

N Brown H1 FY23 Results Presentation Transcript 6 October 2022

Steve Johnson:

Good morning everybody and welcome to N Brown's interim results for the 6 months ended August 2022. I am joined by Rachel Izzard our CFO. Let's turn to the agenda for today. First, I'll give you an update on our highlights so far this year. Then, I will then hand over to Rachel who will take you through the Group's financial results. I will then return to talk in a little more detail about our KPIs and our strategic progress. After that, we'll open up for Q&A.

The current macro-economic climate led to a tough online retail market in the first half. Weighted for our category mix, the online market reduced by around 7% over prior year. Customers are more cautious around discretionary spending as a result of inflationary pressures. Alongside this, we have faced the impact of inflation on our cost base.

We have met the challenging conditions by taking action to mitigate these – and as a result have continued to make progress across our business, balancing a creditable trading performance whilst successfully continuing our strategic transformation.

Although product revenue is down by around 5%, we've been disciplined in our trading approach. We haven't aggressively chased sales and have seen average item values increase by 14%, which more than offset softer website sessions and conversion. Demand has then reduced at product revenue level post the normalisation of returns rates.

Last year was one of unusually low levels of consumer credit defaults as our customers transitioned through the pandemic. As a result, prior year profitability was boosted by the strength of the Financial Services margin. The normalisation of this has largely driven the lower EBITDA in the half.

This is a business which is now in a stronger position than pre-pandemic as a result of all the work we have done over the last few years. We continue to have an incredibly strong balance sheet, a point which is sometimes overlooked. We have accessible liquidity in excess of £200m.

We're pleased that our new trading website for Simply Be has launched to all customers in September. This is a key investment within our digital transformation, providing a mobile-first experience, reducing friction through the navigation and checkout. We'll now move forward with rolling this out to Jacamo in the first half of 2023.

As a result of the impact of the macroeconomic climate on product revenue being expected to continue for the remainder of this year, we are planning for a decline in second half product revenue in line with the year-on-year trend seen in Q2 and September. We have therefore revised our guidance for full year adjusted EBITDA to be in the region of £60m.

I'll now hand over to Rachel to talk you through the financial results.

Rachel Izzard:

Thank you, Steve. Let me start with giving you a summary of the Group's financial performance in the half year.

Overall Group Revenue was down circa £16m driven by a combination of both lower product revenue reflecting the challenging online retail conditions, and lower financial services interest income reflecting the smaller customer loanbook from the start of the year and the softer retail sales through the period.

Gross Profit Margin has stepped back 3.8 percentage points, materially driven by normalising of the FS margin rate post Covid-19. Last year we had exceptionally elevated FS margins, as write offs were atypically low, and we released the majority of the initial Covid-19 bad debt provision. This has been partially offset by heartening growth in the retail gross margin. I'll talk to both these swings later.

Our opex costs to sales ratio has remained below the pre pandemic level of c40%. Vs HY22 we saw an increase in the ratio of c. 3ppts, with a combination of lower operational leverage where we held non marketing costs broadly flat, and our active choice to invest in marketing in line with our strategy. Net, within the absolute spend, we've absorbed an impact of around 2ppts as a result of inflationary headwinds with contract management and volume flexibility.

Combining the lower gross margin, materially driven by the FS normalisation, with the active step up in marketing investment, led to an adjusted EBITDA of £28m, c. £25m lower than the prior year.

Below EBITDA, we saw a £4.2m reduction in depreciation & amortisation following last year's acceleration of amortisation and software as a service change. We successfully held interest costs flat, giving an adjusted profit before tax of £4.3m, down c.£20m on the prior year.

Unsecured net cash was £5.3m up on prior year at £47m and the balance sheet continues to be strong, and we have over £200m of accessible liquidity.

Finally, Adjusted EPS of 0.72p reflects the profit performance during the half.

Looking at the EBITDA drivers, you'll clearly see from this slide that the majority of the EBITDA reduction has come from absolute reduction in FS gross profit.

This is partially due the smaller loanbook size coming into the year, but it's majority due to normalising post Covid-19 with the prior year including atypically low levels of write offs and the release of most of the Covid-19 IFRS9 expected credit loss provision that we put aside at the start of the pandemic.

Our absolute gross profit in retail was down only £2m as we offset most of the market driven volumes impact, through a disciplined approach to trading and margins which I'm going to run through later.

Across the cost base, we controlled costs well, mitigating a lot of the inflationary impacts which cost us c £6m in the half, and leaving the additional strategic investment in marketing, that we talked about at year end, as the main net movement in the cost base.

Looking at the revenue performance I'll start with the context of the market and weaker UK consumer confidence. Over the 6 months period the BRC's online non-food market tracker showed a 14% drop in demand. If we adjust that for our product mix which is more heavily into womenswear and less into white goods, our market dropped by about 7ppts.

In that context our retail product revenue contracted 5.2%, driven by a combination of lower strategic brands product revenue reflecting that tough retail market but with strategic improvements flowing through as well as managed decline in heritage brands product revenue, which has moderated to a lower rate of decline than in prior year as we no longer have a drag from the closure of Figleaves; and in the FS business, the interest income reduced 3.5% due to the smaller loanbook coming into the year and the softer retail sales through the half, albeit the proportion of sales made on credit did increase during the period.

We have been disciplined with our approach to trading and retaining margins and we took the decision not to aggressively drive volumes. I'll come onto the positive product margin rate later in the presentation and Steve is going to pick up on the growth in average item values.

Getting underneath the retail numbers:

As we had anticipated, we have seen a further increase in demand for Clothing and Footwear, particularly in relation to formalwear and occasionwear. Clothing & footwear reflected 70% of mix in H1, an increase over the FY22 mix and we're now almost back at the pre-pandemic level seen in FY20 of 71%. Clothing and footwear remains the heartland of the business and where we see the most opportunity for future growth.

With the mix back into fashion and customer behaviour normalising post pandemic, we expected and have seen a further increase in returns rate. The step up is also driven at the detailed level by customers buying into higher returning categories such as occasionwear dresses. And so overall, we are now running at an average ~ 1%pt below the pre-pandemic rate.

The Group's adjusted Gross Margin was 47.2%, compared to 51.0% in H1 22, and that swing is materially driven by the FS rate normalising post Covid-19. Product Gross Margin has improved, building on the gain shown at year end, with the H1 rate, up 1.4%pts VLY. There is a lot of work underneath the hood with that. Firstly, a pricing & mix benefit of c. 4%pts from a combination of:

- reducing promotional levels as we have traded in a disciplined manner and not chased volumes;
- we've also increased prices in a measured data led way in response to cost inflation;
- the mix has come back into clothing has a higher margin than home;
- and we have also added a small uplift to delivery charges.

Secondly, due to normalising levels of write offs in Financial Services, we have claimed back a higher amount of associated VAT Bad Debt Relief. And we credit that to the Product Gross Margin as we can only reclaim it due to the benefit of being a combined retail and credit provider. This improved Product Gross Margin by c1%pt

Thirdly, partially offsetting this we've seen flow through of higher freight rates with a drag of around 1.5%pts. Looking at FX, the hedging which we had in place has mitigated weaker Sterling.

Finally, there was a further 2%pt adverse impact which primarily relates to additional stock provisioning in light of the lower sales. And on the go forward we are carefully managing inventory intake. That covers retail margin. I'll now move onto FS

The FS margin rate reflects a normalisation post Covid-19. We outlined within our FY22 year end results the elevated financial services margin rate which was seen in that year. Now that we are normalising into this current year, the year-on-year change in H1 is being seen in 2 ways:

Firstly, a release of c. £10m of the extra overlaid Covid-19 additional credit loss provision from year 1 of the pandemic as it was no longer required. Customer behaviour was actually better than expected and so caused a one-off benefit to reported margin last year with a delta for this year vLY of circa 8ppts;

Secondly, last year in H1 we also saw a lower-than-normal level of write-offs, as customers had been supported through the pandemic, with government schemes, which resulted across all the consumer credit market in low defaults and arrears. This year has been more normal, so the VLY shows that impact of around 5ppts.

To give you a sense of this in the actual customer data. Normally we see high retail sales on credit in the peak period in the second half of our fiscal year and then slightly higher write off rates associated with that peak spending circa 6 months later in H1 of the next year.

Looking at the first three bars of the top graph showing H1 performance, you can see how low H1 last year was compared to the previous 2 years for normal write off profiles, with customers being supported through the pandemic exhibiting higher repayment rates and lower write offs. Looking at H1 of this year, you can see how this has now normalised.

In the bottom graph, for IFRS9 we look ahead at future expected credit losses. Looking at the end of the half, we have a provision rate of 13.9%. The performance of the book in the half has been in line with the expected deterioration assumed at year end; and the macro indicators such as inflation and unemployment rates have moved as expected so now the future economic uncertainty we included as a PMA, post model adjustment, at the year end is now reflected within the core base provision, and the PMA released.

In addition, the accounts in payment arrangements have been discounted in the calculation to match our wider provision. This amendment is consistent with year-end. Comparing the provision rate against the last 2 years, the underlying provision rate at the half year is pretty consistent.

This slide on Adjusted Operating Costs ratio shows us continuing to hold our cost ratio below pre Covid levels. On a 1 year basis we have seen an increase in the ratio. Some of this is operational gearing though with the lower revenue impacting the cost ratio for our fixed costs. We have also seen around £6m of inflationary impacts against last year. In absolute terms we have broadly been able to offset the inflation with contract management and volume savings, with the only material absolute increase in spend being the strategic investments in marketing.

Looking at the individual areas, marketing and production includes this strategic decision to invest and is annualised against a low spend in quarter of last year prior to that step up in strategic marketing. We have seen £2m inflation in this area particularly through higher costs being paid in the market for paid social and paid media costs.

The Admin and Payroll increase includes inflationary impacts totalling c. £2m and that include both utilities and payroll.

And finally, Warehouse and Fulfilment absolute costs are slightly lower as with our high flexibility we saved around £4m due to lower volumes. That's then been offset with c. £2m cost of servicing higher returns and around £2m of additional costs from fuel surcharges and other inflationary costs on 3rd party contracts and resources.

This slide shows how the EBITDA of £28m has converted through to net cash outflow of circa £11m driven by in year phasing at this halfway point.

Starting on the left at the top, we have seen an inflow of around £4m which includes benefit from non-cash and other working capital movements partially offset by investment in inventory. The increase in inventory is around £16m and that includes both the increase in freight rates and input costs and us also includes us intentionally moving our mix into newness and we have proportionally more of current season stock as new rather than last and previous than in the prior year.

The customer loan book and securitisation borrowings in financial services have resulted in a cash outflow in the half year. The net loanbook size reduced somewhat generating a net cash return to us, however with the return to normal phasing with the payment arrangements building. This has reduced the eligible pool of loans that we can securitise on, so we naturally reduce the level of securitised debt as we build up this balance of payment arrangements up to the bulk debt sale later in the year.

Non-operational cash outflows of c.£22m include a capital investment of £11m, which is in line with last year and it also includes some minor exceptional cash outflows, interest costs and tax charges, which together are successfully slightly lower than last year.

Across all these categories we saw a net outflow of £10.5m. We have then adjusted the level voluntarily undrawn against the securitised debt by c£15m and that has given us a net cash inflow of £4m.

I'll now walk us through what that practically means in terms of our robust cash and funding positions.

The three key points to highlight are, first, we have unsecured net cash of £47.2m at the end of the half. We also have £45.5m voluntarily underdrawn on the securitisation facility which is accessible. Combined, this reflects a figure of over £90m. That's around £10m lower than at year-end – but as we just walked through, this is normal in year phasing in financial services cashflows. So corporate financing is in a strong net cash position.

The 2nd tranche of our funding is the financial services securitisation facility. The drawn funding of £290.7m is well covered by the customer debtor balances with our gross debtor book being £572m at the end of the half.

Rolling the strong corporate net cash position together with the well-balanced FS securitisation, we have net debt of £244m which represents a further reduction over the year end. So, in summary our

balance sheet remains strong including the level of cash and accessible liquidity which is available to us. In total we have total accessible liquidity in excess of £200m.

Given the challenging macro-economic environment and in particular high interest rates and weak sterling, I thought it made sense to share a summary of our well hedged risk management position for both US Dollar movements and interest rates.

We buy most of our retail stock in \$. For the current financial year, FY23, we are fully hedged at a rate of c. \$1.36 compared to more recent spot rates closer to \$1.10. And for FY24, we have layered cover, for the full year averaging more than 50%.

In terms of hedge accounting effectiveness once we get to accounting for a period, above the line for stock we normally have c80% of stock cost covered by hedges in gross margin from an accounting sense. The remaining cash value of the hedges is reflected through fair value adjustments to financial instruments below EBITDA, but still within PBT. At the end of August, we had a fair value asset of £16m on the Balance Sheet relating to these \$ hedging instruments.

With regards to interest rates, in the prior year we entered into an interest rate swap to a notional value of £250m fixing SONIA interest rates through to the end of December 2024. This minimises the interest rate variability through the income statement and the fair value of this swap was £15m at the half year.

In summary our risk management approach giving us a solid position on forward rates for both dollar and interest.

Now, looking ahead and guidance for the remainder of our financial year. We have seen uncertainty around macroeconomic conditions persist and visibility around future trading trends is obviously limited.

The second quarter product revenue decline of 9.4% has continued into September. Hence at this stage, we have amended our plans and are now planning based on challenging market conditions continuing for longer, with H2 product revenue expected to reduce at a similar rate to quarter 2.

Additional product margin improvements are expected through the Group's pricing response to cost inflation, the movement of the product mix back to clothing, and our ongoing initiatives including data usage to optimise pricing strategies. We will also continue to carefully manage cost and margins whilst planning for ongoing elevated inflation and benefiting from the variable cost model. For half 2 we will normalise against a baseline that already includes the step up in strategic marketing.

Within financial services we have yet to see a significant change in the performance of the debtor book as a result of the macroeconomic environment. We do continue to expect the steady normalisation in arrears rates though to pre Covid-19 Financial Services levels.

As a consequence of these factors, we now expect FY23 Adjusted EBITDA to be in the region of £60m.

Finally, we continue to expect the Group to maintain a strong unsecured net cash position. By year end, we previously expected net debt to be in line with FY22's closing position, we now expect year-end net debt to have reduced below FY22.

So with that I'll now hand you back to Steve to talk you through progress on our strategy.

Steve Johnson:

Thank you, Rachel. I'll now talk about some of the strategic highlights from the half.

We have made good progress across each of our strategic pillars. As a reminder and as outlined at the time of our year end results in May, we have simplified our strategy to make it more focused on the things that will have the biggest impact for our customers and support the growth ambitions of the business, deploying our money, time and resource on the biggest priorities of the greatest value.

These actions make N Brown a simpler, more focused business able to allocate colleagues, investment and marketing spend in the most effective manner. Our focus is on growing the business through our 3 strategic brands, Simply Be, JD Williams and Jacamo, allowing for further simplicity, rigour of execution, delivery of strong customer propositions and marketing efficiency.

Home remains an important category, and our focus has shifted to growing this through the multi-category platform of JD Williams, enabling marketing efficiency and cross shopping.

Our remaining brands are now established as a "heritage" portfolio which includes Home Essentials and Ambrose Wilson and our focus is on stabilisation and value protection rather than growth, with no further closures planned.

We plan to fully integrate our flexible credit offer into the core of the customer value proposition. And we'll elevate data as an asset at the core of the strategy, driving daily decision making and activating our unique data pool.

Picking up now on a number of areas of strategic progress we have been made in the half by pillar.

Within Build a differentiated brand portfolio, we have continued to iterate our creative to better represent the brand positioning. Simply Be, Jacamo and JD Williams have each seen evolved creative and media approaches in the period. For Simply Be, the new creative is grounded in fit which is a key reason why our customers choose us. This was accompanied by a new media approach which saw us move away from traditional TV advertising as we focused our efforts on channels which better reflect where our customer spends time, including digital video, social, out of home and influencers. Simply Be has recently been nominated for 2 Drapers awards including best marketing campaign for our "F-IT" campaign. I'll talk about the other strategic brands in a moment on the following slide.

Now moving onto elevating the fashion and fintech proposition. I've spoken before about our good/better/best price architecture and creating product which represents great value and great quality, while introducing brands which stretch the range within the 'best' category.

We have made further progress in growing our in-house designed products, building on previous work to develop our design team whilst continuing to launch selective new third-party brands on our websites including Twisted Wunder which was our biggest ever new brand launch on Simply Be.

In Financial Services our medium-term strategic priority remains to build a new, more flexible, FS platform, which will enable us to launch new credit products to widen our appeal to customers and work has started on building out the new platform. Alongside this, we have continued to focus on enhancing the existing proposition including better integrating it into the customer journey and, following the introduction of 0% interest offers to new customers, we now launch this to existing customers in Q3.

Now onto Transforming the customer experience. As I mentioned at the start, we have launched the new website for Simply Be, completing the roll out to 100% of customers in September and providing a mobile first experience with reduced friction through the customer journey.

On Win with our target customer, we have focussed on activity to revitalise our lapsed customer base but also to drive frequency and engagement from our existing customers.

We are also investing in our data in this area to better understand our base and how to improve customer targeting and personalisation. With data being elevated from an enabler to a strategic pillar, we have made progress in laying the groundwork in our data transformation.

Our data strategy, due to be released at the end of the year, covers the operating model, the analytics platform and data culture required to establish data as an asset to win. The benefits span direct cost savings, operational efficiencies, and data-enabled use cases targeted at improving revenue and margins. We have already made significant progress towards our target operating model through organisational design, ways of working, and corporate governance, and we have finalised key decisions relating to the analytics platform.

Last year, we saw huge success with the build of our internal tool Pricetagger, which helps us to optimally promote product using pricing elasticity curves and this has now been rolled out to all clothing promotions. And we've developed a mailing selections model to allow us to be more effective with our offline marketing spend by being more strategic in who we send paper to.

Now moving onto a deeper dive on some of these areas. Firstly, looking at how we are developing our brand portfolio.

We've done a huge amount of work over the past two years on clarifying our brands, looking at the brand roles, the target customer and the overall proposition, and this has already yielded some good results. We now focus our growth efforts on our three strategic brands, which are Simply Be, JD Williams and Jacamo.

Simply Be is an inclusive fashion brand for young women. It already has a strong emotional connection with customers who resonate with our size inclusive messaging, and this is what gives us a right to win in this space. As I said on the previous slide, we have moved to a digital-first media approach, which is closely aligned to the customer base.

JD Williams is a fashion and lifestyle platform for 45 + women, a one-stop shop for fashion and home with a blend of own-brand clothing and 3rd party brands. Our ambition is to capitalise on this positioning and in the half we launched our 'Collections' creative approach to help customers understand the full range across categories. It was launched with a new media approach in spring/summer '22, working alongside our brand ambassadors, Davina McCall and Amanda Holden, to bring it to life in an eye-catching, inspirational way. We have also launched JDW Pay as part of our core customer proposition.

For Jacamo, we want to elevate its status in the UK as a menswear platform for all men, and our marketing approach has evolved to showcase the styles, brands and sizes relevant 'for every man' with this creative having been used for spring / summer. Our media approach also reflects the new creative through its communication and storytelling.

A huge amount of work has been put into improving our retail proposition over the past few years. We've built a design team with excellent creative talent, which means we can truly create unique products for our customers that they can't get anywhere else. We'll continue to grow the mix of our own designed product to build handwriting and uniqueness. The investment in our in-house design team has helped drive the proportion of unique product designed in-house from 67% in Autumn Winter 2022 to 93% in Spring Summer 2023.

We have seen significant improvements in the rate of sale achieved on new own brand clothing ranges in the half, including growth against last year of 31% on Simply Be and 39% on JD Williams. This reflects the number of units sold over the length of time on sale. We are measuring how well products sell, which is a good indicator of the strength of our own brand product performance.

We continue to offer 3rd party brands to excite our target customers. We build on the strengths of existing partnerships, onboard new brands and continue to build momentum in premium labels. Launches in the half include Sosandar on JD Williams and we have seen continued good performance of our premium brands on Jacamo including Ralph Lauren and Boss.

Flexible credit has been a core part of our offer for many years, and we know the connection between our retail and credit offer is the secret sauce of our business, enabling customers to buy what they want and manage how they pay for it in a way that suits them. These two elements are intrinsically linked as part of the experience of shopping with our brands. There is no separation between retail and credit, it's all the same customer, and the same experience.

We're currently working on 2 areas in parallel in relation to our flexible credit products. Work has started on building our new tech platform which will help us evolve our credit proposition with more products and a better, digital first service for our customer. Alongside this, we're enhancing the offer on our existing platform and better integrating it into the customer journey.

As a digital retailer technology is key, and we know that to best serve our customers, we must deliver a fantastic experience. The new website front-end and the FS platform are key strategic focuses for the business and so we are pleased to have launched our new trading website on Simply Be and which went live to 100% of customers in September.

This provides a mobile-first experience with easier navigation and reduced friction in the check out.

We continue to provide a range of digital customer metrics to help track the progress of our business.

It's been a challenging trading period and the impacts of this, as well as some of the mitigants are reflected in the KPIs. As we move forward with strategic change, there's plenty of opportunity for further progress. Today I'll talk through five of the KPIs.

First, is the number of orders, which is 10% lower than the prior year. This is the result of a combination of lower website sessions and conversion. As we've said, the market has been challenging, and so there's a big element of consumer confidence playing out in these figures, as well as the impact of a significant increase in the cost of paid search and paid social in the market. This has reduced the paid sessions which we have achieved with that part of our marketing spend.

Second, average item value rose by 14%. The impact on consumer demand of the more subdued backdrop has been mitigated via promotional discipline, measured price increases, a focus on demand for occasionwear v leisurewear and customers trading up into our more premium ranges.

Third, is our total active customers. The number of customers who have been active with us in the last 12 months is flat to the half year but down on the year end. Against year end we're seeing lower re-trade rates which we believe reflects greater caution from consumers.

Fourthly, our arrears rates are up 1.6%pts against the last half year and 0.5%pts against last year end, reflecting some normalisation against the low rates of last year which came as a result of an unusually high propensity of credit customers to pay down balances in FY21 and into FY22, but still significantly lower than pre-pandemic.

Finally, touching on NPS. We recognise it's down on last year as a result of some short term impacts around delivery. NPS remains an important metric and we are focusing on medium term opportunities to improve the customer experience.

At N Brown we are fully committed to embedding sustainability throughout the organisation, our product ranges and all our processes and continue to progress with SUSTAIN, our leading sustainability strategy. Developments in the period included the launch of Simply Be's first clothing rental collection with the UK's leading accessible fashion rental platform, HireStreet. This is another important milestone in the SUSTAIN strategy with the rental edit helping to extend the lifespan of its products and encourage customers to embrace circularity.

Responsibly sourced product now makes up 31% of our own-brand clothing and home textile ranges, as we target 100% by 2030 in line with our Textiles 2030 commitment.

Other developments have included a particular focus on social impact areas. Our new charity partnerships with Retail Trust and FareShare Greater Manchester were announced in September and a more integrated Diversity, Equity and Inclusion policy "EMBRACE" has been implemented. The first 12 months of EMBRACE are targeted on building engagement, awareness and connection supported by five communities which we're establishing to represent core strands of diversity which exist within our business.

Now touching on some upcoming priorities across our strategic pillars as we look ahead to the rest of the year and beyond.

As part of the process of developing our brand portfolio and building awareness of our strategic brands, we'll launch a new influencer and social media strategy for Jacamo as well as new creative platform for each of JD Williams and Jacamo.

Building on the previous successful launches of 3rd party brands, we'll continue to add further selected brands to our offer. And in financial services, we'll continue to progress the building of our new platform to provide flexible credit.

Now that our new website has been rolled out to Simply Be, we look ahead to launching this to Jacamo customers in the first half of 2023 so they can also benefit from an improved mobile-first user experience. We will also be upgrading the "My Account" area of the website, where customers can access account activity such as orders and payments, with updated technology to drive an enhanced customer experience.

And we'll be working towards the launch of a new customer value model and the enhancements that this will bring to the deployment of guardrails around acquisition costs and targeting capability.

We have seen significant success with the build of our internal tool PriceTagger, which helps us optimally promote product using pricing elasticity curves and will be rolling this out across the home category. We will also work on development of our new data platform.

As previously communicated, we have a medium term target of 7% for product revenue growth and 13% for EBITDA margin. We have a business which generates superior EBITDA margins given our integrated retail and financial services proposition. If the macro-economic conditions improve, the Board are confident in achieving these medium-term targets, which will deliver significant returns for shareholders.

We entered the year with caution due to the high inflationary environment but clear that we would have the confidence to invest in our evolved strategy. Although the environment has further weakened in the half, which has resulted in the revision of our full year expectations, nothing has changed in our approach to investing in our evolved strategy, and we do so backed by a strong balance sheet. Providing that the macro-economic environment improves, we remain confident in achieving our medium-term targets.

In an online market which declined year-on-year, we believe that we've made the right decisions around trading, driving some mitigation through average item values and retail margins, leading to only a relatively small decline in product gross profit and an increase in product gross profit margin. Meanwhile, we have tightly managed our cost base, which has been subject to strategic investments in marketing, and inflationary impacts. We've normalised against exceptional Financial Services dynamics as our customers transitioned through the pandemic and this is what has driven the lower year-on-year profit in the half.

Looking ahead to our peak trading period we'll continue to sharply focus on trading through this challenging market whilst continuing to make progress with our strategy.

We'll now turn to Q&A, so if you are not already dialled into the conference call, please do so now and we will take your questions in a moment.

Operator:

Thank you. If you would like to ask a question, you may do so now by pressing star, followed by the number 1, on your telephone keypad. If you change your mind and would like to be removed from the queue, please press star, followed by 2.

We will just take a brief pause while we allow everyone time to ask a question. Our first question today comes from Clive Black with Shore Capital Markets. Please go ahead.

Clive Black:

Oh, good morning, and thank you for the presentation. Very comprehensive. A couple questions, if I may. Firstly, just on current trading, what is the exit rate, in terms of the third quarter, as it stands? You know, has it been relatively steady, as you saw Q2 coming into Q3, or has it actually changed at all? And in that respect, what sort of behaviors have you seen from shoppers over Q2 and Q3 to date, and what they're focusing upon, and what they're not?

And then, the second question is, I guess, more strategic in nature, but -- it is pleasing to see that you've started work on your financial services platform. A few elements to this I think, in my mind is, firstly, what time frame do you think that that is going to take? Understanding it could be long-term. But what do you expect the business to gain from that, be it functionality for shoppers or financial return? Thank you.

Steve Johnson:

Thank you for the questions, Clive. So, I'll pick them up, if that's okay. I think, first of all, in terms of current trading, Q2, we sort of highlighted the performance within Q2, and then we sort of moved into September. Well, with the sad passing of the Queen, the first -- or some -- weeks in September have obviously been a bit in volatile in relation to trading. I know every retail business has sort of seen that. So, it's a little bit difficult to sort of use that period as a proxy for what the possible trading looks like, going forward.

What I can say is that, following on from getting through that period, then, we are seeing similar patterns to Q2. So, that -- hence, we've sort of guided to a potential number that looks very much like Q2 for the remaining part of the year. Now, of course, this may improve. This may get a little bit worse. We don't know, as most retailers are sort of trying to wrestle with. But fundamentally, all we can really do is sort of say, "That's where we are today." And hopefully, we'll see that improve a little bit. We're certainly taking a lot of actions to try and improve it. The team has got some very exciting plans for the -- on the buildup to Christmas. And I would hope that the guys can sort of cut through it a little bit. So, that, in essence, is where we are.

In relation to trends on product buying, we've seen similar trends, actually, all year. We've -- our customers have effectively sort of shopped a little bit more into value, on one hand, but actually, more traded up, on the other. So, our best categories is where we're sort of seeing the growth. And in fact,

our formalwear for mens and our formalwear for womenswear are both up quite significantly on this time last year, as are our -- sort of -- premium dresses.

So, one of the key things that we've pointed out is that our margin rate has improved, and there's been quite a lot of pricing interventions, driven by our data approach. But we're also very pleased to see our customers shop into a higher value category. And that is showing up in our average item value that we highlighted being up about 14 percent.

So, for me, I think we're going to see more of the same. But I'm hopeful that the team can excite customers through a very challenging retail market on the run-up to Christmas. I am hopeful that we can hopefully move that forward.

In relation to the F.S. platform, that's a difficult question to answer. We have started to build. What I can share with you is that, in essence, we prioritized the retail side of the business first, in relation to the building of the new front-end, which is now live on Simply Be. And in terms of keeping the business focused on its key priorities, rather than everybody getting excited on everything, I chose to sort of hold back in developing the financial services platform, to make sure all the engineers were absolutely focused on execution of our retail step first.

Now that has gone live, we're feeling more confident in moving our key resources over to the financial services platform. We have started to build, around four or five months ago. So, we have made a start on that. So, we're not starting from fresh at this stage. But we've got a long way to go. And I'm happy to share the progress as we go forward at this stage. We're getting going. The board has signed off on the investment. We've had an early initial sort of team together and they started the build, and we're moving on from there.

In terms of what we see in relation to the benefits of this, everything is interconnected in relation to our strategy, Transformation. As I'm sure, Clive, you know well, because you've followed our story over the long-term, we've evolved the business to be an e-commerce business. And we see huge opportunity in relation to growing the business in the future through investment in our technology capability, our data capability, and effectively, all parts of our five pillars of the strategy. Our new front-end is really important is because, at the moment, we're operating on old technology, which means that colleagues can't really make changes on a day-to-day basis. With the new technology, they can, so that means we can start to operate on an enterprise operating model, which puts, you know, the power in colleagues' hands. We're empowering them to make more changes to the customer journey and improve the experience for our customers.

We see that delivering value and benefits in relation to natural search, particularly. And with the financial services platform, the combination of those two things, working together in the future, will create a personalized experience for the customer; and importantly, colleagues will be able to make changes on a day-to-day basis to improve our performance. So, all of this stuff hangs together, underpinned by a new data platform, which effectively is the intelligence that fits in the engine of those two platforms. And over the medium term, we expect to see our business moving to -- from strength to strength as a result of that.

So, in short, the answer is I can tell you more in the future. I can guarantee that we are focusing on financial benefits as well as user experience. We see the two hand-in-hand. And the intelligence that we're creating in our data strategy will power both of those things forward.

Hopefully, that answers your question, Clive.

Operator:

Moving on to our next question from Andrew Wade for Jefferies. Andrew, your line is open. Hi, there, Andrew. If you can hear us, your line is open. Please proceed with your question.

Unfortunately, we're not receiving any audio from Andrew's line.

So, as a reminder, if anyone would like to ask a question, please press star, followed by 1, on your telephone keypad.

Rachel Izzard:

We'll leave it a minute and see whether the technology is just delaying through. Or Andy, if you are on the line, you can pop it through to one of us and we can ask the question onto the conference call.

Operator:

We have no further questions on the line, so I'll turn the call back to the management team.

Steve Johnson:

Okay. Thank you. I'd just like to thank everyone for joining us, listening to the presentation, listening to the progress the business is making. And we maintain our view, which is that this is a challenging market, but we're managing wisely in the short-term whilst investing for the medium-term. And we remain confident that once the market returns, this business will achieve its medium-term targets. Thank you very much.

Rachel Izzard:

Thank you, everybody. We'll cut the call there.

Operator:

This concludes today's call. Thank you for joining. You may disconnect your line.

[end of transcript]