

PETER FORSBERG

RAISING THE BAR

We have now simplified Thorn's business model down to the core businesses of consumer leasing and business finance. These two business lines earn a good return on capital and so it makes sense to redirect the capital released from the sale of the NCML receivables management business and the closure of the TFS consumer loan division back into their growth.

Having two businesses each focused on different market segments (consumer and SME) gives Thorn a distinctive market position and a balanced platform with some diversification benefit as these two segments should perform differently through the economic cycle.

Thorn's results this year reflect the combined outcome of these businesses with each having quite differing experiences in FY17.

INDUSTRY CONTEXT AND COMPANY SITUATION

Thorn's consumer leasing business, Radio Rentals, is a strong market leader in an industry where there are two other large constituents and then a number of smaller players. Radio Rentals is a well established brand which has been trading for 80 years this year. To be successfully serving customers for that length of time together with the leading market position brings with it brand recognition and economic scale with around 100,000 loyal customers and a widespread national footprint of over 80 outlets.

However the consumer leasing industry and Radio Rentals specifically have attracted scrutiny from the regulator (ASIC) and the federal government over the recent past on how responsible lending is conducted and the amount that is charged for the service.

The regulator ASIC has examined the quality of responsible lending of many consumer leasing companies over the past few years and has obtained enforcement outcomes against at least eight of them. Its investigation into Radio Rentals culminated this year in our taking up a provision for the expected costs of customer compensation and an anticipated penalty.

At an industry level, the federal government inquiry has reported and put forward recommendations. These are in the process of being translated into legislation in the coming year with caps on the cost to consumers, a protected earnings requirement, restrictions on some fees, changes to responsible lending assessment and suitability, and disclosure.



Radio Rentals supports the recommendations and has moved to early adopt the proposed price caps and most of the other recommendations. While these proposed legislative changes will hopefully settle the regulatory position of the industry and therefore any uncertainty that overhangs it, they will have an effect on the market and its profitability and Radio Rentals will not be immune from that.

Thorn Business Finance is a relatively small player in a large addressable market of 2 million small and medium enterprises representing 61% of Australian pre tax profits and employing 68% of Australian workers. The market for financing is growing as SMEs seek new financing increasingly from the non bank financial sector and particularly so if their financing requirements preclude offering property security, require flexibility or a quick decision. Thorn has positioned itself to provide what the market requires and is helped by its network of brokers and partners who contribute to a growing deal flow. Thorn has also expanded its offer with franchise financing, giving it broader product categories to meet the needs of small business.

Thorn's two core lines of business are therefore well positioned in sectors which have ongoing demand and sound fundamentals.

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FINANCIAL PERFORMANCE

The headline numbers for Thorn in FY17 are all positive – revenue is up 3 per cent to \$299 million, EBIT is up 25 per cent to \$47.1 million, NPAT is up 26 per cent to \$25.3 million and return on equity is two percentage points higher at 12.4 per cent.

Within that performance though is the larger story of simplifying the business, dealing with consequences from historic Radio Rentals issues, positioning for the future and redirecting resources towards the faster growth in business finance than consumer leasing.

Simplifying the business has involved not only reducing it down to the present two business segments but also cutting costs in Radio Rentals and the corporate office.

The financial results are fully explained in the Operating and Financial Review in the Directors' Report. In summary though, FY16's profit after tax was impacted by a \$6.7 million charge for NCML, a \$1.6 million charge for closing the consumer loans business, and a \$2.0 million charge for the first of the regulatory matters while FY17 had charges for further provisions for regulatory matters with a profit impact of \$6.1 million after tax. If all these were adjusted then the reported profit between years would have been up 3.6 per cent.

We recognise that these adjustments have come at a significant cost to shareholders but we trust our actions in facing up to them and working through them provides shareholders with more confidence in the future.



BUSINESS OPERATIONS

A rigorous and disciplined approach to credit risk is key to success in both of Thorn's business units as there must be confidence that customers will meet their commitments. To this end we continue to invest in technology and refine the application-to-approval process to ensure that it is easy to use but rigorous enough to provide the necessary data to make an effective credit assessment in a timely manner.

In consumer leasing, we have also set out to ensure Radio Rentals provides a good value proposition to customers through lower pricing, a more modern and wider range of household equipment delivered through an improved online presence and through refurbished stores with some relocated into high traffic shopping centres to reach more customers and a wider demographic. This year while revenue rose 2 per cent to \$251 million, higher costs including the provision for regulatory matters mentioned above resulted in EBIT falling 17 per cent to \$36.3 million.

Thorn Business Finance saw its revenue lift 23 per cent to \$37 million and its EBIT rise 40 per cent to \$18.4 million. Underlying this was a particularly strong performance by Equipment Finance but a disappointingly lower revenue and EBIT from Trade & Debtor Finance as it reshaped its receivables book to move away from riskier credits towards more traditional debtor finance customers and incurred credit losses in the process.

PEOPLE

Employing and retaining the best people is critical to business performance. This year while Thorn lost some expertise through the business simplification process, the closure of six Radio Rentals stores and some senior resignations, there is a core of expertise which should serve the business well for the future. We know personal service and the customer relationship are crucial to keeping customers happy and loyal, so we tried to isolate these elements of our operation from any cost cutting. In what has been a difficult year for some parts of the business, we are grateful for all who have helped ensure we continue to provide the high levels of service our customers have come to expect.

OUTLOOK

In this report, we have been at pains to show we are facing up to and addressing some difficult business circumstances and being frank about the financial consequences. At the same time, it is important not to cloud the potential we see in the business model.

In consumer leasing, at a time when some 3 million Australians are excluded from the financial mainstream, there is an ongoing need for people to be able to lease consumer goods as an alternative to waiting some years to accumulate funds to buy these goods outright.

However there are some immediate challenges being faced by Radio Rentals in terms of adverse publicity, weaker retail market conditions, regulatory changes, temporary deferral of returning customers due to the launch of the 4 year contract 3 years ago, and significant business change including a transition to a new online origination platform and process. All of these are expected to put pressure on earnings in the short term.

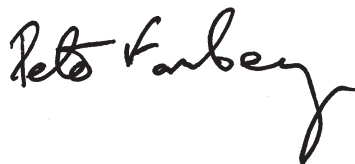
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Over the medium term however the large pool of loyal customers and the more efficient cost base should position it for continued industry leadership and growth.

Business Finance on the other hand has strong momentum currently behind it and the combination of increasing small business demand, the industry structure and the referral network we have established, indicate that performance should continue to improve and see it form an increasing percentage of Thorn's earnings in future.

THANK YOU

Any success the company achieves is due to the efforts of the staff and management right across Thorn combined with the support and loyalty of our wonderful customers, clients and banking and finance partners. I am lucky to work with such a talented and committed team and I thank them on your behalf.



PETER FORSBERG
Acting CEO

