Watches of Switzerland's Q2 Trading Update

Wednesday, 09 November 2022

Brian Duffy Good morning, everyone. Welcome to our call. Thanks for joining us. You'll be hearing from me, Brian Duffy, CEO of the Group. I'll be giving some more background to our trading performance that we reported this morning. And then our CFO, Bill Floydd, will comment on our guidance, and then we'll both be happy to take whatever questions you have. Quarter two, fiscal year 23 was another strong quarter for our Group, bringing to a close a strong first half. Q2 sales grew 30% at reported rates, 21% in constant currency. H1 sales grew 31%, as reported, and 23% in constant currency. There was some disruption during the quarter, but our model and our teams, in particular, prevailed, and once again, delivered good results. We've had a busy programme of new openings and re-openings of refurbished stores, with Battersea in London, a real standout project.

Sales were consistently good throughout Q2, and we finished the quarter on a strong trend. We experienced good sales growth across our portfolio of leading brands. The category is very dynamic, in terms of new products and marketing, and we are working more and more closely with our partners to bring this excitement to our clients. In the US, sales for the quarter were plus 74% in reported currency, plus 46% in constant. The US represented 42.5% of Group sales. The US is now the number one market globally for luxury Swiss watches, and we believe that our analysis of the underdevelopment of this market, due to underinvestment in retail, is now clearly proven and supported by the industry. The US market is now a top priority for Swiss luxury watch brands.

We are building our team and our resources in the US, we're gaining market share, and we're very confident of the long-term growth potential in this market. In the UK, sales were plus 9%. The UK is the number one market globally, in terms of sales per capita for the domestic market for luxury watches. Group sales in the quarter were almost all to domestic clients, with very low levels of tourism. The absence of duty-free sales in the UK, which is unique to this country, will continue to depress tourist sales for the foreseeable future. We have a leading share of the UK market, we've had that for some time, and we further enhanced our leading position during the quarter. We're excited to have launched our entry into the EU market with the opening of four mono brand showrooms in Stockholm and Copenhagen in the half.

The boutiques looked great. We have fantastic teams and we're building our presence and resources in these markets. We believe that the Nordics are underdeveloped for luxury watch retail, and we have very good prospects for growth. Turning to first half profitability, we expect H1 adjusted EBIT to come in between 86 million and 88 million, with the prior period margins benefiting from five million of the UK business rates relief. On the question of whether there are signs of a market slowdown, our situation is that we are not experiencing any measurable negative impact on demand at this time. Our client registration of interest lists continue to grow, sales are strong, and we exited the quarter with good momentum.

As we reported at the end of Q1, we are clearly aware of the macroeconomic forecasts, and we have included some caution in our outlook for the potential of a more challenging condition in H2. We would remind everyone, however, that the supply demand dynamics of the luxury watch markets are atypical, and also, that the WOS group is well positioned to gain market share. In all luxury markets, as I'm sure many of you have experienced, whether travel, hospitality, or retail, it has been difficult to maintain levels of luxury client service during this period. The success of our business has allowed our Group to invest in luxury client service with the Xenia programme, with which we are experiencing a very, very positive response to this programme from our clients, and directly in our sales.

Finally, I'm very proud to report that our foundation trustees have now approved donations of 2.7 million cumulative of the accumulated 4.5 million contributed by the Group to the foundation. These donations have gone to local charities in the UK, Food Banks, Fuel Banks, the Prince's Trust, and Crisis, and in the US, to Habitat for Humanity and Food Banks. We have been also the headline sponsor for the Prince's Trust Palace to Palace bike ride. 100 of our colleagues and friends participated, and through that participation, we raised a further £100,000 pounds. So in summary, we remain very much on track. Our markets are good, our model's working, we're confident about the guidance that we're issuing today, confident and focused on our long range plan objectives. We're also very conscious of a responsibility to our colleagues and the broader community. My thanks to our teams, who have done a fantastic job, as ever, and continue to inspire and deliver in equal measure. I'll now pass over to Bill.

Bill Floydd Thank you, Brian, and good morning, everyone. Turning to the guidance, and as a reminder, we present guidance, reflecting our current visibility of supply from key partner brands, announced pricing, confirmed showroom refurbishments, openings and closures. Our committed capital projects and acquisitions are excluded, and the guidance is presented on a pre-IFRS 16 basis. Our previous guidance used a sterling dollar rate of $1.30 to the pound. Guidance is now upgraded to reflect movements in foreign exchange, with H1 actualising at $1.19 to the pound, and H2 projected using a rate of $1.20. On a constant currency basis, revenue and adjusted EBIT guidance are unchanged. And as we stated in the Q1 announcement, we continue to anticipate the potential for more challenging market conditions in the second half.

On revenue, we've increased guidance by £50 million, with the range now at 1.5 to 1.5 =5 billion. Guidance for adjusted EBITDA margin remains at zero to 50 basis points improvement. Adjusted EBIT guidance increases by £6 million to a range of 163 to 175 million pounds. We have provided further detail in the announcement, including the key headlines when using IFRS 16. From an FX sensitivity perspective, a five cent movement in the H2 average rate would have a revenue impact of around £15 million, and £2 million adjusted EBIT impact. Going forward, we believe that the strength of the luxury watch and jewellery categories, with the unique supply demand dynamics of luxury watches, underpinned by client registration lists, together with our brand partnerships and the success of our model, will continue to support long term sustainable sales growth. We remain confident in the long range plan objectives. I'll now hand you back to Charlie for questions.

Charlie – Operator Thank you. If you'd like to ask your question via the telephone lines, you can do so by pressing star, followed by one, on your telephone keypad. If you choose to withdraw your question, please press star, followed by two. When preparing to ask your question, please ensure your phone is unmuted locally. As a reminder, that's star, followed by one, on your telephone keypad now. Our first question comes from Melania Grippo of BNP Paribas Exane. Melania, your line is open, please proceed.

Melania Grippo Morning, everyone. This is Melania Grippo from BNP Paribas Exane. I have two questions. I would like to know, you commented on the fact that your environment is still good. Could you please tell us if you see any differences across the UK and the US, in terms of price points. How is the high end behaving, compared to the more entry price points? And also, what should we assume are your profitability drivers for the rest of the year, but also, going forward? Thank you.

Brian Duffy Thanks, Melania. Obviously, as we have presented to you all many times, when we entered the US market and when we did the IPO, we were convinced of a structural underinvestment in the market, which I think is now proven. So, we have that structural weakness that's been addressed by investment in the market, coming from the brands, coming from retailers, and the results are there to see. And you see the Swiss export data, the US is clearly getting great support, in terms of supply, but also, as I say, in terms of investment overall. So, the US market, from a growth standpoint, is definitely more dynamic overall. But in the UK, this market has been so strong for so long, it continues to go well. We continue with applying a model.

As I said, we've been really active on investment and new projects, gaining market share. So, the proportions that we talked about in the long range plan, UK, US growth, it remains a focus overall, although we're clearly ahead of the numbers, in particular, with what we've done in the US through existing store and through acquisition. In terms of consumer behaviour, overall, from a pricing standpoint. Well, first of all, the UK has had much more price increases with two waves of price increases, which were entirely currency related. But the dollar been so strong, some price increases were put through at the start of the year, and there haven't been any since. The average price of luxury watches has always been higher in the US, and with the dollar where it is now, that differential's even greater.

In terms of consumer behaviour within price, we've experienced, consistently over the last couple of years, a real preference for the consumer to move up in average price and to move towards more gold. We can't get enough gold products, whether completely 18 karat gold or gold and steel. So there really is a consumer preference to move into precious materials overall. Whether that's seen as a hedge against inflation, or whatever the motivation, that's definitely what we're experiencing, and we're chasing more gold products right now than we are steel. Other than that, no real discernible difference overall. We are seeing a younger consumer demographic. Overall, we're seeing a really good spread of interest in watches and niche brands doing particularly well overall. So, overall, I think it's a very dynamic market and a very good time for the luxury Swiss watches.

Bill Floydd On the profitability drivers question, Melania. So, we'd expect the net margin to stay where it is, product mix, broadly unchanged, continue to get operating leverage from overhead. And then I think the other thing to just bear in mind is inflation. We're well insulated from inflation compared to most, so things like utilities is a very small part of our cost base. So, overall, we're confident with the guidance of zero to 50 basis points margin for the year.

Melania Grippo Thank you.

Charlie – Operator Thank you. Our next question comes from Karina Nugent of Goldman Sachs. Karina, your line is open, please go ahead.

Karina Nugent Hi there. Thank you very much for taking my questions. The first one just revolves around the conversion of the wait list. A common pushback we get from investors is that wait lists may be growing, but you don't need to put a deposit down or anything to secure that place. Are you seeing any changes in the uptake when people are made available, in terms of that product that they're after, particularly on the brands that are not typically on the wait list? And then secondly, I wanted to ask about your allocations from Rolex. Has anything changed since the start of the fiscal year, in terms of your expected allocation from them? Are you benefiting from continued disruption in China, for example? And then finally, as we think about the broader macroeconomic environment potentially getting more challenging, do you see any potential to accelerate your expansion plan in that regard? Whether there are opportunities for M&A or store rents. Thank you.

Brian Duffy Thanks, Karina. Conversion of wait lists has always been very high, and there's really no change. We don't especially track it, other than anecdotally, and as we've said, we're adding more people. And when the calls are made, people are in the store within 24 hours, generally, looking to get their product. So, no reading of any change in those circumstances, and very, very high levels of conversion. Anybody we find who chooses not to buy, it's because they got their product somewhere else, or they have personal circumstances, or whatever, that might change their mind. But honestly, we just move on to the next person, then, and convert very, very high and no change. Allocation, we haven't seen a significant change in allocation during the year in terms of units from key brands. Pricing has got better. Obviously, the price of all products have gone up, so that benefits the ASP.

Mix has been a bit better, too, impacting ASP as well. But as Bill says, we always reflect on most recent information. But I'm just repeating myself from a volume viewpoint, it hasn't changed in a measurable way. And the commitments, we've obviously only got a couple of months to go now. M&A wise, we've always been active. We remain active in the US and now in Europe. I think, as everybody knows, it tends to be smaller, family owned businesses that we are having discussions with, and it all takes time. It takes a lot of due diligence, in terms of availability of information and so on. But no real change in behaviour, I don't think, overall, either from us or from the potential sellers. It remains a focus for us, and we remain as committed to adding to our business through M&A, as we were when we presented the long range plan.

Bill Floydd Karina, you had one there on store rent. Typically, what we do is take a ten year lease with a five year break, and we'd always look at the store, at the end of that five years, do we want to continue? Typically, if we continue after the five years, then we'd refurbish it, and that would then involve a conversation with the landlord at the same time.

Karina Nugent That's really helpful.

Charlie – Operator Our next question comes from Jon Cox of Kepler Cheuvreux. Jon, your line is open, please go ahead.

Jon Cox Thanks very much. Good morning, gents, it's Jon Cox with Kepler here. A couple of questions for you, just on the like-for-like, trying to strip out some of the shop openings you've had. Is there much of a material impact on those sales figures that we see from the nine stores you opened in the quarter? And obviously, you've been opening stores on a rolling basis ahead of that, maybe it's just a couple of points, maybe it's more, maybe it's not. And just what you think the trend has been. It really comes back down to this, is there a slowdown happening? Do you think that stripping out all of that, you are seeing maybe some deceleration in the top line? That's the first question. The second question, just back onto the waiting lists.

I know it's a bit of an old chestnut, but I'm just wondering, in terms of if you have to fill that waiting list today, what would that be in terms of your annual revenue? Is it a quarter of your revenue? Is it a third? Is it a bit more? And you mentioned about that growing a little bit, I'm just wondering how much did it grow? Is it just really fractional, 0.1%?, or is it a bit more meaningful in terms of maybe a couple of percent? And then the last question on China and all of these discussions about opening up. Clearly, you guys could benefit, if we got more Chinese tourists in. But you do allude to the fact that clearly, with the duty-free not really helping so much at the moment, and I know there are lots of discussions going on about that, and whether you may be actually not doing so well.

If the Chinese come back, maybe they won't go to the UK, they'll go to Paris or elsewhere to buy their luxury watches. I'm wondering if you have any thoughts on that. And I just want to tack one on. In terms of your allocation, I've heard that some watch brands are now starting to cut back, particularly for those watches that are maybe typically abundant.

Just in anticipation, potentially, of a slowdown, you don't seem to be seeing any sign of that at all, and I'm just wondering what your thoughts are into 2023 on that. Thank you very much.

Brian Duffy Okay, Jon, we've got a few things to get through there. The best, or the most significant adjustment you would look at, in terms of trying to come up with an LFL is taking out US acquisitions, and we gave that number. Once you've done that, you're not far away from what really is organic growth. We did quite a few openings, like Battersea and so on, but obviously, very late in the quarter, overall, and late in the half didn't really have an impact. And we actually probably had more disruption with construction and significant stores that were closed for periods, including our Meadowhall configuration in Sheffield, a store in Southampton, and some others. But if you take out the acquisitions in the US, you're really not far off of dealing with what has been an LFL type trend for us, overall, which is obviously still very positive.

And trend deceleration, honestly, we are on it, in terms of analysing our sales, daily sales by brand, by store, and we look at it frequently. Throughout the day, we're getting reports, so we're constantly looking at trends. But the ups and downs that always happen in retail, we've put on explanations with regards to specific brand situations on deliveries, or comping this year or last year on new products, or whatever it might be. We have had some disruptions that I mentioned, like during the Queen's funeral, the hurricane in the US, we had the Betteridge stores that we acquired, we closed down for a couple of days, as we completely redid the stock again, because we had some challenges there and re-labelled all of the stock.

So, these are the explanations that we have for the ups and downs. We haven't really ascribed anything at all to changing consumer sentiment. But as you know, both Bill and I have said we are anticipating, along with everybody else, that there's potential for a change in sentiment and behaviour, but we haven't seen anything yet. Wait lists, we don't give out specific numbers, but it's not a percentage of annual revenue, it's more like a multiple. They're pretty significant, the depth of the waiting lists. We are adding to them. Again, we don't give percentages or numbers overall, but net-net, we are adding more names to the waiting list than we're able to take off. We are a lot more edited and analytical on the wait list todayt than we've been historically, given that it's importance. So, we're in more control of it, we're not letting people put their name down for large multiples of product.

We're making sure that people are not putting their names down in different formats, Brian Duffy, B Duffy, and Mr Duffy, whatever. But having done all of those edits and so on, we're still looking at net-net growth of the wait list. We are not anticipating, and we haven't projected in our long range plan or guidance, any benefit to come from Chinese tourism, whenever it returns. There are a lot of views out there as to, will the Chinese consumer be as willing, generally, to spend on travel, versus domestic. I think it's an open question that's out there. And then, of course, we have the duty-free situation. Our view, I'm very confident that the duty-free situation will be changed at some point. It was obviously changed for a few days during September, but I'm pretty confident that it will change.

There is evidence out there to say that the UK exchequer's losing from the potential loss of tourist business, but we've not projected any tourist business recovering at all in any of our numbers, and I don't think it will do significantly until duty-free does come back. Allocation cut back, production cut back, I'm totally unaware of. I've spent a lot of time in Switzerland recently. I was out on Monday, on the jury of the of the GPHG, doing the choice of award winning watches, and I wasn't hearing anything at all then about any negativity. But still, overall, we are short of a lot of products. I think a lot of the brands are still a bit constrained by component manufacturing, case and dial components and others. So, no, I'm not at all hearing of any kind of a cutback of allocation or production.

Jon Cox Thank you.

Charlie – Operator Thank you. As a reminder, if you wish to submit a question, please press star followed by one on your telephone keypad. Now. Our next question comes from Natasha Brilliant of Credit Suisse. Natasha, your line is open, please go ahead.

Natasha Brilliant Thank you and good morning, everyone. I've got three questions, please. First of all, just coming back to tourism, and I hear what you're saying on Chinese tourism. Has there been any change, in terms of the mix of tourists, say, versus local demand in the UK, particularly from the US and the Middle East after the summer? So, have you seen any changes there? Second question on credit sales. Can you just remind us of what percentage of customers purchase on credit, both in the UK and the US, and if there's been any notable changes to those numbers in recent months? And then the third question is on mono brand stores, obviously proving to be a successful strategy. Are there any brands for which you don't currently have mono brand stores, but where there might be potential to open some? Those are my two questions, thank you.

Bill Floydd I'll cover off credit, Natasha. So, credit sales represent 10% to 12% of sales. That hasn't changed in this half. But in terms of the proportion of sales that are going through credit, the cost has, obviously, with increased interest rates, and the teams are doing a fabulous job of managing that as best they can. And the other thing, just to remember, on credit sales is that we act as an intermediary, so we don't bear the credit risk, if there is a higher rate of default going forward.

Brian Duffy On tourism, Natasha, Americans or Middle Easterners are clearly shopping, predominantly in Europe. And again, I've been there recently, and I was in the Mandarin Oriental in Paris and it was all Americans, and they were all there, shopping, for sure. So, I think it's very, very evident that people, in organising their itineraries, are definitely planning, particularly Americans, planning to shop in Europe. We're not seeing much of that here, in the UK. We obviously have a bit of difficulty recording it now, because we used to use VAT free sales as the record of tourism overall. Now, we've got credit card data, but even that's not 100% reliable, because there are a lot of people who live here, either full time or part time, who will use credit cards.

So, overall, the US and Middle East has it nudged up maybe 1% from 2% to 3%, or whatever, it's of that sort of dimension. It's really not significant at all. Mono brands, we clearly have strong partnerships, strategic partnerships, on mono brands, with Breitling, with OMEGA, with Tag Heuer. With TUDOR, we only have three mono brands in the UK with TUDOR, two in the US. We've just opened our first Longines mono brand in the epicentre of luxury retail, known as Glasgow. We have our Bulgari mono brand in the US and that's going very well, as we've reported, and we'd like to do more of that. And we have other discussions ongoing. The format works very, very well. The ability to do adjacent brands together that gives the economy of shared back of house and management, so it works very well, too. So, it's a successful format, overall, and we're clearly ahead of the market on it.

Natasha Brilliant Thank you.

Charlie – Operator Thank you. Our next question comes from Rogerio Fujimori of Stifel. Rogerio, your line is open, please go ahead.

Rogerio Fujimori Hi, Brian and Bill. I have two questions. Could you remind us of the magnitude of the second price increase in the UK for Rolex and the other leading watch partners in September? It's just to help us understand the contribution to your Q2 exit rates in the UK and the pricing tailwind for H2. And then a follow-up question on customer behaviour in the US and the UK. Could you talk about what you are seeing, in terms of contribution to growth, from your top spending VIP existing customer base versus perhaps more aspirational new consumers? Any insights into the behaviour of your top spending customer, especially as macros get a bit more challenging in H2, would be great. Thank you.

Bill Floydd On pricing, Rogerio, Rolex did a price increase in September, averaging 5%. That's UK only, and is a reflection of sterling Swiss franc exchange rates, we think. Other brands, not all, but largely, have done similar kinds of price increases, but again, in Europe only. We've not seen anything in the US of any magnitude since the beginning of the year.

Brian Duffy On customer behaviour, we are tracking repeat customer behaviour, and overall spend patterns and new customers. We are particularly good at recruiting new customers. We're obviously very, very visible where we are, the UK and the US, very active digitally, and the internet is, I think, having a huge beneficial impact on this market, as people tend to do their research and so on online. So, it's really helped us recruit new clients as well. And we've got a healthy increase from them both. Actually more of an increase in repeat clients, overall. The exact stats, we're still just refining and questioning, and in future updates, we might be able to give more specific information on that consumer split. But I'm very confident that directionally, we're increasing in both, and a higher proportion of repeat customers expanding their spending with us.

Rogerio Fujimori Thank you

Charlie – Operator Thank you. As another reminder, if you wish to submit a question, please press star, followed by one, on your telephone keypad now. Our next question comes from Flavio Cereda of Jefferies. Flavio, your line is open, please go ahead.

Flavio Cereda Thank you very much. Morning, Brian. Just two quick questions for me. The first one, on the whole issue of duty-free and tourist sales, if I talk to some of your far smaller competitors in Europe, say, for example, in Milan, what I'm finding out is that the presence of American tourists, which, of course, has been much stronger in Milan, Paris, compared to London in the summer, it works for jewellery, for watches, not so much, for the very simple reason, they don't have the watches to sell. Like you, they don't have the Rolex, they don't have the Patek, they don't have the Audemars. So, it's only a handful of brands who seem to benefit. So, I just wonder, is it significant at all for you, really, this reversal, which you're saying, and hopefully, eventually will come? And number two, the mono bands that you're opening in Europe, like the Breitlings of this world, the performance so far is as expected, is reassuring. You're comfortable that these bands will continue to perform well. Thank you.

Brian Duffy Flavio, I agree. I think the removal of duty-free coincided with the significant change towards a lot of products being unavailable, and wait list only, and therefore, been less available to tourists, so I take your point. There still is a reasonable amount of products, a good value. We do invest in stock. Our stores are full, there's a lot of product for sale. And I think if we had a duty-free, we'd be enjoying more tourist business now, and we would enjoy more when the Chinese start travelling again. But I take a point, and it is correct, that a lot of product, nobody's able to move around countries and get access to Rolex, Patek, or Audemars Piguet, as you rightfully say. And just on that, finally, I'm on this group of retailers that are representing the luxury retail industry with the government, and we have pretty solid evidence of the fact that this is a net loss to the exchequer.

And we're desperately keen that an independent study is done, so that we can all look at an independent analysis together, and hopefully, make the right decision, sooner, rather than later. But as I said earlier, we aren't assuming any change in any of the numbers that we've been presenting. They mono brands in Stockholm and Copenhagen are, collectively, on plan overall. We're doing a bit better in Stockholm than we are in Copenhagen, but it's very much early days. And of course, it's lumpy. Some spectacular days, some disappointing days, but overall, enough for us to feel very positive of the potential in the markets overall. So, we're confident that there's a really good basis for expansion.

Flavio Cereda Thank you.

Charlie – Operator As a final reminder, if you wish to submit a question, please press star, followed by one, on your telephone keypad now. We currently have no further questions. I'll hand back over to Brian Duffy for any closing remarks.

Brian Duffy Thanks, Charlie. Thanks again, everybody, for joining us. Our summary is that we carry on as we were in Q1. We're not seeing a huge change in the marketplace. We're obviously coming into the Christmas season. We're very, very well prepared for it in the UK and the US. We'll get the chance to update you all sooner, rather than later, because we're going to have our half year final audited numbers that we'll be presenting to you in early December, so we will get a chance to update you then on what's happening at Christmas and whether or not our perspective has changed. But we're very, very pleased with our performance. I'm really grateful to all of our teams, who are working extraordinarily hard with the amount of activity that we've got going on across all of our geographies. But, so far, so good. And thank you all for joining us. Thanks for the support, very much, and thank you to our great teams.