

N Brown Q3 Trading Statement FY21 15th January 2021

Steve Johnson:

Good morning, everyone, and thank you for joining the trading update call. This is Steve, and also, on the line from a different location, is Rachel. And I hope you're all safe and well. Here in Brown, we continue to focus on our number one priority of looking after our colleagues, whilst ensuring our business has the agility to respond to the ever-changing external environment and continue to serve our loyal customers.

So, turning to this morning's statement, I'm sure you've all read it. But I'll cover the main points before opening up to Q&A.

So, our product revenue trajectory has showed continued improvement, driven by the five strategic brands. In the period, our product revenue was down 8.9 percent. However, product revenue from our five strategic brands was down a modest 1.4 percent. This was in a period when group marketing costs were 40 percent lower than the prior year. And we were particularly pleased with the performance of JD Williams and Home Essentials. Encouragingly, we saw growth in online customer accounts -- in JD Williams, Simply Be, Jacamo, and Home Essentials -- in period.

Our business model enabled us to pivot to home and gift customer demands. And home and gift sales now compromise 42 percent of the product revenue, compared to 32 percent in the same period last year. As expected, apparel demand was lower as our brands resonate with older customers, who have shown more caution with their clothing expenditure than younger customers.

Our financial services cash collection rate remains stable and remain in line with the prior year. We've also seen an improvement in the quality of the debtor book, with arrears rates at 7 percent, compared to 7.9 percent in the prior year. As of the 2nd of January, the number of customers on a COVID-19-related payment holiday represented just 0.3 percent of debtor balances, down from a peak of 3 percent in May.

In December, we successfully completed our fundraising to accelerate our strategy and eliminate unsecured debt. As a result of the fundraising and on our ongoing focus on cash generation, and in line with the targets laid out in November, we now have a net cash position of £83.7 million. The capital raise will also enable us to invest further in our digital capabilities and accelerate our growth strategy.

We've made good progress with our ESG plan. I am pleased, as part of our focus on plastics in year one of our sustainability plan, we've successfully conducted a trial of green polyethylene dispatch bags. This is important for us as we progress to the goal of 100 percent green polyethylene dispatch bags by the end of FY22. We're also proud to have signed up to the BRC Climate Action Roadmap, to help the retail industry -- including supply chains -- to hit zero net carbon emissions by 2040.

So, moving to our outlook and guidance, as with a number of other retailers, we are currently experiencing delays of two to three weeks for many of our stock deliveries, given global container issues, as well as cost pressures in the supply chain. We're working through the operational

challenges which this presents us and looking to minimize the impact on customers. We now expect to offset more than 80 percent of the absolute gross margin decline driven by the pandemic's impact on sales and bad debt, through operational cost savings, with bad debt provision movement being the main net driver negatively affecting EBITDA.

As a result, we currently expect to deliver FY21 EBITDA of between £84 to £86 million. We expect depreciation to be higher than FY20 as we accelerate the pace of our strategic change. Following the successful equity raise, we are accelerating our strategy, and now expect FY21 CapEx to be circa £23 million. FY21 year and net debt is now expected to be in the range of £285 million to £305 million, down from £497.2 million at the end of FY20. Exceptional costs, driven by restructuring costs, are expected to be circa £10 million this year.

So, in summary, we continue to move through the acceleration phase, simplifying and strengthening our core brand proposition whilst improving our digital capabilities. We remain mindful of the ongoing uncertainties in the U.K. retail environment. But as a digital business, we look forward to building on the unique strengths of the Group's brands in 2021 and beyond. And with that, we will open up to questions. So, over to the operator.

Operator:

Of course. Ladies and gentlemen, if you would like to ask a question, please press star, followed by 1, on your telephone keypads. And if you are joining us online, please click the "Request to Speak" flag icon. We have our first question from John Stevenson from Peel Hunt. So, John, please go ahead.

John Stevenson:

Brilliant. Thank you. Good morning, everyone.

Steve Johnson:

Good morning.

John Stevenson:

Just a couple of questions to get us going. I mean, in terms of your stock of spring and summer, and going into autumn and winter, how is that -- you know, how are you able to sort of shape that in light of Lockdown 3? Or to what extent can you shape it in light of Lockdown 3, given, as you say that you think, obviously, a much bigger pivot into home and gift, and kind of away from clothing at the moment. I assume that's going to be true coming into Easter as well.

Secondly, I don't know if you can comment on how clothing sales fared, you know, relative to what you're seeing in the first half, and maybe comment on the performance of the product brands as well.

Steve Johnson:

Yes. Sure, John.

So, firstly, in relation to the stock side of things, we've actually taken some quite decent action on stock. The stock file is down about 14.5 percent. But that doesn't really tell us the story. In fact,

what we were able to do is sort of clear up a reasonable amount of last and previous. So, on the overall stock position, we're actually quite happy. And we've highlighted two to three weeks' worth of delays for our incoming stock. We think that's -- well, we know that's a global issue, related to the container shortage that I'm sure you've heard lots about. And fundamentally, that is manageable for our business at this point in time.

In relating to buying into -- let's call it "COVID stock" we were able to cancel out of quite a few orders at the start of COVID, particularly in Q1. And we've built back our stock that's relevant for a COVID environment, and -- ever since. And therefore, actually, our stock, we feel, is a sort of good match for the demand that's coming through at the moment.

In terms of the performance of our womenswear brands and our menswear brands, they've all been starting to improve, particularly during the sort of Q3 period. We have pivoted to the home and gift demand because that's what our customers are buying. But we are seeing similar trends to what other people are seeing as well. So, our own label leisurewear grew at 129 percent. We were particularly pleased with that. And leisurewear and loungewear in Jacamo, particularly, was growing as well. So, we are seeing the types of trends that have been well-reported, and we believe our stock file is going to be appropriate for that going forward, John.

In terms of the actual --

John Stevenson:

[unintelligible] -- sorry, Steve. I didn't mean to interrupt. Go on --

Steve Johnson:

Yeah. No. Go on. No. No. That's fine.

John Stevenson:

Okay. Great. I mean, just in terms of your planning for spring, summer, and the sort of stock you had coming through, you weren't expecting kind of normal for the seasonal mix, and you're still sort of buying in for, effectively, COVID mix?

Steve Johnson:

Absolutely. Absolutely. Absolutely.

John Stevenson:

Yeah. Yeah. Brilliant. Thank you.

Steve Johnson:

Yeah. So, that's on the stock side of things. The product side of things, we were just talking about -- I mean, we are seeing continued improvement on the key brands that we've talked about. They were 1 percent down. And I think the sort of key points I would call out -- we have seen some really positive performance in JD Williams. And that actually turned out to be the largest growth in the home blend. In fact, it drove 39 percent growth in the home sales through that period. And we're very pleased with that.

John Stevenson:

Okay. Great. Thanks.

Operator:

Thank you. As another reminder, ladies and gentlemen, if you would like to ask a question, please press star, followed by 1, on your telephone keypads. And if you're joining us online, please hit the "Request to Speak" flag icon. Our second question comes from Clive Black from Shore Capital Markets. So, Clive, please go ahead.

Clive Black:

Yeah. Thank you. Good morning. Good morning, everybody. Two questions, if I may, again. Firstly, you've clearly seen a higher home participation than clothing over the last year. I just wonder what your expectation is, going forward, and whether you would see any re-balancing in that -- or maybe another way of thinking about it, are you seeing home as been strategically more important to N Brown's product assortment going forward? And then, secondly, maybe just by way of reminder, you've outlined that CapEx will be a little bit higher this year than you'd previously expect before the changes in November. What will be the priorities for CapEx, over the next two or three years? Please -- thanks.

Steve Johnson:

Good morning. Thanks for your question. So, we do expect a sort of continuing shape of home in the strategic core. And if we go back to a strategy, we're quite clear that particularly Home Essentials will be one of our strategic brands going forward. And absolutely will identify home as an area to push forward on. I would say, however, that we are expecting to see a bounce back into our clothing performance. As clearly, the vaccination rolls out and people start to get a bit more comfortable and start to have events back in their diaries again. I'm sure we all want to be there. So, we would expect to see our clothing sales move forward again as the lockdown and as the vaccination rolls out and people get a bit more confidence throughout the year. And that would be the sort of expected shape of the curve. But we shouldn't lose sight of the fact that home was identified prior to the pandemic as one of the strategic levers that this business was going to focus on. So, I think Clive, in short, you'll see a shift towards where we're not walking away from it, but we won't see that until the vaccination program rolls out and people start to return to a normality.

In relation to the CapEx question, well, the money effectively landed in the bank, I think on the sort of 22nd and 23rd of December. That's when we officially moved over to AIM and that's when we officially got the money starting to come back into the bank. And sort of typical style our CFO was refinancing on Christmas Eve. So, we've managed to create some additional money to accelerate our strategy straight away. The areas that we are focused on specifically -- which you will hear more about at the preliminaries -- we are focused specifically on our new front-end website, which we expect to be delivering in the next financial year. And we've started increasing the spend on that. And specifically, that's the answer to why that CapEx is increasing at this point in time.

Clive Black:

Okay, thank you. And Steve, just go back to that first question. Just by way of color, can you indicate the differential and average gross margin between home and product -- sorry, apparel,

please?

Steve Johnson:

Yeah, I mean, it is very much driven by where we've been seeing some of the sales as well. I mean, I don't know, Rachel, if you sort of want to come in on this point in time. But we are seeing differences in the types of goods we've been selling as well. So, for example, we managed to get hold of some of the next generation consoles. So, PS5s, particularly, which have come out at a low margin. We've been expanding our Apple product range. And we've done that very, very successfully, as we've leant into wherever the market is. So, there is a perspective that relates to customer demand at the moment, rather than a, you know, a normal market, so to speak. So, Rachel do you want to pick up the margin question?

Rachel Izzard:

Yes. Hello, everybody. And thanks for the good question, Clive. So, on the numbers side, the product gross margin, you're right, home and gift comes at a lower margin than clothing and fashion. On average, it's five to seven points lower, but it can have some extremes. So, for example, the consoles have a relatively low margin, but they're very kind of high fame. Good for branding, good for marketing almost into the customer base. And then, you have the other extreme. Own branded, own designed clothing and fashion has a high margin. But what we get from home and gift is one, it's a strategic pivot, two, it's got a lower returns profile. So, actually the revenue holds up better from a home and gift perspective. And three, we actually see better credit penetration with home and gift. And so, we get a double up on the margin with the financial services business as well. So, on the face of it, it looks like a lower product gross margin with home and gift, but under the hood, there's a lot of good reasons why it's a good strategic pivot for us.

Clive Black:

And you mentioned returns, Rachel. How has that progressed over the last quarter? Final question from me. Sorry.

Rachel Izzard:

Yeah, so, our returns were just shy of 18 percent in the quarter, and if you follow that down just eight percentage points on last year. The majority of that is the mix change, but we're also seeing the rest of the industry we're seeing low returns on all our goods. And we're also starting to see the kind of -- the benefit of some of the fit initiative in terms of clothing and fashion being slightly lower returns. So, we've always historically had lower returns because we're a fit specialist, but it's actually getting better and the home and gift has helped us considerably as well. So, a very low level of return.

Clive Black:

Excellent. Thank you for your help and all the best for the quarter.

Steve Johnson:

Thanks, Clive. Thank you for the questions.

Female Speaker:

Thank you. Our next question comes from Matthew McEachran from N+1 Singer. So, Matthew, please go ahead.

Matthew Mceachran:

Thanks. Good morning, guys. It's a follow up question really just in relation to the gross margin -- product gross margin. And I just wondering if you could provide us with any sort of kind of help around guidance for performance in the second half, given the real shift in that mix. I was just looking back to the first half performance, and effectively what you talked about there was a mixed shift effect of 440 basis points. There were some other drags in H1, which perhaps aren't being repeated. But it feels like that margin mix drag is probably a little bit greater in the second half than it was in the first half. If you can maybe just walk us through some of the kind of guiding points, that would be really helpful.

Steve Johnson:

Okay. No problem, Matthew. Nice to speak to you. I will hand this one back to Rachel, if that's okay.

Rachel Izzard:

Okay. That's fine. So, Matthew, you've hit the right points, to be frank. We will definitely see the next effect, and we'd see it slightly further ahead than half one, in terms of that mix impact into gross margin. We also see -- and in part of the guidance we talked about the challenges on the Q4 supply chain cost -- with be challenges to sea freight, as Steve alluded to. As with the rest of the industry, we know we've got some kind of margin pressure coming through. But that's inclusive within our guidance. And the specific cost of that is a maximum of £1 million within Q4. And specifically, that's the air freight costs. The tariff impact of shipping into Ireland. We're all over and well advanced with that is relatively modest. It's more the air freight challenge at the moment that we're seeing before Chinese New Year, and then we expect it to ease off after that. But we've got £1 million of harm within gross margin expected within Q4 within that EBITDA guidance. So, yeah, mainly mix, but we're also seeing a little bit on margin because of the air freight -- the sea freight issue.

Matthew Mceachran:

Yeah, okay, that's helpful. Thank you. And then, one for you, Steve just in terms of the deployment of funds from the raise. I mean, you mentioned CapEx. Could you just give us a little bit of a flavor as to when you feel you're going to start, you know, accelerating in the recruitment spend. I mean, presumably spring is a good time to do that, but then equally autumn. Is it going to be the first half, do you think, of the financially year? Or more likely to wait for the second half?

Steve Johnson:

Yeah, I mean, I think it's worth just reflecting what our business is trying to do. I know you know our business very well. But ultimately, you know, we did announce that we were focused on profitable growth. And that remains our strategy. And what we've been doing through the period is continuing to enhance our customer lifetime value models. And those customer lifetime value models have led us to different choices in relation to our last customer value lifetime model quite a bit out of PPC. We've also continued with the transformation of our strategy. We now have a

digital model. And if a customer wants to do business with us now, the only place they can do that is by opening an account online. 20 years ago, they could fill out a form, send it in, we would open an account. They could phone us up, we would open an account. We still have some stores where they could go in and open an account. So, the business model is now being moved to a digital model. And with that, we've been transitioning customers as best we could as well in relation to the customer lifetime value models.

So, for example, if you were to go to House of Bath, you'll see that the URL directs you to Ambrose Wilson. That change was made in September last year. And that business, you know, was historically a 92 percent cash offline business. So, we have been moving forward with our transformation in the background to make sure that this is entirely a digital business and only digital customers who are making that journey with us. We do still support them offline. These are high-valued customers, and we'll continue to do so, but as I've said to a couple of people, even Amazon has a telephone number.

So, from our perspective, there's a lot been going on and that 40 percent reduction in marketing is not necessarily all to do with the pandemic. It is absolutely about setting this business up for success in the future.

Now, we started taking some, sort of, more radical approaches to that strategy as a result of the pandemic which, if I recall, was about the 23rd of March when we started looking at this quite hard. I think that was lockdown day, sort of, if I've not quite gotten that right, I apologize, but that date sticks in my mind.

And then, from the start of April, we went to, sort of, really, you know, really accelerate our strategy. It isn't a cut back of cost for the sake of it. This was something we were always going to do. We just accelerated it. And, therefore, that starts to play through into April this year as a sort of annualized approach.

So, our expectation is that we would take that annualized approach, and where we can get more spend-away effectively to support the strategy, it would be around that time moving forward. But what I can't guarantee Matthew -- as I would, sort of, hope you would, sort of, understand this, with all the uncertainty in the world -- what I can't guarantee is that that, sort of, produces an instant result.

Matthew Mceachran:

Yeah, no, absolutely. That's fair. I mean, I guess, part of the reason for the question is, obviously, just, you know, to get a sense of when, you know, when you're really starting to accelerate, as you just mentioned, but also, you know, the timing of the payback. You know, it seems likely that of you do up the ante, even with the focus on the ROI, it probably is an investment in the current year, particularly with IFRS 9, I guess, as well.

Steve Johnson:

Yes.

Matthew Mceachran:

And then there's probably a lag effect in terms of how it plays through your P&L.

Steve Johnson:

Yes.

Matthew Mceachran:

But I get the point about the efficiency, so yeah, thank you for that.

Steve Johnson:

Yeah, yeah. I mean, we have raised the money. We've already started spending the money on the CapEx. The new front-end websites is an area that we believe is fundamental to the strategy of this organization. Having a, sort of, more nimble faster developing ecomm business is fundamental to the strategy, and the CapEx initially is going to support that in the best way we can possibly do it, and we've already started spending some more money to do that, which is why CapEx is going up.

In relation to customer recruitment, our plans for next year will face into an annualization of the strategic changes that we made from around April, and we will absolutely be looking to get behind the medium-term objectives that we set as part of the capital raise. Now to remind us, both medium term objectives were 7 percent product revenue growth at a 40 percent EBITDA margin, and we committed to those over the medium term. To achieve those in the way that our business model is structured, Matthew, means that clearly, we have to go after aquisition.

Matthew Mceachran:

Okay, that's brilliant. Thanks very much, Steve.

Operator:

Thank you. Our next question comes from Andrew Wade from Jefferies so, Andrew, please go ahead.

Andrew Wade:

Morning. Couple questions from me. First one on the marketing side. Obviously, you talked about being 40 percent down overall, but presumably there would have been reallocation by brands and so on. Just interested to know how much some of those core brands, the likes of Simply Be, JD Williams, Jacamo, etc, how much the marketing spend is down there. That's one.

Second one -- which of the five brands, the five, sort of, focus brands, do you see the biggest strategic opportunity? And then, the third one -- are you starting to make positive moves in terms of organic traffic yet, or will that be more driven by the new front-end website when we get that?

Steve Johnson:

Yeah, so I'll take the, sort of, last one, we'll work in three, two, one way, if that's okay, Andrew, but nice to hear the question.

So, in terms of organic traffic improvements, the new front-end website will -- if delivered, executed beautifully -- will provide us with that platform to achieve those efficiencies. Our Google

Lightbox score, at the moment, is not where we want it to be, and natural traffic is only, sort of, 11 to 12 percent of our overall traffic. And that is absolutely why we're developing our front-end website so that we can effectively benefit from those efficiencies as we go forward. So, that isn't going to change until we deliver that, and we expect to deliver that in the next financial year. Again, we'll talk more about that at the, sort of, preliminaries, Andrew, but your question is absolutely right, and your hypothesis is right.

In terms of the strategic brands, which ones are we really excited by? I think that's a really difficult question. I mean, it's like, which is your favorite child. It's a really difficult question in the sense that, you know, what we know is that at the moment there's a lot of demand for home and gifts. We're absolutely over the moon that we could launch a home business in April last year that's really helped us, and our pivot as an organization into that home and gift sales have really helped this business, and it's come, through, sort of JD Williams, so those are the two that, you know, we've been excited by through the period.

Obviously, if I come back to the question from Clive. As the vaccination rolls out and people start to return to normal and have things in their calendars to go out on a Friday night, Saturday night, the odd family event, you know, then clearly, you know, our apparel sales would expect to move forward again.

So, I mean, I think this is a difficult question in the context of where the world is at the moment. What I would say is, all five brands are strategically important to us, because in our strategy, they defined clear segmentations, and it's the segmentations that enable us to compete in different markets. That means that this business has the opportunity to grow. So, we are absolutely clear that they play a really, really good role strategically for us in the future, and we need to get behind them all. And hopefully that covers those two answers.

Andrew Wade:
Yeah.

Steve Johnson:
Now passing it to Rachel to talk a little bit about the shape of the marketing costs, if that's okay.

Rachel Izzard:
Happy to. So, to be fair, I haven't got the stats to hand of exact change of the ROI for each of the brands. To give you a sense, though, of the shape of where we've been placing our bets, you're right, we've put majority of our money into the strategic brands. The non-strategic brands, some of the more - you know - we're phasing through, such as House of Bath pointing into Ambrose now, and High and Mighty pointing into Jacamo. And, for example, Oxendales is within that packet of brands, and at Oxendales, we haven't had to do huge amounts of marketing spend because it's organically going incredibly well at the moment. Because for those retailers, which includes us that can retail to Ireland successfully at the moment, there are very few that can do it. We're one of the few that can, and that means we're seeing considerable growth without having to spend marketing money in Oxendales.

So very little of our money has gone to the non-strategic brands, so significant phasing of ROI

there. We're putting most of our money into the strategic brands, and the shape of that has gone more, as Steve alluded to, away from classic pay per click and more into paid social, inorganic or organic social, and some level above the line.

So, we went back above the line for the first time in fiscal year in two of our brands, so Home Essentials had above-the-line support in Q3 as did Simply Be. The ROI is still tinged by - we did have quite a significant amount of above the line this time last year for Simply Be, though, so it's not as simple as we're just seeing, kind of, an increase in spend. We are cycling against a relatively large spend for Simply Be this time last year. But first time in a year going above the line, Simply Be and Home Essentials -- that went well. A majority of our spend pushing into the five strategic brands and reshaping away from pay per click and into more efficient ways of marketing, in particular, on the social side. So, a relatively complex answer to a simple question, Andrew, but -

Andrew Wade:
Yeah.

Rachel Izzard:
-- as Steve said, we're very active in what we're doing rather than just papering the walls with marketing spend.

Andrew Wade:
Thank you.

Operator:
Thank you. So, we currently have no further questions. So, as a final reminder, ladies and gentleman, if you would like to ask further questions, please press * followed by one on your telephone keypads. We have just had a question come through from Paul Rossington from HSBC. So, Paul, please go ahead.

Paul Rossington:
Good morning, everyone. Hopefully you can hear me.

Steve Johnson:
Hi, Paul, we can hear you now.

Paul Rossington:
Thank you. Just one last question from me. I think most of the key questions have been asked, but can you just give a little bit of color or flavor on how your online KPI's have developed in Q3? And maybe even just a bit of color of how they, kind of, change in and out of lockdown trading periods, if you're able to do so. That's it. Thank you.

Steve Johnson:
Yeah, thanks. As you know, at this stage, we haven't really, sort of, moved to clearly articulating a different set of, sort of, KPI's, a digital set of KPI's. The business is working with those in the background. What I think we'll find is that next year our focus will be on growing our active online

credit files with a focus on AOV and a focus on AOF. What we have seen through the period is that our active file overall has declined as you would expect given the, sort of, fact that sales are less than they were this time last year.

Some of that in relation to the strategic changes that we've talked about, so I'll use House of Bath as an example. Some of that is in relation to the regulatory changes that we announced in January last year, which I'm pleased to say have now fully annualized. And actually, those regulatory changes, the last three of which was to give customers a lot more control over their credit limit increases, and one of those changes did take £25 million off the sales line through the year.

So, we were right to, sort of, highlight the fact that there was going to be material changes as a result of those changes, and that has played through, and that has played through into the active file again. So, the active file is down, and actually, when we look at the credit performance particularly, I guess the thing that I'm heartened by is towards the back end of year, as we started to really be able to pivot into the home and gift sales, probably it's not difficult to see that that would have a higher AOV and actually higher attachment rates, so the, sort of, financial services products, therefore.

And average order frequency of the new customers that we've been bringing in is starting to tick up, as well, which, sort of, says hopefully that the green shoots of our new customer lifetime value models are pointing us in right directions for the customers that we're starting to recruit versus the customers we used to recruit. So, we are pleased with the progress that we're making, and as I said, there's a clear story around the average active credit file.

Rachel Izzard:

And I'll just add to that, Paul, in terms of the new customer acquisition within that, overall, for the period, new customer acquisition was down 1 percent versus last year, but that was very much steady throughout the four months. And towards the backend of the four months into November into December, we are into positive trajectory year on year with higher new customer acquisition than this time last year, despite that 40 percent reduction in marketing.

So, we're seeing considerably better momentum and bang for our bucks with what we're doing, to play back to Matthew's question about acceleration and acquisition as well. So, within that overall file movement, we're very happy to see significant momentum from our perspective, versus where it's been in terms of new customers.

Paul Rossington:

That's great, thanks very much, and well done again, today. It was a good statement.

Male Speaker:

Thank you, Paul.

Female Speaker:

Thank you. Ladies and gentlemen, if you would like to ask a question, please press * followed by one on your telephone key pads now. We currently have no further questions, so I'll hand back over to you, Steve.

Steve Johnson:

Great. I'd just like to say thank you for joining the call. I wish you all safe and well and look forward to speaking to you again, hopefully at some stage a bit more face to face, but I look forward to seeing you at the preliminaries. Okay, thank you.

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