

SuperGroup.Plc

FY 17 H1 Pre-Close Statement Analyst Conference Call

10 November 2016

Speakers: Euan Sutherland and Nick Wharton

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Presentation

Operator

Hello, and welcome to the SuperGroup FY17 H1 Pre-close Trading Statement Analyst Conference Call. Throughout the call, all participants will be in a listen-only mode, and afterwards there'll be a question and answer session. Just to remind you, the conference call is being recorded. Today I am pleased to present Euan Sutherland. Please begin your meeting.

Euan Sutherland

Thank you, and good morning, everybody. Thank you for joining us on today's call. As always, I am joined by Nick Wharton, our CFO, and I will hand over to him in a moment to run through the detail of the statement.

As an overview, I'm pleased to report that the positive sales progress established over the last two years has been maintained. Like-for-like growth was broadly consistent in each quarter – in quarter one and quarter two – despite lacking the strong trading performance in the first half of last year.

I'd just like to highlight three important factors that contributed to this performance. Firstly, the ongoing business model diversification across geography, channel and category that lessens our reliance on any individual market or sector. Secondly, ecommerce continues to go from strength to strength as we highlighted at our Capital Markets Day. And we've worked hard to improve our proposition. This represents a significant ongoing growth opportunity for us. And finally, we continue to benefit from the continuity ranges which protect our sales when the weather does not conform to seasonal norms.

After that, I'd like to focus in on the extra progress that has been made on our strategy. We will provide more flavour on our progress with our results in January, but a few highlights today would include our EXECUTE strategy, focusing on expanding our business globally, adopting the right entry model for each country. In the year-to-date we've extended our global footprint by opening 67,000 square feet of net new retail space, all outside the UK, as well as adding 30 franchise stores, three licenced stores, and 21 wholesale concessions. We remain on track to deliver new space in line with guidance for the year.

Secondly, our longer-term development opportunities in North America and China are each progressing in line with their plans, with the key focus in each market being the successful trading of our newly opened stores in New York, Philadelphia and Orlando, Beijing and Shanghai. And as always, we continue to underpin our growth through our ENABLE programme in people, systems, processes and infrastructure. Significantly, during the half year, we have opened our two new distribution centres in Europe and the USA, and these will operate as planned through peak trading this year and remain on track to be fully operational in early 2017.

Finally, in terms of product, womenswear remains our largest growth opportunity. Growth was well balanced in the half, with menswear delivering similar high growth rates to womenswear. Our stream of new product development through sport and Idris premium contributed meaningfully to sales as we approach the anniversary of each of their launches. And our launch this year of gifting and footwear ranges in the latter part of the first half have also achieved good initial sales results.

I'll now hand over to Nick to go through the detail of the announcement, and I'll come back and summarise in a few minutes.

Nick Wharton

Thank you, Euan, and good morning, everybody. The trading update we've issued today covers the 26-week period to the 29th October 2016. And I'll walk you through the announcement, fleshing out the numbers where we feel it will be helpful.

It's perhaps most helpful to start with the impact of currency on our performance. As you know, we have a large effective natural hedge within the business, with almost half of our revenues generated in euro, and we also have a conservative financial hedge which extends out over 18 months. Now, what this means is that in the short term, any bottom line impact from currency is relatively moderate on our P&L, but as a general rule, the revenues and costs throughout the profit and loss account would at least in part reflect spot rates and therefore will increase in scale.

So to the detail, starting with revenues, the sales performance through the first-half year has again seen good growth achieved across all of our sales channels and key geographies. Group sales grew by 31% with our retail division growing by 25% and wholesale by 44%.

Firstly, to our retail division, the first half has seen consistent trading performance in each of the quarters. In each quarter, total retail sales grew by approximately 25% with like-for-like performance in Q1 at about 12% and 14% in Q2. Even discounting for the impact of currency, which is about a third in all of our headline sales numbers, total half like-for-like at between 8-9% is pleasing when set against the prior year, which saw like-for-like across the half at 17%.

In channel terms, ecommerce remains our fastest growing route to customer. The major drive of sales growth remains stock availability, benefitting from the introduction of a single retail stock pool, which we only executed in October of 2015. And if you remember from the Capital Markets Day, this meant that the number of units available to support underlying customers is roughly eight times higher than in the first half of last year. While very pleasing to deliver 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 mixed drag, costs are anticipated to remain within the guidance that we gave at the prelims.

The first-half performance in our wholesale division reflects our increased focus, investment, and development of this channel, both in terms of forward orders and in-season sales. Encouragingly, we have seen sales upside from the expansion of our customer base and increased sales to existing customers, both of our core ranges and our new sportswear and premium ranges. We're also starting to improve traction in our USA wholesale operation.

Turning now to gross margin. Most significantly, we continue to generate buying gains from direct sourcing and increased scale that we part-invest back into the customer. However, the stronger relative growth in wholesale revenues will create an adverse mix impact in the first half, which we estimate to be about two-thirds of the overall margin decline at around 80 to 90 basis points. Structural mix therefore represents the primary driver, but there are two other one-off factors which have impacted our margin in the first half. Firstly, as part of the DC migration project, we took the pragmatic decision to clear some residual stock in both retail and wholesale, rather than transfer it to our new distribution centres and incur additional cost. And secondly, as you'll recall from earlier in the summer, we did trial the effectiveness of a number of new value-added promotions, for example a full-store 3 for 2, and these diluted margin and will not be repeated. Looking forward, in the second half of the year, subject as always to balanced sales growth, we would expect to see margins return to their normal guidance level for small accretion after some initial headwind from input inflation. If we deliver small margin accretion throughout the larger second half, this would suggest our full-year margin dilution will be between 40 and 60 basis points as our new guidance.

Finally, to profit generation, where it's important to note that our profits have historically been significantly weighted to the second half. Our guidance for the 26-week period is for underlying PBT between £20 and £22 million, after charging, £1.7 million of distribution centre, dual running and other risk mitigation costs, and the losses incurred in our development markets of the USA and China. Putting some numbers on this, the mid-point of this range would imply a headline profit growth of around 9% and this would increase to about 17%, adjusting for the £1.7 million of one-off DC-related costs. Adjusting further for the losses in China and the US would suggest our profit growth in our core operations of around 20%, which is in line with the volume growth [on a constant currency basis] of the business.

So that completes my summary and I'll now hand back to Euan.

Euan Sutherland

Thank you, Nick. So in conclusion, this is a good performance again in the journey to create Superdry as a global lifestyle brand. We are an opportunity-rich organisation, clearly illustrated by the continued strong trading in the first half, which benefited from many positive and planned drivers, including disciplined new space growth, ecommerce investment, new product innovation and a re-energised wholesale channel. That said, focus is key to our success, both in the execution of the clear growth opportunities for the brand and in delivery of the key third-quarter trading period immediately ahead of us. And just a final reminder, as Nick said 75% of our profits are half-two weighted. So with that, I will open up to any questions that you might have. Thank you.

Q&A

Richard Chamberlain

Could you comment on the very strong wholesale sales performance, in terms of how much of growth is being driven by sales to existing customers, the UK and internationally, and how much to new accounts.

And then an update on the sourcing environment, in particular Turkey, have you seen any disruption there and comment on the outlook for sourcing costs in general.

Euan Sutherland

So starting with wholesale growth, a lot of it is through existing customers in terms of the true multi-brand wholesale base. We're clearly increasing our franchise base every year and, as we've said, there's 30 new franchise stores that have opened in the first half, on top of around 50 that opened last year, so a slight acceleration in the number of new franchises opening and that is worldwide, so a good split between Europe and rest of world, as we look at it. Wholesale in general has been predominantly into existing businesses that are growing their franchises, with a bit of new business as well, so we're quite happy with the balance of that. The wholesale growth is as a result of the last couple of years of investment that we've been talking around these calls, sorting the behind-the-scenes infrastructure, both for the main line and the in-season sales opportunities and we've seen both of those feed into some very strong results this time around.

Briefly, on Turkey and I'll hand over to Nick just to cover a little bit of FX on that too, we did see some disruption in Turkey in the summer when the national disruption happened. That was the entry point into our peak production and distribution period for autumn/winter. That, practically the same as every retailer I think, caused us some delays in receiving autumn/winter stock through the early part of September. We have contingency and diversification in our plan, which has helped us, in that we are less dependent on Turkey than we once were, with a more balanced sourcing base across India and China now which allows us the dual-sourcing routes and we've now caught up. So we don't believe that it materially impacted the trade that you've seen reported through September and October but it was less smooth than any kind of normal season. There are some headwinds in sourcing, just pass you over to Nick to cover some of this.

Nick Wharton

A reminder in terms of the currencies we source in and the rough mix of that, somewhere in the low 40% is sourced and paid for either in each of US dollar or in sterling but a lot of that sterling supply is in sort of non-sterling-denominated territories, so there is an inflationary risk on that, with the balance of around 15% being sourced in euro. There are a number of headwinds that we face, FX is obviously one of them but also there is some cotton inflation that we are facing in the market, although we do buy forward on fabric, again to protect ourselves from that and there is a small amount of labour pressure in China, etc. So there is a tough environment and background. As we just said that will impact us progressively as we go through the period from a financial perspective and the hedge unwinds but we do believe we are advantaged against many of our competitors in terms of having more points of mitigation.

Nick Wharton

So fundamentally we have the opportunity that we are a scale business that is growing rapidly, so that gives us a strong negotiation point. We've got an ongoing programme of direct sourcing, with a target to improve that materially over the next couple of years. We're also increasingly dual-sourcing to protect supply and take cost advantage. And progressively, over the next couple of years, we'll start to see the benefits of our design-to-customer programme, particularly around increased harmonisation between our wholesale range and our retail range, giving us significant buying opportunity and scale. So in the second half, we think we will get back to the position where we will be accreting margin slightly. In the next year, there'll be a further drag and challenge into our ability to accrete margins. At this stage, we feel we'll be targeting to a flat [operating] margin performance.

Nick Wharton

Again saying that our preference, if we do face inflation, will be to take the long-term view for the brand and not pass that on immediately to our customers, again reflecting the fact that we have more levers to pull, in terms of mitigation, than many of our competitors.

Richard Chamberlain

Sure, okay, that's great. Thanks a lot guys, cheers.

Operator

Thank you. Our next question comes from the line of John Stevenson from Peel Hunt. Please go ahead, your line is now open.

John Stevenson

Can you talk about how extensively the new DCs are going to be employed coming to peak?

And then also if there's anything KPI-wise you can talk about around the USA, in particular the scale of the wholesale business that you've now built compared to where it was last year.

And finally, if we can talk about the wholesale order book for spring/summer next year?

Euan Sutherland

Okay, well perhaps I do the first couple and then pass over to Nick for the final bit of that. The new DCs, one in Belgium and one in the US, we said we would do a two-step process on this. Again, this reflects our cautionary approach around major infrastructure projects. We try and do one [major project per year] and this was our one. There were two DCs in it but it's the same kind of master system on it and we do it in a de-risked way, so we have both facilities open. They are doing probably half of the job that they will be doing when they're fully operational in early 2017. So in Belgium, we are running our off-price channel through that for the UK and Europe, so they are supplying our outlets. Full price stores and ecom stock has been kept in the UK facility for the whole of the UK and Europe for peak trading, which de-risks, given existing processes and existing teams, that very big volume base and we've got the Belgium operation up and running with the outlet volume, which again brings on and inducts the new team working with the same system that controls everything but with a more focused route to market.

The USA facility is ramping up and supporting retail stores only. Ultimately, that will get to supporting wholesale and ecom as well but we will filter those in, in a measured way, through the lower-volume periods of early 2017. Both facilities are performing ahead of plan, both facilities have come in slightly ahead of plan in terms of their timeline and slightly under budget as well. So we're pleased with the performance in the first half, there was a lot of work to do to open two more DCs, considering we were only operating with one, effectively, up until then.

Euan Sutherland

In terms of USA KPIs, we are pleased with the performance. Very similar report, really, to update you on today as we updated at the Capital Markets Day; retail, ecom and wholesale are all showing strong growth. Particularly on wholesale, the business is more or less doubled, up, c.70% year on year, albeit from a small base, and we improved the margin delivery from that because we've resourced the route to market out of less favourable environments for the brand into much more favourable environments for the brand. So out of the three routes to market – retail, e-com and wholesale – wholesale is the one which is – has taken the longest to turn around. The growth prospects there are still very good, they just have taken that a little bit longer. I think we reported this time last year, or for the period this time last year, that we'd been slightly slow landing retail; that's now got into good shape and we're just catching up a bit on wholesale.

Nick Wharton

In terms of wholesale trajectory and the forward view on that, while we're pulling lots of organisational and structural levers, and capability levers, in the wholesale structure, how they crystallise is through greater in-season sales, by having more inventory flexibility going into the season. And then, second, higher forward-order sales from better sales processes, but also better sourcing processes that we – so that we fulfil a greater proportion of the orders that we take.

If you look at the last three halves, in terms of wholesale growth, half one of last financial year grew by 8%, half two grew by 20% and, obviously, we've just seen half one grow by 40% in moving currency terms, so about 30% in constant currency terms. What we saw, in the second half of last year, was the start of the benefit of in-season sales from greater inventory flexibility, and the last half has seen both better forward-order crystallisation and better in-season. So essentially what we've got now is a step forward in the larger foundation and the larger base of the wholesale business, but we'll start to annualise the improvements that we've delivered as we get into the second half.

So I think, going forward, our guidance on wholesale, and we don't really guide on sales but we'd hope that the wholesale business, on a constant currency basis, grows, you know, by a team's performance each season. And while the order book, going forward, is not quite closed for the total of the second half, the order book would support that kind of guidance.

John Stevenson

Okay, brilliant. Thanks Nick, thanks Euan.

Operator

Thank you. Our next question comes from the line of Graham Renwick from Exane. Please go ahead, your line is now open.

Graham Renwick

Good morning guys. Just a quick one from me. Just wondering if you can give us the like for like development across Q1 and Q2 on an ex-currency basis?

Euan Sutherland

It's pretty consistent, really.

Nick Wharton

Yeah. There'll be a bigger currency hit in the – I don't have the exact numbers in front of me but, as you can imagine, most of the currency dynamic was a post-Brexit thing. So, essentially, you've got a full-quarter impact in the second quarter and only, a two-month impact in the first quarter. So there'll be a more significant impact of currency in the second quarter, but if you look at the headline number, the headline number was about 200 basis points higher in the second quarter than in the first quarter, so it's probably driven by currency – on a "constant currency" basis very constant.

Graham Renwick

Okay, thank you guys.

Euan Sutherland

As we look across the like for like performance in the first half, we were pleased at the consistency of the delivery in both quarters, and also up against some very tough comps from the previous year, in what was a relatively tough spring/summer and early autumn period; when it's very cold and wet at the start of the spring/summer period and warm and dry at the end, that's not the best environment for anybody. But we're pleased with the consistency of how we delivered it, across retail channels and ecom as well, the shape was good.

Graham Renwick

Thank you.

Operator

Okay, as there appear to be no further questions I'll return the conference to you.

Euan Sutherland

Okay, thank you. I guess, just to close the conference call, if anybody has any further follow-up questions we are around this morning, so we'll be happy to take them on a one-to-one basis. But thanks very much.

Operator

Thank you. This now concludes our conference call.