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Presentation

Operator

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

Euan Sutherland

Thank you and good morning everybody; thank you for joining the call. I'm here today, as usual, with Ed Barker, our CFO. You will have seen the quarter three trading update that we issued earlier today, covering the 13 weeks to 26th January. Now I'll just give you a quick overview and then Ed and I will take any questions that you may have.

When we updated you in December, we further highlighted the issues that we're facing and the actions being taken to tackle them. This announcement shows that Superdry remains on track against that backdrop and market expectations. As expected, sales in the third quarter continued to be impacted by both the ongoing issues in product mix and relevance and until very recently the lack of any prolonged period of cold weather across our key markets.

In spite of these issues, global brand revenue rose by 5.4% to £479 million, driven by our wholesale performance, predominantly through strong forward order dispatches, complemented by continued strong full-price wholesale growth in our USA market. Group revenue fell by 1.5%, impacted by subdued performance of our retail channel. Extra to the issues that we had outlined in December, our e-commerce performance reflected the strategy to reduce promotional activity on our own sites in key European territories, such as France, Belgium, Holland and Scandinavia. In product terms the story was very much the same as we've previously reported in December. We saw relative weakness in jackets and sweats, both because of the warm weather impact and the lack of innovation to drive relevance. However, we continue to perform well in the areas where we have innovated and moved on, such as our active range of snow and sport, as well as in dresses and in t-shirts. The intensified transformation programme that we updated in December, which builds on the product and innovation programme launched last summer has continued to gather pace in the period and we're very pleased with the progress to date. We will give extensive details of this at a capital markets day planned for the end of March, focusing on our work on product and brand and the cost transformation programme. So, today, just a few words on each of those ahead of that event.

The product diversification and innovation programme has continued at pace and the appointment of Phil Dickinson as creative director has added further focus and drive to this. Phil has hit the ground running and is working well with the wider exec team and design, creative and marketing teams and we are very excited about the impact that he is making. The programme of work to evolve the brand is well underway and making strong progress, driving commercial improvements in our brand architecture which can be flowed through product, stores and online and also through our key relationships with our wholesale and franchise partners globally.

Our cost efficiency programme, which is targeting gross cost savings of at least £50 million a year by FY2022 started before Christmas and has gathered significant pace in the new year. This programme includes a granular view of our store portfolio, central costs, procurement and the supply chain.

So, in summary on these opening comments, we recognise the current short-term and largely legacy product issues that we face. This is a tough period for the brand. However, against this challenging backdrop, we are very much in line with market expectations for this year and have delivered positive brand sales growth again. We are excited about and confident in the transformation programme that is underway and look forward to sharing the details with you next month at the capital markets day. Happy to take any of your questions on Q3.

Q&A

Operator
Thank you. Ladies and gentlemen, if you do wish to ask a question, please press 01 on your telephone keypad. If you wish to withdraw that question, you may do so by pressing 02 to cancel. There will be a brief pause while questions are being registered.

And the first question comes from Michelle Wilson from Berenberg. Please go ahead, your line is now open.

Michelle Wilson
Hi, good morning.

Euan Sutherland
Morning, Michelle.

Ed Barker
Hi.

Michelle Wilson
Three questions from me, please, first of all on guidance. When you set the guidance at the half-year of £55–70 million, I think you flagged that at the mid-point of the guidance you were factoring in PBT down £11 million in November and December and then normalised, or in line with your expectations, for the remainder of the year. How has January done? Was that back in line with your expectations and is it still possible to hit the mid point of your previous guidance, which would be the top end of the current consensus range?

And then a second question on e-commerce: you mentioned the lower discounting being a bit of a drag on revenue; should we see a positive impact on gross margin from that for the period and for the remainder of the year?

And then thirdly, just on the appointment of Phil Dickinson as Creative Director, looking at his background it's very much sports brand focused. Is that an indication of increasing focus on Superdry Sport going forward?

Euan Sutherland
Okay, thanks for that. If I do the last one first and then I'll hand over to Ed and give you just a bit of a shape on the guidance and the e-com piece. Yeah, Phil has done a couple of stints at Nike but has also worked for a number of other brands, both on the agency side and directly. He's got quite a background in womenswear as well. We do see that there is opportunity across the main line but there is significant opportunity in Superdry Sport. We have another couple of concepts and sorts, which we want to share with you at the end of March, building on some of the work we've done with our Icons and also the work that is underway to drive the premium range of Edit. So he's got a very broad background; he's a very commercial, creative individual and he's got a real passion for the journey that we're now going on. So good fit and great experience, I think, would be the headlines and I think the best thing to do would be for you guys to hear from him directly in the capital markets day and that's what we're intending to open up with, so you can have full access to Phil and where we're going.

Guidance, Ed?

Ed Barker
Yeah, so in terms of your other two questions, Michelle, so the first thing is this is really just a trading update so we're not going to go into detail on profit guidance or gross margin but what I will do is just replay to you what we said on 12th December around the range of £55–70 million. In order to meet the top end of the range we would have needed an extended period of cold weather and more consumer confidence. We haven't seen that and therefore we said we would be more at the bottom end of the range without those items, so therefore comfortable with that range of £54–63 million, which is the current consensus range as a result of that.

In terms of gross margin, again we said that in the first half we'd seen a 70 basis point deterioration, most of that due to the wholesale mix, which we'll continue to see into the second half. But the second half will be dependent on the level of clearance activity required in terms of trying to clear through some of the excess stock that we have as a result of the sales performance. And we said that that would be an increased level of gross margin deterioration in the second half as a result of that. Clearly we are going through the January sale into February now. We've still got three months of the year to run in terms of that clearance but we would expect that gross margin deterioration to be, yeah, 100–150 basis points, I would think, at this stage but still dependent on the clearance activity, in line with what we said back on 12th December.

Michelle Wilson
Okay, great, thank you.

Euan Sutherland
Thanks Michelle.

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
Hi, thanks, morning guys.

Euan Sutherland
Hi John.

John Stevenson
Hi. Can you talk a little bit more about the exit rate just in terms of, obviously, how things hopefully improved as the weather kicked in and maybe touch on how you performed sort of territory by territory? And also I don't know if you've got any stats around the autumn/winter 2019 sell-in that's been going on, obviously, the last sort of – for 5–6 weeks, any sense of how the new ranges are performing, or anything you can add in terms of clarity around that?

Euan Sutherland
Yeah, no, absolutely. Let me give you some flavour and some colour around that. So exit rate out of the quarter was better, better across all channels. We saw some more normal weather hitting us kind of final week of the quarter and first week of quarter four. Every time we have seen that, we have seen the business react positively. We just haven't had enough of those weeks yet to string that performance together. So that continues to give us confidence. We – clearly these weeks are much smaller than the weeks in November and December, so there is less impact in it but in terms of percentages we've definitely seen a pick up and a good reaction to that, which kind of gives us more confidence in the underlying position of the business.

Autumn/winter sell-in, a couple of pieces on this just as shape. Clearly we have more stock than we thought we would have at the end of autumn/winter 2018. The rest of the market has the same issue, pretty much, across wholesale, so it was a slightly tougher sell-in than we would have hoped if we had had a normal winter season. That said, the reaction to the updated range, as far as we got to it, for autumn/winter 2019 has been good, holding our guidance on wholesale and we've also got the extra category – incremental category of kidswear, which we are starting to sell-in now. So mainline has gone out, as you say, it's been in place and been selling out for about four weeks or so and the comments I've just said kind of relate to that. Kidswear we delayed slightly, we've pulled together a separate sell-in, which has just happened and the appointments, certainly, for that, have shown very good interest in that range. I haven't got any indicative numbers yet. But that looks like it will be a positive reaction to that new range.

So a couple of pros and cons, to be honest, just looking at a kind of honest assessment of where the market is but I am keen to reiterate that our guidance on wholesale remains.

John Stevenson
Okay, brilliant, can you comment a little bit on the sort of country performance?

Euan Sutherland
In the forward order book or the existing?

John Stevenson
Sorry in the – for the quarter.

Euan Sutherland
For the – sorry, for the quarter, yeah.

John Stevenson
Yeah.

Euan Sutherland
So the – I guess the standout performance for us was US again, US wholesale growing strongly again, so having some good impact in there. We saw good growth in Eastern Europe and rest of world. We've seen relative weakness, if you go to the other end, around UK and Germany. I think some of the wider issues around, potentially, Brexit, consumer confidence and weather hitting there. Germany, I think a tougher economic environment right now but it's across the board good, in wholesale terms and the numbers in the quarter are strong. But if you wanted me to rank them it would be kind of USA top performer and then Eastern Europe and rest of world next. Does that help give a position?

John Stevenson
Yeah, that's great. Thanks. Thank you.

Euan Sutherland
Yeah, okay. Thanks John.

Operator
...question comes from the line of Kate Calvert from Investec. Please go ahead, your line is now open.

Kate Calvert
Good morning all. Three from me.

Euan Sutherland
Good morning.

Kate Calvert
The first one is on the online business. Was your UK online business in growth in the third quarter? The second question relates to gross margin because you have already mentioned that the second half gross margin performance is in line with sort of the guidance you gave in December but have you had to spend more on marketing to try and shift the stock? And the third question actually is on your stock levels; you said they're higher than ideal. What's your view on the quality of that stock?

Euan Sutherland
Okay, let me pick those out. If I go to stock first and just give you an indication of kind of quality of stock, we have our youngest stock file that we've ever had in the business, so 90% of the stock that we are holding today is autumn/winter 2018 and spring/summer 2019. So if you remember back the last couple of years, we had a job to clear up to seven seasons' worth of old stock; that has been done. So we've done what we said we would do on that. Clearly we've gone through autumn/winter 2018 and underperformed where our expectations were and in particular in the key categories of jackets and sweats, so we have more stock than we wanted to as we've exited that but it's relatively new stock.

Now, clearly, given the change in product direction and the changes we've made last March, then we don't particularly want to drag much of that into full-price stores again, so we're just looking at how we exit that stock as we go through the final quarter of this year and into next year. But the ageing of the stock much, much better, the much more current stock; we do have a lump of stock which we have to work our way through.

On marketing we have still been very selective around our marketing spend; it's still very, very low in comparison to other competitors and it's still much more in the digital performance marketing arena. We saw the relative efficiency of that spend be challenged as we went through December, so the cost per click and the other digital metrics being quite challenging. We only have spent marketing where we've seen the route to a good return directly on sales in that period, so while we spent a little bit more, it wasn't significant in the period. Online – online was challenging in the UK very much for the reasons of mild weather, lack of jacket sales and sweats. So that was under pressure, as we've seen everywhere. When you look across the whole world for us, in retail, given the proportion of jackets and sweats in our mix then that's been under pressure for the reasons that we've said and it's a more fundamental product issue that we've highlighted rather than a channel-by-channel issue.

On margin, Ed, do you want to just update on that?

Ed Barker
Yeah, so it wasn't so much that we were updating on it here because that's not what we're doing as part of this trading statement. What I was reiterating and replaying is what we had said back in December, that we expected margin to step down in the second half, as we would have to discount more in order to clear through our stock. Also in that mix is that slight increase in marketing but nothing significant around that. And – but what we're broadly saying is that we're happy with the consensus range.

Kate Calvert
So can I just come back to you on your UK online; was that negative then? Is that what you're –

Ed Barker
So over – well, you can see the e-commerce number overall was negative and as part of that –

Kate Calvert
Yeah.

Ed Barker
– the UK was negative.

Kate Calvert
Okay.

Ed Barker
But different countries up and down as part of that.

Kate Calvert
Right, okay, thanks very much.

Operator
Thank you. Our next question comes from Niraj Amin from UBS. Please go ahead, your line is now open.

Niraj Amin
Hi, morning guys.

Euan Sutherland
Morning.

Niraj Amin
I just had a quick follow-up from Kate's question, actually, around inventory levels. Can you kind of just remind us your kind of routes to market in being able to clear some of this excess stock and if you fast-forward to the end of the year, where would you like to be in terms of inventory position? Should we be thinking about this also having a kind of spillover effect into the first half of FY2020 or would you like this to be almost done before the year end?

Ed Barker
So in terms of the inventory levels that we're carrying, we said that at the half-year it was a little bit higher than we had liked. We expect that to continue through. So in terms of how we would normally clear that, we would have our January sale, where some of the currencies and – with the lowest rates of sale would move into it. We would then hold some of that stock for the same January sale next year. So we would be clearing autumn/winter 2017 alongside autumn/winter 2018 as part of that. We wouldn't want to necessarily send all of the stock back to depot.

Equally, we would flow a lot of that stock that is in depot down into outlets and we have the flexibility of how much we specifically make for outlets alongside that. Our third route, after that, is we have some further, kind of more discounted channels, around eBay and things like that, where we would put the stock out. So those routes are our natural routes to market. And as Euan has already said, the stock is at its cleanest, or youngest than it has been in, certainly, the recent years of Superdry. Therefore, in order for those flows to work, we will be holding more stock at year-end as we hold it over for the next January sale and also to flow into outlets. So we're going to be at a higher level of stock than we would have necessarily expected at that point in time but instead we won't be making for outlets and shipping that in as part of it. So you can expect a higher level of stock come the year-end.

In terms of then how we clear that through that next year and the impact of it, obviously we've had the impact of clearance going on throughout this year. So will it be highly incremental to that? We don't expect so. Will it be a continuation of the clearance that we've seen this year in terms of how we're doing it? More than likely. Okay? Still there?

Niraj Amin
Great, sorry, that's perfect. Thank you very much.

Ed Barker
Okay.

Euan Sutherland
Okay, thanks Niraj. Thanks.

Operator
Thank you. Our next question comes from Wayne Brown from Liberum. Please go ahead, your line is now open.

Wayne Brown
Morning gents.

Euan Sutherland
Hi.

Wayne Brown
Just four from me. I'll just take them one at a time, if that's okay? Just on sales densities, it looks like sales densities are down by about 11%, if my maths is correct. So can you just talk to me about where you are seeing – if there are any geographical areas where you are seeing hit the hardest and I'm assuming the UK is probably up there in the ranks of them, so can you talk to me about store impairments and closures that we should expect at the prelims?

Ed Barker
Yeah, so shall I take that first?

Euan Sutherland
Yeah, go on.

Ed Barker
So yeah, broadly, your maths is right, somewhere about, like for likes, when you triangulate them, to around that sort of range and store densities, as you say, around that sort of range. That is exactly why we are undertaking the store review, Wayne. It is right now that we are seeing the channel shift that we continue to see and the relative deterioration.

There's going to be two elements to that, in terms of how it will be looked at. There's the accounting element, where we are driven by the accounting standards in terms of looking forward 3–5 years and where those stores could be, in profitability terms, going forward. Again, as we said at the half-year and have said previously, as at today, we don't have a long tail of unprofitable stores but if you throw that 3–5 years forward, with the deteriorations that we've been seeing, that could well result in an impairment and onerous lease but that is an accounting-driven and non-cash-driven exercise. The other exercise and the more important exercise is the commercial exercise of us deciding on what the right-size store estate is, going forward. We've always talked about having 60% of our leases coming up for a lease event in the next four years, so we have a very flexible portfolio and we can choose at each of those lease events how we want to treat each of those stores. So we can keep them, we can close them, we can transform them. We could resize them, we could relocate them as part of it and that's part of this very detailed exercise that we're going through at the moment and we'll come back to, at the CMD that we're planning towards the end of March and talk in more detail about how we're looking at that and how we're looking at the market evolving.

Wayne Brown
I mean if possible, at that CMD, it would be great just to get an idea of how the performance of the estate is split, potentially, between the stores that have recently been refurbished in the way, versus the old way and to see what is not working. But I just wanted to ask you a question on higher stock levels. Clearly your wholesalers will be having similar issues and for them to be buying into the next season's orders, historically you guys have always bought back some of those franchisees' stock, so that they can have a clearer stock position. Can you give us an idea as to have much of the wholesale flash-franchisee inventory you may be, potentially, having to buy back this year versus last?

Euan Sutherland
I think there's a very small amount of legacy franchise agreements which were set quite a while ago in the business that have an opportunity to return stock in our wholesale book. All of the newer, over the last four years or so, wholesale and franchise agreements have meant that the franchisees will clear on site and not bring that back into us. So we don't see that as a major risk, or a change, that's happening. I think it was – there are, I think literally, a couple of –

Wayne Brown
Okay.

Euan Sutherland
– very first agreements that were set up when the organisation was in its first waves that were kind of subject to a larger returns piece.

Wayne Brown
Should we then expect, maybe, a slower rate of growth in wholesale in the next 12 months, if that franchisees are maybe having to clear stock in light of the retail performance that you guys are seeing?

Euan Sutherland
So I think, as we said before to the first question, I think there are some –

Wayne Brown
Yeah.

Euan Sutherland
There are some ups and downs in there, to be honest. Everybody has had a tough autumn/winter, across the world and so there is more stock in the system still to clear through than we would all want. That's offset by some good interest into the new autumn/winter ranges and the kidswear piece there. I think the upside for us is that we're still opening a considerable amount of wholesale space, both in multi-brand and in franchise and that pulls through product.

The final bit – and I guess this was a point which I should have added to John's question, around the shape of the wholesale buy in autumn/winter, the development that we did in creating our B2B website will mean that our wholesale accounts have much stronger access to in-season orders, so the shape is changing in wholesale away from some of the up-front orders into stock being shipped as we go in the season.

So a number of moving parts in that: we're still confident in strong wholesale growth going forward and that underpins the strategy but clearly there are some ups and downs that we will push through.

Wayne Brown
Okay and just on the US I think if you can just kind of give us your view as to how the retail business is performing there and if it's the expectation to offer the US to be break even or loss-making this year. And then lastly, on UK online being negative, I'm just – conceptually I'm trying to – I'm find that quite difficult to understand, just growing from a year ago from probably achieving growth rates akin to online pure-plays to now being negative, I don't quite know how that deteriorates so quickly. And do you think, actually, it might have something to do with the fact that the option count is down so much, year on year. Is it fair to draw that direct correlation?

Euan Sutherland
I think it would be a complete act of fiction if you were to take that conclusion from that because if you look at the option count online, that hasn't moved. I think the actions that we took back in March to change the product direction were the right ones. However, we've said that it will take us 18 months to work those through. I think the biggest impacts we've seen in online have been reflective of the truth of the matter, which is that we've had a very mild winter and with 60% of our business being in heavy outerwear, it hasn't triggered a consumer need and we're struggling with some of the relevance in some of our other categories, the next-biggest category being sweats, which needs a revamp and it's getting the revamp that we've said. So I guess that's the truth of the matter. You can – it's nothing to do with the option count, especially online, because we offer every single option online and we are over-optioned compared to all of our competitors at this stage.

So that was the e-comm one. In the US we haven't split out the detail yet and it's just a trading update, so we'll update at the next – at the year-end around the position for profitability of the US. And at the capital markets day within stores we'll give you the detail of how that impacts the US, as well as the rest of the stores dates. So more detail of the capital markets day and the year-end update as normal will give you the kind of profitability position.

Wayne Brown
Thank you very much.

Euan Sutherland
Okay.

Operator
Thank you and as another reminder, if you do wish to ask a question, please press 01 on your telephone keypad now. There'll be a further pause whilst any questions are being registered.

We have a question from the line of Andy Wade from Numis. Please go ahead, your line is now open.

Andy Wade
Morning chaps.

Euan Sutherland
Morning Andy.

Ed Barker
Morning.

Andy Wade
Morning, just one quick one from me. You sort of talked about how you had more stock going into the second half and you began that – clearing that stock in January. I just wondered how much of a boost to the overall trading numbers that – what must have been a reasonable-sized clearance activity in January would have had.

Euan Sutherland
Well, we had a lot of stock the previous year as well, if you remember –

Andy Wade
Yeah.

Euan Sutherland
– because we were in the third wave – no second – second sale of our three-sale period to clear seven seasons' worth of old stock.

Andy Wade
Yeah.

Euan Sutherland
So if you look at the relativity, there is not much benefit in that. We have held to our 30% and 50% in sale in terms of discount; we haven't gone to 70% or anything else, so we've been much more structured within that. So I think, on a like-for-like business, there wasn't – there isn't a particular benefit year on year. We have seen the exit rate be better than that, as we've said to the previous question. So no, there isn't a kind of boost that we've seen by piling in lots of extra stock, year on year, in January.

Andy Wade
Sure, okay. I mean in absolute terms it would still be, presumably, relatively meaningful. So if you go to a position where you're not promoting as heavily next year, as an example –

Euan Sutherland
Yes, that's right.

Andy Wade
– it will be quite a meaningful headwind –

Euan Sutherland
Yes, it is a bit of a headwind.

Andy Wade
– to the like-for-like number that you need to find next year.

Euan Sutherland
Yeah, I mean I guess as we come down from the large number of options that haven't sold because of the relevance issues, then we will be able to buy better volume behind the key lines, get greater sales through the full-price season and therefore have a change of shape to each season, so less into the discounted sale period. So yes, you're right, the shape will change. And we're actively trying to change that shape on the way into Christmas this year by coming off promotion and going full price into several territories. So you're right.

Andy Wade
Okay, great, thanks very much.

Euan Sutherland
Okay, thanks.

Operator
Thank you and as there appear to be no further questions, I return the conference to you.

Euan Sutherland
Great. Thank you very much everybody. I'm looking forward to seeing you at capital markets day next month. A lot to update on the transformation plans and the confidence that we've got around new product direction and brand updates. So thank you very much for joining the call; any other questions today, please give us a call and we'll handle those one by one. Thanks very much everyone.

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