Smith was carrying too much stock that was not saleable and was overvalued. By December 2015, a rapid clearance sale was needed at a time the business should have been achieving strong margins. However, cash receipts were simply insufficient to meet commitments," Mr Hayes said.

"Dick Smith failed because the company did not have enough cash resources available to meet its current and future commitments. The appointment of the Administrators on 4 January 2016 was the only step available to the Board and Management."

While the Report goes into some depth on these causes of failure, it does not draw conclusions regarding the nature of claims that could be brought. The Administrators have determined it is too early for those conclusions.

A short summary of the key points from the Report is attached.

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MEDIA RELEASE KEY POINTS

What is DSG?	DS Holdings is an Australian Public Company. DS Holdings is the ultimate holding company of the Dick Smith Group (**"**DSG**"**) which consists of 11 wholly owned subsidiaries. DSG operated consumer electronics retail stores and an online consumer electronics retail business throughout Australia and New Zealand operating from in excess of 390 locations with in excess of 3,000 employees. The majority of the network was bannered as **'**Dick Smith**'** stores but also incorporated **'**Move**'** bannered stores, **'**Electronics Powered by Dick Smith**'** outlets in David Jones stores, and commercial and on-line businesses.
What is the purpose of this report?	The purpose of the Administrators' Report is to provide creditors with details about the business, property, affairs and financial circumstances of DSG in preparation for the forthcoming second meetings of creditors of the Australian entities. The report also informs creditors about the investigations undertaken by the Administrators and the Administrators' opinion about each of the options available to creditors at the second creditors' meeting, together with their opinion as to the course of action the Administrators recommend is in creditors' best interests.
What is the status of DSG?	On 4 January 2016, DS Holdings and its Australian subsidiaries were placed into Voluntary Administration by its Directors, and Partners of McGrathNicol were appointed Administrators (refer to section 2.1 for full details). Following DSG being placed into Voluntary Administration, lenders to DSH (the Banks) appointed Receivers and Managers to recover the assets subject to their security. Partners of Ferrier Hodgson were appointed Receivers and Managers.
Who controls DSG now?	The Receivers have responsibility for the day-to-day management of the Dick Smith business, with the security held by the Banks enabling them to assume control of most of the entities in DSG. The Receivers also have the current conduct of Public Examinations of various individuals concerning the failure of DSG. The Administrators have undertaken investigations into the affairs of DSG and the reasons for its failure.
What is the ownership structure of DSG?	DSG was owned by Woolworths from 1982. In late 2012 it was acquired by Anchorage. In late 2013 DSG was listed on the ASX. DSG remains publicly owned but subject to Administration and Receivership. Its shares are likely now of no value.
How did the Dick Smith business trade?	DSG reported profitability in FY14 and FY15 of $19.4 million and $37.4 million respectively. Its net assets at FY14 and FY15 year-end were $166.9 million and $169.1 million respectively. Dividends were paid to shareholders during FY15 and FY16.

Why did DSG encounter financial difficulty?

DSG grew its store network during FY14 and FY15. This required a significant investment in inventory, capital expenditure and resultant accumulation of creditors and borrowings. Although DSG reported profits, its growth required considerable financial commitment, during a period where DSG was losing market share. The competitive electronics environment resulted in tightening cred it terms, the need for major inventory impairment, and significant cash pressure in late FY16. Increased borrowings and new finance facilities were required and ultimately DSG could not operate within the terms of those facilities.

DSG's management accounts to December 2015 indicate considerable losses for the six months to 31 December 2015 of $116.7 million. Those losses are attributable to poorer than expected sales and margins, inventory write downs, lease provisions and other asset impairments.

Why do the Directors of DSG believe it became insolvent?

The Directors of DSG have provided us with the following reasons for its failure:

- Cash pressures were evident from late November 2015;
- DSG was issued with a breach notice by its Banking Syndicate on 31 December 2015 and was given 10 days to remedy that breach;
- DSG's proposals to remedy the breach were not deemed acceptable to the Syndicate; and
- Accordingly, the Directors had no choice but to appoint voluntary administrators.

Why do the Administrators believe DSG became insolvent?

The Administrators consider DSG failed because it was unable to make scheduled payments without breaching the terms of its Bank facilities.

During late 2015, DSG required additional funding from its Banks as well as a facility from Macquarie Bank. Following the impairment of DSG inventory in November 2015, temporary extensions were sought to the Bank facilities in December 2015 which were granted subject to certain conditions. In late December 2015, DSG was notified it had breached those conditions by making certain payments to Macquarie Bank. Whilst Management considered the payments were not a breach of the conditions, DSG was unable to make further scheduled payments to Macquarie which were due and payable in early January 2016. After considering their financial forecast, the Board appointed the Administrators.

What were the underlying causes of DSG's failure?

The Administrators consider the reasons DSG failed include:

- The consumer electronics market is highly competitive with rapid changes in consumer demand patterns;
- DSG had a store network much larger than its competitors, and so a higher cost base, with considerable exposure to and reliance on the fast moving office/computer products market;
- DSG was losing market share by experiencing declining comparable sales. Revenue growth was based on store growth and commercial sales at low margins;
- DSG's expansion plan required considerable financial commitment, utilised all cash resources, required considerable supplier commitment and required Bank borrowings;

- Inventory decisions made in this environment were not consistent with consumer demand, and DSG was ultimately left with a considerable level of obsolete and inactive stock, requiring a major write down;
- Clearance sales did not generate sufficient sales or margin to alleviate the cash pressure;
- Inability to obtain favourable credit terms impacted on stock levels, product mix and store presentation; and
- Cash flow pressures lead to banking covenants being breached that could not be remedied.

What was the outcome of the sale process?

The Receivers marketed the Dick Smith business for sale in early 2016. Despite considerable initial interest, a buyer could not be found for the retail business as a going concern. The Receivers attribute this to:

- Considerable losses in 1HFY16, from which potential buyers considered recovery would be very difficult;
- Difficult trading conditions occasioned by major suppliers not providing new trading terms to the Receivers while existing debts were outstanding;
- Resultant inability to rectify product mix and fully stock stores with appropriate product.

Ongoing trading losses would ultimately put at risk employee entitlements, so absent a buyer for the network, the Receivers embarked on a managed wind down to realise inventory, pay employee entitlements and reduce secured debt.

Subsequently, the Receivers sold the intellectual property and on line business to Kogan.com.

Will employees be paid their outstanding entitlements?

The majority of outstanding employee entitlements have been paid by the Receivers. An amount of $2.1 million, relating to historical underpayment issues remains outstanding, however will be paid by the Receivers this calendar year.

Will the Banks be repaid their debt?

The Banks will be repaid a proportion of what they are owed but are likely to suffer a significant shortfall. The ultimate outcome for the Banks is largely dependent on further asset recoveries by the Receivers and the settlement of security interests with trade creditors.

Apart from employees, will unsecured creditors be paid a dividend?

There is no expectation that unsecured creditors will receive a return unless very significant recoveries are made in the Liquidation process.

Will gift card holders receive a refund?

Gift card holders are classed as unsecured creditors under Australian and New Zealand Corporations Law. There is currently no expectation that unsecured creditors will be paid a dividend unless very significant recoveries are made in the Liquidation process.

Will shareholders be paid?

There is currently no expectation of a return to shareholders and we have advised shareholders accordingly.

What is the total financial shortfall to creditors of DSG?

The total shortfall to creditors of DSG will be in excess of $260 million.

The substantial difference between the shortfall of $260 million and the book value of DSG's assets at 30 June 2015 of $170 million, requires fuller investigation and reconciliation. However, it is largely attributable to significant trading losses in 1HFY16, losses on the wind down of inventory during the receivership, and the very significant supplier and Bank commitments.

What claims will a liquidator investigate?

Whilst the Administrators have considered the underlying causes of DSG's failure, our investigations into claims arising from those matters are at an early stage.

We have undertaken preliminary enquiries which will continue after the appointment of liquidators. In particular, we note there could be voidable transactions the liquidators will pursue.

What is the purpose of the second meeting of creditors?

The purpose of the second meetings is for creditors to resolve the future of DSG. In this regard, the options available include whether DSG should be returned to their Directors; or enter into a Deed of Company Arrangement; or enter into liquidation.

What do Administrators recommend creditors should do?

As DSG is insolvent and no DOCA proposals have been put forward, the Administrators are unable to recommend that DSG be returned to the Directors or that DSG enter into a DOCA. Accordingly, the Administrators' recommendation is that creditors vote in favour of DSG being placed into liquidation.

Where I can get more information?

If you require any further information, please review the McGrathNicol website and contact Link Market Services on 1300 853 481 or by email dicksmith@linkmarketservices.com.au.