

N Brown FY20 Q3 Trading Statement

Steve Johnson:

Good morning, everyone, and thank you for joining the trading update call. I'm Steve Johnson, CEO of N Brown, and with me is Craig Lovelace, our CFO.

I'll start off with some highlights before handing over for the Q&A. I'm sure you've all read this morning's statement, but let me cover the main point, starting with the highlights. We grew digital revenue by 2.5%, driven by strong growth at Simply Be and Ambrose Wilson. Product revenue is down 4% as we continue to manage decline of legacy brands. 87% of our product revenue is now digital, an increase of 5ppts. Financial Services revenue is down 4.6% due to lower product revenue and impact of previously announced measures undertaken on changes to our lending practices. And I'll talk more about that in a minute.

Firstly, looking at product. This has been an encouraging period of peak trading for the business as we delivered digital revenue growth across both womenswear and menswear as customers responded well to our ranges. Within womenswear Simply Be delivered a really strong performance with digital revenue growth of 13.1%, which we're delighted with. Ambrose Wilson also delivered strong digital revenue growth at 7.9% in the period, and 63% of its revenue is now digital, an increase of 10ppts year on year.

Menswear digital revenue through the Jacamo brand increased 3.2% in the quarter against a strong performance in the comparative period when sales were boosted by clearance of stock from store closures. The market has remained highly promotional and this has led us to change our product gross margin guidance from a range of minus 50 basis points to minus 150 basis points, to minus 125 basis points to minus 175 basis points.

Importantly, our stock levels at the end of the period were 6% lower year on year and we expect this to decline further by year end. As ever, we continued to focus on cost initiatives to improve profitability.

Moving onto Financial Services. I'll come on to the outlook but want to start by talking about the current year, predominantly due to a lower than expected benefit from an IFRS9 non-cash provision movements, combined with lower Financial Services revenue and the highly promotional market I've already mentioned, we now expect FY20, adjusted profit before tax to be in the range of £70million to £72million.

Let me comment more on what's behind the Financial Services aspect of this. In response to wide-sweeping regulatory intervention across the Financial Services sector, we continued to make a number of significant changes to the way we manage our debtor book. These have resulted in a reduction in year-on-year debtor balances which declined by 2.9% in the first half of the year and by 2.6% at period end. Following a decline of 1.4% in the second quarter, Financial Services revenue fell by a further 4.6% in the period, due in part to these lower balances and associated interest income, and due also to a fall in administration fees as fewer customers entered into arrears.

We expect that the steady improvement in the quality of our debtor book and the changes that we

have made in response to the new regulatory environment will have further medium-term consequences for the performance of our Financial Services business. Improved credit quality will feed into a reduced IFRS9 bad debt provision; our IFRS9 bad debt provision ratio declined to 11.9% as at H1FY20. This compares with a 17.9% provision when IFRS9 was first introduced. We believe that while further impairment improvement can be expected, the pace of improvement will slow.

In addition, changes to our policies and procedures, specifically the embedding of new measures around affordability and the introduction of new rules concerning credit limits - effective March and December 2019 - and a persistent debt, which is due to take effect in March 2020 and December 2020, will have a significant influence on the size and shape of our debtor book.

The Group continues to assess its strategies to mitigate the impact of these changes, including the phased introduction of new financial products and further reductions in its operating cost base.

So in summary, I am encouraged with the performance of the business and the digital growth delivered across menswear and womenswear. Clearly, we are facing into challenges and there are multiple moving parts in Financial Services that we are dealing with, however, I am confident we are moving in the right strategic direction.

Looking ahead, we are positive about the future. We've made good progress with our ongoing strategic review. Our work so far has highlighted the need to have a tighter brand portfolio, a sharper focus on product, and a cost base appropriate for delivering sustainable digital growth. We look forward to providing further details at our full year results in April. And with that, we will open it up to your questions. So over to the operator.

Operator:

The first question on the line comes from John Stephenson from Peel Hunt.

John Stevenson, Peel Hunt:

Good morning, guys. A couple of questions to get it going. First off, I don't know if you can put a number on the overall Financial Services impact in your profit guidance this morning. Second question, just in terms of the, I suppose, the non-core or some sort of traditional product lines that have the transition which seems to be accelerating. I wondered if you could comment in terms of how that process is going and what your expectations are over the next 12 or 18 months. And finally, obviously, just looking at the regulations that are coming in. It sounds like that's more of an issue for sort of FY21 and FY22 in terms of Financial Services book and income that you're going to derive from that. How significant do you think those regulatory changes going to be on the business?

Craig Lovelace:

Right, John. So there's a lot of questions there, so we'll try and go through them. Forgive me if I forget discrete elements of it. But in terms of the impact end year for FY20, two of the three components that have caused us to reset guidance have been Financial Services related, we haven't called out discrete elements because in some ways they are interlinked. But the reality is we are 4.6% down on interest revenue. There is a linked product revenue decline there. And that is a

substantive change from where historically the Group has trended on interest revenues. So we were 2.7% up on interest revenue in H1. We've certainly seen the impacts of the regulations introduced last year on balances and so that is a core component of the guidance reset. And indeed, from an IFRS9 perspective, the balance sheet bad debt provision is the biggest single sensitivity and judgment call on the balance sheet. You're well aware we've moved in the last two years from an 18% provision to a 12% provision. I still expect the provision ratio to improve this year, just not in the quantum that we initially expected. And there are numbers of nuances on that judgment, but it is ultimately an accounting estimate that we have lost today on with our auditors. So that addresses the FY20 point. I'll get Will to remind me if I miss any element on that, but I'm just going to jump to the third question, John, on future regulatory impact. Just to be clear, in 2019 calendar we saw regulations introduced on affordability. So a tightening of credit from an affordability assessment perspective and, indeed, reductions in the amount people can have a credit limit increases. There was a second tranche of credit limit increase correspondence and restrictions as recent as December last year. We've barely even got into a single statement being run to see the impact, but we do believe that will have an impact going into FY21. There will be, obviously, the wave from the regulation impact we've seen in this fiscal year. And then finally we've called out persistent debt. We have already started to implement elements of this, we've written to customers in June of last year, we write again in March and then finally in December. So in actual fact, implications for balances from persistent debt specifically are unlikely to actually impact until FY22. But the reality is we do anticipate there's a cumulative impact of these. Some annualise, but some are new, clearly. We believe the reset guidance recognises that. It's the right thing to do to call it out at this time. We are still looking, certainly, for the persistent debt a long way in advance. But the reality is it's an industry wide impact. The right thing to do to call it now.

John Stevenson, Peel Hunt:

Okay, when you talk about the ongoing guidance, obviously you flagged this this morning for FY21, do you think that actually brings in sufficient downside, if you like, from the new regulations or will it be further in FY22?

Craig Lovelace:

We have we have estimated the impacts, and that guidance reflect those impacts.

John Stevenson, Peel Hunt:

Okay, great. Thanks.

Craig Lovelace:

And I believe you had a -- my apologies, John -- a middle question on product.

John Stevenson, Peel Hunt:

Yeah. Yeah, exactly right. On the transition clearly, you know, the digital side has gone extremely well, and clearly, a number of the brands are performing extremely well. But I guess, you know, we've still got a group that's struggling with transition. If you could, maybe, just sort of comment on how that transition is going against your expectations.

Craig Lovelace:

So we're going to give you a full strategic update in April of this year on where we're going with

the brands. It is actually in line with where we expected. We've been continuing to pull out of unprofitable, offline activity that clearly has implication for the Product brands. But we will be updating much more fulsomely on where we expect the group to go from a product perspective in April.

John Stevenson, Peel Hunt:
Okay. Thanks, Craig.

Craig Lovelace:
Thanks, John.

Operator:
The next question comes from Matthew McEachran from N+1 Singer. Matthew, your line is now open.

Matthew McEachran, N+1 Singer:
Yeah. Hi, guys. Sorry, you're probably going to get quite a few questions on FS this morning. Could you just remind us what the year on year movement was at the half year end on the book? You're talking about it being roughly 2.6% down at this point. Could you just remind us where you were at the end of the half?

Craig Lovelace:
So in terms of absolute gross amounts, Matthew?

Matthew McEachran, N+1 Singer:
Yeah. So the actual size of the book, year on year, just at the half year point.

Craig Lovelace:
I'm going to do this from memory, but from memory it's something around the £680 million mark. I don't have it in front of me.

Matthew McEachran, N+1 Singer:
I had forgotten what the number was. Was that slightly already in decline or was it --.

Craig Lovelace:
It was 2.9% down, we're 2.6% down at the moment. I expect to see it continue to decline simply because balance, certainly when there's an impact of a regulation, they can't increase as much as they had. And so we're certainly seeing the impacts of that.

Matthew McEachran, N+1 Singer:
Okay. And I was just looking back at some of the notes I had from the from the results meeting. And we were talking about the, you know, the income capture procedures and, obviously, the more onerous affordability checks. And I think at that point you were flagging up there were some systems and processes improvements that were anticipated to lead to at least some improved conversion rates. Is it the case that these have not occurred or is that the obstacle in the way is just

greater than what you anticipated?

Craig Lovelace:

No. I mean, the checks on affordability, we have absolutely implemented. They are part and parcel of our efforts to improve the book over the last two, three years. The fact is, though, there is a tightening of the issuance of credit to certain customers and it's not just us. So we traditionally, in the past, we may well have been able to offer credit. Some of the affordability tightening has restricted the ability to do so. So the systems have never been an issue. The visibility on customers is greater than it has been at any other time. So it is just a continued improvement in tightening and restricting the risk on the book.

Matthew McEachran, N+1 Singer:

So, okay, but just going back, at the actual point of sale to the customer, has the hope for improvement in terms of income capture in that process, has that come through?

Craig Lovelace:

When you say -- so, apologies, Matthew. When you say, "income capture," Just take me through that.

Matthew McEachran, N+1 Singer:

So when a customer's coming through and going through that process of being credit checked and making purchases. When you initially introduced the processes, presumably there was, you know, they were quite onerous compared to what they were historically. And at the interims you talked about fintech partners helping you to improve those front-end processes and acceptance rates. So I asked if that was a positive or if it didn't happen and that's part of the drag?

Steve Johnson:

Matthew, let me pick this up -- this is Steve. There are some systems that we had already in place, and this is an important point to capture levels of income and expenditure from a sort of customer perspective in making that credit lending decision. And what we're highlighting here is that we've made some other policy changes. So some of them sit within our scorecard, i.e. we've just got less risk appetite, and some of them are actually functional changes. So one of the changes that we have implemented and following this sort of spirit of the guidance that is out there and something that we would do because we're a great business who wants to improve customer outcomes, is to follow one of the implementations. And one of those implementations is simply to look at customers at a bureau level to understand whether they are two payments in arrears with any other provider.

Now, clearly until you implement that, and if you've got a customer who's continuing to pay you and looks like a good customer at this end, and there's nothing to say that customer isn't a good customer, that then you wouldn't have made a different decision. But once you understand that that customer is potentially two payments down somewhere else, then as a responsible lender, what you want to do is make sure you don't make it worse for that customer. That's not our business.

So we want sustainable shopping experiences, and that's one of the changes that we've made. And clearly that is one of a number of things that will have some impact. To counterbalance that, we've

introduced to the point that you were digging around, new processes. So we've recently gone live with a company called Aire Labs. And what Aire Labs does is where we were historically potentially going to make a decline decision because we didn't have enough information, but is in the sort of marginal case, and then we ping off to Aire Labs, and Aire Labs has a system that asks more questions of the customer to enable us to make a more informed choice. And that process, therefore, has been enhanced. That has been live for the last six weeks, seven weeks, something along those lines. And so far, it's really helping us make better informed decisions for the customer as part of that process. The crux of it, though, is the pressures are greater than the opportunities. And I guess that's just hopefully a helpful summary.

Matthew McEachran, N+1 Singer:

Yep. That is helpful. Thank you. And in relation to the redress outflows, how much of the provision has gone out the door actually in cash terms, how much is left to do in this final quarter and what's the remainder in FY21, please?

Craig Lovelace:

I'm not expecting any remainder in FY21, Matthew. The vast majority has gone out the door. Not everybody cashes those cheques. There's often a delay, but we've processed rapidly through the vast bulk of those claims as we speak. So I'm expecting it to be resolved in line with what we previously said by the end of the fiscal year.

Matthew McEachran, N+1 Singer:

Yeah. Yeah. Understood. Okay. I think that's it for me. Thanks very much, guys.

Craig Lovelace:

Thanks, Matthew.

Operator:

The next question on the line comes from Simon Bowler from Numis. Simon, your line is now open.

Simon Bowler, Numis:

Hi. Thanks. I was wondering if you could just comment on the change in your net debt guidance. It looks to have kind of increased at the midpoint by around about £15 million. But it sounds like inventory is running down, that the debtor book is reducing and a good proportion of the £10 million or so profit reset around the noncash bad debt provision. So I was just wondering what the other moving parts are around there?

Craig Lovelace:

It's largely the timing cycle of AP runs and general working capital. It really isn't any one specific item influence here. And I think we've made a point of calling out that we absolutely expect net debt to come down next year given a reduction in debtor balances.

Simon Bowler, Numis:

Okay. And then with regards to that reduction in debtor balances, and I guess a linked question to the Financial Services income. At this stage, is there any way you can talk around quantifying

what level of reduction in the debtor balance or the FS income? Will it be reducing across fiscal '21, '22, or we're not talking anything that extreme or too early to say at this stage?

Craig Lovelace:

I would much rather go through the next three months seeing the impact of the second phase of credit limit increases, which only went live on the 17th of December, and certainly I would be expecting in April to be in a much better position to call that. Just looking at the half on half numbers, the gross debtor balances were down from £680million to £660million. So there was some early impact there - there's a £20million impact and that wrapped in some of the early affordability of early credit limit impact. I will give more clarity in April, but I would expect to see similar quantum on that nature from recent credit limit restrictions going into next year. But we'll come back in April with a lot greater clarity.

Simon Bowler, Numis:

Okay. And then finally, I guess on the back of your comments around expecting net debt to reduce next year, then there's no reason for us to be kind of thinking about the dividend? It was obviously only recently reset, but just on the new profit shape and the cash shape, there is no need for us to be considering it, that is what I read?

Craig Lovelace:

We will be talking about the dividend, as we always do, at the prelims.

Simon Bowler, Numis:

Okay, fine. Thank you very much.

Craig Lovelace:

Thanks, Simon.

Operator:

Our next question on the line comes from Caroline Gulliver from Jefferies. Caroline, your line is now open.

Caroline Gulliver, Jefferies:

Good morning guys. I just wondered if you could talk through some of the potential cost saving opportunities you might have either on the product side of the business or the Financial Services side of the business. Obviously, you've lowered guidance, or improved guidance if you like, on cost savings control, which is I assume is mostly volume related. But are there any different buckets you could point us to where cost savings could happen?

Craig Lovelace:

Yeah. I mean, just to clarify, on the OPEX savings that we've seen this year to date and expect, we've expanded guidance on the level of savings. There's been an element of volume there, but there's also been a significant element of efficiency improvements, in particular in the marketing spend area. We've spent a lot of time refining our visibility on the return on investment we get. We've talked in the past about moving to a customer lifetime value model. And that really has seen a shift out to spend further from paper, further from digital PPC, more spend into social media,

really driven by a return on investment focus. So by far and away, the biggest element to saving has been in that marketing space. Some of it has had to go into margin to support the promotional environment, and that has been, again, regrettably consistent. But we do see across, in particular, that line, a real capacity for further improved efficiency. Now that we know and we've proven that we can reduce costs safely, that gives one a proven track record of doing that next year. And that is absolutely necessary to counterbalance some of the headwinds that we're seeing from FS margin.

Clearly, there will be variable savings. I absolutely get that in the supply chain. We've made continued efficiencies in that. And I expect that to further continue certainly as we get into the realm of continuing to improve our fit pieces probably fewer, fewer suppliers in the future, more focused on expertise and fit.

So it's across all cost areas where the real message of tight focus on costs, continued efficiency, I think we have capacity to deliver that.

Caroline Gulliver, Jefferies:
Thank you.

Operator:
It would appear we have no further questions that have been registered, so I will hand back to the host.

Steve Johnson:
So thank you for the questions, really appreciate it. I appreciate that some challenging points in today's announcements. I do, however, think to reiterate Craig's point, now is the right time to talk to those from a market perspective. I am really looking forward to coming at the end of the year and talking about the future shape of our business. I've given an inference in the statements I've given and look forward to really sharing the detail with you in April. Thank you very much.

Craig Lovelace:
Thank you all.

Operator:
Ladies and gentlemen, this does now conclude today's call. Thank you for joining. Have a wonderful day.

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