SuperGroup Plc

SuperGroup Plc Interim Results
Wednesday 16 December 2015 – 11 am

Euan Sutherland
Group Chief Executive

Morning everybody. Thank you for coming. We are going to start the Presentation, both halves of the Presentation with a bit of a view of some of our new innovations, some of which are outside. So I am going to press this button and click straight into the latest representation of our Snow Range, which is a very small part of our new innovation, but actually quite an interesting lead into some of the directions we are taking the Brand.

Typically in SuperDry format this is a video that was shot by our in-house team. Shot in Chile. It is a very low cost approach. We didn't buy the helicopter but we placed Superdry graphics on it. It is on YouTube, we don't do a lot of above the line advertising. It had over a million views in the first seven hours, so a very successful gorilla tactic I guess, which is very typical of the Brand. But we will come back and introduce the structure of the Presentation after we have watched the video.

[Insert – Video clip]

So just one example of some of the full price new innovations that are coming through to market now. This has been the second year that we have tested the Snow and Ski range. It goes into wide scale, wholesale distribution as of next summer. So just a taste of that.

I will make a few comments up front then I will hand over to Nick to go through the detail of the numbers and then as we promised in the summer, every six months we will come back and update on where we are on the big strategic initiatives for the Group we committed to back in March.

Looking at a trading overview first, very pleasing that the positive performance that we saw in sales has been translated through to positive performance in profit across all of our key channels and operating territories. Continued strong performance in e-commerce as we have invested in that channel to market and critically the infrastructure improvements that we committed to back in March with the single pick face, has been successfully implemented in The Duke and has sustained better availability as we have gone into peak season. We are on track to deliver our committed 120-130,000 square feet of new space in Europe. We aim to be at the upper end of that guidance as we get towards the end of the year and very solid growth in franchise and in wholesale and a better quality of growth in terms of better quality of stock and margin that has been delivered in the half. That has delivered a 54% growth in Group profit and if you exclude the US business that we acquired end of last year, that is plus 74%. Critical number for us is on a two year basis as we make up for the profit decline last year, that looks like a plus 22%. So our commitment to the market to be low double digit profit growth every year has been a part of the first half. And of course the first update on the maiden dividend that we have at 6.2 pence per share.

On current trading… I wasn't intending to update any detail on current trading today. We are coming back in the early weeks of January to do that. I will make two comments though. Black Friday was successful for us. We don't really participate in any large promotional activity on Black Friday, we didn't last year, we didn't this year. We did see good sales growth though and we did see the move to online from stores that was reported in the rest of the market. Also our promotional participation is slightly down year-on-year. We committed, the last time we met, to doing the same promotional activity in three weeks before Christmas and that is what we are doing. So that is a sub-category rotation of 20% which we have done now for three years. So there is no change to our participation in terms of promotional sales.

In terms of quick update and headlines on the four pillars. I guess the headline here is that we are on track, still a lot of work to do. But early progress in some significant milestones that we have got here. Our commitment to extending our consumer insight continues, taking that into Europe and then the next phase taking that into the US and getting into more in-depth category work. And really working on colleague engagement as we grow the business to be a significant player internationally.

Enable, a lot around the infrastructure improvements on our single stock file, a lot of complexity in that combining retail and e.com stock successfully delivered in the half and well prepared for peak season. Further strengthening of the top team with Nick Tatum who joined us from Tesco and is now fully embedded into the Global Retail Director role, and good progress on Wholesale.

On Extend, as we have seen in some of the videos and some of the product you have seen outside, good work on the innovation early days. So still a lot of work to monetise that and get it into proper distribution. IDRIS had a successful launch on 26th November. That is in 35 stores as planned. We have just extended that to a further 8 stores as the sales have come through on plan. And the sport ranges that you see outside, early tests in the summer, doing well, that is rolling out in women's wear this week for a January launch and in menswear we will roll out in March.

And finally in Execute, very much the same plan as we highlighted back in March. Focus on the EU, the US slightly behind in terms of retail stores, slightly ahead in online and slightly ahead in Wholesale. So just a little balance difference as we land and turnaround the 15 legacy stores that we inherited in the US business.

At this point I will hand over to Nick to talk through some of the detailed numbers and I will come back and give you more flavour of the strategy in a few minutes.

Nick Wharton
Chief Financial Officer
Thanks Euan and good morning everybody. My financial presentation today will break down our performance in the first half and as always give some key performance indicators around our revenue and our principle costs. And I will also update full year guidance.

So firstly by means of an initial overview, while our earnings are very second half weighted, the period saw us deliver strongly against all of our key performance metrics. And this provides a sound base from which we enter the key third quarter trading period. The financial profile that you see in front of you reflects the impact of sustained retail like-for-like growth, with mix benefits into gross margin and consequent operating cost leverage. As Euan has said, at the earnings level, profit before tax increased year-on-year by 54%. And this metric increases to 74% if you exclude the losses within our North American operation. And equally important on a two year basis this non US profit before tax measure increased by about 21% over a two year basis in line with our intention to deliver consistent, low, double digit earnings growth in our core business.

Looking at EPS, benefiting from profit growth and also a reduction in our effective tax rate, underlying EPS has increased year-on-year by 68%. And finally on this slide, to our Maiden dividend, our Maiden interim dividend is at 6.2p, which is in line with our dividend policy and equates to one-third of an implied full year dividend for the previous year if calculated on a cover of 3.2 times. And this cover compares to our guidance range of between 3.0 and 3.5 times.

So I will now dive into the detail of our P&L starting with sales. As you can see from this slide is a cascade from Group sliced to through our key channels. And total revenues increased year-on-year by 22% and importantly we delivered positive growth in all our key channels and each of our key territories. Now while retail like-for-like was our largest single contributor, I will actually start with EU new store expansion, as this represents our single most significant forward value opportunity.

During the half, the Group opened new space equivalent to 9% of its year-end portfolio and with the benefit of prior year openings actually increased our average operating space across the half by 21%. These stores in total contributed about 9 percentage points of our total growth which is towards half of that on a proportionate basis and most importantly these investments continue to deliver very strong returns on our invested capital.

And while against soft comparatives, like-for-like sales were strong in each quarter. These sales benefited from our ongoing innovation programme with women's wear representing our fastest growing category in each quarter. Strong e-commerce benefited us and also a targeted promotional activity and marginally more favourable weather conditions year-on-year.

Turning finally to our Wholesale Division. We continue to deliver improvements to our Wholesale business. And the increase in sales we have seen over this six month period, reflects the initial consumer response to the investments that we are making. Our growth in the first half of 8% is very similar to the growth in the second half of the previous financial year. In this particular period, performance has benefited from the buyout of our US operation, but has also been understandably impacted adversely by the strengthening of sterling against the Euro.

Going down the P&L now to Gross Margin. Gross margin increased year-on-year by 110 basis points over the period. The key driver of this margin accretion remains our improved sourcing from both scale benefit and also the increased level of direct sourcing within our model. We would expect a similar profile in the second half with sourcing gains continuing, but a growing offset from the impact of currency headwinds. And as an illustration of this our second half Euro and dollar hedges each matured at a rate which is about 5% worse than the maturity in the first half.

Our first half has also seen a material benefit from enhanced retail mix and this level of mix is significantly beyond that which we would normally expect from our expanded EU operations where higher price premier drive higher relative margins to the UK.

And finally on this slide, we have seen a small 20 basis points drag from our focus new promotional activity during the half and that has introduced to clear fashion stocks in situ at the close of the season. However, we have now established our promotional pattern over the full year and therefore looking forward we would anticipate that the impact of promotions on margins will be neutral year-on-year from the second half forward.

Now look at costs, splitting these costs between sales and distribution, which is the vast majority of our costs and then into our central Head Office related costs. At the summary level our sales and distribution costs have increased by 19.4% year-on-year. Now recognising the natural cost leverage from positive like-for-likes, this increase is marginally below our guidance of increasing in line with sales even after absorbing the higher relative operating costs in our inherited US operation.

Reflecting our rollout strategy, if we work from left to right on this slide, the largest absolute change is within store related costs which have increased by 18% year-on-year roughly in line with our increase in space. But you can see to the side of that, we also continue to invest in in-market resource such as area managers and store development capability to support our growing EU operations.

The next three columns on the slide relate to our distribution. Now distribution costs have increased in total by £6.7 million across the period year-on-year, but as always it is worth highlighting the logistics impact of our clearing strategy of redistributing slower moving continuity inventory through our various channels. While clearly this maximises full margin sales in our prime sites, it does drive significant logistics cost through that uplift activity. In effect a healthy proportion of our distribution cost, compensate for our higher achieved gross margins.

Looking at the dynamics of distribution costs, taking each of those three columns in turn. The first year-on-year increase of £5.8 million relates to the uplift in cost from our higher sales volumes but in the same mix as the previous year. The second much smaller impact reflects the adverse mix this year on last year. And this largely reflects our channel mix towards e-commerce where e-commerce sales are a higher unit delivery cost than sales in stores.

The final column is also key. The final bar highlights our continuing productivity improvements. Year-on-year reductions in our average cost per unit have reduced overall costs by about three-quarters of a million pounds in the half year-on-year. And this is on top of the two and a half million pounds of productivity savings we delivered last year.

Now to central costs and our central costs profile reflects our strategic focus on strengthening our core people capability and central infrastructure in order to support both our envisaged growth, but also to deliver the efficiencies that Euan will cover later. And in terms of scale, our central costs in the full year for last year were around £40 million. In the first half these costs increased by 20% year-on-year on an underlying basis, excluding the costs of our North American business which weren't in the prior year base and incentive costs which were very low last year. And we would highlight a specific guidance that we would expect the incentive growth in the second half year to be around the same level as that in the first half.

The principle drivers of costs around our Head Office mirror our strategy with the dominant driver being the strengthening of our teams both centrally in Cheltenham and also in key regions. Our central investment year-on-year of £1.8 million has focused on strengthening our design teams to provide that constant stream of innovation, to support our fast growing e-commerce channel and also on merchandising capability.

In terms of IT, the depreciation, licence and support costs associated with our continuing physical expansion and strengthening of our IT core backbone, introduces about £1 million of cost into the business on a year-on-year basis.

We thought the US merited a bit of focus and a single slide to cover our progress in this territory. The repositioning of our US business has taken longer than we originally envisaged. From our experience to-date, we remain confident that our strategy to develop the US operation remains sound and that the challenges we faced in the first six months are operational and can be overcome with time.

Specifically within retail, the actions taken to exit legacy stock in order to introduce a better product selection, to increase skew density through the addition of fixtures, and to revise our pricing and promotional strategy have all been executed in line with the plan that we developed pre-acquisition. However as an illustration of our operational challenges what we could not really anticipate was the up to six weeks delay in getting our product through the US customs that we experienced as a new importer to the States and also one that we found out was unfamiliar with some of the vagaries of country of origin labelling requirements in the States. So we did have operational delays in delivering that execution.

We are too early to judge the impact our changes to retail. We have seen very good growth in our e-commerce channel where it is easier to turnaround the proposition, and we are making good progress in Wholesale. We have also mitigated the rent burden in all of the inherited stores which were significantly loss making.

Having lost some of the sales traction from these delays in the key shoulder period before Thanksgiving, we now believe the loss from our North American business will be in the range of £3 million to £3.5 million in FY16. And when we achieve that, that will represent a reduction of about a third compared to the loss position that we inherited in this business. And we also believe there will be a similar though smaller drag on FY17 before delivering a profitable business in FY18.

So joining all that together in terms of operating margin, our overall operating margin has increased by 180 basis points year-on-year and this premium expands to 410 basis points excluding the impacts of non comparative year-on-year incentives and the margin diluted impact of our US business. The prior year operating margin was however impacted by the lack of like-for-like leverage. So maybe a better margin comparison would therefore be the 9.3% operating margin delivered in the first half of FY14. And our performance here on an underlying basis at 9.9% represents a 60 basis point improvement on that more appropriate base.

The main factors driving enhanced margin were the mixed benefit from the strong retail growth and the efficiency gains not only from lower cost prices achieved in buying, but also with productivity improvements primarily within the distribution centre, but also with physical stores.

So we will now turn to a few slides around the Balance Sheet, and firstly to our cash generation. Our cash generation remains strong with positive net cash flow achieved through improved working capital efficiency which has more than compensated for the material increase in capital investment across the year.

Our working capital position reflects the cash inflow opportunity discussed at the time of the full-year results in July from the unwind of excess stock from the previous yeaend and also the introduction of more effective inventory management processes which will reduce our inventory over time while not damaging availability.

Our headline stock levels, as you would expect as a growing business, are 9% higher on a year-on-year basis. However like-for-like stock has reduced by about 3% after adjusting for the stock required by our store expansion during the year and also the take on of US stock.

We have also seen a material improvement in our trade payables position, benefiting from two things. Firstly, the slightly later phasing of Autumn/Winter deliveries as we faced stock closer to the season and also from the progressive movement of our key suppliers from payment by letter of credit to more standard open account terms.

And looking now to capex and the Group continues to invest confidently across the business. The majority of our investment as always continues to be focused on opening new stores and refurbishing existing stores to our latest design, look and feel. And as a reminder, these investments deliver attractive returns on capital. Over the past four years, the 70 or so stores that we have opened have delivered an average payback of 22 months, where those paybacks are calculated after the impact of any cannibalisation and also after tax. And we remain committed as a Management Team to achieving a 30 month payback or better on each and every new store.

The development of infrastructure to improve functionality and build resilience is a constant in any growing business. And this has continued in the past six months with the introduction of new tools for the business, such as merchandised planning systems, all upgrades to core systems that include in the last six months the sales order processing system that is at the core of our wholesale business.

The first point of guidance. Our guidance for full year capex is now around the £45 million mark and the increase from our previous guidance reflects three factors. Firstly being our increased new space guidance, secondly the acquisition of a freehold Head Office, adjacent to our current location that will secure our tenure in Cheltenham for the medium term. And finally, the initial costs of our expanded or new DC facilities in the EU and US respectively, which will be a programme throughout 2016 but will have some capital expenditure in the remainder of this financial year.

So more fulsomely to guidance. An overall, reflecting the net neutral impact of our updated guidance from a P&L perspective, we remain comfortable with consensus expectation for full year PBT at £72 million. But I will take a little bit of time to focus on the revised guidance within here.

At this point in the year we have good visibility of our new store pipeline and are now confident of opening just over 130,000 square feet in Europe which is at the upper end of our previous guidance with a small risk to the upside in terms of this metric. However the majority of this additional space will naturally be backend loaded and so will have limited profit impact in terms of the current year, but will place additional costs and upward pressure on our central and S&D costs from the infrastructure costs associated with those new stores and also the setup costs of those stores.

Now while our gross margin accretion in the first half was only marginally stronger than our guidance range for the drivers that we feel able and confident to predict, the first half has also benefited from a significant mix impact and accordingly we have strengthened our full year guidance for gross margin by about 35 basis points at the midpoint of those two ranges.

And finally, as discussed previously, while remaining confident in our long-term opportunity in the US, we have lost some traction which will adversely impact FY16 and to a less degree, FY17 earnings. And we now estimate that losses in the US this year will be between £3 million and £3.5 million, representing a one-third reduction from our inherited loss position which as a reminder is about £5 million per annum.

And to complete the picture, in a way reflecting these losses, we now anticipate a full year effective tax rate of 22%.

So to summarise. The first half has seen solid progress across each of our key financial metrics, leading to a significant uplift in profitability. Our gross margins continue to accrete, benefiting from favourable channel mix and scale economies. And while we retain as always a close focus on cost, we will continue our disciplined investment across the business in new stores, infrastructure and enhanced capability of our central support teams, and this will continue in the mid-term.

Our excess inventory position at April is beginning to unwind, further strengthening our cash position which remains very healthy, regularly funding our planned future investments and our maiden interim dividend that will be paid to shareholders in February.

So thank you. I will now pass over to Euan after a video, who will cover our key strategic progress.

[Insert video clip]

Euan Sutherland
Group Chief Executive

So early good signs from the premium range. We offer that up to Wholesale as of January. So that goes kind of more mainstream as we go forward. IDRIS is actually in Regent Street today looking at the Spring/Summer range. One stat for you, he went on the Jonathan Ross show and mentioned Superdry once. We got a 60% immediate uplift in people on the website straight away when that happened. So interesting dynamics for us, first early phases into a more premium position.

So I wanted to update you on the four pillars. The importance of this really is every six months we will keep you appraised of progress on the longer term plan. As a business we are now using these as a filter for all of the big projects that are happening throughout the business so there is some order and data behind what we are doing. So embedding the DNA of the business and using data to go alongside the kind of instinct that we have used all the way through the first few years of the brand. Enabling is all about infrastructure and there is a continual investment in improving infrastructure across all of our business. Extend, all about driving new innovation and being the latest in the cutting edge in the product that you see around you today. And Execute, brings all of that together and delivers that on a global stage in an ordered way that we can capture the growth across the world.

So just a quick update on what we have been doing in the first half and what is to come in the second half. The same format as we used in the summer update. In the half we have increased the penetration of frequency of shop up to 1.9 times, that is continuing to move half on half in a very strategic and a very important measure for us in terms of visits to store. Consumer insight continues to inform us and we have now got a base big enough in Germany to have specific German insight which is being fed into the latest buy, and will continue to drive a differentiation in our European markets. And also really engaging all of our colleagues across the world, over 5,000 colleagues now in multi sites. So very important to stretch that DNA through our business.

Near-term priorities. More of the same. So extending now into the US and extending into product categories for the insight and also looking at adapting some of our store format and environment mainly to incorporate the new innovations that are coming into the UK and European store base.

On Enable, a lot of work done in the last six months, a lot of work still to go. So still in the early stages of upgrading our infrastructure across the world. From a team point of view, the Exec Team is now complete with Nick Tatum joining and the big activity which we successfully completed was the single stock file between e-commerce and retail. That is the first of a two-step process. The second step of incorporating Wholesale will happen in early 2017 because in 2016 calendar year will be focused on rolling out an EU and a USA DC. The way we think about our year is that from January to June, is our opportunity to do development work around the business. From June to September, we will embed that. And then from September through to Christmas we will trade the business in our busiest peak season. So we are just staging in a hopefully sensible prioritised order, some of the big developments. What we don't want to do is to land too many big developments in any one year. So 2016 is all about European DC and EU DC.

The only other thing I would pull out here is the continued benefit we are getting from the multi-channel vehicle of i-Kiosk, so you can go into store, if you don't see your size or you want to buy something that is not ranged in that store, we can order it for you there and then instore. Worked very well in the UK, we have begun to roll it out in Europe very similar results there, so we will continue to rollout i-Kiosk across Europe and early stages now we have tested that with franchise stores which we believe is a very big opportunity for that smaller store base. That will continue through the second half.

In Extend, I think we have covered a lot of this. A lot of innovation coming through now. The structural changes we put into the management team with Jules and James, really focusing 100% on product, is starting to bear fruit. Our focus as a management team is to take that out to more of the chain, more of the countries, more of wholesale. So IDRIS Spring/Summer is already on its way into the stores and as I said, that will be launched to wholesale globally as of next month. If 2015 was all around IDRIS and Premium, 2016 will all be around sport for both men's and women's. So big opportunity for us to focus around there and ski as we have said before.

A couple of images of the sport range. A real step on from the summer test which went very, very well. This product is landing in stores this week. Early reaction is very positive. So the full range will be in stores and you will see it in our windows come January so a full price representation of something as we through the early weeks in January.

And menswear, is going to land after the women's wear range in March. So again significant for us that we have tested women's wear in this new innovation first, where traditionally we would have tested menswear. Early reaction from wholesale and franchise customers is very positive to both sides.

On Execute, as Nick said, we are at the upper end of our space guidance for this year, 63,000 square feet of new space launched in the half, 14 net new owned stores. The vast majority of those in Germany. In this half, the kind of last couple of weeks, we have opened our second biggest store in the world in Cologne, it is 20,000 square feet, so just smaller than the Regent Street flagship we have here. Got off to a great start, it is on Schildergasse which is the Oxford Street if you like of Cologne. And some good results, solid performance out of the German new stores.

Other points to pull out here, franchise stores, 19 franchise stores opened across the world. Again they tend to be smaller stores, so have a higher net number of those opening, but on plan to deliver the franchise part of the wholesale growth plan. And early good progress with Trendy around the set up of the joint venture. We have now hired the Management Team for the joint venture and we have set up the first three stores for trial in Beijing and Shanghai which we plan to open in the early summer.

So pulling it all together, financially a good half, very pleased at the spread of results. Very consistent across all channels. As Nick said, a lot of the big numbers come in this quarter, so while we are not updating, it is fairly solid but still a long way to go in Quarter 3.

On the strategy point, good early progress, but it is still early days. There is still a lot of work to do. So no change to the strategy, no change to the update or the guidance that we set out in March. It is more of working through what we have committed to you that we were going to do.

So that is it I think in terms of the key points. We will just open it up for questions.

Q&A Session

<u>Question 1</u>

Michelle Wilson, Berenberg

Could you just talk a little bit more about the distribution centres in Europe and the US and what benefits they can bring? Will it be a case of reducing distribution costs in those markets? Or is it that you can improve the delivery and combine in those markets as well?

Answer: Euan Sutherland
Yes a bit of both really. I think there are service improvements that we can make especially online to European customers and US customers. Delivery timescales to those customers are longer than the kind of pretty much top of the class performance we can deliver in the UK. So that is a customer benefit. In the longer-term there are efficiencies that we can make out of having a better service to our stores and e-com there. Ultimately the jigsaw comes together second half or 2017 when we have a single stock pool with Wholesale as well. So we are relatively sub-optimal until we get through to that, but it is a step by step plan to get there. Anything to add?

Further answer: Nick Wharton
I think the only thing to add is in terms of risk and migration and all of those kind of things that are always front of mind. So larger EU distribution centre in Belgium is

with the existing 3PL partner, so a partner that understands our business model. The space already exists and it is modular. So we can contract it or grow it within reason to address the dynamics of the business. And our US DC will also be a 3PL much smaller footprint and will concentrate on physical retail at the start points so we don't try and run before we can walk.

Further question
Great, and that kind of feeds onto a question on like-for-likes in Europe. So I think the like-for-likes at the moment are predominantly UK, if not all of UK. How should we think about like-for-likes once European stores start to feed into that? Are you actually seeing cannibalisation of European stores or are we seeing a big benefit from bringing out stores under retail ownership?

Answer:
I think that the reality is probably that in about a year from now we will have a more meaningful population of like-for-like stores that give us a better read across what would be the EU portfolio. We do if we talk about Germany, we do have a small proportion of stores that are truly like-for-like, but it would be perhaps misleading to talk about that too much, although I would say they are delivering maturity and positive like-for-like. That population as an example will almost double in the next six months, so it gives us a better read on the pure performance of those stores and reads into cannibalisation, but our German performance, we have talked about before, is in line with our expectation. There are swings and roundabouts between particular stores, but they are delivering very good returns on capital.

Question 2

Tom Gadsby, Liberum

Hi, I have got three questions. One is a quick follow-up on that. What proportion will Germany be by year-end, and when do you think that is going to be accretive to margins?

Second quick one on national living wage costs over the next few years. You may have mentioned it before, but if you could update on that please?

And the third one on what is your view of the consumer at the moment and the general health of the clothing retail market right now?

Answer: Euan Sutherland
If I do the last bit first and then I will hand over the two financial ones to Nick. I think the market we see in the UK and in the EU is pretty tough. It is milder weather, you see that on the news every day. We have got to the conclusion that our strategy tries to de-risk us both from a geography and a channel point of view, both moving into online and better service delivery. And also going across geographies. So we can't do anything about the weather so it will be what it will be. What we have got to do is provide a strategy and an infrastructure that can cope with that. In my last 22 years or whatever, I think that I have probably said for 22 years, Christmas is getting later and later, it always feels like that, or maybe it only feels like that because I forget between December and the next December that it felt like that now. We are seeing a continued move to online. So we saw that from Black Friday. We are well set up to grab that and we have continued to invest there. Online still remains a smaller proportion of our total business though, so I guess that is the first comment on promotions. You see a lot of people going red and white across Europe. I was in Germany last week and many of the retailers were all red and white sale. You see

that as you walk through the shopping centres here. That I think has been the case for the last 2 or 3 years. So while it is intense and it is milder than we would all like, our position has not materially changed in that. You will see us doing an event post Christmas, we did that last year. And you will see us in Europe on sale, because that is what we have always done. There is no material change to how we are treating it. So I can't and I won't comment any more on kind of current trading now other than there is a long way to go in the next few weeks.

Further answer: Nick Wharton
In terms of Germany. Germany retail, whether you include e-commerce or exclude e-commerce is a bit less than 10% of our total retail operations. And it is only marginally dilutive to the overall retail mix. What we have there is two compensating factors. So there is a higher cost to serve in Germany from employment costs and to a degree rent costs. And one of those will be offset when we move to a larger EU DC that will service retail as we have talked about before. But we do have a slightly higher price premium positioning in Germany which delivers higher gross margin. So the dilution is relatively moderate against the retail average, so that is where we would see that.

In terms of national living wage, we are on record and our commitment to our colleagues is to pay the national living wage to all our colleagues regardless of age, which is what we think is the right thing to do. It is what we have always done in terms of the application of the minimum wage. But we also want to ensure that we maintain our differentials. Progression through the business through experience and expertise is important to us. Therefore we need maintain those differentials and the combination of those two things will introduce some costs to the business. Through all the actions we have in place regarding the development of the infrastructure of the business, we believe there is productivity improvements we can get at, such that the net impact of all of that is a few hundred thousand pounds of drag into next year which is not quite lost in the round, but something that is perfectly manageable for a business of our scale.

<u>Question 3</u>

John Stephenson, Peel Hunt

John Stephenson from Peel Hunt, a couple of questions please. Could you talk about the benefit you have had on availability from the single stock file or any of the benefits that have come through maybe already?

And just on the US, obviously it is transformational in terms of what you are doing to the business, can you talk about operationally what we are going to see whether it is the number of doors on the wholesale accounts, the scale of what will be delivered in Spring/Summer, Autumn/Winter next year and maybe if you are going to see some new store openings next year?

Answer: Euan Sutherland
Okay, I can take both of those. I think key availability kind of benefits for online are still to come. I think year-on-year we were in good availability online last year through to the final couple of weeks before Christmas. The impact of that was that because we had pushed so much stock into stores, then as online continued to over perform last year we were relatively weak on availability. So I think we have seen good availability instore and online more balanced. We have held off out of stores until much later until a kind of two day re-plan basis, more stock. So that has helped us, but we were doing that naturally better for most of the year. The bigger benefit

comes in the next couple of weeks really as we work dead-ended stock into some stores where online was continuing to perform very strongly. Overall though the operation is working very well and it is quite a complex operation being able to have one distribution centre with an operational picking bulk for stores every day on a re-plan and picking 24 hours a day on single items for individual customers. So quite a complex integration of systems and operation. The encouraging thing for us is looking forward to 2017, integrating wholesale stock gives us ultimate flexibility of all of that across our DC network.

On the operational benefits in the US, I think if you went to those 15 stores now versus six months ago, you would recognise them as European or UK Superdry store both in the range, breadth, density, the fixturisation and everything else. So they look much better, they are still sub-optimal in their size and location though. You can't get away from that they were not particularly strong property deals. And the fact of the matter is we will trade those stores until the lease breaks come through and we will rebalance that. We are looking at testing more stores in the late spring/summer in the North-Eastern seaboard area so anything from Philadelphia, New York, Chicago and Boston area. If you take those points as kind of corners if you like of where we will test, those stores that we are looking at right now are much more regular in terms of size that you would see in Europe or in the UK. And the property access deals look doable in terms of the current capex paybacks that we are seeing. Our policy has always been in the US as a long-term play. There is not an instant solution and that we want to prove the model. So gaining lots of confidence online, very easy to change online because we can do it from Cheltenham as we have said, and some good reaction to the brand there. Some good reaction to the new innovations as well. Snow for example working incredibly well in the US market already and it has only been out online for 2-3 weeks. But going down very well.

Wholesale, the number of doors, I think we are taking it from some of the discount doors that the licensee had put us into before. We have taken it out of that and we are putting it into full price. So again supports more of the quality of stock and quality of margin we can deliver. And really good interest from all of the wholesale accounts you would expect us to be in. Everything from Bloomingdales to Nordstrom and some of the regional players too. So early days, two out of three channels showing some really good performance. Third channel we have still got some work to do on those 15 stores. It will be easier when we have got our own store format there with the size of store that can support the range we now have.

Further question
How are you doing in wholesale?

Answer: Euan Sutherland
I haven't got that number off the top of my head, but I can get that for you. It is increasing as we go through week by week.

<u>Question 4</u>

Richard Chamberlain, RBC

Richard Chamberlain, RBC. Again a couple of questions please. So Nick I think you mentioned that the new space has come in at the top end of plan or will be coming in at the top end for fiscal 2016. I just wondered if you could mention where that extra space is coming on? Is that Germany or other markets?

And second, I guess Euan, on the e-commerce side, e-commerce penetration, I wondered if you could just sort of touch on how that penetration varies between UK and International and in particular in the US? Presumably that demand is concentrated where the stores are or is it already much more widespread and is that making it any easier to test new stores if you see what I mean going forward?

Answer: Euan Sutherland
Yes so perhaps if I pick up on the e.com first and you can talk about where the new space is coming from. E.com and the US isn't where the stores are, it is very widespread. So that is encouraging in the fact that customers are shopping across the whole of the territory, so that gives us a bit more confidence. Our plan to rollout own space though is one of being conservative and going for very simply the States in the US which are Eastern seaboard and have two seasons. So we capitalise on the strength we have in outerwear. And it does tend to be there are the two coastal strips in the US which are the easier places to land new brands so we will take those easier steps first. But no, e-commerce is across the whole of the US. So hopefully encouraging for long-term penetration of the brand, it is not centred around where the stores are. Because of that we have done some different things in stores to test East and West. And we have done some different things in stores versus online just to test some of the dynamics there.

Further answer: Nick Wharton
In terms of space, broadly the second half will mirror the first half. So in the first half, roughly half the stores were in Germany. That takes us still to a level where against our ambition we are still less than 50% penetrated so Germany will still be the major focus for us. But we will see expansion in many countries in that second half, including as an example, a couple of stores in Stockholm, so we like Scandinavia again because it has two seasons and that is beneficial to us in terms of our overall proposition in sales intensity. So a couple of stores in Stockholm and also stores in Italy and continued stores in France.

<u>Question 5</u>

Andy Wade, Numis

Two from me. First one in terms of your Opex bridge. Could you go through what is the distribution cost part of it, the volume related distribution costs? Is that delivery into stores and delivery online excluding the mix effect? Is that basically what that is?

Answer: Nick Wharton
So you have got three columns. Firstly you have got a big increase which is purely value but it is in the same mix as last year so it takes out.

Further question
When you say that, is that delivery into stores and delivery for e-commerce, but in the same mix proportion for last year?

Answer : Nick Wharton
Yes and then you have got a small drag which is actually there is more e-commerce in the overall mix therefore it is adverse and then we get half of that back in productivity gains.

Further answer:
Fine okay, that is all very clear, thanks. And then the second one on wholesale. Obviously a big move in the wholesale operating margin. Nearly 800 basis points. It

wasn't a huge amount of sales growth in there and so that is not going to be from leverage. And the things that you pull out I think, well one is bigger full price, more full price sold through. And the second one, I think there is a reference to other income. Could you just give us a bit more colour on that?

Answer: Nick Wharton
Yes the two, those are the two biggest factors, putting more flavour on those, essentially the yield from a wholesales was significantly improved in terms of the gross margin, so we had a lot less sales through clearance channels. So we had less necessity to sell to the likes of TKs or M&M from that perspective. And that has a substantial benefit in terms of the gross margin. And then in terms of the other income aspect, essentially that is franchise income. So we have got an expanded franchise base, so that has given essentially a kicker straight to the margin.

Further question
So that presumably won't increase that much, I mean it is mostly going to have been the full price?

Answer: Nick Wharton
Mostly the quality of earnings through the wholesale channel.

Further question
So this is where I am getting at. So the wholesale gross margin effectively would have been up. Let's say most of that 800 basis points is wholesale gross margin improvement. So let's say 600 basis points. Your overall gross margin, well actually your promotional element is down 20 basis points. So is the implication there that the retail promotional element was up about, increased by about 300 basis points to offset that 600 basis point from wholesale?

Answer: Nick Wharton
No I think there is a bit of apples and pears in there. The point you are potentially getting to is that the progression in retail margin was much lower than wholesale margin is true, but you can't make that linkage directly into the level of promotional activity in retail.

Further question
Why not? Would that not fall within the reduced amount of full price sold through in wholesale and not fall into that markdown line that you have got in the bridge?

Answer: Nick Wharton
No that, we are trying to isolate to help you essentially. The retail activity is promo. So no wholesale margin is just essentially treated. We don't break out in that bridge wholesale discounting. Wholesale is just wholesale from that perspective. So in GP that 20 basis points is purely a physical and e.commerce retail activity.

Further question
So I don't get what is squaring the circle then, because you have got benefits from sourcing, you have benefits from bought in gains. You have got 600 basis points on wholesale gross margin from increased full price sell through. What is going the other way?

Answer: Nick Wharton
Well you have the proportion of the business that is wholesale against retail.

Further question

But that would have been a benefit as well wouldn't it, that is helping you. So you have got three big things helping you, mix, number one which is like 100 or whatever, you have got buy-in which is another 100 or whatever and then you have got the better full price sell-through in wholesale which is going to add a third of 600 or well a third of 800 or third of 600 whatever the number is. So you are up 400, but net you are only up 100?

Answer: Nick Wharton
Yeah, that is all in the mix, sorry. Shall we take, rather than protracting this now, probably easier to take it offline and talk it through afterwards.

Euan Sutherland
Any other questions? No it doesn't look like it. Thank you very much for your time. See you at the next update.

End