N Brown Q3 Trading Statement conference call
23rd January 2018

Angela Spindler:
Morning everybody. Thank you for joining us. I've got Craig Lovelace, CFO, with me and Bethany Barnes who heads up IR.

So, we've seen a good performance over the period continuing the good momentum we saw in the first half and within that we've delivered another record-breaking Christmas period. This is achieved, as you know, in a market that continues to be challenging. More on that in a moment.

I'm also pleased to report good progress on the strategic levers that we've previously described, so 74 percent online penetration up 4 percentage points. International progress with the USA up 22 percent. Power brands as a whole were up 7.3 percent. And we are today announcing a new strategic partnership with Zalando.

But back to the trading period. Our customers are feeling the pinch, so we've proactively invested in promotional activity across our brands to drive continued growth in market share. And although this has had an impact on our profit gross margins we're pleased to be attracting new customers to our fashion offer.

We also saw good progress in financial services with continued strengthening in the quality of our loan book and this is reflected in our guidance. The resiliency this provides us has enabled us to maintain our profit forecast while continuing to invest in value for money to our customers.

Power brands performed strongly as a whole with revenue up 7.3 percent. Simply Be, however, stole the show growing at 14.5 percent with the integrated multi-media Christmas campaign landing really well. We also saw good growth from Jacamo and JD Williams. The return to growth in the USA reflects the success of our new marketing strategy combined with our new web platform and we expect USA growth to continue to accelerate.

The performance of our brands is being driven by our online channel. Online penetration of new customers is now at 82 percent and total online sales were up 9 percent in the period. From a technology point of view, we continued to deliver many enhancements in the period. We introduced things such as upgrading our Simply Be app, and the launch of Simply Be perks, our loyalty program. We've rolled out delivery subscription offers on all three power brands and we're on track to deliver global ship anywhere by the end of this financial year and this allows us to broaden our access to international markets.

Partnerships remain a key area of focus to give us more routes to market for our power brands and we're pleased to announce a new deal with Zalando for Simply Be and Jacamo, which will give us access to more than 22 million active customers across fifteen countries.

So, to close, as shown in our new guidance the shape of our P&L this year has changed. However, overall, we're confident in achieving our profit expectations for the full year. I'm now going to open this up for your questions.

Operator:
Okay. So, our first question comes in from the line of John Stevenson. Please go ahead.

John Stevenson:
Morning all.

Angela Spindler:
Morning.

Craig Lovelace:
Morning, John.

John Stevenson:
Just a few questions around the financial services margin if I can to start. I've always thought of this as a bit of an oil tanker business to an extent and being very, very predictable. The extent of the margin shift is a surprise in such a short space of time since the interims, so if you could talk about the implicit new provision rate in the new margin guidance that would be great.

And how many - what portion of the book has gone on to the low minimum payment rates. And then also I suppose any change in the basis of the provision policy or, you know, percentages, over the last 12 months.

Craig Lovelace:
What I'll do, John, and I hope this will be of benefit to others on the call, first I'll bridge between prior guidance and updated guidance. I'll then bridge overall between FY17 to guided GY18, and then I'll touch on provisions. So, three parts to this answer.

John Stevenson:
Okay, brilliant.

Craig Lovelace:
Firstly, bridging between the previous guidance and this updated guidance. Just over half of the improvement is fundamentally down to improvement in the quality of the loan book itself. This is not new. It's been ongoing. We are tightening criteria for the book. As you know, we have been exiting some of the riskiest debt. So, it's a general ongoing improvement in the book. There is a small debt sale we made within this, which we made in the half, but the size of that was consistent with last year. So, that's just over half of the improvement.

Just under half of the improvement was down to a small change we made in our minimum payment terms at the end of H1, which I mentioned when we met at the interims. I'll touch a bit

more on that in a minute. That was a shift, from 5 percent to 4 percent. So, those were the two drivers.

Looking at the overall year-on-year bridge, really, the primary driver is the underlying quality of the debt book – this accounted for just over 200 basis points of the year-on-year move. The minimum payment changes account for circa 190. And other initiatives - which you're aware of - such as our variable interest rate trials - account for the remainder, circa 150.

So, those are the moving parts of the year-on-year. Clearly, when you wrap this all together and you look at the improving picture in the book, which obviously factors through to the impairment calculations, I expect a further reduction in the provision this year, something in the order of 200 basis points. So, clearly, we still have time to go in the year.

John Stevenson:
Yeah.

Craig Lovelace:
So, those hopefully give some input. I'll give more detail on minimum payments at the prelims, so you can see the impact of that. But hopefully, that's covered the primary drivers of the change.

John Stevenson:
Okay. And that's really helpful, Craig, actually. Just on the latter bit, actually, the 150bps from the variable rate trial, I see now on the websites you're offering, you know, 25 percent representative rates on Jacamo and Simply Be, compared to 50-odd percent. Can you talk a little bit about the effect that's had on the business, in terms of how that's flowed through?

Craig Lovelace:
You mentioned right at the start, the book is an oil tanker. I still think that that is not an unfair analogy, in some respects. We do offer the lower rates to a cohort of new customers if their risk determines it. The practical fact is, the bulk of accounts on the loan book still have a risk profile that supports the historical APR rates. So, we're not seeing a wholesale re-pivoting of the book to lower rates. We are setting it as much as we can on a lower rate if the person's risk allows it. We're not yet, clearly - because we haven't fully rolled out the new variable APR system across our brands - we're not yet at the rate for risk to an individual. So, that still remains absolutely the intention within our replatform.

John Stevenson:
Okay. Great. Just to confirm, there have been no changes to the sort of the rate within the provisioning or how - you sort of degrade people as they sort of go through the months.

Craig Lovelace:
The provision model is still done under IAS-39, our favorite accounting standard. And so, to that basis, nothing has changed on that.

Notwithstanding that, the eagle-eyed amongst you will have noted a comment on IFRS-9 in the statement. I will update much more wholesomely on it at the prelims. But I'm highlighting it here because it will impact our FY19 results. But it is prudent just to highlight that there is a moving accounting standard from IAS-39 to IFRS-9 next year. So, further information to follow. But I thought it was best to highlight it now at this early juncture.

John Stevenson:
Okay. Brilliant. Okay. Thanks, Craig.

Craig Lovelace:
Thanks, John.

Operator:
So, our next question comes in from the line of Kate Calvert at Investec. Please go ahead.

Kate Calvert:
Morning, everyone. Could you give us an update on what's happened to your debt per customer over the period, and also can you give an idea on the change in the number of financial customers as well? And on the other side, can you talk about - on the product side, can you talk a bit about some of the corrective actions you're taking to correct the performance of the secondary brands, please?

Craig Lovelace:
Okay. On the debt per customer, I'd rather give more detailed figures on that at the prelims, given this is a trading update. But ultimately, it has gone up in a sustainable fashion.

Kate Calvert:
All right. Thank you.

Angela Spindler:
In terms of corrective actions on the secondary brands, the main brand within secondary brands in terms of volume and revenue is Fashion World.

Fashion World had pretty touch comps. Also, we have deliberately taken marketing spend out of Fashion World and put it into the power brands. So actually, it's pretty much on target for the period.

Figleaves is a brand where we're making quite a lot of changes and something we can give a little bit more colour on at the prelims. However, there's a new management team in there doing some very interesting things in terms of driving that brand going forward. So, we're excited about the prospects in the mid to long term, but that's in the middle of a transformation really. So, I guess therefore, you know, they're the two main things to speak to in the secondary brands.

In terms of Fifty Plus, which was the last of the seven titles if you've been following the story, that we've migrated into JD Williams, as we simplify our brand portfolio and move to something that is much more media friendly in terms of our go-to market. So, Fifty Plus was the largest and last one for us to migrate. We always see a dilution in response rates when we make that change.

One of the things that we're able to do, though, to correct that because those Fifty Plus customers are largely online, we're able to personalize, using a software tool called monetate, their online experience such that we can present to them products that are more relevant to them. Typically, they're a bit less fashion-forward than the new contemporary JD Williams customer so we are able to reflect that in the way we present products to them and which products we present as we can personalize the web experience. So, that's what we're on with doing and we would expect to see those response rates improve going forward.

Craig Lovelace:
Okay. Just to respond briefly with a final point on your earlier question. Obviously the take up on minimum payment has been higher than we expected. So that in itself on a purely mathematical basis will drive a higher debt figure, but we've also seen more people paying their balances overall so ultimately by moving to a lower minimum payment you're actually seeing more people paying on a more regular basis. The arrears profile has improved. So, there are many moving parts as always on the book. Overall absolutely the math would indicate more, but one important thing to note as well is there is no change in any way shape or form to the levels that we extent to people on their accounts. We haven't suddenly expanded the credit limits in any way, so it is really business as usual in the policies and procedures on opening credit balances that has always been the case.

Kate Calvert:
Right. Very clear. Thank you very much.

Operator:
The next question comes in from the line of Simon Bowler from Exane. Please go ahead.

Simon Bowler:
Morning all. Just three questions from myself if that's okay. Firstly, the JD Williams including Fifty Plus, when we look at the 3 percent year-on-year growth from JD Williams, is Fifty Plus accounted for within the base and in the current year numbers or how is that being treated?

Angela Spindler:
Yes. It's fully included in it, Simon. So new customer growth was 12 percent on JD Williams, which we're really pleased with and the dilution to revenue has all come from the migration of those Fifty Plus customers, which now are completely included in the JD Williams base and I've just described how we intend to improve the response rate there. We do tend to see a dilution in response rate when we migrate someone from brand A to brand B, but obviously in the medium to longer term it's the right thing to do to drive our media return on investment.

Simon Bowler:
Okay. That makes sense. So, the underlying kind of health or growth in JD Williams would be better now at 3 percent given the Fifty Plus impact that you've spoken to?

Angela Spindler:
Absolutely. Yes.

Simon Bowler:
Okay, great. And then in terms of the minimum payment changes, I guess one impact that it has is it ultimately kind of drives more interest income through from consumers so there's a margin impact, but also a revenue uplift and are you able to kind of quantify at all what the uplifted revenue was from that kind of minimum payment change that was put through?

Craig Lovelace:
No. I mean, I think it ultimately at this point the guidance that I gave on the change in gross margin guidance I think hopefully should steer to the impact it's had.

Simon Bowler:
Right. Okay. Fine. And then in terms of the kind of outlook, I realize it's early to be talking about the outlook for fiscal '19, but how's your thinking about the financial services gross margin from an FY19 perspective given the extent to which it stepped up this year.

Craig Lovelace:
So, obviously, we've seen a continued improvement in the book. I think it's sensible to see elements of that continue. But on the flip side, as well as seeing improvement in the book, there are also elements that are on the downside. So, for example, the better quality of book equals lower administration and other fees as well. So, I think, overall, at this stage, I think it would be sensible to pencil in something like 250 basis points decline in FY19 from where we currently stand. There are lots of moving parts. But at this stage, we'll give further guidance, obviously, at the prelims. But I think that's a sensible position to take.

Simon Bowler:
Okay. That's great. Thank you, Craig.

Operator:
The next question comes in from the line of Paul Rossington at HSBC. Please go ahead.

Male Speaker:
Good morning, everyone. Can you hear me?

Angela Spindler:
Yes, we can hear you --

Craig Lovelace:

Good morning, Paul.

Paul Rossington:
Good morning. So, it's following-up from the point on the financial services margin decline in FY19. Is there going to be an offsetting benefit there on the product gross margin? You'd expect to see less promotional activity than last year? Or we're looking - otherwise we're looking at a lower group gross margin year-on-year?

Craig Lovelace:
So, overall, on product gross margin, clearly, it's a competitive environment out there. So, I think we are guiding, overall, to a flattish product gross margin. Importantly, we're still comfortable overall with FY19 PBT consensus.

Paul Rossington:
Okay. Understood. Thank you. Secondly, you're comfortable with that consensus, is that pre or post IFRS-9?

Craig Lovelace:
Well, IFRS-9 has an impact on FY19. We're still working that through. So, it's too early to even indicate, you know, that impact. So, everything we said is pre IFRS9.

Paul Rossington:
Thank you. I presume it - does that mean you'll be re-stating your FY-18 base as well?

Craig Lovelace:
So, what I'm attempting to do when we meet at the prelims is give an indication of what FY18's figures would look like under an IFRS-9 world. So, that is what we'll be indicating in April.

So, restating is absolutely the wrong word. Its effect - there will be an effect, because what IFRS-9 is doing - IAS-39, our current standard, looks back at the loan book. So, you're looking at evidence, objective evidence of an impairment event. IFRS-9 looks forward. So, at the point you take on a new customer or a sale is made, you're looking forward over the expected lifetime of that customer, including future credit limits increases, and you're effectively looking at the likelihood of default in the future. So, it's quite a different basis. It's a complex basis. We will be giving detailed guidance in April as to the impact. And then, obviously, the first time we'll report under IFRS-9 will be our half-year in '19.

Paul Rossington:
Okay. Understood. Thank you.

Craig Lovelace:
And the impact could be positive or negative. That's why we're not giving an indication of numbers at the moment. We want to do a proper assessment and then we'll fully disclose that in April.

Paul Rossington:
Okay. Understood. Understood. And thank you for that colour.

And separately, just on Jacamo, I mean I understand a dilution from Fifty Plus means that JD Williams' growth looks slightly lower than it would otherwise be, on a headline level. But the Jacamo business does appear to have kind of dropped into this lower kind of single-digit growth territory. It was previously, I think, a bigger engine of growth for the business. What - you know, is Jacamo not benefiting from some of the other initiatives which have been rolled out at group level, like the variable APR or the improved payment systems? Or why is it such a big disconnect, perhaps, between Jacamo and Simply Be? I'm just trying to understand why. There doesn't seem to be kind of an obvious reason why that one has slowed down relative to the better rates of underlying growth we're seeing at JD Williams and Simply Be.

Angela Spindler:
I mean, we're pleased with the performance on Jacamo. It did have a very strong trading period over Christmas. I think the market has been pretty tough. And we have really great share gains in menswear, off the back of that performance. Plus, Jacamo has pretty tough comps. So, it is in line with our plans. And the level of investment in Simply Be was higher, and the growth rate was therefore higher. But you know, we were pretty pleased with Jacamo and we're certainly pleased with our menswear share.

Craig Lovelace:
Paul, as a parting comment, just on your query on IFRS-9, it's a really important takeaway: there is no cash impact.

Paul Rossington:
Thank you very much.

Craig Lovelace:
Thanks.

Angela Spindler:
Thanks, Paul.

Operator:
Okay. So, our next question comes in from the line of Andy Brough. Please go ahead.

Andy Brough:
Yeah, hi. Could you just talk a bit more about the product margin? Do you see this as a permanent step down given the backdrop of competition or, you know, do you see it kind of going back up in two years' time?

Craig Lovelace:

Morning, Andy. I don't see it necessarily as permanent. I mean, clearly the market backdrop is heavily promotional at the moment. The change in guidance this time around was driven by promotions, which was an over participation certainly in cyber. There was a mix impact and a P&P impact. And while I think FY'19 I expect to see it flatish, I wouldn't be calling it as a permanent position.

Andy Burrough:
Okay.

Operator:
The next question comes in from the line of Tony Shiret. Please go ahead.

Tony Shiret:
Morning all. Just following up on that, can you tell us which products you had to invest more in, in terms of promotions? I mean, that looks like a big change in guidance based on one quarter and looking at your sales performance it looks like it's womenswear, but can you give a bit more colour on it?

Angela Spindler:
Promotionally, Tony, it's absolutely across the board. And as Craig pointed out, it was the strong performance relatively in the period of those Christmas trading weeks, particularly in the cyber fortnight, which really, really drove good demand across the piece.

You're absolutely right to point out, though, there is a lower performance on ladieswear and, of course, from a mix effect that also plays into gross margin. The main impact on ladieswear in relative terms was the poorer response rate from the migrated Fifty Plus customers that we've already spoken to. So, we absolutely see that recovering moving forward.

Craig Lovelace:
And I'll just add to that, Tony. A small part of the gross margin move comes through the USA and clearly, we've been pushing more heavily on that. There is a degree of greater discount in the USA. It's a small element that is still nonetheless consistent with our strategy and consistent with pushing that brand forward.

Tony Shiret:
Okay. Thanks.

Angela Spindler:
Thank you.

Operator:
The next question comes in from the line of Andrew Hughes from UBS. Please go ahead.

Andrew Hughes:

Yeah, good morning everybody.

Angela Spindler:
Morning.

Craig Lovelace:
Good morning, Andrew.

Andrew Hughes:
Just had another question on the minimum payments change. I mean, thanks for all the detail you've given on it. I've just wondered why you've made the change and why you've done it now and where do you now sit within the industry average in terms of minimum payment? And what was the last change and what was the result of that?

Craig Lovelace:
The change was from 5 percent to 4 percent. It was made at the end of H1 and it was driven by giving customers a greater range of options from a payment perspective. I mean, it was clear that there was a pinch on consumer spending coming so we took a long hard look and it was a sensible decision. We've actually seen a higher take up than expected, but also more people paying the balances overall. So, it's a positive impact on arrears and therefore gross margin, but importantly from a customer perspective it's a more affordable way.

Andrew Hughes:
I'm just trying to get my head around it a bit more. You say more people are paying off, but the size of the loan book is actually gone up? Aren't those sort of opposing comment?

Craig Lovelace:
No. So, you’ve got the balances themselves - so because people drop from 5 percent to 4 percent theoretically it will take a marginally longer period of time to repay the balance, although they're free to clearly pay the balance at any point. That’s a critical point. The fact is, though, dropping down to a smaller payment we wrote to all our customers that this was a change in policy. Some people took advantage of that who may have been overpaying. The majority still overpay, but some people still took advantage of that drop. Others, who were potentially struggling to make their minimum payments now make it - it's much more affordable to them. But it's critical to understand that most people pay greater than the minimum amount. It's just helpful to some and it lifts some out of a previously more difficult position, where they would have been more impaired from an accounting perspective, to a position where they're effectively making the minimum payments on a much more sustainable basis.

Andrew Hughes:
Right. Okay. So, is that partly why your provision rates come down, because more people are actually paying off?

Craig Lovelace:

Yes. So, fewer people are in arrears.

Andrew Hughes:
All right. Okay. And where does the 5 percent sit, you know, within the industry average? I think Next is on 5.5.

Craig Lovelace:
We're broadly in the pack.

Andrew Hughes:
The pack. Yeah. Okay. All right. Great. Thank you.

Operator:
Okay. So, we have no further questions coming through on the line. So, I'll hand it back over to yourself, Angela.

Angela Spindler:
Okay. Well, thanks, everyone, for dialing in, and thanks for your questions. Have a good day.

Craig Lovelace:
Thanks, all.

Operator:
Ladies and gentlemen, thank you for joining today's call. You may now replace your handset.