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Operator

Hello and welcome to the analyst update call. Throughout the call all participants will be in listen only mode and afterwards there'll be a question and answer session. And just to remind you this conference call is being recorded. Today I am pleased to present Euan Sutherland, Chief Executive Officer. Please begin your meeting.

Euan Sutherland

Thank you very much and good morning. Everybody. Thank you for joining the call at short notice. I'm joined by Ed Barker our CFO. You will have seen that we've updated on trading today, against a backdrop of weaker consumer confidence this summer. As you'd expect Superdry is not to been – has not been immune to the market wide issues that have also been affecting our peers. I wanted to update you on two financial impacts on our performance this summer. Firstly weather related trading and secondly foreign exchange cost. The summer and the autumn to date have seen very unusual and unseasonably hot weather conditions consistent across all of our major markets of the UK, continental Europe and on the east coast of the USA. Every market in which we operate has reported exceptional weather conditions over the whole of the last five months. Critically these conditions have continued through into September and the first half of October and that has impacted demand for Autumn Winter product. Particularly in the sweats and jackets categories. Which in Superdry account for around 45% of our annual sales. We have also seen this weather impact through the well-publicised challenges facing some of our trading partners impacting our short-term e-commerce and wholesale growth. This is expected to adversely impact full year profits by around £10 million. Now as we begin to transform the product portfolio at Superdry as part of our global digital brand strategy and the work we started in the earnest in the summer of this year, we will reduce the risk of this recurring in future years by lowering the extent of our reliance on those cold weather categories. We're now five months into this 18 month product diversification and innovation program to broaden choice for our global consumers. This will address our dependence on heavier weight product and allow us to maximise the global Superdry brand impact. We will appeal to more global consumer life stages and occasions and provide tangible long term growth for the brand.

So what does that mean? In simple terms we're rapidly accelerating expansion into lower participation categories. That is where Superdry underperforms its natural market share such as dresses, skirts, women's tops and denim. And this summer one of our fastest growing categories has been women's dresses. We are further extending into new market segments where the brand can sit comfortably such as premium with Superdry edit for women and men into sport where we have already created a growing whole year-round business and license product categories.

While continuing very important to maintain strength in our core categories of sweats, jackets and T-shirts by driving more relevant innovation based on consumer insights and market by market range selection. In addition we have just launched a program of fast to market, high quality men’s and women's fashion that lands every six to seven weeks online in top stores and for key wholesale customers. This product diversification and innovation program along with the appointment of Brigitte Danielmeyer our Chief Product Officer who starts with us today will optimise Superdry's product offering in the future.

Secondly, we've seen an impact from historic post-Brexit foreign exchange hedging mechanisms that Superdry had put in place. These have not turned out to provide a degree of protection as was expected when they were set up. This will lead to around 8 million in extra foreign exchange costs, but evenly over the financial year. In terms of the half one out turn, we have detailed what we expect to report and importantly this reflects continued positive brand growth despite the warm weather disruption which is still lead by strong performances from the capital light channels of wholesale and our own e-commerce site.

The importance of Superdry's cold weather categories and the normal profit cycle of its business where we typically deliver 70-75% of full year profit during the second half of our financial year means that our full year profit will be heavily influenced by the performance in the second half. To give some context in the small number of cooler days in September, we saw strong performances. Particularly from our cold weather product categories as fruitful materially increased.

Finally, it's clear to us that global consumer behaviour is changing at an ever-faster rate and the reality is that Superdry must continue to invest in order to stay at the leading edge of development. Based on our global digital brands strategy announced in September 2017, we anticipate making accelerated developments in the region of £5 million in the second half of financial year 19. In brand communications digitisation and automation across the business and as I've outlined earlier in product development. The investment in adapting our stores for digital world is highlighted at the prelims in July 2018 continues at pace with encouraging early signs.

Looking ahead there are challenges of course. As we've highlighted today and not least as we enter peak trading period, but I believe that Superdry is in a far stronger position than it has ever been. The business is in great shape for peak trading and we will weather the short term impacts presented this summer. We have a strong brand, loyal consumer base, and we have significant opportunities ahead in terms of geographical expansion, category extension and the ability to leverage our multi-channel operating model in a digital world. It's clear our world is changing. Our customers are changing's and Superdry is changing too. I'll pause there and happy to take any questions that you may have.

Q&A

Operator
Thank you and ladies and gentlemen if you do have a question please press 0 and then 1 on your telephone keypad now. If you wish to withdraw your question you may do so by pressing 02 to cancel. And there'll be a brief pause while questions are being registered.

The first question is from Michelle Wilson from Berenberg. Please go ahead your line is now open.

Michelle Wilson
Hi, good morning. Thanks for taking my questions.

Euan Sutherland
Hi Michelle.

Michelle Wilson
Hi. I've got a few if that's okay.

Euan Sutherland
Okay, sure

Michelle Wilson
So first of all could you fully explain the details around the FX hedge? So, what exactly was put in place and what went wrong there? And then in terms of the wholesale business, I noticed in the statement you mentioned that wholesale would grow at high single digit for the first half, but also for the full year. Could you just talk us through what's happening in the wholesale business? Why that order volume is declining? Why you expect that to continue into the second half? And then the third one around the inventory position just as it stands today. Where you expect it to be at year end and a little bit of an inventory rebasing has this kind of warm weather issue halted that rebasing? And exactly what that means for the cash position now after the special is paid in the next few months and then at the yearend as well, please?

Euan Sutherland
Okay great. Let me take those in the order wholesale first and then FX and then inventory. Wholesale, yes we've updated because we're trying to give everybody the visibility that we can see as we sit here today so we have further visibility in wholesale ahead given the order book. That is slightly lower. We were guiding to kind of small double digit moving to high single digit. Basically, that's due to the end season order piece of our order book. We see our wholesale customers and they've giving us feedback. Not just our brand but all brands have got a fair degree of stock still to get through. So, that's slowed up the flow of in season, so we're reflecting that. Going through into the second half on a cautious basis. So, that's quite simply the kind of move on wholesale. Actually, I'd just comment briefly on inventory and a kind of context piece and then hand over to Ed to talk about FX and inventory.

Inventory clearly, we have routes of our product which goes from full price into outlet as well as a flexible sale period which we can implement into the second half. At this stage though, even although we are chronologically halfway through the year it is only a quarter of the way through the Superdry year. So, we still have a lot of opportunity to sell full price and off-price product in the rest of the year. So, I guess that's the difficulty with this announcement at this point in our year is the degree of uncertainty but degree of opportunity that we have as we look into what is a very big second half for us. So, hopefully that does give you a bit of context into that. I'll hand over to Ed on FX to give you a bit more of the details.

Ed Barker

Thank you. Yeah, okay. So, just to give a little bit of overview on FX first in terms of the context. You know you'll all be aware that Superdry is a global business. We operate in a number of different countries and therefore operate with a number of different currencies and that means our arrangements are complex. We've also been growing at a very good rate. And as we have grown, we have not applied hedge accounting. And therefore, we've not needed to match our hedges to cash flows exactly which is the requirement of hedge accounting. And that's because we have a large natural hedge as part of our business and that natural hedge is growing and changing as the business grows year on year with its international operations. So, post-Brexit we've seen some quite significant currency movements and that moves us into a more volatile world. To give you a little bit of background again FX contracts help for trading. Total around 600 million in terms of their cash flows and that's fairly evenly split over inflows and outflows and that's to hedge our sales, cost of sales and costs that are denominated in foreign currencies. And therefore, this movement that we're reporting today represent a movement of just over 1% on those cash flows hedged.

In terms of the historical hedges in place, what we have found is that they are not fully aligned with the FX rates that we've assumed for buying and selling purposes within the business. So put simply, this means that the price that we expect to pay for our stock is a little bit higher than we had expected and the amount that we expected to receive for our FX denominated sales is a little bit lower than we'd expected. And that's because our hedges are not quite as effective as we had first thought.

In terms of inventory Michelle, and your question there we were in a good position on inventory exiting the year. We had seen 16% sales growth last year and only 3% inventory growth and that was part of the inventory reduction program that you talked to. That program was due to end at the end of the summer and we have worked our way through that. Of course with lower sales over the summer there will be some additional stock that we hadn't originally forecast for, but Euan points out we have roots to clearing that stock both within our full price estate through our normal sale mechanisms and also through our outlets which are there in order to clear stock. And therefore, we'll talk more about the inventory position and where we're exiting interims when we're further through peak as part of it.

I think you fourth element of your question was around cash. Clearly, we're not updating on any cash actual guidance today. We're not giving any additional CAPEX update. I think we talked about CAPEX at prelims being in the 50 to 60 million range and probably at the lower end of that range. Clearly, lower profits will impact the cash position. But we are a cash positive business at half year and year end and historically. And therefore, you know, there is capacity within our cash to absorb the ups and downs of trading.

Euan Sutherland

Okay, thanks Michelle.

Michelle Wilson

Great, great. Thank you very much. Could I just follow up on the FX? I guess there's other businesses that have similar currency exposure, which haven't had these similar issues. Why is it that Superdry has had them and how do we get comfortable that this won't occur again in the future?

Ed Barker

So, again it comes back to the historical hedges that we had in place weren't fully aligned with the rates assumed for the buying and selling purposes. So, when we align those and have you know clearly the business working on those, that should you know take out that degree of risk. We'd also looked towards you know I alluded to hedge accounting and that it hadn't been right for the business during its growth phase. The business is going to continue to grow but IFRS9, I don't want to get into the technical details, but there has been an accounting standard change that means it will be easier to apply hedge accounting going forward and when the time is right we would look to move Superdry to hedge accounting. That means that our cash flows will be much more aligned with the hedges that we have in place because that's the only way that you can apply hedge accounting.

Michelle Wilson
Okay, great thank you. And what would need to be triggered for the time to be right to move to that?

Ed Barker
So, we have a number of different products in our portfolio. And we have different cash inflows and outflows at the moment. We need to be able to align the business with all of those in order to be able to do it. So, I don’t want to put a timeframe on it at this stage. It's something that we need to look at over the next six to 12 months and you know we'll come back to you at - certainly by prelims and let you know where our thinking is on that.

Michelle Wilson
Great. Thank you very much.

Ed Barker
Okay, thank you Michelle.

Operator
And as a reminder if you have any questions for the speakers please press 0 and then 1 on your telephone keypad now.

Euan Sutherland
Okay, if there are no other questions for the call we are around all day. Very happy to take your one on one calls at any point. Come through to Ed or Adam or Estelle. Very happy to do that. We do have our capital markets event planned for tomorrow afternoon, which is going ahead at our Regent street store in London and we look forward to seeing you there. We will update on the previously announced programs that we've highlighted and some of the investments that we've talked about today. I guess all that remains for me to say is that we are very confident of the medium and long term growth plan in the business and that we're very confident that we will weather this very unusual summer period and move the business from strength to strength. So, thank you for joining the call today and again happy to talk one to one with anybody who wants to follow up with any other questions. Thank you.

Operator
This now concludes the conference call. Thank you all for attending. You may now disconnect your lines.