

SENATE ECONOMICS REFERENCES COMMITTEE INQUIRY  
IN RELATION TO THE CAUSES AND CONSEQUENCES OF  
THE COLLAPSE OF LISTED RETAILERS IN AUSTRALIA

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**SUBMISSION BY ANCHORAGE CAPITAL PARTNERS**

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**Date of Document:**

18 March 2016

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# Submission by Anchorage Capital Partners

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18 March 2016

Senator Chris Ketter  
Chair  
Senate Economics References Committee  
Parliament House  
Canberra ACT 2600

By email: [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au)

Dear Chair and Committee Members

I am pleased to make this submission to the Senate Economics References Committee on behalf of Anchorage Capital Partners Pty Limited ("Anchorage"). Funds managed by Anchorage owned the Dick Smith business ("Dick Smith") from November 2012 until the company was listed on the Australian Stock Exchange ("ASX") in December 2013.

The sudden and dramatic collapse of Dick Smith, an iconic and well respected brand in Australia's retail landscape, has had far reaching social and financial ramifications. Everyone at Anchorage shares the dismay felt in the community regarding the recent circumstances at Dick Smith. In particular, we feel for the employees, many of whom we know well. We welcome the Senate Inquiry and would be pleased to assist in any way we can.

This letter summarises the key facts of our submission, with further detail provided in the body of the submission.

**The largest beneficiaries of Anchorage's investment in Dick Smith were Australian investors.**

Anchorage is an Australian fund manager that specialises in acquiring companies, improving their operations, and later selling these companies to generate a return on investment. Anchorage focuses on companies in turnaround or transitional situations, and its founders have a strong, 30-year track record in this area (including investments in businesses such as Golden Circle, Burger King New Zealand and Total Eden). The majority of our investors are Australian fund managers, many of whom manage funds on behalf of Australian 'mum and dad' investors. As such the majority of the financial returns from Anchorage's investment in Dick Smith benefitted local Australian investors, a substantial portion via superannuation funds.

**Dick Smith experienced significant improvement in performance during Anchorage's ownership.**

Anchorage acquired Dick Smith from Woolworths Limited ("Woolworths") in November 2012. At the time, Dick Smith had experienced declining profits for several years and Woolworths had reduced the size of the store network by ~23% since the beginning of financial year 2011 ("FY11"). As an 'orphan' business in a large organisation, Dick Smith was also suffering from a lack of strategic focus and an uncertain outlook. During our period of ownership, Anchorage implemented a comprehensive transformation and investment program, covering all areas of the business including store operations, e-commerce, product range, and supply chain. We addressed the significant balance of old and obsolete stock, including stock that was left over from the store closure program conducted by Woolworths. Significant investment was made in the business by opening around 35 new stores (including launching the innovative 'Move' concept and acquiring the electronics departments of David Jones' stores), and substantially expanding the marketing and advertising program. The transformation program was highly successful and resulted in earnings before interest, tax, depreciation and amortisation ("EBITDA") increasing from \$23.4M in FY13 (the year of acquisition) to \$74.4M in FY14 (the year of the Initial Public Offering and ASX listing ("IPO")).

**Anchorage was able to sell the business for more than we paid due to the significant improvement in performance and outlook during our ownership.**

The acquisition price paid to Woolworths reflected the poor financial performance of Dick Smith leading up to the acquisition by Anchorage. At the time there was also significant uncertainty surrounding the outlook for the business, the economy and the worldwide retail sector. Anchorage's offer represented the most attractive price received by Woolworths following a lengthy global sale process.

The share price of any IPO is determined by market demand. In the case of Dick Smith, the IPO price reflected the significant improvement in earnings as a result of Anchorage's transformation and growth program, the improved outlook for the business, and its well capitalised balance sheet. The offer was significantly over-subscribed, and numerous well regarded institutional investors participated in the offer. The share price traded around the IPO price for approximately 21 months after the IPO.

Regardless, the IPO price, and subsequent publicly traded value of Dick Smith's shares, had no impact on Dick Smith's underlying operational performance or the financial issues it experienced late in 2015.

**Anchorage sold its controlling interest more than two years before Dick Smith fell into financial difficulty.**

Anchorage sold 80% of its shareholding in Dick Smith via the IPO in December 2013, and ceased to control Dick Smith from this time. We sold our remaining 20% shareholding in Dick Smith in September 2014, at which time the shares were trading above the IPO price and the business was performing well. Following the IPO, I remained as Chairman of Dick Smith to assist with the transition associated with the business becoming a publicly listed company. My resignation from the board of directors ("Board") was announced in December 2014 (effective February 2015), more than 12 months before the appointment of the administrators.

**Anchorage left Dick Smith in a strong financial position and the company demonstrated strong performance until very recently.**

Dick Smith was in a strong financial position at the time of the IPO and when I resigned from the Board, and the company demonstrated strong financial performance until as recently as August 2015. Publicly available information shows that:

- **Anchorage left Dick Smith with strong earnings momentum.** Dick Smith delivered strong earnings until very recently, long after our involvement ended:
  - The company achieved its Prospectus forecast in FY14, further increased earnings in FY15, and in August 2015 gave guidance of another profit increase in FY16.
  - Since the IPO Dick Smith declared and paid shareholders nearly \$50 million in fully franked dividends, the most recent of which was paid in September 2015.
- **Anchorage left Dick Smith with a strong balance sheet.** Dick Smith had a well-capitalised balance sheet at the time of the IPO and when I resigned as a director:
  - At the time of the IPO, Dick Smith had a high quality 'stock on hand' position as a result of the clearance of old and obsolete stock. As at December 2013, shortly after the IPO, Dick Smith had no borrowings and \$93 million in cash and short-term receivables.
  - In December 2014, when I tendered my resignation from the Board, Dick Smith still had no borrowings, \$98 million in cash and short-term receivables, and stock holdings in excess of comparable consumer electronics companies, i.e. it had ample amounts of stock and a strong funding position.
- **Dick Smith's share price remained strong long after the IPO.** Dick Smith shares continued to trade around the IPO issue price until August 2015, approximately 21 months after the IPO and many months after I resigned as a director. As mentioned above, the company had also declared and paid \$0.20 per share in fully franked dividends up until September 2015.

In June 2015, many months after Anchorage's involvement with the company ceased, a new banking syndicate granted Dick Smith a significantly increased debt facility. In our experience, such facilities are only provided following extensive due diligence investigations by the financiers. It follows that only six months before the appointment of administrators and receivers this banking syndicate considered Dick Smith's financial performance and outlook to be sufficiently strong to justify the new facility.

**It is the role of the administrators to ascertain the causes of Dick Smith's financial difficulties.**

Given the serious consequences of Dick Smith's financial situation, there has been significant speculation about the causes of the company's recent difficulties. We understand that, under Australian corporations law, the administrators are required to undertake an independent review and prepare a report setting out the factors that led to the company's insolvency. I left the Board more than 12 months ago, and since this time we have had limited visibility into the financial affairs of Dick Smith. As outlined above, as far as we were aware, the company was performing strongly until very recently. We await the release of the administrators' report which we hope will provide clarity on how a company with such a strong balance sheet and operating momentum has ended up in this regrettable situation so suddenly.

I reiterate Anchorage's offer to assist the Committee in any way we can.

Yours sincerely,

Phillip Cave AM  
Managing Director

## 1. Purpose of this submission

This submission is in relation to paragraph (a) of the Terms of Reference only and, in particular, Anchorage's investment in Dick Smith. Paragraph (a) of the Terms of Reference refers to: "*the conduct of private equity firms prior to, during and after corporate takeovers*". This submission does not relate to paragraphs (b) to (f) of the Terms of Reference, as these matters do not relate to Anchorage, the IPO or Anchorage's involvement with Dick Smith.

## 2. Structure of this document

Our detailed submission is structured as a chronology of key events relating to Dick Smith, and addresses five key and distinct phases:

- (a) Phase 1: Dick Smith's performance prior to the acquisition by Anchorage (the period prior to November 2012);
- (b) Phase 2: Anchorage's period of ownership of Dick Smith and the comprehensive transformation program (the period from November 2012 to December 2013);
- (c) Phase 3: The IPO (in December 2013), after which time Anchorage no longer controlled Dick Smith;
- (d) Phase 4: The period following the IPO until the date Phillip Cave tendered his resignation from the Board, at which time Anchorage's formal involvement with Dick Smith ended (the period from December 2013 to December 2014); and
- (e) Phase 5: The period after December 2014.

We have also included the following:

- (a) a summary of Dick Smith's financial performance before, during and after Anchorage's period of ownership;
- (b) background information in relation to Anchorage;
- (c) responses to erroneous and misleading claims concerning Anchorage's involvement with Dick Smith; and
- (d) observations on the important role of the administrators in determining the causes of the financial difficulties experienced by Dick Smith.

## 3. About Anchorage Capital Partners

Anchorage is a specialist private equity firm that seeks to invest in businesses that are not operating at their full potential, which could be for a variety of reasons including being an 'orphan' business unit of a public company (as Dick Smith was), lack of capital or poor management. We aim to transform these businesses through a wide range of operational, cultural and growth initiatives. We invest heavily in staff/talent, operations, IT systems, branding/marketing, new product development and growth initiatives.

Anchorage has \$450 million in funds under management. The majority of our investors are Australian fund managers, many of whom manage funds on behalf of Australian 'mum and dad' investors. As such the majority of the financial returns from Anchorage's investment in Dick Smith benefitted local Australian investors, a substantial portion via superannuation funds.

Anchorage's style is to be actively involved in the management of its investee companies through comprehensive business planning and engagement to continually improve operating performance. The partners and investment professionals of Anchorage have considerable experience in company management, corporate strategy, management consulting and corporate

finance. Anchorage's founders have been involved in private equity investments in Australasia for over 30 years.

Anchorage's current investment portfolio includes Brand Collective (clothing and footwear), Mark Group (solar and renewable energy), Acrow (formwork and scaffolding), Shoes & Sox (children's footwear) and Affinity Education (childcare). Anchorage's prior investments include Burger King New Zealand, Total Eden, Golden Circle, First Engineering and Dick Smith. All were successful investments that left strong, growing companies for their next owners and delivered attractive returns for our investors.

#### 4. Summary of Dick Smith's financial performance

The table below shows the key line items from Dick Smith's proforma income statement for the past five years, commencing from before Anchorage's ownership through to the most recently published results for the year ended June 2015. Anchorage acquired Dick Smith during FY13, and the IPO occurred during FY14. The impact of the transformation and investment program under Anchorage's ownership can be seen in FY14 and FY15.

Figure 1: Summary proforma income statement, FY11 to FY15<sup>1</sup>

Financial year ended June (A\$ millions)	2011	2012	2013	2014	2015
Sales	1,281.1	1,369.5	1,280.4	1,227.6	1,319.7
EBITDA	36.5	32.6	23.4	74.4	79.8
Net profit after tax	15.9	13.2	6.7	42.1	43.4

The table below shows the balance sheet since the acquisition by Anchorage. Balance sheets prior to this time have not been publicly disclosed by Woolworths or Dick Smith.

Figure 2: Summary proforma balance sheets, June 2013 to June 2015<sup>2</sup>

Financial reporting period ended (A\$ millions)	Jun-13	Dec-13	Jun-14	Dec-14	Jun-15
Cash and Cash Equivalents	46.5	65.2	29.9	17.9	29.5
Trade and Other Receivables	10.4	27.6	46.7	79.6	53.3
Inventories	168.5	238.8	253.8	335.8	293.0
Other current assets	15.7	6.1	5.5	11.3	14.1
<b>Current Assets</b>	<b>241.2</b>	<b>337.7</b>	<b>335.9</b>	<b>444.7</b>	<b>390.0</b>
<b>Non-current assets</b>	<b>103.1</b>	<b>102.7</b>	<b>115.3</b>	<b>115.5</b>	<b>118.5</b>
<b>Total assets</b>	<b>344.3</b>	<b>440.4</b>	<b>451.2</b>	<b>560.1</b>	<b>508.5</b>
Trade and other payables	153.3	263.8	247.7	337.9	228.4
Other current liabilities	19.0	17.9	19.1	20.4	17.6
Borrowings	--	--	--	--	70.5
Other non-current liabilities	15.6	15.3	17.4	22.8	22.8
<b>Total Liabilities</b>	<b>187.9</b>	<b>297.0</b>	<b>284.2</b>	<b>381.1</b>	<b>339.4</b>
<b>Net assets</b>	<b>156.5</b>	<b>143.3</b>	<b>166.9</b>	<b>179.1</b>	<b>169.1</b>

<sup>1</sup> Prospectus and other financial statements. Figures shown are 'proforma', which means certain adjustments have been made to statutory financial results to remove the impact of unusual or non-recurring items.

<sup>2</sup> Prospectus and other financial statements. Note the FY13 figures, including inventory of \$168.5 million, are sourced from the FY13 statutory accounts and FY14 results presentation, which differ slightly from the figure in the FY14 annual report of \$170.8 million.

## 5. Chronology of events

### 5.1 Timeline of key events

The following is a chronology of key events relating to Dick Smith:

- (a) February to September 2012: Woolworths conducts a lengthy global sale process to divest Dick Smith;
- (b) 26 November 2012: Dick Smith Holdings Pty Limited (a company formed by Anchorage) acquires Dick Smith from Woolworths;
- (c) November 2012 to December 2013: Anchorage implements a comprehensive transformation and investment program at Dick Smith, resulting in significant improvements in operational performance and earnings;
- (d) December 2013: Initial public offering of Dick Smith on the Australian Stock Exchange. The issue price was \$2.20, determined by market demand for the offering (which was heavily oversubscribed);
- (e) June 2014: A banking facility with Westpac Banking Corporation is put in place<sup>3</sup>, refinancing the existing facility with GE Capital. Dick Smith had no borrowings on this facility at both year-end June 2014 and half year-end December 2014, when Anchorage's formal involvement with Dick Smith ended;
- (f) August 2014: Dick Smith releases financial results for FY14 and reports that sales revenue, EBITDA and net profit after tax ("NPAT") all achieved the Prospectus forecast. Dick Smith declares a \$18.9 million fully franked dividend (\$0.08 per share)<sup>4</sup>;
- (g) September 2014: Anchorage sells its remaining 20% shareholding in Dick Smith<sup>5</sup>, following the end of the IPO voluntary escrow period;
- (h) December 2014: Dick Smith announces that Phillip Cave has resigned from the Board (effective February 2015), following which Anchorage's formal involvement with Dick Smith ended<sup>6</sup>;
- (i) February 2015: Dick Smith announces 2015 half year results. Sales revenue, EBITDA and NPAT increase relative to the same period a year earlier<sup>7</sup>. Dick Smith declares a \$16.6 million fully franked dividend (\$0.07 per share). Robert Murray is appointed chairman of Dick Smith<sup>8</sup>;
- (j) June 2015: A banking facility with National Australia Bank, Bank of New Zealand and Hong Kong and Shanghai Banking Corporation is put in place<sup>9</sup>, replacing the facility with Westpac Banking Corporation;
- (k) August 2015: Dick Smith releases FY15 results. Sales revenue, EBITDA and NPAT increase relative to FY14, and Dick Smith gives guidance of a further profit increase in FY16. The company declares a fully franked dividend of \$11.8 million (\$0.05 per share)<sup>10</sup>, and announces it has drawn borrowings of \$70.5 million (net borrowings of \$41.0 million).

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<sup>3</sup> Dick Smith 2014 annual report note 26 ("Debt Facilities"), page 84

<sup>4</sup> FY14 annual report

<sup>5</sup> <http://www.asx.com.au/asxpdf/20140919/pdf/42sb92nqqv6qnt.pdf>

<sup>6</sup> <http://www.asx.com.au/asxpdf/20141202/pdf/42v6pykm7mppy8.pdf>

<sup>7</sup> <http://www.asx.com.au/asxpdf/20150217/pdf/42wmzb0lq6s23k.pdf>

<sup>8</sup> <http://www.asx.com.au/asxpdf/20150302/pdf/42x0fkm0j7wn0j.pdf>

<sup>9</sup> Dick Smith 2015 annual report note 24 ("Debt Facilities"), page 82

<sup>10</sup> <http://www.asx.com.au/asxpdf/20150818/pdf/430kvg0j8gf850.pdf>



Chairman Robert Murray and CEO Nick Abboud both acquire further shares in Dick Smith<sup>11</sup>;

- (l) October 2015: Dick Smith announces a profit guidance downgrade for FY16<sup>12</sup>;
- (m) November 2015: Dick Smith announces \$60 million stock impairment/write-down of stock<sup>13</sup>; and
- (n) January 2016: Directors of Dick Smith appoint McGrath Nichol as voluntary administrators<sup>14</sup>. Secured lenders, National Australia Bank, Bank of New Zealand and Hong Kong and Shanghai Banking Corporation, appoint Ferrier Hodgson as receivers<sup>15</sup>. Trading in Dick Smith shares is suspended<sup>16</sup>.

## 5.2 Detailed commentary on key events

### ***Phase 1 – Dick Smith performance prior to the acquisition by Anchorage (the period prior to November 2012)***

In January 2012, Woolworths announced that it would "accelerate the restructure of its speciality consumer electronics brand, Dick Smith, with a view to divesting the business in a staged and considered process"<sup>17</sup>. In the same announcement, Woolworths stated that a restructuring provision of \$300 million would be taken in the first half of FY12, reflecting the diminished value of the Dick Smith business. Woolworths appointed a reputable investment bank, Greenhill, to advise on the divestment process and to conduct a global search for a suitable purchaser for Dick Smith.

In September 2012, Woolworths agreed to sell Dick Smith to Anchorage, which had put forward the most attractive proposal following a lengthy global sale process<sup>18</sup>. Completion of the transaction occurred in November 2012. Under the terms of the sale agreement and subsequent arrangements, Woolworths received total consideration of approximately \$115 million for the sale of Dick Smith to Anchorage<sup>19</sup>.

At the time of the acquisition by Anchorage, Dick Smith had experienced several years of declining earnings (refer Figure 1 above). There was significant uncertainty surrounding the outlook for the business, the economy and the retail sector. Woolworths had also conducted a significant store closure program commencing in FY11, as shown in the table below:

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<sup>11</sup> <http://www.asx.com.au/asxpdf/20150831/pdf/430yv7vl277b1j.pdf>,

<http://www.asx.com.au/asxpdf/20150302/pdf/42x0fkm0j7wn0j.pdf>

<sup>12</sup> <http://www.asx.com.au/asxpdf/20151028/pdf/432gj7x5w1f89t.pdf>

<sup>13</sup> <http://www.asx.com.au/asxpdf/20151130/pdf/433dy00wqbgm4x.pdf>

<sup>14</sup> <http://www.asx.com.au/asxpdf/20160105/pdf/4346lly4rnwjc1.pdf>

<sup>15</sup> <http://www.asx.com.au/asxpdf/20160105/pdf/4346y44y9gj3yn.pdf>

<sup>16</sup> <http://www.asx.com.au/asxpdf/20160104/pdf/4345ylpx14tl1c.pdf>

<sup>17</sup> <http://www.asx.com.au/asxpdf/20120131/pdf/424175tf3ldzv4.pdf>

<sup>18</sup> [http://www.woolworthslimited.com.au/page/The\\_Newsroom/Press\\_Releases/Archives/2012/Sale\\_of\\_Dick\\_Smith\\_Electronics/](http://www.woolworthslimited.com.au/page/The_Newsroom/Press_Releases/Archives/2012/Sale_of_Dick_Smith_Electronics/)

<sup>19</sup> FY13 accounts, page 37

Figure 3: Dick Smith store numbers FY11 to FY15<sup>20</sup>

Store numbers	June 2011	June 2012	June 2013	15-Oct 2013*	June 2014	June 2015
<i>Dick Smith Stores</i>						
Opening Balance	416	394	348	323	323	344
Opened	16	7	2	5	22	14
Closed	38	53	27	--	1	7
<b>Ending Balance</b>	<b>394</b>	<b>348</b>	<b>323</b>	<b>328</b>	<b>344</b>	<b>351</b>
David Jones Stores - Ending Balance	--	--	--	30	29	28
Move Stores - Ending Balance	--	--	--	1	4	14
<b>Total</b>	<b>394</b>	<b>348</b>	<b>323</b>	<b>359</b>	<b>377</b>	<b>393</b>
<i>(Note: 15-Oct-13 Dick Smith brand store closures not disclosed, so "opened" is net of closures)</i>						
<i>* Prospectus date</i>						

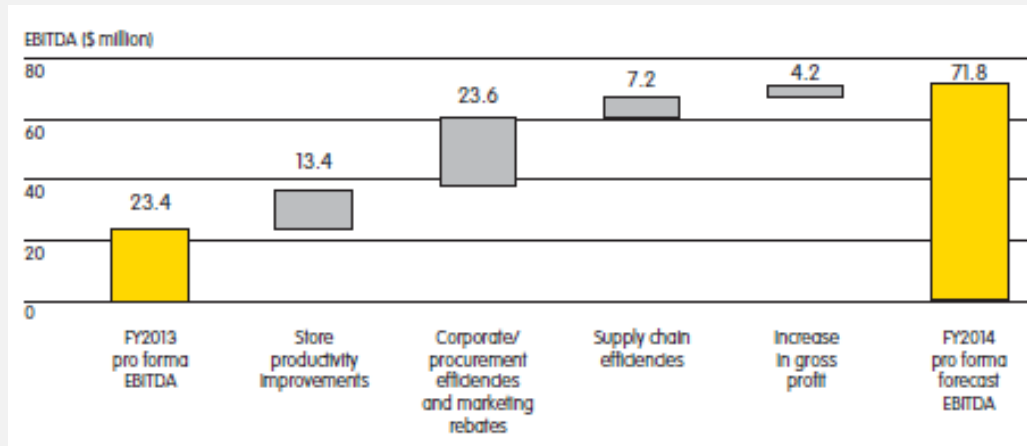
**Phase 2: Anchorage’s period of ownership of Dick Smith and the comprehensive transformation program (the period from November 2012 to December 2013)**

Immediately following the acquisition of Dick Smith, Anchorage, in partnership with the new management team, began to implement a comprehensive transformation and growth program. This very successful program resulted in EBITDA increasing from \$23.4 million in FY13 to \$74.4 million in FY14. An extract from Section 5 of the Prospectus describing the transformation initiatives and impact on the financial performance of Dick Smith is included below. Schedule 2, also an extract from the Prospectus, sets out a more detailed listing of the transformation initiatives.

*Extract from Prospectus, section 5.4.4*

“The financial impact of the transformation program and growth initiatives can be classified into four main categories: store productivity improvements, corporate/procurement efficiencies and marketing rebates, supply chain efficiencies and gross profit improvements.

Figure 4: Reconciliation of pro forma FY13 to pro forma forecast FY14 EBITDA<sup>21</sup>



<sup>20</sup> Prospectus page 66, other public filings

<sup>21</sup> Prospectus page 58. Note that actual reported FY14 EBITDA was \$74.4 million

- **Store productivity improvements:** Management has implemented a range of initiatives to deliver greater levels of store staff productivity, including embedding new KPI dashboards in all stores, linking store incentives to these KPI dashboards, removing middle management positions in store and developing new staff rostering policies and processes to better match staff levels with customer traffic. At the same time, to improve in-store customer experience, Dick Smith has rolled out its bespoke “Serve Forward” staff training program to all store managers, revitalised its recruitment profiles and policies, and conducted an extensive program of customer insights research. Occupancy costs were managed by developing strong alliances with major landlords and addressing unproductive space in larger format stores.
- **Corporate/Procurement efficiencies and marketing rebates:** A number of improvement initiatives were driven in key head office functional areas. Dick Smith management has increased the efficiency of media expenditure, substantially increasing media volumes and share of voice, and also increased marketing collaboration with suppliers. Lease agreements for corporate offices were also renegotiated, as were all major corporate supply agreements.
- **Supply chain efficiencies:** Dick Smith’s supply chain has been substantially restructured since the Acquisition. Both the Hoxton Park, NSW and Perth, WA distribution centres were closed in late FY2013, and a number of freight flow efficiencies were implemented, including shipping bulky items direct to store and rerouting supplier shipments direct to the distribution hubs of Dick Smith’s freight partner. Staffing levels were reduced in the remaining distribution centres in Chullora, NSW and Auckland, New Zealand to reflect lower inventory holding levels and reduced freight flows through the distribution centres. Major supplier agreements were also renegotiated.
- **Increase in gross profit:** Pro forma gross margin is forecast to increase from 23.7% in FY2013 to 25.1% in FY2014 as a result of a wide range of pricing, supplier and range mix initiatives, as well as improvements to buying and stock management practices. Agreements with major suppliers have been renegotiated and new buying disciplines introduced to improve planning and increase accountability for stock levels and discounting. New pricing and promotion practices were developed in collaboration with suppliers, and improvements were made to in-store markdown procedures. Dick Smith’s range was revamped to focus on higher margin products and brands, and a new direct sourcing office was established in Hong Kong to enable more efficient purchasing, particularly for private label products and accessories. In addition, the roll out of new stores is forecast to contribute to an increase in gross profit in FY2014. Despite the forecast increase in gross margin in FY2014, the gross profit contribution of existing stores in dollar terms is expected to be lower than in FY2013 due to higher sales in FY2013 as a result of increased promotional and inventory clearance activity.”

This transformation program required significant investment in the business to trial and open new stores (including the acquisition of the David Jones electronics department and the launch of the innovative ‘Move’ concept)<sup>22</sup>, and to expand the marketing and advertising program.

#### Cost reduction initiatives

Dick Smith's declining revenues and the Woolworths store closure program meant that, at the time of acquisition, Dick Smith’s cost base was higher than comparable consumer electronics companies (refer analysis below). Accordingly, several of the initiatives in the transformation program were designed to address this, including:

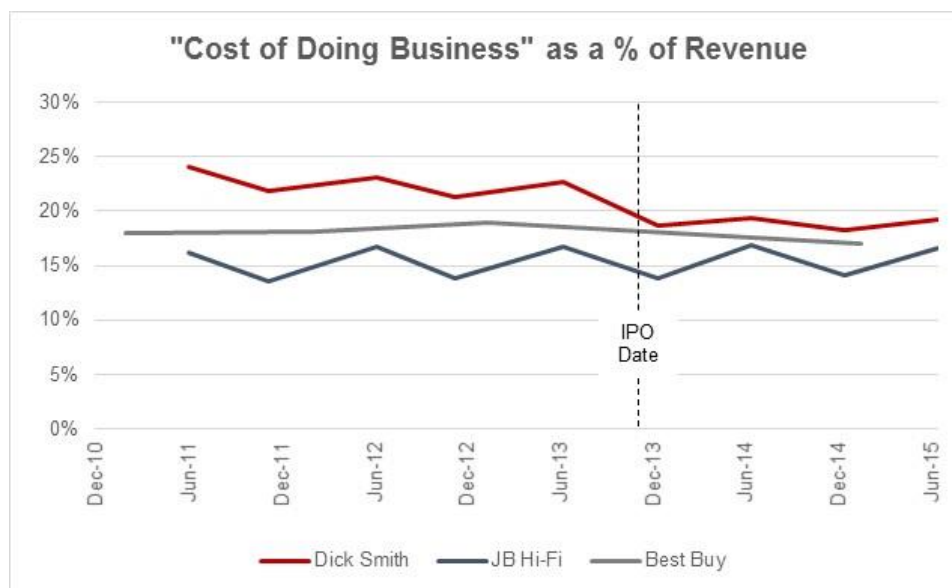
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<sup>22</sup> Prospectus, page 70

- (a) Adjusting store labour and store area management structure as appropriate for the lower number of stores;
- (b) Renegotiating marketing supply agreements (while significantly expanding marketing activity);
- (c) Consolidating the supply chain into one distribution centre in Chullora (New South Wales), down from three before the acquisition; and
- (d) Various other corporate procurement efficiencies, particularly renegotiating key agreements (e.g. freight, catalogue printing, utilities, phones, etc).

Even after these initiatives, Dick Smith still retained a heavier cost structure than comparable consumer electronics businesses, as shown below.

Figure 5: "Cost of doing business" relative to comparable consumer electronics companies<sup>23</sup>



### Management of stock levels

When Dick Smith was acquired in November 2012, it was carrying significant amounts of old and obsolete stock, partially as a result of the store closure program conducted by Woolworths. With reference to a review conducted by a third party expert, it was determined that the stock was over-valued by \$58M, ~16% of the value of stock at the time (relative to a ~23% reduction in the number of stores by Woolworths between the beginning of FY11 and the acquisition by Anchorage). Management conducted a clearance program to normalise the stock levels, which was completed by June 2013 and had no impact on earnings or cashflow following this time<sup>24</sup>.

It has been incorrectly speculated by certain commentators that the stock clearance went too far and left Dick Smith with too little stock at the time of the IPO. As at December 2013, the closest balance date to the IPO, Dick Smith's stock levels (measured in number of days of sales of stock held) were higher than comparable Australian and international consumer electronics retailers, as shown in the table below:

<sup>23</sup> "Cost of doing business" includes all fixed supply chain costs, rents, labour and other overheads. Excludes costs included in gross margins, e.g. variable supply chain costs. Calculated as cost of doing business divided by sales revenue.

<sup>24</sup> Prospectus page 65

Figure 6: Stock holdings relative to comparable consumer electronics companies at the time of the IPO of Dick Smith, measured in number of days of sales held<sup>25</sup>

Company	Days of stock held	Balance date
Dick Smith	94	December 2013
JB Hi-Fi	80	December 2013
Best Buy (US)	63	February 2014

Following the IPO, Dick Smith went on to achieve the FY14 forecast included in the Prospectus<sup>26</sup>. It would be very difficult for the business to be able to do this if stock holdings were too low at the time of IPO.

**Phase 3: The IPO (in December 2013), after which time Anchorage no longer controlled Dick Smith**

Dick Smith commenced trading on the Australian Stock Exchange on 4 December 2013. The IPO was the culmination of a rigorous preparation process involving highly regarded specialists to advise Dick Smith and its directors on the proposed IPO and preparation of the Prospectus. These specialists included:

- A leading law firm, Minter Ellison, to advise on legal matters;
- A 'big 4' accounting firm, Deloitte, to act as Investigating Accountant for the financial disclosures in the Prospectus;
- Two leading investment banks, Macquarie and Goldman Sachs, to advise on the offer and to manage the distribution of shares; and
- Various other specialist advisors.

As is customary, at the commencement of the IPO process, a due diligence committee ("DDC") was established. The DDC met 11 times prior to lodgement of the Prospectus with ASIC and twice following lodgement. The DDC was responsible for, among other things:

- (a) planning, implementing and overseeing the due diligence program to thoroughly validate the information contained in the Prospectus;
- (b) supervising the preparation of the Prospectus; and
- (c) ensuring that the Prospectus complied with the content requirements of the Corporations Act, that there were no omissions of any information required by the Corporations Act to be included in the Prospectus, and that no statement in the Prospectus was misleading or deceptive.

The Prospectus was reviewed by the Australian Securities and Investments Commission ("ASIC") and ASIC's comments were addressed prior to issuance of the final Prospectus.

<sup>25</sup> Stock holdings are often benchmarked across companies of different sizes by measuring how much stock is held in terms of number of days of future sales that level of stock holding will support. Stock holding in Figure 6 is calculated as current inventory balance divided by the last 12 months of cost of stock sold, multiplied by 365 days. Data sourced from public filings for Dick Smith, JB Hi-Fi and Best Buy, with balances taken from the closest reported date to the IPO of Dick Smith

<sup>26</sup> <http://www.asx.com.au/asxpdf/20140630/pdf/42qhzyp8plxhb.pdf>

At the date of the IPO, Dick Smith was in a very strong financial position with strong earnings momentum. In particular:

- Stock holdings were in line with comparable consumer electronics companies (as shown in Figure 6 above). This stock balance contained very little old or obsolete stock given the clearance activity that had taken place early in 2013.
- As at December 2013, one month after the IPO, Dick Smith had no borrowings and \$93M of cash and short term receivables (refer Schedule 3).

On completion of the IPO, Anchorage retained a 20% shareholding in Dick Smith. Those shares were subject to voluntary escrow until the release of Dick Smith's financial results for FY14<sup>27</sup>. Accordingly, at the time of the IPO, Anchorage remained the largest shareholder of Dick Smith (although following the IPO, Anchorage ceased to control Dick Smith).

The IPO issue price of \$2.20, which implied a total value of Dick Smith's shares of around \$520 million, was determined based on demand from institutional investors who participated in the IPO. The IPO price reflected the significant improvement in earnings as a result of the transformation program, the strong outlook for the company and its well-capitalised balance sheet. The offer was significantly over-subscribed.

Dick Smith's share price subsequently traded around the issue price of \$2.20 for approximately 21 months following the IPO (refer Schedule 1), until the release of financial results in August 2015 (nearly a year after Anchorage ceased to be a shareholder in the company and many months after Phillip Cave ceased to be a director). Regardless, the publicly traded value of a company's shares has no impact on its underlying operational performance.

#### Acquisition accounting adjustments

It has also been mistakenly speculated that the use of post-acquisition accounting adjustments may have misstated profits around the time of Anchorage's ownership. This is incorrect.

Post-acquisition balance sheet adjustments are required under Australian Accounting Standards for all acquisition transactions, not just private equity transactions, in order to reconcile the purchase price paid to the accounting carrying value of net assets acquired<sup>28</sup>.

Both the stock adjustment and fixed asset adjustment were determined with reference to reports provided by third party experts. The adjustments were determined in close consultation with Dick Smith's auditors, and in accordance with Australian Accounting Standards, were finalised almost a year after acquisition to allow time to monitor the appropriateness of the adjustments. In the case of stock adjustments, the auditors were able to review clearance activity in the second half of FY13 prior to the finalisation of the post-acquisition stock adjustments and release of the FY13 accounts. These accounts included an unqualified audit opinion from Dick Smith's auditor<sup>29</sup>.

The Prospectus presents both statutory financial statements that reflect the acquisition adjustments, proforma income statements that remove the impact of these and other non-recurring items, and reconciliations between both, together with detailed explanations. Furthermore, the Prospectus quantifies the sales impact of FY13 stock clearance and includes metrics such as EBITDA that ignore the impact of non-operating items and depreciation.

Section 5 of the Prospectus sets out this position clearly, in particular:

- (a) Section 5.3.1: Explains that FY13 statutory results were impacted by the acquisition accounting adjustments to stock and fixed assets, and that under Woolworths' ownership Dick Smith was audited as a division of Woolworths;
- (b) Section 5.4.2: Quantifies the sales impact of the stock clearance in FY13 under Woolworths prior to the sale to Anchorage, and during Anchorage's ownership;

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<sup>27</sup> Prospectus page 119

<sup>28</sup> AASB3, "Business Combinations"

<sup>29</sup> FY13 financial statements, page 5

- (c) Section 5.7.1: Reconciles FY13 proforma and statutory results, clearly isolating the impact of the acquisition adjustments (including stock and fixed asset adjustments) and depreciation, among other adjustments; and
- (d) Section 5.10: Contains a detailed explanation of historical results from FY11 to 1QFY14 (most recent accounting period before the IPO), highlighting where necessary the impact of non-recurring items, including stock clearance.

In accordance with ASX listing rules, ASIC policy and market practice, the financial statements in the Prospectus were reviewed by an independent investigating accountant<sup>30</sup>. Section 9 of the Prospectus contains the investigating accountant's report, which cites no issues with the Prospectus disclosures.

For those specifically interested in more detail on the mandatory acquisition accounting adjustments, the FY13 accounts contained additional disclosures. These accounts were filed with ASIC and were publicly available before the IPO.

***Phase 4: The period following the IPO until the date of Phillip Cave's resignation from the Board, when Anchorage's involvement with Dick Smith ended (the period from December 2013 to December 2014)***

Anchorage ceased to control Dick Smith on 4 December 2013, the date of the IPO, when Anchorage sold 80% of its shares in Dick Smith. Anchorage's chairman, Phillip Cave, remained on the Board as Chairman of Dick Smith in order to help with the transition associated with the business becoming a publicly listed company.

Following the IPO, Dick Smith performed strongly. In FY14, Dick Smith achieved financial results in line with the forecast included in the Prospectus<sup>31</sup>:

- (a) sales of \$1.228 billion relative to a Prospectus forecast of \$1.226 billion;
- (b) gross profit percentage of 25.1% relative to a Prospectus forecast of 25.1%; and
- (c) EBITDA of \$74.4 million relative to a Prospectus forecast of \$71.8 million.

By June 2014, Dick Smith's stock balance had increased by \$85 million relative to June 2013 (refer Schedule 3). As explained in Dick Smith's FY14 results presentation (refer Schedule 4 for the relevant extract), a significant driver of this increase was the addition of 54 new stores to the network, including taking over all of the operations (and stock) of the electronics department of David Jones. Management also acknowledged in the FY14 results presentation that at the time the stock level of the business was \$30 million too high.

Even with this level of investment in stock and growth in FY14, at the end of December 2014 Dick Smith had no borrowings and held more than \$98 million in cash and short-term receivables, higher than the same time a year earlier (refer Schedule 3). In other words, when Phillip Cave tendered his resignation from the Board of Dick Smith, the business had ample stock and a very well capitalised balance sheet.

***Phase 5: The period after December 2014***

Following Phillip Cave's resignation from the Board, Anchorage has had no formal involvement in the operations or governance of Dick Smith, and has had limited visibility as to the company's financial performance.

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<sup>30</sup> See ASIC Regulatory Guides 170, 228, 230, ASX Listing Rule 1.3.5

<sup>31</sup> FY14 annual report

On 18 August 2015, Dick Smith announced its results for FY15, which exceeded its results for FY14.<sup>32</sup> In particular, sales had grown to \$1.32 billion and EBITDA had increased to \$79.8 million. At the time of release of FY15 results, Dick Smith gave guidance of a profit increase in FY16, stating: “Anticipate NPAT between \$45m and \$48m in FY2016” (compared to \$43.4 million in FY15)<sup>33</sup>. Dick Smith declared a fully franked dividend of \$11.8 million (\$0.05 per share), which was subsequently paid in September 2015. This took the total dividends declared and paid by Dick Smith since the IPO to nearly \$50 million.

Dick Smith's share price traded around the issue price of \$2.20 for approximately 21 months following the IPO until the release of financial results in August 2015. Refer to Schedule 1 for the share price history since the IPO. Despite the fall in share price in August 2015, as a sign of confidence in the business, at the end of August 2015 CEO Nick Abboud and Chairman Robert Murray made further purchases of Dick Smith shares<sup>34</sup>.

The FY15 financial results showed that in June 2015, National Australia Bank, Bank of New Zealand and Hong Kong and Shanghai Banking Corporation agreed to provide a \$135 million debt facility to Dick Smith<sup>35</sup>. This facility replaced the smaller banking facility with Westpac Banking Corporation that was put in place in June 2014. In our experience, facility agreements of this nature involving banks of this reputation and standing are only entered into once the banks have completed substantial due diligence investigations. It appears that as recently as June 2015 (approximately 6 months before receivers were appointed), these banks felt the performance of, and outlook for, Dick Smith justified providing a significantly larger debt facility than the company had previously.

Dick Smith had drawn down \$70.5M in borrowings by year end June 2015, resulting in a net borrowings position of \$41.0M (refer Schedule 3). The decision to take on this borrowing was explained in Dick Smith's FY15 results statement as deliberate to “utilise balance sheet strength” to “take advantage of economies of scale, strong A\$ and branded supplier offers” to buy stock, which would drive growth and margin improvement in FY16. Dick Smith had \$293 million of stock at the end of FY15, relative to \$254M a year earlier, which was described as “clean inventory” (i.e. limited old or obsolete stock), with the increase reflecting the “timing of buying”<sup>36</sup>. These decisions to take on additional borrowings, as well as the decisions in relation to stock purchasing, were made many months after Anchorage's involvement with Dick Smith ended.

On 28 October 2015, in a trading update, Dick Smith stated “Reflecting this caution [based on recent trading], the Company presently anticipates FY2016 NPAT could be \$5 million to \$8 million below previous guidance of \$45 million to \$48 million”<sup>37</sup>.

This was followed by an announcement in November 2015 that, following a review of its stock and with the assistance of external consultants, “stock holdings remain above management's preferred levels” and that “the Board has determined that a non-cash impairment of \$60 million (pre-tax) is required”<sup>38</sup>. In that announcement, Dick Smith flagged that further impairments may be required, depending on Christmas trading. Dick Smith concluded that it was unable to re-affirm the profit guidance previously provided.

On 4 January 2016 the Directors of Dick Smith appointed McGrath Nichol as voluntary administrators<sup>39</sup>. Shortly thereafter the secured lenders appointed Ferrier Hodgson as receivers<sup>40</sup>.

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<sup>32</sup> FY15 annual report

<sup>33</sup> FY15 results presentation, page 22

<sup>34</sup> <http://www.asx.com.au/asxpdf/20150831/pdf/430yv7vl277b1j.pdf>,  
<http://www.asx.com.au/asxpdf/20150901/pdf/4310j5ps10kl6f.pdf>

<sup>35</sup> FY15 annual report, Note 24 “Debt Facilities”, page 82

<sup>36</sup> FY15 results presentation pages 11 – 13

<sup>37</sup> <http://www.asx.com.au/asxpdf/20151028/pdf/432gj7x5w1f89t.pdf>

<sup>38</sup> <http://www.asx.com.au/asxpdf/20151130/pdf/433dy00wqbgm4x.pdf>

<sup>39</sup> <http://www.asx.com.au/asxpdf/20160105/pdf/4346lly4rnwjc1.pdf>

<sup>40</sup> <http://www.asx.com.au/asxpdf/20160105/pdf/4346y44y9gj3yn.pdf>



## 6. Response to claims and criticism

Dick Smith is an iconic brand so understandably there has been significant media and public interest in the recent events surrounding the company. However, there has been some misinformed criticism of Anchorage's involvement with Dick Smith, including the specific suggestion that Anchorage's actions during its ownership period contributed to the financial difficulties that led to the appointment of administrators in January 2016. Publicly available information shows that such claims are misleading and factually incorrect. Specific points of criticism have been addressed in Schedule 5.

Certain critics have based their criticism of Anchorage on an article written by Forager Funds published on 29 October 2015<sup>41</sup>. This article contained many factual inaccuracies and erroneous conclusions. The article has since been discredited, including by the facts set out in this submission.

## 7. Role of the administrators

Since the appointment of administrators and receivers in January 2016 there has been significant speculation as to the causes of Dick Smith's financial difficulties. We understand that the role of the administrators includes to "investigate the company's business and financial circumstances", and to publish the findings in a publicly available report. Until the administrators' report is released, any claims or assertions as to the causes of Dick Smith's financial difficulties are purely speculation. In light of the scale and complexity of the Dick Smith business, the administrators have sought, and been granted, an extension of the deadline for filing their report until August 2016<sup>42</sup>.

As Phillip Cave resigned as chairman of Dick Smith almost 12 months ago, Anchorage has limited visibility into the facts and circumstances which resulted in the appointment of administrators and receivers. As mentioned above, when Anchorage's involvement with Dick Smith ended, the company was in a strong financial position, had no borrowings, and had strong earnings momentum. We await the release of the administrators' report which we hope will provide clarity on how a company with such a strong balance sheet and operating momentum has ended up in this regrettable situation so suddenly. Given the administrators' report has not yet been released, Anchorage may seek to contribute further to the Senate Inquiry following the release of the report.

The sudden and dramatic collapse of Dick Smith, an iconic and well respected brand in Australia's retail landscape, has had far reaching social and financial ramifications. Everyone at Anchorage shares the dismay felt by many regarding the recent circumstances at Dick Smith. We particularly feel for the management and employees, many of whom we know well. We welcome the Senate Inquiry and would be pleased to assist in any way we can.

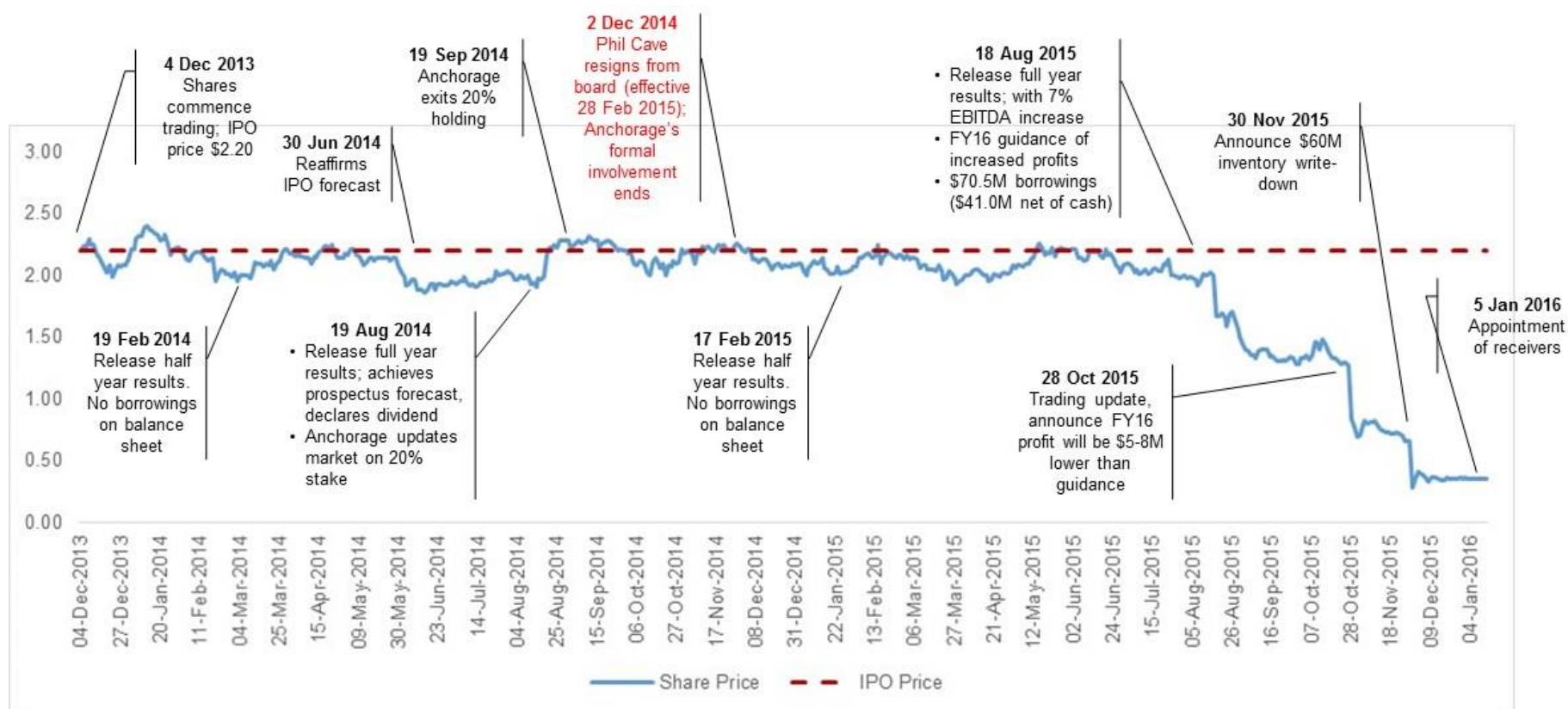
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<sup>41</sup> <https://foragerfunds.com/bristlemouth/dick-smith-is-the-greatest-private-equity-heist-of-all-time/>

<sup>42</sup> <http://asic.gov.au/about-asic/media-centre/key-matters/dick-smith-holdings-limited/>

## Schedule 1– Dick Smith share price trading history

- Share price traded around the issue price of \$2.20 until August 2015 (around 21 months post-IPO)
- In the last two weeks of February 2015 (the end of Anchorage’s formal involvement), the shares traded in the range of \$2.10 to \$2.25
- Dividends of \$0.20 per share (fully franked), totalling nearly \$50 million, were declared and paid since the IPO



Source: Factset, public announcements

# Schedule 2– Dick Smith’s transformation strategy (extract from the Prospectus)

## 4.1.3 Dick Smith’s transformation strategy

At the time of the Acquisition, Dick Smith was experiencing declining profitability. Following the Acquisition, the Dick Smith management team, led by Nick Abboud, rapidly implemented a comprehensive transformation program, positioning the business for sustainable growth. The program covered all areas of the business and addressed revenues, gross profits, costs and the balance sheet, as well as customer experience and internal culture. New management talent was also added to the business to complement the existing management team, to bring additional retail and transformation expertise and to provide management the capacity to progress multiple transformation and growth initiatives in parallel. Nick Abboud and the management team, with over 200 years of cumulative retail experience, also drove an internal cultural shift towards a customer-centric focus, a bias to action and accountability for results. In addition, the transformation program incorporated deep engagement of:

- customers, through a detailed program of customer surveys, engagement forums, and brand positioning studies;
- suppliers, through multiple presentations designed to inform suppliers of the new direction of Dick Smith, and Managing Director and CEO engagement with key suppliers; and
- employees, through new training programs, frequent communication updates and engagement forums to allow feedback and discussion.

An overview of the major initiatives under the transformation program, including the benefits already delivered and the benefits that the Company believes are still to be realised, is set out below.

### 4.1.3.1 Figure: Dick Smith’s transformation strategy

	Examples of initiatives	Benefits realised	Benefits still to be realised
<b>Stores and staff</b>	<ul style="list-style-type: none"> <li>■ Rolled out new store key performance indicator (“KPI”) dashboards to all stores</li> <li>■ Implemented new staff incentive model linked to KPI dashboards</li> <li>■ Implemented new staff rostering processes and staffing policies</li> <li>■ Implemented “Serve Forward” staff training program for in-store staff focused on customer service and empathy</li> <li>■ Improved in-store markdown policies</li> <li>■ Developed strong alliances with major landlords</li> <li>■ Improved recruiting profiles and policies</li> </ul>	<ul style="list-style-type: none"> <li>■ Improved store labour efficiency and profitability</li> <li>■ Improved in-store customer experience</li> <li>■ Improved gross margins through better promotion management</li> </ul>	<ul style="list-style-type: none"> <li>■ Opening of additional new stores (discussed further in Section 4.4) under a more profitable model</li> <li>■ Additional labour efficiencies from ongoing rostering refinements</li> <li>■ Ongoing staff productivity improvements</li> </ul>

	<b>Examples of Initiatives</b>	<b>Benefits realised</b>	<b>Benefits still to be realised</b>
<b>Suppliers and buying</b>	<ul style="list-style-type: none"> <li>■ Developed strategic relationships with key suppliers</li> <li>■ Renegotiated a number of supplier agreements (e.g. pricing and terms)</li> <li>■ Revamped range and mix of brands and products, and increased focus on mobility and private label</li> <li>■ Developed new pricing and promotional practices in collaboration with suppliers</li> <li>■ Opened new Hong Kong sourcing office and re-tendering of sourcing costs</li> <li>■ Improved buyer disciplines and accountability</li> <li>■ Improved collaboration between buying and operations</li> </ul>	<ul style="list-style-type: none"> <li>■ Store-in-store relationships with Apple and Samsung</li> <li>■ Mutually beneficial supplier agreements on commercially competitive terms</li> <li>■ Improved gross margins from pricing and product mix</li> <li>■ Clarity on range and price strategies</li> <li>■ Access to latest products and brands</li> </ul>	<ul style="list-style-type: none"> <li>■ Ongoing Apple and Samsung store-in-store roll out</li> <li>■ Continued range improvements through strengthening supplier relationships</li> <li>■ Further sales uplift from dynamic pricing and mix</li> <li>■ Improvements from ongoing supplier management and range reviews</li> <li>■ Continued improvements to private label mix and profitability</li> <li>■ Brand consolidation</li> </ul>
<b>Marketing</b>	<ul style="list-style-type: none"> <li>■ Developed new marketing program</li> <li>■ Implemented 'Dick Live Daily Deals'</li> <li>■ Renegotiated marketing supplier agreements</li> <li>■ Conducted extensive customer research and engagement</li> </ul>	<ul style="list-style-type: none"> <li>■ Substantial increase in marketing volumes, efficiency and 'share of voice', including greater frequency of catalogues and increased number of days of television commercials</li> <li>■ Improved collaboration with suppliers</li> </ul>	<ul style="list-style-type: none"> <li>■ Ongoing improvements to marketing of promotions and supplier collaboration</li> </ul>
<b>Inventory management and supply chain</b>	<ul style="list-style-type: none"> <li>■ Undertook significant clearance of aged and obsolete stock</li> <li>■ Improved stock management and ordering practices</li> <li>■ Upgraded store replenishment system</li> <li>■ Streamlined and right sized distribution network</li> <li>■ Optimised freight movements including adding direct to store and direct to customer shipping</li> <li>■ Optimised staffing to reflect new inventory levels</li> </ul>	<ul style="list-style-type: none"> <li>■ Significant reduction in aged and obsolete stock</li> <li>■ Reduction in freight and inventory handling costs</li> <li>■ Reduction in 'out of stocks'</li> </ul>	<ul style="list-style-type: none"> <li>■ Ongoing distribution centre optimisation</li> <li>■ Improvements to product returns processes</li> <li>■ Additional benefits from direct to store and direct to customer logistics</li> </ul>

	Examples of Initiatives	Benefits realised	Benefits still to be realised
<b>Omni-channel</b>	<ul style="list-style-type: none"> <li>■ Migrated website to new digital platform allowing greater flexibility, functionality, efficiency and customer experience</li> </ul>	<ul style="list-style-type: none"> <li>■ Improved visitation and sales through improved pricing, convenience, attachment and delivery functionality</li> </ul>	<ul style="list-style-type: none"> <li>■ Ongoing improvements to web platform and to functionality</li> <li>■ Roll out of delivery from store fulfilment to cover all of Australia and New Zealand</li> <li>■ Expansion of online product range beyond in-store range</li> <li>■ New delivery options and pricing</li> <li>■ Improved product ranging through in-store online portals</li> </ul>
<b>Other</b>	<ul style="list-style-type: none"> <li>■ Renegotiated all key contracts and procurement agreements</li> <li>■ Addressed excess space issues</li> </ul>	<ul style="list-style-type: none"> <li>■ Sustained lower and more flexible cost base</li> </ul>	<ul style="list-style-type: none"> <li>■ Head office functional efficiencies</li> <li>■ Ongoing store relocation/upgrade opportunities</li> </ul>

In Australia, these initiatives have already delivered significant improvements to Dick Smith's financial performance (detailed further in Section 5). The Directors believe that the significant increase in the underlying profitability of Dick Smith and the sustainability of the increase have been evidenced in the 1Q2014 results. In Australia, Dick Smith is now positioned for growth and has already commenced implementation of its growth plan (described in more detail in Section 4.4).

While these transformation and growth initiatives in Australia are well underway and are delivering significant benefits, the implementation in New Zealand commenced later, with many of the initiatives yet to deliver their full potential. At the time of the Acquisition, New Zealand operated functional reporting lines, where, for example, the head of buying reported into the head of buying in Australia. Following the Acquisition, the decision was made to hire a Director of New Zealand to bring increased focus to the New Zealand business given the different competitor, consumer and supplier dynamics in that market, delaying the implementation of some of the transformation initiatives. FY2014 is therefore anticipated to be a transition year for the New Zealand operations, reflecting the timing of the implementation of Dick Smith's transformation program. Management forecasts a significant improvement in New Zealand EBITDA in FY2014, despite a decline in like for like sales. The key transformation initiatives being implemented in FY2014, which are expected to drive the improvement in gross margin and the cost of doing business ("CODB"), include a new pricing structure, improved vendor terms, store productivity improvements and marketing methodology.

In addition to these transformation initiatives, Dick Smith's management undertook a wide range of programs to transition Dick Smith away from Woolworths' shared services and policies. The majority of the transition services are now complete, with the remaining minor transitions expected to complete within FY2014. These include Woolworths' stocktake resource, alarm monitoring, pallet services, time and attendance, and data management services. Dick Smith continues to use Woolworths' switch services, covering payments and gift cards.

COMPANY OVERVIEW Dick Smith Holdings Limited PROSPECTUS | 35

Source: Prospectus pages 33-35

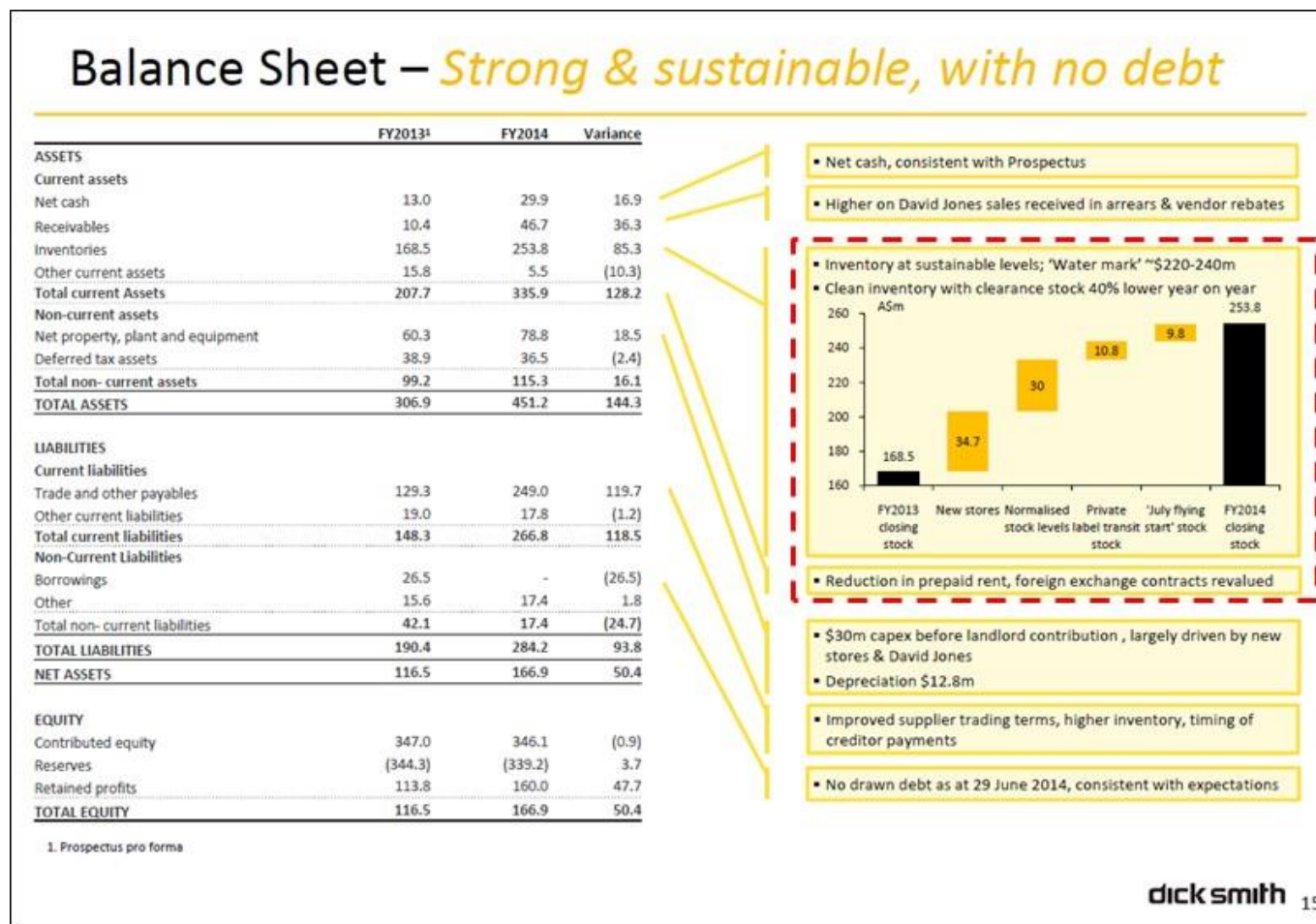
## Schedule 3– Dick Smith balance sheets

	Jun-13	Dec-13	Jun-14	Dec-14	Jun-15
Cash and Cash Equivalents	46.5	65.2	29.9	17.9	29.5
Trade and Other Receivables	10.4	27.6	46.7	79.6	53.3
Inventories	168.5	238.8	253.8	335.8	293.0
Current Tax Receivables			2.0		10.5
Financial Assets	5.6	2.4	--	5.0	1.8
Other Current Assets	10.1	3.7	3.4	6.3	1.9
<b>Other Current Assets</b>	<b>15.7</b>	<b>6.1</b>	<b>5.5</b>	<b>11.3</b>	<b>14.1</b>
<b>Total Current Assets</b>	<b>241.2</b>	<b>337.7</b>	<b>335.9</b>	<b>444.7</b>	<b>390.0</b>
Plant & Equipment	60.3	70.9	78.8	86.7	92.5
Deferred Tax Assets	42.9	31.8	36.5	28.7	26.0
<b>Total Non-Current Assets</b>	<b>103.1</b>	<b>102.7</b>	<b>115.3</b>	<b>115.5</b>	<b>118.5</b>
<b>Total Assets</b>	<b>344.3</b>	<b>440.4</b>	<b>451.2</b>	<b>560.1</b>	<b>508.5</b>
Trade and Other Payables	153.3	263.8	247.7	337.9	228.4
Lease Liabilities	--	--	1.4	1.1	1.9
<b>Trade and Other Payables</b>	<b>153.3</b>	<b>263.8</b>	<b>249.1</b>	<b>339.0</b>	<b>230.4</b>
Borrowings	--	--	--	--	70.5
Provisions	16.1	15.4	13.6	12.6	13.3
Financial Liabilities	--	--	1.3	--	--
Current Tax Liabilities	--	--	0.0	3.7	--
Deferred Income	2.9	2.6	2.8	3.0	2.4
<b>Other Current Liabilities</b>	<b>19.0</b>	<b>17.9</b>	<b>17.7</b>	<b>19.3</b>	<b>15.7</b>
<b>Total Current Liabilities</b>	<b>172.3</b>	<b>281.8</b>	<b>266.8</b>	<b>358.3</b>	<b>316.5</b>
Provisions	13.9	11.3	7.3	8.4	6.1
Lease Liabilities	1.7	4.0	10.1	14.4	16.8
<b>Total Non-Current Liabilities</b>	<b>15.6</b>	<b>15.3</b>	<b>17.4</b>	<b>22.8</b>	<b>22.8</b>
<b>Total Liabilities</b>	<b>187.9</b>	<b>297.0</b>	<b>284.2</b>	<b>381.1</b>	<b>339.4</b>
<b>Net Assets</b>	<b>156.5</b>	<b>143.3</b>	<b>166.9</b>	<b>179.1</b>	<b>169.1</b>

Source: Dick Smith public filings. Note the FY13 figures, including inventory of \$168.5 million, are sourced from the FY13 statutory accounts and FY14 results presentation, which differ slightly from the figure in the FY14 annual reports of \$170.8 million.

## Schedule 4 – Drivers of stock increases after the IPO

**FY14:** Results presentation, page 15, describing the drivers of stock increases in that year:



**FY15:** Results presentation, page 11, describing the drivers of stock increases in that year:

## Balance Sheet – *Positioning for sustainable growth*

\$m	28 Jun 2015	29 Jun 2014	Variance
Cash & Cash Equivalents	29.5	29.9	(0.4)
Receivables	53.3	46.7	6.6
Net Inventory	293.0	253.8	39.2
Other Current Assets	14.1	5.5	8.6
<b>Current Assets</b>	<b>390.0</b>	<b>335.9</b>	<b>54.1</b>
Property, Plant & Equipment	92.5	78.8	13.8
Deferred Tax Assets	26.0	36.5	(10.5)
<b>Non-Current Assets</b>	<b>118.5</b>	<b>115.3</b>	<b>3.3</b>
<b>Total Assets</b>	<b>508.5</b>	<b>451.2</b>	<b>57.4</b>
Interest-bearing Liabilities	70.5	-	70.5
Trade & Other Payables	230.4	249.1	(18.7)
Other Current Liabilities	15.7	17.7	(2.1)
<b>Current Liabilities</b>	<b>316.5</b>	<b>266.8</b>	<b>49.7</b>
Other	22.8	17.4	5.4
<b>Non-Current Liabilities</b>	<b>22.8</b>	<b>17.4</b>	<b>5.4</b>
<b>Total Liabilities</b>	<b>339.4</b>	<b>284.2</b>	<b>55.2</b>
<b>Net Assets</b>	<b>169.1</b>	<b>166.9</b>	<b>2.2</b>
Issued Capital	346.1	346.1	0.0
Reserves	(339.4)	(339.2)	(0.2)
Retained Earnings	162.5	160.0	2.4
<b>Total equity</b>	<b>169.1</b>	<b>166.9</b>	<b>2.2</b>

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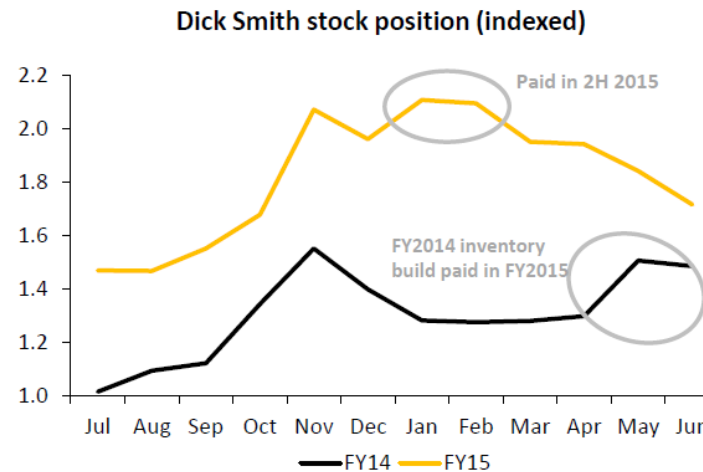
- Concession sales (received in arrears) & vendor rebates
- Clean inventory, with increase reflecting timing of buying
- Private label stock to increase as PL mix improves
- \$31.6m capex, largely driven by new stores & online investment
  - Depreciation \$14.8m
- New facility in place - greater financial flexibility & better terms
  - \$41.0m Net Debt, reflecting timing of stock purchases
- Improved supplier trading terms, higher stock levels offset by timing of creditor payments
- Primarily lease liabilities



**FY15:** Results presentation, page 13, explaining the decision to increase investment in stock to benefit the company in subsequent periods:

## Balance sheet – *Utilising strength to drive growth*

- Utilised balance sheet strength & bought stock before currency-fuelled COGS increases
  - Timing of investment took advantage of economies of scale, strong A\$ and branded supplier offers
- Earlier payment of suppliers resulted in \$41m net debt, higher stock & lower payables
- Impact anticipated to unwind in 1H2016
- Higher stock weight in Private Label & accessories to benefit FY2016
- Resulted in Gross margin uplift in 4Q 2015 ~20bp, offsetting related higher interest cost



dick smith

ELECTRONICS  
POWERED BY dick smith



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## Schedule 5 – Responses to specific criticism of Anchorage

There has been some misinformed and factually incorrect criticism of Anchorage’s involvement with Dick Smith. Major points of criticism are addressed below.

Claim	Facts
<p><b><i>Dick Smith was in poor financial health when Anchorage’s involvement ended</i></b></p>	<p>Dick Smith was in a strong financial position with strong earnings momentum both at the time of the IPO and when Phillip Cave tendered his resignation from the Board in December 2014, which ended Anchorage’s formal involvement with the company.</p> <ul style="list-style-type: none"> <li>• Balance sheet: Anchorage left Dick Smith with a well-capitalised balance sheet <ul style="list-style-type: none"> <li>○ At the time of the IPO, Dick Smith only had \$27 million in temporary borrowings (\$14 million in borrowings net of cash) on a working capital line of credit to fund the seasonal increase in stock for the upcoming holiday season, a very small amount of borrowing for a company of Dick Smith’s size. Borrowings were zero by the end of December 2013 following this holiday trading season, one month after the IPO.</li> <li>○ At the time Phillip Cave tendered his resignation in December 2014, Dick Smith had no borrowings, \$98 million in cash and short-term receivables, and stock levels that were much higher than comparable consumer electronics businesses<sup>43</sup>;</li> </ul> </li> <li>• Earnings: Dick Smith had strong earnings momentum at the time of IPO and when our formal involvement ended. The company achieved the Prospectus forecast in FY14, grew sales and earnings again in FY15, and in August 2015 gave guidance of further profit improvement in FY16; and</li> <li>• Share price: Dick Smith’s shares traded around the IPO price until as recently as August 2015 (around 21 months after the IPO). The company also declared and paid \$0.20 per share in fully franked dividends since the IPO, a total of almost \$50 million in dividend payments.</li> </ul>
<p><b><i>Clearance of stock by Anchorage during its ownership contributed to the financial issues the business faces today</i></b></p>	<p>At the time of the acquisition by Anchorage, Dick Smith carried significant amounts of old and obsolete stock, partially driven by the store closure program undertaken by Woolworths prior to sale, which resulted in a ~23% reduction in the number of stores between the beginning of FY11 and the date of the acquisition by Anchorage.</p> <p>At the time of the IPO, after the clearance program, stock levels were still higher than comparable consumer electronics businesses<sup>44</sup>, as shown in Figure 6 above. The stock clearance also meant that the stock contained limited old or obsolete items, and therefore stock was very ‘clean’ at the time of the IPO.</p> <p>Following the IPO, stock levels increased again, the drivers of which are clearly explained by management in the FY14<sup>45</sup> and FY15<sup>46</sup></p>

<sup>43</sup> Based on analysis of days of stock held relative to JB Hi-Fi and Best Buy

<sup>44</sup> Based on analysis of days of stock held relative to JB Hi-Fi and Best Buy

<sup>45</sup> FY14 results presentation, page 15

<sup>46</sup> FY15 results presentation, page 11

Claim	Facts
	<p>results presentations. Relevant extracts from these presentations are included in Schedule 4. The increases were largely driven by the company opening new stores (including taking over David Jones' electronics departments) to drive future increases in sales and profits. In both years management also acknowledged they were carrying stock levels that were surplus to requirements at the time. In neither year did management explain the stock increase as being caused by having too little stock in previous years.</p> <p>When Phillip Cave tendered his resignation in December 2014, stock levels were significantly higher than comparable consumer electronics businesses<sup>47</sup>, but Dick Smith still had no borrowings and \$98 million of cash and short term receivables. In other words, at this time the business had significant holdings of stock but still had a very strong balance sheet. So it is incorrect to suggest that Anchorage could have contributed to any stock issues that Dick Smith may have experienced in the past 6 to 12 months.</p> <p>Some critics have focused on the significant reduction in stock holdings between November 2012 (time of acquisition) and June 2013, asserting that this change was the result of stock clearance activity. This is completely misleading as much of this movement reflects the natural seasonality of the business. Stock tends to peak around November prior to the important holiday period, with cyclical lows occurring around June. As such, comparison of these two different points in time in the annual cycle is irrelevant.</p>
<p><b>Acquisition accounting adjustments, particularly stock provisions, impacted reported profits in FY13 and FY14</b></p>	<p>Post-acquisition balance sheet adjustments are required under Australian Accounting Standards for all acquisitions, not just private equity transactions, in order to reconcile the purchase price paid to the accounting carrying value of net assets acquired. Both the stock adjustments and fixed asset adjustments were determined with reference to reports provided by third party experts. The adjustments were determined in close consultation with Dick Smith's auditors, and in accordance with Australian Accounting Standards and were finalised almost a year after acquisition to allow time to monitor the appropriateness of the adjustments. In the case of stock adjustments, the auditors were able to review clearance activity in the second half of FY13 prior to the finalisation of the post-acquisition adjustments and release of the FY13 accounts. These accounts included an unqualified audit opinion from Dick Smith's auditor. The Prospectus also contained detailed disclosures on the acquisition adjustments.</p> <p>With respect to stock, \$58 million in stock provisions were taken to the acquisition balance sheet to reflect the significant balance of old and obsolete stock at the time of acquisition. As described above, this old and obsolete stock was partially a legacy of the Woolworths store closure program prior to the sale of Dick Smith to Anchorage. The clearance of this stock occurred in FY13 and had no impact on FY14 results<sup>48</sup>. In FY13, the clearance had the effect of boosting sales, the impact of which was quantified in the Prospectus<sup>49</sup>. The clearance also impacted statutory profits<sup>50</sup>, so an adjustment was</p>

<sup>47</sup> Based on analysis of days of stock held relative to JB Hi-Fi and Best Buy

<sup>48</sup> Prospectus page 65, "...new management of Dick Smith implemented a further inventory clearance program from 26 November 2012 to 30 June 2013."

<sup>49</sup> Prospectus page 56

<sup>50</sup> Prospectus page 65, "...the magnitude of the price discounting meant that gross profit margins on these sales were significantly reduced."

Claim	Facts
	made to FY13 profits to reverse the impact of the acquisition adjustments, including the stock provisions <sup>51</sup> .
<p><b><i>Anchorage was an irresponsible owner of the business, and cut costs too far</i></b></p>	<p>At the time of the acquisition of Dick Smith by Anchorage, Dick Smith's cost base was higher than comparable consumer electronics companies (refer Figure 5 above). This was partially a legacy of the store closure program by Woolworths prior to sale. In order to normalize the cost base, the transformation program included several initiatives to address costs, as outlined in Phase 2 above. At the same time significant investment was made in staff, stores, marketing/branding, range/suppliers, operations and IT systems.</p> <p>This transformation program and investment caused EBITDA to increase from \$23.4 million in FY13 to \$74.4 million in FY14, and set Dick Smith on a path to the increased profit achieved in FY15. The cost base remained higher than comparable consumer electronics businesses throughout this time, as shown in Figure 5 above. Therefore it is not logical to suggest cost reduction activities during Anchorage's ownership period somehow caused the financial issues experienced by Dick Smith today.</p>
<p><b><i>Anchorage caused the private label issues that are alleged to have contributed to the financial issues the business faces today</i></b></p>	<p>Anchorage has no knowledge as to whether or not Dick Smith's private label strategy or inventory have contributed to the financial issues that caused the appointment of administrators. However, private label has long been a part of Dick Smith's business model, and the sales mix of private label declined during our ownership.</p> <p>Private label is a significant trend in nearly all retail categories globally, given the higher gross margins that can be generated. Nielsen states that private label penetration in Australia across all retail categories increased from 14% in 2010 to 21.3% in 2013/14<sup>52</sup>. Many consumer electronics companies including Best Buy and JB Hi-Fi sell private label products.</p> <p>Dick Smith has long been a trusted name in certain private label product categories. Indeed, we understand that when Dick Smith was founded the significant majority of its product range was branded "Dick Smith".</p> <p>During our ownership, private label as a percentage of sales actually decreased as a result of the restructure of the product range and supplier relationships. At the time of the acquisition of Dick Smith by Anchorage, private label as a percentage of total sales was 13-14%<sup>53</sup>. By the time of the IPO, at the end of our ownership, private label as a percentage of total sales had decreased to ~10%<sup>54</sup>. So to allege that Anchorage started Dick Smith's private label strategy is inaccurate.</p> <p>As outlined in the Prospectus, at the time of the IPO, Dick Smith management was "focused on increasing sales and margins of private label products through an expanded private label product range, revised price and cost positioning, new product packaging, and the possible creation of an additional portfolio of private label brands"<sup>55</sup>. We note that the FY15 annual report states that management's goal at that time (August 2015) was to increase</p>

<sup>51</sup> Prospectus page 62, which reconciles FY13 statutory and proforma income statements, including the adjustment for "Discount on Acquisition" which reflects the provisions taken at the time of acquisition

<sup>52</sup> Nielsen Global Private Label Report, November 2014

<sup>53</sup> Sale process management presentation, dated February 12, page 17; vendor financial due diligence report

<sup>54</sup> Prospectus page 38

<sup>55</sup> Prospectus page 48

Claim	Facts
	<p>private label mix to 15% of sales<sup>56</sup>, a level only marginally above the mix of sales at the time of acquisition by Anchorage. A Morgan Stanley analyst report from 2014 estimated at this time Dick Smith's private label mix was 11%<sup>57</sup>, which is still below the level when the business was acquired by Anchorage.</p>
<p><b><i>Anchorage paid too little for the business when it was acquired from Woolworths</i></b></p>	<p>The price paid for Dick Smith by Anchorage has no bearing on Dick Smith's current financial position. Likewise, the IPO price and subsequent trading price of Dick Smith's shares have no bearing on Dick Smith's current financial position.</p> <p>Anchorage's proposal was the most attractive received by Woolworths following a lengthy global sale process conducted by a leading investment bank. At the time the business was suffering from lack of management attention and investment as an orphan division of Woolworths. It had experienced significant earnings declines and Woolworths had closed a significant number of stores. All of these factors contributed to an uncertain outlook for Dick Smith at the time, which was exacerbated by the uncertain outlook for the broader economy and worldwide retail sector. Woolworths received \$115M for the business, representing ~5x FY13 EBITDA for a business with declining earnings and an uncertain future.</p>

<sup>56</sup> FY15 annual report, page 4

<sup>57</sup> "JB Hi-Fi – 10 reasons to upgrade", Morgan Stanley, 15 April 2014

# Schedule 6 – Extract from AFR Chanticleer article, 11 February 2016

Extract from Chanticleer column in the Australian Financial Review, 11 February 2016

## **Forager's Inaccuracies**

In response to comments by the chief investment officer of Forager Funds Management, Steve Johnson, and his numerous anonymous supporters on his blog, Chanticleer is providing some of the inaccuracies in a report on Dick Smith Holdings published by Forager in October last year.

To put it in context, Anchorage Capital Partners bought Dick Smith from Woolworths in 2012 on deferred terms of \$94 million. It later listed the business in 2013 at a value of \$520 million.

The Forager blog was titled "Dick Smith is the greatest private equity heist of all time". In other words the starting point of the analysis was that Anchorage was run by thieves, robbers and white-collar criminals.

Forager's analysis suggests Anchorage misled investors and used acquisition-accounting adjustments to misrepresent the 2014 net profit forecast in the prospectus. If that is true Anchorage executives are headed for jail.

Forager said that \$55 million in plant and equipment write-downs in 2012 reduced the annual depreciation charge by \$15 million.

"Throw in a few onerous lease provisions and the like, totalling roughly \$10 million, and you can fairly easily turn a \$7 million 2013 profit into a \$40 million forecast 2014 profit," Forager said.

But page 55 of the prospectus shows the 2012 depreciation and amortisation was \$12.5 million. The 2014 depreciation was higher than 2013 at \$12.8 million reflecting the 45 per cent increase in fixed assets in the year due to investment in new stores and the takeover of David Jones Electronics department.

Forager's \$15 million depreciation number is plainly wrong. It suggests an average life of assets of less than four years whereas page 61 of the annual accounts says the useful life is five to 10 years for leasehold improvements and plant and equipment.

Notes to the 2014 accounts show the movement in provisions in the year to June 2014 was \$6.9 million, not \$10 million.

Dick Smith met its prospectus forecast in 2014 and reported a higher profit in 2015.

Forager's blog said that Anchorage liquidated inventory as fast as possible to generate cash and pull it out of the business.

In November 2012, Dick Smith had inventory that cost \$371 million but which had been written down to \$312 million. Forager said that by June 30, 2013, inventory had dropped to \$171 million producing a "monstrous" \$140 million benefit to operating cash flow "basically from selling lots of inventory and then not restocking".

The comment about the write-down in inventory ignores the fact that Woolworths closed more than 100 stores between June 2011 and June 2013. The net reduction in stores was 93 or 22 per cent of stores at June 2011 and it left an inventory hangover. The excess inventory was written down of \$58 million after a valuation by Hilco Valuation Services and in accordance with fair value adjustments required under Australian accounting standards for all acquisitions.

For the Forager conspiracy theory on profit manipulation to work it must also include the independent auditors who reviewed the valuations. The acquisition adjustments and the impact on earnings were disclosed on page 62 of the prospectus.

Forager claimed that most of the marked-down inventory was probably sold by June 2013 "but there would still be some benefit flowing through to the 2014 financial year".

But pages 56 and 65 of the prospectus show that all inventory clearance and associated provisions occurred in the 2013 financial year.

Forager says new shareholders "footed the bill" for repurchasing inventory which by the end of 2014 was \$254 million. It cited the \$95 million increase in trade payables. But it ignores all other elements of

working capital including cash, receivables and inventory. The net change in working capital accounts was \$17 million which could fund sales and profit growth the following year.

The usual way for comparing inventory levels is stock turn which is cost of goods sold divided by inventory. Dick Smith's stock turn was below comparable companies when bought by Anchorage but at the time of the receivership its stock turn was in line with competitors.

Its stock turn fell below comparable companies in 2014 but that was explained in the 2014 accounts.

Forager says all the moves made by Anchorage came home to roost in 2015. This ignores the fact the company's financial performance had improved for two years straight. After Anchorage had severed ties with the company, Dick Smith's management felt so confident about the business it issued a profit forecast.

There is one mystifying aspect of Johnson's response to Chanticleer's column earlier in the week. He promotes his links with The Australian Financial Review on the same website that is used as a platform for anonymous people to trash the Financial Review.

The Financial Review logo is on the Forager home page. I assume he pays something for that privilege but it is unfortunate because it suggests that this masthead endorses a fund manager with a poor track record for managing money in international markets.

The actively managed Forager International Fund has been unable to beat its benchmark over the past six months, over two years or since its inception as the Intelligent Investor International Fund.