SuperGroup.Plc

1H16/Q2 Market Briefing

Thursday 5 November 2015

Euan Sutherland, Chief Executive Officer

Good morning everybody, and thank you for joining us on today's call where we'll be covering the performance of the business in the half year to 24 October 2015. I'm joined today by Nick Wharton, our CFO, and I'll hand over to him in a moment to briefly run through the detail of the Statement.

By means of a trading overview, I'm very pleased to report that the positive sales momentum we delivered in the first ten weeks of the financial year continued through the rest of the first half. While prior year comparatives remained relatively weak, encouragingly all of our channels: store, web and wholesale, delivered positive like-for-like growth, with our e-commerce business in particular going from strength-to-strength.

In addition to trading strongly through the half, we've made good progress against our four strategic objectives. Delivering these objectives will build both Superdry's international scale, primarily through opening of new stores in Europe and further global e-commerce growth, while also improving efficiency across the business.

We will provide much more flavour on our progress at our Interim Results in December, but it's worth focusing on a few highlights from the past six months now. The **Embed** element of our strategy is about driving the brand DNA through everything that we do and ensuring the development of the brand is informed by true consumer insight. Through the in-depth quantitative and qualitative research we have continued to build our bank of insight. This in turn provides the confidence for us to **Extend**, our second pillar, and broaden the appeal of the brand through ongoing innovation into adjacent product areas. Clear examples of this are the launch of Superdry Sport for Women, with a small collection which has performed very well, our Snow range; and finally and most exciting for us, our Premium range in collaboration with Idris Elba, which will launch later this month. Everything is on plan.

Our **Execute** part of our strategy focuses on expanding our business globally. We continue to expand confidently in Europe, opening 14 stores in half one, representing about half of our full year goal of adding around 130,000 square feet. We've also extended our global footprint through our wholesale partners, adding 16 franchises, 4 licensed stores, and 16 wholesale concessions in the half.

Looking longer-term, we are progressing well in the first stages of resetting our US businesses, though this has taken slightly longer than we had thought in our first estimate. Then on the other side of the world, together with Trendy, our joint venture partner in China, the set-up there is gathering pace with the aim of opening our first stores in Spring 2016 still on track.

Finally, we need to underpin our growth through our **Enable** programme in people, systems, processes and infrastructure. In line with our plan we discussed in July we have successfully combined our store and e-commerce stock into one single stock pool prior to our peak trading period, which is a very important infrastructure step. On the people side, I am delighted that Nick Tatum has joined us as Global Retail Director, and with his appointment that completes the new Executive Team.

I'll now hand over to Nick to take you through the details of the numbers, and we'll come back to question and answers. Thank you.

Nick Wharton, Chief Financial Officer

Thank you Euan, and good morning everybody. I'll work through the announcement starting with sales.

Total Group sales in the first half of the year increased by 22%. This was driven primarily by strong growth in our Retail division where sales rose by over 30%, benefitting from both a healthy new store opening programme and strong like-for-likes.

New own store space in Europe remains the Group's key priority and key value driver. Year-on-year our space has grown by 21%, of which for detail about a third relates to the US space we acquired earlier this year. Specifically in the half year we opened 63,000 square feet of new space, of which 53,000 square feet was outside the UK. Importantly, with a total European store footprint at the start of the year of only around 720,000 square feet, this represents a significant increase year-on-year, and as Euan has mentioned, we remain confident of opening around 130,000 square feet in the full year.

On like-for-likes, while against soft comparatives and benefitting from favourable weather compared to last year, our like-for-like sales maintain their momentum, growing by 15.5% in the second quarter and 17.5% over the half. And from a product perspective, our fastest growing range was womenswear where we saw the initial favourable design impact from our newly recruited Category Team.

Looking now at Wholesale. We continue to deliver improvements to our wholesale business, and the increase in sales over the six months reflects the initial customer response to those investments. Our growth in the half of 8% was similar to that in the second half of last year, but it has benefitted from some new business from our US operation, but has also understandably been adversely impacted by the strengthening of Sterling against the Euro.

Now looking at margin. We expect to see growth in the first half ahead of our full year guidance of 0-30 basis points. But this is due entirely to the strong participation of our Retail division which delivers higher margins than our wholesale operations, but also together with the benefit of lower year-on-year clearance activity within wholesale such that we have a higher quality wholesale sales operation. We would, however, expect margin accretion to soften during the second half given the far stronger retail comps we are facing and those ongoing from currency headwinds.

As regards to our net cash position, we continue to generate healthy cash flows. Our closing cash position of around £80m at the end of the half represents a good improvement from the same time last year, and this readily funds both the ongoing investment in the growth of the business, including our initial £9m cash injection to the Chinese joint venture, and our maiden dividend that we will pay early in 2016.

Finally to profitability. With a successful first half behind us we can enter the critical peak trading period between now and Christmas confident in the strength of our offer. And notwithstanding the significant hardening of comparatives across the second half, particularly in our e-commerce business, we remain on track to deliver full year underlying profit before tax in line with our existing guidance.

That completes my summary and I'll pass back to Euan.

Euan Sutherland

Thank you, Nick. We'll move across the questions. Thank you.

<u>Q&A session</u>

<u>Question 1</u>

Tushar Jain, Bank of America Merrill Lynch

Just two questions from my side. First of all, I just want to understand what's the total impact of promotional activity in the retail segment on the gross margin, and what has been the uplift on like-for-like sales because of promotional activities?

The second question is, I just want to understand in terms of the management structure, are all the key roles being filled or are you still looking out for some specific roles that needs to be filled within the Group?

Euan Sutherland

Promotions, if you remember in our model are a very small proportion of our sales, and if you look at the first half, in particular, it is the lightest area of our promotion. We did have a very short clearance activity through August, but if you look at it in total promotional participation terms in the year, still single digits, very, very small impact. So no real impact on that, and no real impact on the gross margin, Nick, in terms of that for the half.

Nick Wharton

No. I think where we'll be on that is we now have those clearance events on a very focused basis as part of our trading model. We held one of those, as Euan said, in the early part of August in a very concentrated time window. That is non-comparative year-on-year, but because it is a focused activity it is a relatively small participation of sales and therefore a relatively small impact in terms of the gross margin, but it is non-comparative year-on-year.

Euan Sutherland

Just a comment on promotions. Going forward we're just about to enter that very important kind of 6/7 week pre-Christmas where every retailer is at their promotional peak. For us it's our promotional peak too, but relative to all other retailers it is still tiny in terms of the proportion of our sales that goes into the promotional pot.

Just on the team. Nick Tatum, we're very pleased that he is joining us on 30 November. 25 years at Tesco in roles from store operations through to category management, he's been in the Buying team and also the Strategy team. Great fit for our organisation. The reason that we have picked Nick is that the big job to do in supply chain and Retail, which he will look after, is the improvement in efficiencies of our programme. He has huge experience in that area. That role is the final role in the Exec line up, so we're not looking for anybody else, the team is complete at that point.

Tushar Jain

Thanks for that. Just on the promotions, I assume you are pretty comfortable with your inventory position going into Christmas, no over-inventory overhangs or something?

Euan Sutherland

Yeah, we are. I think the big infrastructure programme of putting the e-commerce stock and retail stock together was our big target, was one of the very first milestones we had laid out in the strategy. That's complete. That gives us visibility across both channels of all of the stock that we have, which is an important advantage year-on-year, and that's been successfully put in place. And then if you look at total stock levels, we're in a good place.

Nick Wharton

Part of our business model, as you know, is one of high availability and therefore by definition high stock cover, so from a structural perspective we have good stock protection going into peak. That said, as we discussed at the end of the year where we did have a bit of a legacy carryover of inventory, we would expect some inventory efficiency during this financial year across each half.

<u>Question 2</u>

Tom Gadsby, Liberum

Hi, good morning. I've got a few actually. The first one is just the retail like-for-like, does that include the US business? It's not clear from the definition whether that's in there.

Nick Wharton

It's not in like-for-like. The US is not like-for-like at the moment, it'll be like-for-like next year.

Tom Gadsby

Okay, thank you. I missed what you said about the gross margin guidance, there was a bit of crackling on the line, what was that, you said 30 bases points, is that 30 bases points you're ahead of or for what period?

Nick Wharton

Yeah, the full year guidance is zero to 30 basis points, we'll be ahead of that in the first half, but the most significant contributor to that by a large extent is the mix between our Retail and Wholesale businesses, recognising the differential margin in those businesses at the gross level, therefore with what is 30% growth in retail against 8% growth in wholesale and that misbalance, that will drive a healthy mixed balance into the first half gross margin, and with our comps in the second half from a retail perspective there's a reasonable expectation that that wouldn't continue for the full year.

Tom Gadsby

Okay, so you're not particularly sort of making any change to the guidance at that point?

Nick Wharton

No, I think in terms of guidance per se we're half way through the year chronologically, but not financially, and therefore peak trading is ahead of us. It's good to have a solid half behind us but most of our profit is made in the second half and in the third quarter.

Tom Gadsby

Sure. Then on gross margin again how much of the benefit in the first half was from buying in stock with a strong pound?

Nick Wharton

The underlying fundamentals of our margin growth are pretty in line with what we talked about at the end of last year, so we continue to get scale benefit which is probably as significant as the currency benefit from there. So we're still seeing small amounts of accretion from that, some of which we'll always reinvest back into the customer in terms of price and customer experience. So we still continue to see that but it's relatively moderate compared with the mixed benefit that we've just talked about.

Tom Gadsby

Okay, thank you on that. And the stock levels versus last year, you said they're in a good place, what's the percentage change versus last year in terms of closing stock?

Nick Wharton

We're still working through that as in being sort of six or seven days after the end of the half, but we'd expect that stock overhang to unwind materially over the full financial year with a decent amount in the first half. So it'll still continue to grow in line with the operating footprint of the business, but we'd expect that growth to moderate.

Tom Gadsby

Okay. And then one last question, what's the competitive environment like in terms of your pricing? Where are you pricing your T-shirts and hoodies versus last year?

Euan Sutherland

We continue to invest in price, so any margin gains we're very actively looking category by category if we need to move our prices globally. There's a constant debate with every range update that we do, the competitive environment is pretty tough still, so what we've seen from our competitors across every high street globally, I see it in Europe, in America and in Asia, is that there's a lot of promotional activity. We actively don't take part in that, we haven't done that, and as we said on the previous question our only real spike in promotional activity is in the next six weeks or so. We will continue to do that. It is incredibly important for us to have quality branded product at a really good price globally. But I can't give you a simple answer to where the price is because in each market we will be sensitive to the pressures on that market and we will price accordingly.

<u>Question 3</u>

John Stevenson, Peel Hunt

Hi, good morning. A couple of questions please. Just starting off with the international performance, if you could add a little bit more colour in terms of how it's done. I'm particularly interested in how, now we've got some more stores in Germany that have annualised you can maybe talk about this like-for-like they're delivering after they've come through that sort of first year.

The second question, just on online, I know you don't necessarily quote a number, there's clearly a lot of momentum, there's a lot gone on operationally as well in terms of sort of the iKiosk and moving that into Europe, maybe you can comment on the sort of momentum you've got going through there.

And finally, I don't think you quote the constant currency sales figure, I'd be interested to see how you've done actually in total.

Euan Sutherland

Okay, let me pick up the first two, I'll leave the last one to Nick to comment on. So Germany continues to be a strong market for us, as you said, a lot of the new space that we've opened in the first half is in Germany and we have some key openings in the next six weeks in Germany still to come. Our plan is, as we said back in March, much more ordered in terms of which countries and the concentrations that we're going in to, so Germany and Austria is the focus right now, we're then moving up into Scandinavia and you'll see the first Scandinavian stores opening in the second half of the year too.

The annualising space that we've got in Germany is actually coming through fairly strongly. I think we've said before in the strategy update that our view on the maturity of new space in Germany is slightly longer than we thought in the kind of first phase, that continues to be the case but continues to be very solid, and we've seen that with the stores as they have kicked into like-for-likes in Germany.

So good footprint in Germany, continuing with the same vein really in terms of size of store. Store densities, customer numbers, customer visits being very similar to the UK.

Online, yes you're right, we did the big infrastructure project with the two stock files, that's taken us quite a lot of the half to make sure that was right in preparation for peak. In terms of other infrastructure pieces online, three things: firstly is more promotional capability online, all that does is allow our online business to be as flexible as the till systems in our stores, with the basic kind of mind-set in that any way any customer wants to buy from us they can, we make it as easy as possible, so that brings online in line with stores.

Secondly, we've put in faster and better online experience so you'll see if you're in different countries there was a different processing speed if you like in simple language, that's been addressed in the half and in the next two weeks you will see if you have a full PC offer a much wider screen impact which will launch in two weeks' time as well. So some nice kind of frontline PCs.

And then on the multichannel piece on iKiosk, you're right, that was a good test last year in the UK. By this time last year we had it in half of the UK stores, by full year last year we had it in all UK stores, and by this peak we have put it into Europe, both in terms of our owned stores and also we're testing it with our franchise partners as well. Early days on the European roll out but very similar results, so strong pick up by our colleagues in stores using iKiosk; customers very comfortable in every country using that technology too.

So as we've said in our brand strategy, the third pillar of that was to drive multichannel customers, the iKiosk is the bridge between online and in store when you're instore and that will continue to be a focus for us, but early stages into Europe very encouraging.

John Stevenson

Okay, and reasonable to see then the growth rate in online have sort of accelerated?

Euan Sutherland

I think they're fairly consistent with the last split that we showed you at the full year. As Nick said, the shape of our first half, second half shows much stronger like-for-likes as we pulled the plan together the second half of last year. E-commerce was a very strong part of that too, so relatively the comparatives that e-commerce have to get through are even bigger than the whole business. So I think that's a similar shape.

Nick Wharton

And John, to your point about currency, I guess our principle here is really to play a straight bat and therefore we've done everything in moving currency, recognising that currency is a movement year-on-year which can be either a tailwind or a headwind. You were right to say it is a headwind currently and to give you some indication of scale, although we're not in a position in the announcement of doing both data points because of its complexity essentially and it's materiality, but to give you an indication, in quarter two in retail like-for-like the currency drag was between 100 and a 150 basis points.

<u>Question 4</u>

Richard Chamberlain, RBC Capital Markets

Thanks very much, morning guys. I just wondered, I think, Euan, you said that the US reset just took slightly longer than you thought and I just wondered why that was the case, which areas you're talking about.

And then also I just had a question on the overall sourcing environment. I mean we know clearly we've got a strong dollar headwind at the moment but it feels like other factors might be getting a little bit easier in places like China and Turkey, obviously falling local supply costs as well. Is that something that you're seeing and can that help to offset some of this strong dollar impact on the gross margin hearing into next year? So two questions. Thanks.

Euan Sutherland

Okay, I'll do the second one first and come back to the US. I think you're right, I think that there aren't as many kind of absolute sourcing headwinds, I think for us we're still relatively small on the world sourcing stage, and so we have the opportunity to be a little more nimble in terms of where we place our sourcing base. What we're trying to do at the moment is to spread the sourcing base for a couple of reasons, one is we want to have longer and shorter lead time response. Because we've opened up the open to buy we've been able to respond faster within seasons, so some of the stock updates from early on in the season we've been able to repeat because we have more flexible sourcing out of the Near East and Turkey in our base there.

Contrary to that, also opening up the US business and the China joint venture has put a focus on our Chinese sourcing operation and there are some reasonably favourable opportunities there in both the duty and the routes and the sourcing base. So there are some bigger kind of headwinds which would affect larger producers, we're kind of below that line and able to flex with our sourcing bases, so we've got some opportunity as we said in the next five years to be more efficient in that area and that remains the case.

Coming back to the US, we laid out a plan, if we'd been launching in Europe where we've got more expertise and more knowledge of everything from customs through to local production, through to where you make the fixtures and all of that kind of stuff, we would have been a little faster.

We would have had the impacts of the US customs, for example, we're a new supplier as SuperGroup going into the US and they've got new supplier, standard processes to grab most of your imports and have a real good look at it so that's delayed stuff into stores by two or three weeks. So it's those kind of very operational things which have hit us.

We have now, in terms of the space of where we are, we're doing the hard yards as we said in the last update which is clearing out of all of the old Sunrise stock. That's been done so we now have the new stock ready. We have the fixtures and the density upgrades all done but the last ones were only finished last week. We'd hope that to have been finished by the end of September rather than the end of October so that's taken a little bit longer.

And then in Wholesale I think we probably underestimated the negative impact of the Sunrise business on our partnership relationships with some of the wholesale partners and it's taken just a few more months of meetings and convincing them that actually we've got some really interesting new stuff coming through.

That's now coming through both on a big five, national wholesale base and also now on a regional base. We have now recruited our regional wholesale team across the US which will start to infill some of the more regional accounts too. Everything is on plan it's just kind of taken a couple of months longer than we would have ideally wanted to do. And that comes back to the final comment on the US is this is not a short-term sprint it's a long-term, steady as we go strategy, there's no miracle in this it's just build a good business over a longer period of time so I don't think there's any particular issues there. We would like to be a little bit further ahead but we're not.

<u>Question 5</u>

Anjli Shah, Stifel

Morning guys. Just two quick questions from me please. So first of all on the single integrated stock pool when can we expect that the wholesale stock pile will also be integrated? And also do your systems now allow you to have a single view of stock?

And the second question is progress made on open to buy, are you able to quote some percentages?

Nick Wharton

In terms of the stock pool we've got quite an extensive supply chain development programme over the next few years so we need to phase that in order to manage the risk of execution. So how that works roughly is the important priority before peak this year was to combine our store retail and e-commerce stock availability so that will give better availability actually into both channels as we go into this peak.

The next priority for us is during the Spring/Summer of next year, you'll recall we're going to expand our EU DC, so that's the next biggest priority for us to get nearer to market support for the geography that is our biggest growth area. And what that means is if that's the priority for essentially Calendar 16 to execute well, before peak, that means that the stage after that, which is to combine the Wholesale and Retail pools into a single pool of stock will be during essentially the first half of Calendar 2017. So it's ranked in terms of priority and then phased in terms of risk and making sure we deliver one thing great every year.

In terms of from a systemic perspective we've always had a clear view of what stock sits in what channel. The issue in terms of single pool is the flexibility of moving it readily between channels.

Euan Sutherland

Just picking up your second one on open to buy it varies by category because it varies on the technical build-up of the garment. So if you have a very technical snow jacket or windcheater it's very difficult to repeat that buy because it's quite a complex garment construction. But if you've got a graphic t-shirt or a hood that gives us much more flexibility.

So I can't give you one answer for the whole range other than indicatively we would have bought 100% nine months in advance, as the season starts we're probably about 70% - 75% bought. But that varies dramatically so every week we are updating our buys on graphic t-shirts and hoods and joggers. We will still be placing one buy for a very technical windcheater or a jacket at the start of a season to make sure we've got it in time. But hopefully that gives you some kind of view of where we are.

<u>Question 6</u>

Paul Steegers, Bank of America Merrill Lynch

Morning guys. Most of the questions I wanted to ask have actually been answered, there's maybe two. Just on the China JV with Trendy where you are there in terms of the set-up? I appreciate it's early days, but in terms of are you completely on track? What are you seeing and what are the losses there for the current year?

And then secondly there's a view out there that SuperGroup does well in terms of retail like-for-like against easy comps, but less well when comps are tough, obviously your comps are tough now going forward in the second half; in your business plan and looking at your collections, Autumn/Winter, would you still be hopeful of positive like-for-like growth in Half 2 on the retail level? Can you give some colour on that please?

Euan Sutherland

Okay we'll do the China one first and then come onto the like-for-likes. So China is still in the set-up phase, the first store is due to open late Spring, early Summer next year, that's still on track. We now have recruited all of the joint venture senior team. We have done all the hard work of the regulatory and legal set-ups and everything else. That's all in place. We've selected the range, we're now going through the detailed Chinese testing before it can go on retail sales.

So I guess the summary in all of that is everything is on plan, lots of hard work to do between now and late spring before the launch.

Just an overall comment on like-for-like and I'll hand over to Nick for the detail, clearly I think every retailer finds it difficult if there's a very tough comparative period. We feel like we are set up well for peak season, the stock levels are there, the infrastructure project's done. As a retailer we would always be looking for positive like-for-likes, I think there's a relativity around that, first half/second half, which is very significant with us.

Nick Wharton

Yeah just in terms of China the anticipated costs for us in the second half of the year, and there's not a lot in the first half, is towards about £1m of cost to us which would be a non-comparative cost into the second half.

I think in terms of like-for-like we feel we're very well-prepared, we feel our proposition is in a good place, but it's difficult not to face into the stark reality of the fact that we don't exist in isolation and our comparatives do move pretty swiftly and pretty steeply between the first half and the second half. So when we've been talking about it earlier in the day in the first half it's great to have it behind us but on a two-year basis we've done about 12% like-for-like and our one year comp in the second half is about 11.3%, so it does indicate the size of the challenge in the second half. But we are confident but never complacent.

<u>Question 7</u>

Andrew Wade, Numis Securities

Hello there chaps I've snuck in at the end. Just a quick one first of all on gross margin, just a quick bit of back of fag packet it looks like mix 30% in Retail, 8% in Wholesale could have got you getting on for 100 basis points. Then you've got scale FX and you mentioned that Wholesale had improved as well. It sounds like unless you're going to be a long way ahead of that, 0 – 30 in H1 that there has been a reasonable chunk of reinvestment in there. Is that fair or am I back of fag packet wrong?

Nick Wharton

Directionally those numbers aren't unreasonable. There is, as you said, a bit of non-comp promotional activity through our events in August which would dilute that slightly. There's then mix impacts between the channels within Retail, so e-commerce relative to UK, as an example. And as Euan says we are looking continually to reinvest in the brand and within that in pricing on a geographical and skew option-specific basis. So part of our model is to take the gains that we get from sourcing and ensure that part of those are reinvested in the customer. But directionally you're not wrong.

Andrew Wade

Okay. And you mentioned the mix bit, we've touched on this bit before, but you mention between e-commerce and UK, as I understand it the e-commerce is higher right because some of it is selling international without the VAT piece?

Nick Wharton

Yeah in its broadest sense the EU physical is margin accretive against the UK, e-comm depends on what territory it is and if it's through our own channels or through a partner channel.

Andrew Wade

Fine, okay, helpful. And then the second one just on the Wholesale side, obviously up 8% with a bit of benefit from the US, I was quite surprised actually that there is a big number in terms of the franchises licences in the wholesale businesses opened during the period, that alone probably could have accounted for a big chunk of the wholesale improvement, is that fair or is there some underlying growth there as well or indeed some churn?

Nick Wharton

Yeah there's some underlying growth in there. I think the factor which we don't put everything in the statement, what we have got in the first half is a lot less clearance activity. So we've got a higher quality Wholesale business, so it's more mainstream, full price, than it is clearance. And what that does it will accrete the margin, back to the previous point, but it puts a slight dent into the Wholesale revenue in the first half. It is pretty much a first half factor not a second half factor.

Euan Sutherland

But Andy just a final point on the number of franchises and concessions those stores are obviously much smaller than our own stores, so you have to open a lot more of those to get the same impact even though there's more.

Andrew Wade

Yeah I'm just thinking on the base there you've got 200 or whatever the number is now, Wholesale and network businesses and you're adding 16 franchises, four licences and so on and that as a proportion of that is, whatever, 10+ maybe a bit more. That's what I was getting at.

Euan Sutherland

Yeah and they weren't all open on the first day of the half.

Andrew Wade

But on the flipside there were have been full year effective stuff. Anyway we're getting into details there which no one else needs to know. Okay good that's very helpful I appreciate that answer. That's clear. Thanks.

Concluding comments: Euan Sutherland

Okay thank you everybody, if there's any more detail you need during the day please feel free to call through. Thanks very much.