MATALAN

27 April 2020

Matalan Covid-19 Investor Update

Matalan, a leading omni-channel fashion and homeware retailer, today issues a further update on developments in its business regarding Covid-19.

This update to Investors follows that issued by the Company on the 11th of April 2020 and contains a number of forward-looking statements, including with respect to our expectations for our business and financial performance, the market generally and the UK's response to the Covid-19 pandemic. As always, Investors are cautioned not to place undue reliance on such forward–looking statements as they are inherently uncertain and are not guarantees of future performance or financial condition.

Background

- The UK "locked down" on the 24th of March and all 232 of our UK stores have been closed since that date.
- Experts tell us Covid-19 peaked in the UK on the 14th of April and speculation is now very much of the approach to be taken towards an easing of the current restrictions.
- If we follow the pattern of other European countries this suggests easing should commence during May, albeit with social distancing measures still enforced. We expect it is likely that the easing of lockdown restrictions will be phased and gradual.
- In recent days we have seen some large format, out of town retailers, re-open their stores. Matalan is not classified as an 'essential' retailer like some of those that have re-opened, but the physical scale and layout of our stores means that once we are legally permitted to re-open, we will be able to operate in a safe and Covid-19 compliant way far more easily than many high density, high street clothing retailers. We are currently readying our store environment to enable both customers and colleagues to observe social distancing guidelines.

Public Policy

The public policy framework of government support has changed since our last update on the 11th of April:

- On the 11th of April we confirmed that we were not eligible for the Large CBILS or the CCFF schemes, but were actively lobbying government to amend the eligibility criteria.
- Following the government's removal of the turnover ceiling on the Large CBILS scheme on the 16th of April, Matalan is now theoretically eligible for the Large CBILS.
- This support scheme offers the prospect of accredited Lenders (of whom we have two in our RCF group) providing additional funding with a Government-backed partial guarantee of 80% against the outstanding balance of the new facility.
- The accredited Lenders can be asked to provide a loan of up to £50 million to applicants.
- We are in active dialogue with two of our RCF Lenders on this opportunity, but would caution that the discretion as to whether to provide funding sits with the Lenders themselves. Large CBILS is a partial guarantee scheme only; Lenders have to deploy their own capital, and still bear the risk of 20% exposure.
- We have enquired with the accredited Lenders as to the extent to which this scheme could provide funding into the existing debt basket ranking pari passu with the 1st lien bonds. The Lenders have confirmed that they would require any such funding to rank alongside the most senior debt in the structure, which would require Matalan to seek the relevant Bondholder consents to increase the size of the super senior basket.
- We also note that the Government announced on the 23rd of April that it would introduce measures to temporarily void statutory demands and winding-up petitions for commercial tenants who have been affected by Coronavirus. These measures will be in force until the 30th of June. This is helpful in enabling us to manage and forecast our rent payment obligations with more certainty over the coming months.

Financials

Cash and Revolving Credit Facility ('RCF')

At our financial year end on the 29th of February 2020, we held £61 million of cash on the balance sheet with a bank balance of £52m.

At that year end date, our £50m RCF was undrawn except for the utilisation of ancillary facilities for HMRC guarantees and LCs totalling £10m, and ring-fenced at £12m. In early April we obtained the consent of our Lenders to fully draw down the balance of our RCF in cash to boost our liquidity reserves. This drawdown of £38m cash was completed in recent weeks. This is the first time in its history that Matalan has had to draw down on its RCF.

The RCF contains a springing covenant that is tested if the outstanding amount under the RCF equals or exceeds £17.5m. On the 3rd of April the RCF Lenders agreed to waive the covenant for the purpose of drawing the RCF in April. They also provided waivers in relation to any Default or Event of Default that had arisen prior to the 3rd of April as a result of Covid-19 measures, and on or after the 3rd of April as a result of Matalan commencing negotiations with any creditor with a view to rescheduling its indebtedness.

Trading and Working Capital

Approximately 85% of our revenue comes from our UK stores and the majority of the balance from the UK online channel. Since our stores were temporarily closed on the 24th of March, we have continued to trade online, implementing all necessary social distancing protocols to protect our colleagues. Online demand has been resilient and skewed into our very strong Baby and Kids categories particularly. However, as is the case with many other retailers, the measures we have taken to adapt our operating procedures have temporarily constrained our despatch volume capacity. As such, although this channel is currently trading broadly in line with last year, and at very strong margins, it will require some configuration work to be able to grow further.

Given this current operating constraint, whilst we work to further improve warehouse despatch capacity, we have rapidly accelerated our progress in enabling online parcels to be picked and despatched from selected stores. The ability to do this capitalises on our previous investments in RFID technology, providing high levels of store stock-file accuracy, a prerequisite for online fulfilment. In our Liverpool Wavertree store we are currently trialling and finalising the development of the solution to allow fulfilment of online orders from stores. We have an initial plan to accelerate its roll out to 20 of our largest stores starting in May and this could result in additional online despatch capacity of up to another 40%.

We recognise how hard it will be for Investors to model the various elements of working capital through this period. As you would expect, we have worked hard to manage and forecast our working capital as prudently and accurately as we can having taken swift and decisive action:

- As soon as lockdown was announced**,** we worked with our Suppliers to cancel all spring/summer product not yet shipped and made amendments to our stocking plans for autumn/winter. These in total save £142m against our planned stock buy which was set to support a modest level of sales growth during the current financial year. Offsetting this is the impact of much lower sales volumes, which we expect to result in approximately a £50m increase in stock levels against last year during May. These increased stock levels will unwind as we re-open post-lockdown.
- We have negotiated a number of changes to our supplier terms. In aggregate these have resulted in a significant extension of our average payables days and these changes are forecast to deliver £23m of cash benefit within the current financial year ending February 2021.

Matalan pays for around 75% of its goods for re-sale in USD, and as such hedges currency risk deeply and up to two and a half years out. As a result, on entering the lockdown period, we held forward currency trades of approximately $700m that due to the fall in GBP against USD, are materially in profit. In the last two weeks we have broken the following trades;

- $105m of now surplus current year FY21 trades
- $145m of largely second half FY22 trades

The immediate liquidity released from these trades totals almost £12m, and we are able if necessary to release significant further liquidity should it be required.

Costs & Capex

We have also taken significant action to manage our cost base. The enforced store closures have led us to place over 90% of our colleagues, over 11,000 people, on furlough, and we will be accessing reimbursements via the Government's Coronavirus Job Retention Scheme. On the basis of an 8.5 week lockdown this equates to a cash saving of £21m against our original budget. In the event the lockdown extends to 12.5 weeks, with the stores not re-opening until w/c 21st June, this would equate to a cash saving of £31m.

Alongside our people, property costs are our largest overhead. In regards to our store rents we sought to postpone rent payments for the March quarter, and consequently wrote to landlords and did not pay rents due of £23m at the end of March. The majority of these postponed payments are expected to be spread over the course of H2 FY21 and H1 FY22. In addition, 12 months business rates relief from the Government commencing from the 1st of April, equates to a permanent saving to Matalan of £44m. Note that this is a relief on business rates and will not reverse as a timing difference.

In addition, we have taken a further £10m out of our broader FY21 cost base and have scaled our capex spend back to £25m, representing a near 45% reduction in capex against FY20. Our forecasts still include a level of discretionary uncommitted marketing spend and uncommitted capex which could be reduced further in the event of a prolonged lockdown scenario.

HMRC

HMRC is allowing VAT payments due between the 20th of March 2020 and the end of June 2020 to be deferred to the 31st of March 2021. We are deferring our quarterly VAT payment as allowed by HMRC. In addition, we have made a successful Time to Pay application in April in relation to other tax payments. In totality, in agreement with HMRC and expecting subsequent successful Time to Pay applications during the affected period, these steps will provide a temporary liquidity benefit of up to £20m through towards the end of June this year, before largely unwinding at the beginning of July.

Funding

In spite of these steps, our revised projections indicate that due solely to the direct impacts of Covid-19, the group will require an additional injection of funding to enable it to manage the short to medium term cash flow impacts arising due to the loss of store revenue.

Whilst we continue to run sensitivities and understand the phased re-opening of physical retail within the UK, it is too early to publicly finalise a funding number. However, we are aware of the number being speculated on by the press of funding up to £60m, and want to reassure Investors that such a level of funding could support the business through a prudent downside set of Covid-19 exit assumptions, specifically:

- A full lock down scenario lasting 12.5 weeks i.e. our shops do not re-open at all until w/c 21st of June.
- Thereafter, a depressed recovery curve post re-opening in late June, which assumes that stores experience a 75% decline in year-on-year sales for a month post re-opening. We have then allowed for a further 8 weeks trading at 50% down on last year, followed by the last three weeks in September improving to 25% down against last year.
- Note these reflect downside assumptions, against which we believe that there is significant potential to over-perform both in terms of re-opening timeline and performance thereafter. Equally, the business does have further liquidity levers that it could pull should they be needed

We are currently assessing a number of alternative funding options and will provide further updates to stakeholders in due course. We have been supportive of requests from certain larger Investors for access to their own professional advisers, and we note that Perella Weinberg Partners and Kirkland & Ellis have agreed to advise Investors in the coming weeks.

We hope this update has been useful in setting out the impacts Covid-19 has had on the Matalan business, and significant steps the Management Team have taken to mitigate those impacts. We remain confident that our business has the right underlying strategy, which is one that has driven market outperformance over recent years. We will continue to evolve and adapt that strategy to meet our customers' needs going forwards, as they themselves adapt their behaviours as we all emerge from lockdown in the coming weeks and months ahead.

Ends

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