

## UK TRIP OBSERVATIONS

Checking in on our investments with offshore operations.

### INVESTMENT INSIGHTS

During the period we visited the UK and Ireland to see a few of our portfolio holdings with offshore operations.

### NICK SCALI – UK EXPANSION

Nick Scali has been a long-term holding in the Fund. The business demonstrates all the characteristics we look for in an investment: net cash balance sheet, market-leading position in the sofa category domestically with best-in-class operating margins, a founder-led management team with Anthony Scali at the helm for the past 20 years, and an attractive valuation. In April 2024, after many years of market diligence, the company made the decision to enter the UK via the acquisition of furniture retailer Fabb Furniture ('Fabb'), gaining access to an initial store network of 21 stores. While the loss-making Fabb was acquired for just £2, the company raised A\$50m to fund store refurbishments and working capital. We consider this a relatively low-risk entry to a new geography.

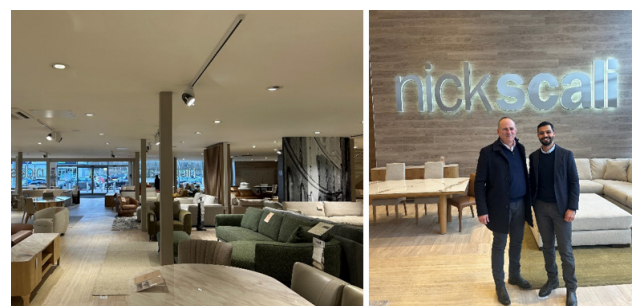
We met with Rodd Orrock (Head of Nick Scali UK) at one of Nick Scali's recently converted stores in Thurrock (just outside of London) to get an update on the progress of converting stores to Nick Scali branding and product as well as the initial customer response. We walked away positively disposed towards the transaction and made the following key observations:

- Nick Scali's product range is unique relative to local competitors, with a more modern look and brighter colour palettes. Some adjustments need to be made to dining and coffee table sizes to account for smaller houses in the UK. Nevertheless, Anthony on the most recent results call noted the best-selling sofa in the UK is the same as the best seller in Australia.
- To date, six stores have been converted to Nick Scali format in the UK and these stores are all located in retail parks outside the major city centres. Anecdotally, foot traffic at these retail parks is high and indeed the Lakeside Retail Park we visited rivals

some of Sydney's busiest centres such as the Moore Park Supa Centa.

- There are ~30m dwellings in the UK vs ~11m in Australia so the market opportunity is significant. Given population density is higher as well, management expect the UK stores to generate higher sales per square metre than Australia.
- Conversion rates to date have been solid at ~75% on customer quotes, but store traffic remains below Australian levels, indicating the brand is still building awareness among customers.
- Interest-free promotions are highly advertised in store. Unlike Australia, ~40% of transactions in the UK are done using interest-free credit for terms of between 6 and 48 months.
- Some operating cost synergies have already been realised with the Fabb headcount reduced from 270 people to 120 by leveraging the Australian operations for key functions such as buying and marketing.
- Pre-acquisition, Fabb was generating gross margins of just 41% vs 65% for Nick Scali in ANZ. Nick Scali has made changes to the way sales staff operate, removing on-floor discounting and customer returns, which lifted gross margins immediately. As they start to sell more Nick Scali product that is sourced from low-cost Asian factories, gross margins are expected to move into the high 50s.

While it remains early days, we are optimistic the brand will gain traction in the UK market.



## CHEMIST WAREHOUSE – IRELAND

Another portfolio company we visited was Chemist Warehouse in Ireland where we met with local CEO and joint venture partner Colin Galligan. Chemist Warehouse has been operating in Ireland for five years now and our key observation was that the discount pharmacy model is gaining traction. Anecdotally, Aldi and Lidl entered the Irish market 20 years ago and from a standing start have been able to capture a combined 26% market share, completely disrupting the local grocery industry. We believe Chemist Warehouse is on a similar trajectory.

We visited three stores in Dublin (Blanchardstown, Henry St and Talbot St) and store traffic was elevated at each for Tuesday morning trade. Store layouts are similar to Australia with shelves stacked above eye-level with pink and yellow price stickers creating what management describe as ‘theatre’ in the stores. Most pharmacies in Ireland have a dispensing counter near the front of the store and are focused on prescription medicines. Chemist Warehouse flips this model by placing the dispensary at the back of the store and typically sells more ‘front of shop’ items; e.g., vitamins, fragrances, skincare. The average pharmacy in Ireland is generating a healthy gross margin of 40%, which allows Chemist Warehouse to undercut prices by 20-30%. These discounts drive a disproportionate increase in sales volumes, which allow Chemist Warehouse to generate significant operating leverage on its fixed costs (labour and rent) and effectively earn a similar profit before tax margin of ~10%.

Some other observations we made:

- Relaxed pharmacy ownership rules have allowed Chemist Warehouse to acquire larger sites in Ireland with the Blanchardstown store we visited occupying ~1,000 sqm vs the ~500 sqm average in Australia.
- Sales mix is over 90% skewed to ‘front of shop’ items, indicating the local consumer still doesn’t view them as a traditional pharmacy. Management have adapted the range to stock more Irish brands but have also kept Australian brands where it makes sense (e.g., Bondi Sands in sunscreen).

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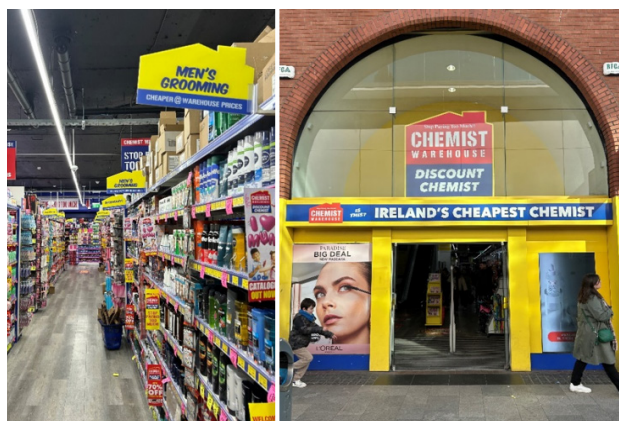
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- Chemist Warehouse is yet to introduce higher-margin private label products as they are looking to build trust with the consumer by stocking big-name brands such as L’Oréal. They are also in the process of building their own warehouse; this should allow for better inventory management and lays the foundation for launching an e-commerce offering.
- There are ~2,000 pharmacies in Ireland and the market remains highly fragmented with ~60% of the market comprising operators with only one or two pharmacies.
- Boots, a key competitor in Ireland with 92 stores, has been aggressive in securing exclusive leases with shopping centres to limit these precincts to one pharmacy. This has made it difficult to secure new sites and Chemist Warehouse have adapted by taking on bulky goods centres and high street locations.

Chemist Warehouse currently has 12 stores in Ireland and is aiming for 15 stores by the end of June. We think 40-50 stores is a realistic long-term target. If they are successful in capturing market share in Ireland, we expect Chemist Warehouse to enter the UK where Boots is also the major competitor.

By Vinay Ranjan, Deputy Portfolio Manager



Left: Aisle in Blanchardstown store and Right: Henry St shop front

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