

**Full-Year Pre-Close Trading Update Analyst Conference Call**

**11.05.2017**

## Presentation

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### Euan Sutherland

Good morning everybody and thank you for joining us on today's call. As always I'm joined by Nick Wharton, our CFO, and we'll hand over to him in a few minutes to run through the detail of this morning's statement.

Having launched our 4"E" strategy in early 2015, I'm pleased with the progress we've made across all aspects of the business. Through the on-going execution of our strategy we will continue to diversify our business model across geography, channel and category, in turn lessening our reliance on any individual market or sector. And in a post-Brexit environment we believe this to be a sensible place to be.

Our strategy is designed to create long-term sustainable revenue and earnings growth. In this context a further quarter of strong like-for-like performance is pleasing and what is as important to us is the broadly even split of double-digit like-for-like across the longer trading periods represented by each of half one and half two.

In completing my overview of trading, two factors continue to benefit us; firstly e-commerce continues to grow from strength to strength delivering full year growth of 35%. As we highlighted at the capital markets day in September last year, this is a function of continued investment and continued improvement. As a committed multi-channel retailer we have a well-positioned, differentiated proposition, which in the fastest growing consumer channel represents a significant on-going growth opportunity for the brand.

Secondly, product is king for any retailer and we continue to benefit from a strong blend of innovations and continuity ranges. Jackets is a great example of this. For the first time this Autumn/Winter season, we executed an integrated marketing campaign emphasising the size and technical quality of our range, which includes physical and digital catalogues, store displays and YouTube influencer and other social media strategies. This approach proved highly effective and we will be repeating this in the Summer campaign about to start and in Winter campaigns as we go through the new financial year.

In addition to our strong trading performance we have also made good progress against our strategy. We will focus this at our results presentation in July but a few highlights at this point would include our Execute strategy, which focuses on expanding our business globally. We maximised the value from each market through channel models tailored to each country, balancing owned and franchise retail stores, e-commerce and wholesale and Nick will cover progress here in a few moments.

In the year to date we have extended our global footprint by opening 80 Superdry stores; 62 of these were franchise stores increasing our global footprint to 335 franchise stores with the balance representing 154,000 square feet of net new owned retail space. Including a further year of opening over 100,000 square foot of space in Western Europe. Consistent with our commitment to address any under-performing space we closed six legacy stores, largely smaller and ex-franchise stores in the UK, EU and USA. We closed the year with a total of 555 stores globally across franchise and owned stores and our next generation stores have continued to perform well on test in the UK and we plan to re-fit between 10 and 12 UK stores in FY18.

The development of our longer term opportunities in North America and China continues with the focus in each market being the successful blend of trading between newly opened stores, e-commerce and wholesale channels. Performance continues to be encouraging with further stores, including a larger number of franchise stores in China planned for 2017/2018.

As we continue to underpin our growth through our Enable programme in people, systems, processes and infrastructure. Our most significant achievement during the year was the opening, ahead of schedule and on budget, of our new distribution centres in Europe and in the USA. We are well placed to expand the breadth of their operation this year and start to access significant efficiencies as we go forward.

I'll now hand over to Nick to go through some of the detail with the key numbers and then come back at the end of the call.

### Nick Wharton

Thank you Euan and good morning everybody. Today's update confirms our trading performance for the final 16 weeks of the year and I'll just walk through the announcement fleshing out the numbers where we believe it to be helpful.

As has become necessary over the past couple of reporting cycles, it's perhaps most helpful to start with the impact of currency on our performance. As Euan has just stated we have a large and growing natural hedge within the business, with almost half of our revenues in Euro and we also have a conservative financial hedge extending forward up to 18 months. So in overall profit terms, currency has remained relatively benign in the second half, however as we are not fully hedged some of our revenues and costs throughout the P&L will at least in part reflect spot rates. This serves to increase their scale in terms of both revenue and costs, which does drive some like-for-like benefit but also does serve to erode both our gross and operating margins.

So to the detail, starting with revenues. We're consistent with the first half, approximately one third of our sales growth is from that currency change we've just talked about. Our second half sales performance is again positive with good growth achieved across each of our sales channels, including stores, and a profile broadly consistent with the first half. Illustrating that, group sales grew by 24% against 27% on a full year basis and within this retail grew by 17% and wholesale by 42%.

To each channel and firstly to retail. As Euan has stated, we're pleased to have delivered further strong growth, totalling 17% across the second half with like-for-like growth within that of 13% consistent with the first half. Within the second half, reflecting the more challenging comps, the fourth quarter delivered a stronger two year like-for-like performance of around 25% than the 16% delivered in Q3. In terms of e-commerce, this remains our fastest growing route to customer. While very pleasing to have delivered further market-leading growth in this key channel, naturally this growth will have an impact on sales and distribution costs from the higher unit cost to serve, however despite this mix drag costs are anticipated to remain in line with the guidance we gave at the half year.

The second half has seen the continuing strength in our Wholesale division, with sales growth of 42%. Having reset our Wholesale business model over the past two years, we're now confident to increase the scale of this low capital route to increasing our market penetration to complement both owned stores and e-commerce. The drivers are broadly the same as those discussed at the half year, with further sales upside from expansion of our customer base, including a 23% year-on-year increase in the number of franchise stores but also significantly increased sales to existing customers, both with our core ranges and our new sportswear and premium ranges.

Turning now to gross margin and starting with H2. In H2, in addition to the small margin drag from FX that I highlighted in my introduction, margins have once again been impacted by the adverse mix impact from the stronger relative growth in Wholesale revenues and we estimate that this impact will be similar in magnitude to the first half at approximately 100 basis points. Excluding this impact from mix and currency, our underlying second half trading margins were marginally lower year-on-year. After the one-off factors that diluted margins in the first half, this performance is in line with the guidance we provided at the half-year for broadly flat trading margins after absorbing some initial input inflation.

So joining this together for the full year, largely reflecting a full year mix impact of approaching 1% point, we anticipate full year FY17 margins to reduce by between 120 and 140 basis points. And finally to profits where our guidance for the year is for an underlying PBT between £86 and £87 million and within this we can confirm two things; firstly that the distribution centre dual running and other mitigation costs will be in line with the previous guidance of £2 million and that our operations in North America will break even in our second year of ownership in line with the development plan we outlined in March 2015 when we acquired the US license.

At the mid-point of the profit range, this would imply a group level profit growth of around 17%. As you know we adjust to give an underlying performance, adjusting for DC related costs, offset by the reduction year-on-year on development market losses. That would suggest a profit growth in our core operations, slightly stronger than the headline level, at around 18% but again that level is broadly in line with the volume growth in the business. So that completes my summary and I'll hand now back to Euan.

#### Euan Sutherland

Thank you, Nick. So in conclusion, FY17 has been a good year of financial progress again as we develop Superdry as a global lifestyle brand. The focus is key to our success, the benefit of which is clearly illustrated by continued strong trading which in turn benefited from many positive and planned drivers, including disciplined new space growth, eCommerce investment, product innovation, and a re-energised Wholesale channel. Looking forward we're fortunate to manage an opportunity-rich business. These clear opportunities will create an increasingly international footprint that serves to lessen our reliance on any single market and provide confidence in our ability to deliver sustained revenue and profit growth looking forward.

Thank you for that; Nick and I are now happy to take any of your questions.

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## Q&A

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### John Stevenson

First, on the retail store performance, on the refurb, I wonder if you are maybe going to give a little bit more detail. Particularly on the sort of smaller stores that should have had a more profound impact in terms of better option count and so on.

Second question, on the USA, if you could maybe comment on the scale of the business now in terms of brand sales compared to when you took it over two years ago.

### Euan Sutherland

Retail refurb – as you know we refurbished two during last year, White City in London and Arndale in Manchester. We then took that refurb programme and put it into all of our newer stores at the back end of the year, so we're seeing that format working both in a refitted format in two stores in the UK and also in new space. That's all performing well, so the delta that we were quoting at the capital markets day, which was about a +20% in the sales line, has been maintained. We've been – as always for this team – reasonably cautious, making sure that growth can be sustained, and it has.

So the plan now is to continue two-fold. Firstly, for all of our new openings into FY18, they will get that Arndale type treatment which drives density and also the new look of the brand, and we're intending to open between ten and 12 UK refits as we go through FY18. So about 10% to 12% of our UK space. Some of those stores are larger; some of those stores are smaller. We're seeing a density benefit as part of that uplift in all sizes of store. So it's been sustained and it's pretty consistent in terms of the benefit going through. We've got a large number of trading weeks under our belt now that gives us confidence to keep going with that reinvestment into the UK.

### John Stevenson

Have you put it into Europe yet?

### Euan Sutherland

Although it's not refitted in Europe; it is in new stores in Europe, largely because lots of our European estate is fairly young, so we're still maximizing the benefit of the first fit in those European stores. As we get a more mature European store base we will have refitted the UK. The intent then is to move that refit model into Europe at the right time financially.

### Nick Wharton

The turnover we inherited of the US business was about £25 million. The business is now larger than that but actually the return – improvement in profit that we've delivered – is more a function of return than it is of scale, again because of that cautious nature of the rollout. In each of the channels, eCommerce has grown significantly as we've put a brand foundation into that market. So the biggest source of new scale is through eCommerce but from a very low base. In terms of stores, they are more substantial; obviously we've opened some stores, but more importantly we've delivered like for like consistently through this year.

The first half, like for like was very strong against essentially the inherited store proposition in the previous year; but actually, we've still continued to deliver healthy store like-for-like in the second half of the year, which is a better measure of the performance of the repositioned proposition. But you must remember that also counter against that is actually our Wholesale business we had to reset significantly. The Wholesale business we inherited did have some scale, but it was scale that is unhelpful to the brand as it was in the wrong price channels. Our Wholesale business is probably actually smaller than the business we inherited at that time. So we have a larger business, but the more significant thing is we have a much more profitable business going forward. So the scale of the business is larger than the £25 million we inherited but probably not of the scale that you might expect.

### John Stevenson

Can you put a number on it?

**Nick Wharton**

For the acquired stores it's around the £35 million level now.

**Richard Chamberlain**

**Richard Chamberlain**

Couple from me please on the Wholesale performance. Obviously very strong sales performance during the quarter has had a diluted mix effect on gross margin. Can you say what the mix impact was at the operating margin level from the outperformance of wholesale? Given your plan for wholesale going forward, do you have a target "retail-wholesale" split over time? At the moment it's around 70:30 in the business. Should we expect that over the medium to long term,?

**Nick Wharton**

So the second point, we don't really have a target for our channel mix. Our strategy and our objective is through efficiency to improve the returns that we get in each of our individual channels. We are very confident using all of those routes to market to optimize the value extraction from any particular market, and that will vary by the markets both by their nature but also over time. Wholesale is a very good route to build brand awareness in an entry market; it's also low capital and lower risk if we perceive a market as potentially having greater challenges in terms of doing business. And also, we – we obviously need to follow where our customers want to buy the brand. So our ambition therefore is to improve the productivity of each of those channels, rather than particularly direct our customers to any point of distribution.

And in terms of the operating margin, I think that's probably one for the prelims, to work that through and make that more transparent in terms of the bridges that we give you at the time of the prelims in terms of the mix impact on that operating margin together with the FX impact that I highlighted in my overview, together with that ongoing cost investment.

**Richard Chamberlain**

Leisure trends, or the more sort of sporty ranges in store, how have they been performing? Any plans also to extend that category going forward?

**Euan Sutherland**

Performance has been good. We are working our way through the iterations of the range development. Both range development in terms of the look and the feel of it, and also the technical capability. It's been quite a change for us to move out of a more fashion-based fabric into our supply chain factories that will give a technical performance power to that range. So there's been a huge amount of work done both in the design lab and also in mainline. So it continues to be a big focus for us; probably the biggest innovation focus that we've got in the business. The market for sport and [inaudible] leisure continues to grow very fast. So there's more news to come as we go through the summer for some of the global opportunities in terms of locations for sport. But we've got confidence that that will continue to grow as part of our portfolio. So lots of work in the background but probably by the time we get to July we'll be able to give you more specifics on geographies, locations, and some of the product developments which are coming to market.

**Conrad Bartos**

Was the magnitude of the sales mix and the FX impact on gross margin in line with your expectations? And if not, what cost lines were leveraged to bring PBT in line?

**Nick Wharton**

I think it's fair to say that – as we discussed at the half year, we are pleasantly surprised by getting a further six months of further selling season of step change improvement from the Wholesale business. So being transparent the mix impact, in terms of the margin, from Wholesale growth was a surprise to us against our internal expectation. Very pleasing to have got further step change improvements, but as we said before, that's not sustainable. We see the Wholesale business as probably being a mid-teen constant currency growth business in the future, complementing very nicely other channels to the customer.

The cost efficiency opportunity, as we've talked about historically, from our design-to-customer ("D2C") process that we're implementing in the business, is very broad. D2CSo goes from the conceptual inception of a product all the way

through to its sale, whether that be Wholesale or in a store, or through ecommerce. So we have seen efficiencies which we've guided the market historically to say that we'd expect to start seeing that leverage particularly from our head office perspective in FY18. We've seen a little bit earlier than we anticipated, which has helped bridge that profit gap, as you articulated, in the second half.

So not any particular single area. We've got multiple efficiency opportunities across the business. They've all come in slightly larger and slightly earlier than we thought, but no single silver bullet in that.

#### Graham Renwick

Going back to gross margin, you mentioned excluding channel mix and currency trading margin you were expecting margins to be marginally weaker in the second half versus your initial expectation. Are you able just to expand a little bit more on that, please?

#### Nick Wharton

At the half year we guided to broadly flat trading margins. That's set against, a historic norm on that basis of nought to 30 basis points. We knew we were going to face a little bit of input inflation in that, hence taking the small accretion guidance that we've been at for a couple of years, to something which was described as broadly flat. We're a little bit negative in the second half, which we're interpreting as being in that range of broadly flat.

While there are a lot of moving pieces in our margin performance in the second half, it was where we outlined. If there is a slight movement on that, we had a slightly more successful sale than we probably anticipated in terms of the consumer take-up of that. Nothing material, but that's probably the one single-largest factor on that basis. But as you know, our second half, particularly in the fourth quarter, trade is very much at full price. The only promotional activity you will have noticed in the UK and Europe was we ran over Easter two-for-one promotion on polos, which is something seasonally relevant for our customers at that time. But pretty much we traded as we expected, and therefore delivered the margin pretty much in the range that we guided to.

#### Euan Sutherland

Just a small kind of sub note, regarding One New Change in the City. If you've been walking past you will have seen some activity in there, this is a one-store-only exit, we have given up that lease because we've got a very advantageous property deal on that. The new store is going to be some form of cycle gym. So if you've seen promotional activity there, that's because we're exiting that location consistent with our plans to exit any poorer performing stores or deals where the property numbers add up significantly. So that's not typical of the rest of the business globally. That's just a one-off.

#### Wayne Brown

Two questions from me. You've given guidance on gross margins and you've explained some of the mix impact there. Can you talk us through cash margins and what that guidance would necessarily look like if we looked at cash margins? And you've described really strong growth in ecommerce, so well done on that front, but you've described it as a differentiated ecommerce channel. I suppose that is in relative terms to the peer group can you give us your view as to what you mean as being differentiated?

#### Nick Wharton

In terms of our ecommerce proposition, we believe we are advantaged in terms of the customer experience that we offer to our customers, whether that be the experience that they have actually on the site, or as importantly, the experience of the delivery proposition. It's a channel that we are well invested in, and we are a very strong believer in the multichannel opportunity for the brand. So in terms of the on-site experience, we have a significant number of local websites where we define local as being local language, local pricing, but as importantly, local language customer service as well. So that's a good example of that.

We also continue to invest in the experience online through – through videos, images, etc., to get a good experience there.

From a delivery proposition, we're very much a believer in a fast and free customer experience, and that's both outbound but also returns. We think this is a major differentiator and a major contributor to higher customer conversion and customer experience. So on those benchmarks, even against pure play retailers, we think we have a differentiated customer proposition.

#### Euan Sutherland

I think we're best in class, and we are constantly benchmarking ourselves on that. We operate the policy that we want the customer to decide which channel they access the brand from, and we will make our proposition as relevant and as efficient as possible for them. So it's a customer-driven strategy.



**Nick Wharton**

In terms of the cash margin question, if I'm interpreting it correctly, in terms of the operating margin performance in the business, the biggest impact on the operating margin performance during the year will be the drag impact of FX. So the impact on that top line is mitigated throughout the P&L through the impact on costs. So essentially with a benign FX movement throughout the whole P&L, our cash profit remains roughly neutral but we have a higher numerator in terms of the revenue, therefore our cash delivery of profit is roughly in-line with expectation, on a constant currency basis. But our operating margins will be diluted predominantly through the impact of FX.

**Euan Sutherland**

Thank you for coming on the call. If there are any follow-up questions, we'll be around all day and happy to – to follow up with you.