

MC GROUP

Management Discussion and Analysis for Q2 FY2019 (October – December 2018) and for six-month period FY2019 (July – December 2018)

Economic outlook and retail industry

Thailand's overall economic growth has continued to rely mainly on exports and tourism which have withered under the weight of global uncertainties, e.g. economy and politics from powerful countries and disturbed by sharp decline in Chinese tourists in some periods. In addition, the overall retail industry has grown at declining and lower rate than GDP's growth since year 2015.

In the first half of year 2019, the big picture and direct impacts toward trade and investment are related to the political stability after the election, GDP (Gross Domestic Product) number, exports and public investments, tourism, agricultural product prices including household debt to GDP accelerated at 78% due to mainly increasing of auto loan, home loan and personal loan. (Source: Business Outlook Report 4Q2018 Bank of Thailand and Thai Retailers Association)

Overall Business Performance

Income Statement:

(THB millions)	2Q FY19	2Q FY18	% chg	FY2019	FY2018	% chg
	October-December 2018	October-December 2017		July-December 2018	July-December 2017	
Sales revenue	1,099	1,194	(7.9%)	1,914	2,084	(8.2%)
Total revenue	1,114	1,215	(8.3%)	1,936	2,113	(8.4%)
COGS	480	546	(12.2%)	807	963	(16.2%)
Selling expenses	306	323	(5.3%)	572	599	(4.5%)
Administrative expenses	111	121	(8.6%)	227	241	(5.6%)
Earnings before share of profit (loss) from JV	217	224	(2.8%)	330	311	6.2%
Share of profit (loss) from JV	(1)	9	(105.8%)	(10)	14	(170.3%)
EBIT	217	233	(6.8%)	320	324	(1.3%)
Finance cost	(0)	1	(105.5%)	0	1	(98.7%)
EBT	217	232	(6.5%)	320	323	(0.9%)
Income tax expenses	21	27	(21.3%)	27	29	(6.2%)
Net income	196	206	(4.6%)	293	294	(0.4%)
Non-controlling interest	(6)	(7)	(16.6%)	(9)	(11)	(13.4%)
Net income to the firm	190	198	(4.2%)	284	283	0.1%
Gross profit margin	56.4%	54.3%		57.9%	53.8%	
Net profit margin	17.0%	16.3%		14.7%	13.4%	

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For Q2 FY2019 (October – December 2018)

Mc Group Public Company Limited (“the Company”) reported its total sales revenue of THB 1,099 mn. in Q2 FY2019, a decrease of 7.9% or equivalent to THB 95 mn. from the same period last year amidst continued spending contraction and household debt rise from prior year resulting the Company's lessen degree of promotion and managed more efficiency of some distribution channel for keeping overall business performance on track.

Consequently, the control of discount pricing in free standing shop affected same store sales slipped by 7.2% from the same period last year which was close to total sale revenue thanks to new stores opening from 894 POS to 927 POS and better performance from local department stores after inventory program management. Nevertheless, if compare with last quarter (July – September), total sales revenue increased by 34.8% or equivalent to THB 284 mn. from retail season which current quarter (October – December) is the highest retail season.

As result of continued cost management and sale boost policy from activities matching with societal trend and consumer lifestyle rather than promotion, the Company recorded overall gross profit of THB 620 mn. or a 4.3% decrease from the same period in calendar year, with the higher gross profit margin of 56.4% from 54.3% from the same period last year. Gross profit margin of the apparel business was 57.9% increased from 55.5% and for watch business, gross profit margin fell to 47.6% from 50.9% from the same period last year.

Selling, general and administrative (SG&A) expenses were at THB 417 mn. a fall of 6.2% or THB 28 mn. from the same period last year, mainly due to lower marketing support and selling expenses amidst consumption slowdown. SG&A expenses to total sales revenue edged up to 37.9% from 37.2% in the same period last year from decreased total sales revenue.

The Company's earnings before interest, taxes, depreciation and amortization (EBITDA) was at THB 249 mn. decreased by 7.6% or equivalent to THB 21 mn. from the same period last year but in less ratio than total sales revenues, resulting in an EBITDA margin of 22.3%, which rose from 22.2% in the same period of prior year.

The Company registered a net profit of THB 190mn., down 4.2% or equivalent to THB 8 mn. from period of October - December 2017 with net profit margin at 17.0% increased from 16.3% as a result of gross profit margin and more efficiency of cost management.

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For six-month period FY2019 (July to December 2018))

From overall business performance in Q2 FY2019 and above-said economic outlook, the Company reported its total sales revenue for the 6-month period FY2019 of THB 1,914 mn., declined by 8.2% or equivalent to THB 170 mn. from the same period last year resulting in same store sales which dropped by 6.9% from the period of July to December 2017.

Nevertheless, the Company recorded higher gross profit margin at 57.9% from 53.8% in the same period last year resulting in overall gross profit of THB 1,107 mn. or a 1.3% decrease from the period of July to December 2017. Gross profit margin of the apparel business was 59.5% increased from 54.9% and for watch business, gross profit margin fell to 49.8% from 52.5% from the same period last year.

Selling, general and administrative (SG&A) expenses for the 6 months period FY2019 were at THB 800 mn. a fall of 4.8% from the same period last year or THB 41 mn. mainly due to lower marketing support and selling expenses. SG&A expenses to total sales revenue edged up to 41.8% from 40.3% in the same period last year.

The Company's earnings before interest, taxes, depreciation and amortization (EBITDA) was at THB 385 mn. decreased at 3.6% or equivalent to THB 14 mn. from the period of July – December 2017 but in less ratio than total sales revenue resulting in EBITDA margin of 19.9%, up from the same period last year which EBITDA margin was at 18.9%.

The effective tax rate for the 6 months period FY2019 stood at 8.4% due to the tax privileges under Investment Promotion Act granted to the Company's subsidiary. These tax privileges will gradually expire in 2019 and 2021.

The Company registered a net profit of THB 284mn., an increase 0.1% or equivalent to THB 1 mn. shift to 14.7% from 13.4% from the same period last year (July – December 2017) due to higher gross profit margin.

Remark: Change of accounting period and new international financial reporting standards adoption

MC Group Public Company Limited and its subsidiaries ("MC" or "the Company") changed in accounting period starting from 1st January to 31st December to the period from 1st July to 30th June, starting from the period ended 30th June 2018 onward. During the period, the Federation of Accounting Professions announced a new standard on international financial reporting 15: Revenue from contracts with customers (IFRS 15) which is effective for annual reporting periods beginning on or after 1 January 2019, with earlier application permitted. The Company and its subsidiaries agreed to adopt the new IFRS 15 Revenue prior to the effective date, resulting in the adjustment of financial statement in earlier period for comparison and impact toward result in adoption of such new standard financial reporting.

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As of 31st December 2018, the Company had a total of 927 outlets according to the distribution channel management as follows:

By distribution channel	Apparel and lifestyle Products under “MC Group”		Watch Products under “Time Deco”	
	Number of POS	Increase (+) /Decrease(-)	Number of POS	Increase (+) /Decrease(-)
Free standing shop	299	+11	19	+3
Modern Trade	514	+18	75	-1
Mobile Unit	6	-	-	-
Total POS (Domestic)	819	+29	94	+2
International markets	14	-	-	-
Total	833	+29	94	+2

**During October to December 2018. Mc Group has 38 new points of sale and 2 enlarged stores.*

Financial Position Analysis

Balance Sheet:

(THB millions)	31 December 2018	30 June 2018	% change from end of FY2018 (30June2018)
Cash and short term investments	1,212	1,011	19.8%
Account receivables	497	414	20.0%
Inventory	1,929	2,179	(11.5%)
Other assets	1,207	1,266	(4.7%)
Total assets	4,844	4,870	(0.5%)
Account payables	256	210	21.9%
Interest-bearing liabilities	0	16	(100.0%)
Other liabilities	465	446	4.3%
Total liabilities	721	671	7.3%
Equity attributable to the firm	3,971	4,053	(2.0%)
Non-controlling interest	153	146	4.7%
Shareholders' equity	4,124	4,199	(1.8%)

Assets

As of 31 December 2018, the Company recorded total assets of THB 4,844 mn. compared to THB 4,870 mn. as of 30 June 2018. A decrease of THB 26 mn. in total assets was main results of

- 1) A decrease in inventory of THB 251 mn. from better efficiency of inventory program management compatible with distribution plan
- 2) An increase in cash and short-term investment of THB 201 mn.

Liabilities

As of 31 December 2018, the Company had THB 721 mn. in total liabilities, rose by THB 49 mn. from THB 671 mn. as of 30 June 2018. This was mainly due to an increase of THB 46 mn. In trade payables.

Shareholders' Equity

As of 31 December 2018, shareholders' equity of the Company amounted to THB 4,124 mn., fell by THB 76 mn. from THB 4,199 mn. as of 30 June 2018. The main factors contributing to net dividend payment of THB 323 mn. and stock repurchase of THB 46 mn. while an increase of total comprehensive income for 6-month FY2019 of THB 293 mn.

Liquidity

As of 31 December 2018, cash and cash equivalents of the Company amounted to THB 697 mn. net increased by THB 346 mn. from 30 June 2018 as a result of following factors:

1) An Increase in Cash flow from operations of THB 646 mn. driven mainly by the Company's cash profit of THB 374 mn. and a fall in inventories of THB 260 mn.

2) An Increase in Cash flow from investment activities of THB 86 mn. due to a redemption in short-term investment of THB 144 mn., the net purchase of property, plant and equipment for business expansion of THB 41 mn., investment in joint-venture of THB 11 mn. and purchase of intangible asset of THB 10 mn.

3) A Decrease in Cash flow from financing activities of THB 385 mn. of which came from the payment of dividend at THB 323 mn., stock repurchase of THB 46 mn. and short-term loans from financial institutions of one of the Company's subsidiaries at THB 16 mn.

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Key Financial Ratios

Financial Ratios			
		31 December 2018	30 June 2018
<u>Liquidity Ratios</u>			
Current Ratio	times	5.6	6.1
		For 6-month FY2019 (July - December 2018)	For 6-month FY2019 (July - December 2017)
Average Days Receivable	days	43	49
Average Days in Finished Goods Inventory	days	448	378
Average Days Payable	days	52	81
Cash Cycle	days	439	346
<u>Profitability Ratios</u>			
		For 6-month FY2019 (July - December 2018)	For 6-month FY2019 (July - December 2017)
Gross Profit Margin	%	57.9	53.8
- Apparel business	%	59.5	54.9
- Time Deco	%	49.8	52.5
Net Profit Margin	%	14.7	13.4
EBITDA Margin	%	19.9	18.9
Return on Equity (Annualized)	%	14.1	14.0
<u>Efficiency Ratios</u>			
		For 6-month FY2019 (July - December 2018)	For 6-month FY2019 (July - December 2017)
Return on Assets (Annualized)	%	11.7	11.1
<u>Leverage Ratios</u>			
		31 December 2018	30 June 2018
Interest Bearing Debt to Equity	times	-	0.00
Debt to Equity Ratio	times	0.17	0.16

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Outlook

The Company continues to make strategic investments in the light of an expected recovery of domestic economy during the latter half of 2019 in order to lay a strong business foundation for gaining competitive advantage, add value to its brands and further enhance consumer accessibility with details as follow.

- **New Product Introduction.** The Company has a plan to accelerate its **denim product sales** under “Mc Jeans” brand through its collection of selvedge or self-edge or “red-edge” denim. This collection offers unique identity as it is made from sanforized denim of narrow and tightly woven fabrics processed under higher quality control compared to general fabrics. The edges of denim are woven with colored yarns that give it a sturdier hand. Selvedge has long been considered a premium feature of denim people seek after. Moreover, the Company also promoted its **non-denim or casual wear products** led by a new brand “U-P” with 2nd collection of monochrome and pastel wears after its premiere during the end of 2018. This new collection is suitable for people with sport casual styles who prefer one-tone looks of monochrome or fresh and comfortable tones of pastel colors. Plus, the Company’s sales of **fashion accessories and personal care products** are still growing continuously as the Company is dedicated to creating new products that fit lifestyles of consumers and appeal to their tastes.

- **Same Store Sales.** The Company planned to increase its same store sales in a sustainable manner through 3 key strategies. (1) **Value creation and brand awareness building** using brand differentiation by promoting Mc’s DNA of authentic jeans through executing new marketing strategies. The Company recently allocated 20 million baht in marketing budget additional to its normal annual marketing budget of 200 million baht to conduct campaigns through points of sales in forms of Gift with Purchase, fun activities and special discounts. (2) **Introduction of products** that are in line with social trends and preferences of new generations of consumers in forms of both new innovations and special collections. For instance, The Company launched project “Mc X” offering “Black Valentines by Mc X Jindachot” collection with the popular siblings, Ploy and Sean Jindachot. (3) **Customer Relationship Management** that allows the Company to leverage on its existing 650,000 members of MC Club (as of 31 December 2018). The Company incessantly grows the membership of Mc customers and new customers which is expected to top 1 million members within a year. For this quarter, **a mobile application will be launched to enable effective campaigns** that are more suitable for target customer groups to improve information accessibility to be faster and more convenient anywhere at any time.

- **Omni-channel Strategy.** This new business model the Company adopted seamlessly connects all sales channels in a network. The Company has a plan to add 40 more points of sales in 12 months to reach 1,000 points of sales within the next 2 years through its “Mc” and “mcmc Outlet Store” located inside and outside PTT gas stations. Plus the Company will further develop its online marketplace “mcshop.com” by sourcing products from new business alliances who own world-leading brands that are popular among Thais and introducing to existing MC GROUP customer base of millions of people. The Company recently invested in “Mcmillion”, a integrated warehouse management and product delivery operator for e-commerce business to minimize delivery time for customers who make online purchases in order to support its long-term growth in the future.