Homebush Corporate Park
29-33 Carter Street
LIDCOMBE NSW 2141

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Market Briefing

Grays eCommerce Group CEO on FY16 results and outlook

Interview with Mark Bayliss (CEO & Executive Director)

In this Market Briefing interview, Grays eCommerce Group's CEO & Executive Director, Mark Bayliss, discusses the company's results for the 12 months ended 30 June 2016 (FY16) and strategic outlook including:

- *Drivers underpinning growth in Continuing Operations*
- *Strategies in place to support continued growth in the Business to Business (B2B) and Business to Consumer (B2C) divisions*
- *Further strengthening of the Company's balance sheet*
- *Implementation of a dividend policy for FY17*
- *Growth outlook for FY17*

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Grays eCommerce Group's FY16 results showed strong growth from Continuing Operations, with revenue up 13.7% to $124.9 million and EBITDA up 32.8% to $14.3 million. What were the key drivers for this growth?

Mark Bayliss
The growth Grays experienced during FY16 was primarily driven by the strong performance of our B2B division, which we are particularly pleased about. The decision to invest in our most profitable and growing B2B categories contributed to our strong underlying result.

We chose to invest in new yards, people and technology to grow scale and capabilities in Automotive, which was a substantial component of B2B earnings. In addition, current commodity prices drove strong growth for our Transport and Mining category, as a large quantity of equipment and vehicles were earmarked for sale

Grays also benefited from the strategic decision to enter the agriculture category, with revenue and EBITDA growth coming from our DMS Davlan acquisition, which was accretive to earnings during the second half of FY16.

The strong EBITDA growth from Continuing Operations of 32.8% was achieved even with the increased investment into B2B resources to support growth initiatives. The benefits from these investment initiatives will underpin further growth in earnings.

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How successful have Grays eCommerce Group's strategic initiatives been since the divestment of Fixed Price Retail (FPR) Assets?

Mark Bayliss
The strategic divestment of our FPR business in November 2015 allowed us to focus on our highly profitable B2B online auction business, where we are the market leader. We have expanded the scope of our B2B offering into new markets where we see vast opportunities for long term growth. For example, we commenced a controlled expansion into South East Asia during FY16 and have already seen a solid pipeline of sales activity.

The acquisition of DMS Davlan in June 2015 was a key strategic move for Grays, allowing us to establish a foothold in the growing agriculture vertical. Having completed the integration of DMS Davlan in the first half of FY16, it was earnings accretive in the second half. Another B2B initiative was to increase the number of Business Development Managers by 50% over FY16 to facilitate growth of our successful Automotive category.

In relation to our refocussed B2C online auction business, we successfully implemented new sourcing strategies to encourage quality supply, improve vendor yield and ultimately lift the average sale price obtained at auction. Having sold our FPR business in the first half, we refocussed offerings to key B2C categories and launched the GraysOnline eBay store during the second half that provides a "buy now" channel for selected electronics and IT items.

In our IT category, we enjoy strong margins in excess of typical retail margins. Another added strength of the B2C division is that many vendors are consigned and our margins are guaranteed.

In line with our decision to exit the FPR business, we reduced warehouse space and costs via selective outsourcing and implemented measures to better and more carefully manage seasonality in volumes.

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While Grays delivered strong growth in B2B revenues and earnings over FY16, EBITDA margins actually contracted. What was responsible for the margin contraction and what trends should investors expect to see in FY17?

Mark Bayliss
The strong revenue growth of 30.7% mainly reflects the underlying growth in our core markets of Auto, Mining and Contracting and Transport; the result of initiatives put in place during FY16.

While the EBITDA to revenue margin declined, the better measure to look at for our business is the EBITDA to net revenue margin. This margin actually increased on FY15, partially offset by strong growth from our Automotive category, which has lower margins than other categories.

Over FY16, our expenses were up $10.7 million due to acquisitions and investments made to support sustainable revenue growth, including the purchase of new facilities and hiring of additional new business development staff. Looking forward to FY17, we expect to see our investments in new facilities and staff generate revenue growth.

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The balance sheet of Grays eCommerce Group changed significantly during FY16. Could you explain the key changes?

Mark Bayliss
Our balance sheet movement reflected the transformation of Grays to a primarily B2B auction business.

The composition of our inventory changed substantially as we sold down disposed operations' inventory from $11.9 million at 30 June 2015 down to $0.2 million at 30 June 2016. This decline in inventory was partially offset by a $4.3 million increase in B2C continuing operations' inventory.

The reduction in non-current assets of $9.8 million was the result of the sale of FPR, partially offset by the acquisition of DMS Davlan and a future tax benefit recognised from the loss on the sale of FPR.

In relation to liabilities, a reduction in creditors post the FPR sale drove an $8.1 million decline in payables, while the DMS Davlan acquisition was debt funded, resulting in Grays taking on $2.4 million debt. Provisions increased by $3.6 million primarily due to an onerous lease provision recognised on the sale of FPR.

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Grays eCommerce Group generated strong cash flows from Continuing Operations of $10.7 million during FY16, however this was lower than Continuing Operations' EBITDA of $14.3 million. What are the key reasons for the difference?

Mark Bayliss
There are three reasons for the difference.

Firstly, following our decision to refocus our B2C auction business to key categories where we have a competitive advantage, an inventory realignment accounted for a $1.4 million net increase in inventory – being a $4.3 million of inventory purchases partly offset by a $2.9 million increase associated payables.

Secondly, prepayments increased by $2.5 million from advances to secure consistent wine supply and a $1.5 million net reduction in provisions from the payment of increased B2B FY15 employee incentives in FY16. Finally, we improved debtor collection by $1.7 million.

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Can you provide some colour around customer retention and member growth?

Mark Bayliss
A key strength of Grays is the relationships we have been able to build and maintain with our customers. We have been pleased with the strong and consistent growth in Grays' member numbers, having achieved 10% growth in registrations during FY16 to 2.17 million members.

We are particularly pleased with our customer retention, with 61% of buyers in FY16 having been members for over 12 months and 37% being members for at least four years.

We are encouraged by the loyalty of Grays' members, with the majority purchasing multiple items in FY16 and 29% purchasing at least four times.

Our platform experienced heavy traffic during FY16, with in excess of 1 million unique visitors accessing the site per month, resulting in 3.9% of these visitors placing a bid for an item.

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Where do you see the greatest growth opportunities for Grays eCommerce Group?

Mark Bayliss

We believe there are significant opportunities for us to realise sustainable growth, leveraging our core competencies and local expertise in B2B auctions.

We are well positioned to continue to grow our Automotive category having invested in new yards, staff and technology. Additionally, the Australian market has a surplus of equipment from the completion of a number of infrastructure projects and we made some key hires in our Civil & Construction category to facilitate growth from this category. Given the current commodity price environment Grays is also well placed to benefit from mining equipment and transport transactions.

Other B2B opportunities relate to expanding our expertise into new markets. Having entered South-East Asia during FY16 we are encouraged from the solid pipeline of deals we can see and believe we can leverage the expertise of our Australian team to manage controlled growth in this region.

In relation to B2C growth opportunities, our focus is to grow in categories with high margins, where we have had a strong track record. For example, Grays' has a large customer base and sufficient scale in the consumer AV and IT markets, we also have profitable exclusive contracts with major brands to refurbish and resell their product direct to consumers in Australia and NZ. This vertically integrated reverse logistics solution, combined with our broad customer reach makes it hard for other sites to compete. We also favour categories where we can directly source high end products from wholesale markets, including Furniture, high end BBQs and Premium Jewellery. Furthermore, we are investing heavily to further enhance the Grays Wine user experience to facilitate growth from this category.

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What policy has been put in place for dividends going forward?

Mark Bayliss

Given the strong growth in underlying earnings and cash flow generated by the business, the Board was pleased to announce the introduction of a dividend policy, linked to growth in earnings per share with an expected dividend payout ratio around 40% of net profit after tax. It is anticipated dividends would commence following the release of H1 FY17 results and be fully franked.

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What is the outlook for FY17?

Mark Bayliss

The transformation to a dedicated online auction business has brought Grays a number of growth opportunities and the investments in new sites, technology and people are expected to deliver a full year benefit in FY17. Overall, we expect that the business will grow earnings solidly over the coming financial year, with FY17 EBITDA being higher than FY16.

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Thank you, Mark.

For further information, please contact +61-2 9112 9440 or go to www.graysonline.com.au or www.graysecommercegroup.com.au