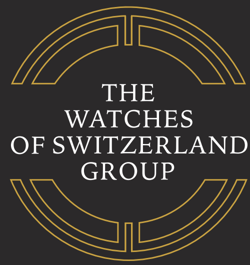

WATCHES OF SWITZERLAND GROUP PLC

WATCHES OF SWITZERLAND GROUP Q2 RESULTS UPDATE 2021

09 NOVEMBER 2021

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WATCHES OF SWITZERLAND GROUP
Q2 RESULTS UPDATE 2021

TRANSCRIPT

Brian Duffy: Thanks, everybody, for joining us. You've obviously all seen our RNS and, I'm sure, absorbed it and been through it. So I just want to add a couple of comments of added color. Overall, we're clearly very pleased with the half-year numbers that we're reporting: very strong performance, both UK and US; half one sales up by almost 45% versus last year and 41% versus two years ago. Our team continue to do a great job overall. The environment that we're in is a very strong one, we think, for our categories, both luxury watches and jewelry, and our feeling is that demand continues to increase in further outpacing supply overall.

There's a couple added comments. We changed how we're handling Rolex stocks during the period, and effectively, we changed our in-store stock over to being effectively demonstration stock. We present it as being for exhibition only, and we're doing that simply to keep a reasonable representation of the brand in store overall, not selling that stock, but customers are able to see the product, try it on and register their interest in buying when availability is there.

The level of stock that we're at, we've obviously worked through with Rolex specifically UK and US, and it's a level of stock that we will effectively maintain for the foreseeable future, and this system of having in-store stock for demonstration purposes only is likely to remain, we think for the indefinite future. So what that meant is that we restock our Rolex position during the quarter, during the half, and consequently, our Rolex sales during the period were actually a bit less than our overall sales growth that we're reporting.

And our strong sales growth for the half and for the quarter, therefore, was due to very strong performances from other luxury watches, and jewelry category is strong, but we're pretty sure that we are getting shares through our continued store investment multi-channel approach, the great systems, technology, increased marketing, and I think very importantly, our confident buying decisions that we made. We decided to buy good quantities and sufficiently far in advance because we're very confident about this period and we're very confident about the upcoming holiday season overall.

We think the best way to look at our numbers, as you do, would be looking at the two-year stack. There's clearly a lot of moving parts when you compare to, last year, the influence of lockdown and significant impacts in traffic and so on. So looking against two years ago, we think, is the most relevant comparison, which, when you do, you see that we were up around 41% in constant currency against that period, but you've got to bear in mind that two years ago, we had a good amount of international business here in the UK. Of a total group that represented around 33%, 34%, the combination of tourism and airports, and effectively now, our business is 98% domestic. So when you make that comparison, you effectively have to take 30% out of the base, and when you do that, you see a very, very strong performance with domestic clients, UK and in the US.

So business continues to power on. We're reporting strong sales, but also reporting improved profitability due to the favorable margin mix coming from the favorable product mix overall, which Anders will comment more on. In addition to our underlying base business, we're also pleased to report progress on our long-range plan objectives of in incremental growth through our agreements to acquire stores in Greenwich, Connecticut, [Bail and Aspen 00:04:17], Colorado, and complete deals in Minneapolis and Plano, Texas. David Hurley, who leads our business in the US, and the US team, are doing an amazing job of finding and connecting with potential acquisitions while keeping the current business moving forward very well. So all of that has led us to upgrade our outlook due to the improved performance of our base business plus the incremental acquisitions. And now to talk through the outlook and the performance further, I'll pass over to Anders.

Anders Romberg: So thank you, Brian. Yeah, obviously a really pleasing first half, and to Brian's point, the product mix this year is very different from what we experienced last year. That normally was last year when we were selling to waiting lists of hard-to-get products. So the representation of the supply-constrained brands peaked at about 70% in the first half last year versus a normalized base of around 60 we experienced in '20 and we've experienced this year as well.

So the business is back to what it used to be in terms of mix as such, and that's driving the margin performance and, obviously, sales, as such, and a particularly positive surprise has been our online performance. We had planned online down internally here, given the fact that we were up against the period when stores were closed. We felt that was the right way to look at it. To our surprise, actually, we've done better, so we're obviously trading up 24% on last year.

So really pleasing results overall, and that has led us then to look at our business and where we see demand sitting at the moment. We're done with the restocking exercise, so we will sell what we get going forward here throughout the year, and on that basis, obviously, we're calling up the year by 100 million. Part of that call-up is due to the acquisitions that Brian alluded to. On a trailing 12-months basis, that is worth around $100 million sales, and obviously we'll have four months of complete transaction volume going through as part of our balance of year. And our profit is looking better because we hadn't planned for the margin upside that we've experienced through the first half, and we expect that mix of product to remain in place throughout the balance of the year.

In addition to that, we get some better leverage on our cost base. We've squeezed out another half point out of that, and that is against a year where we actually benefited from some government support in the first half, as you can see in the disclosures. So very, very positive all around, I would say.

In terms of our capital program, we are on track to deliver on our plans. We actually have called it up by another 5 million or so, and that is obviously linked to the acquisitions to some degree, but we're also investing more in technology throughout the year. So overall, really good.

Cash is coming in better than what we had expected. The display stock that Brian was alluding to is obviously paid for, and as we get products in, they vanish before we actually have to pay for them. So we get cash generation from our stock, which is a new one. So obviously, overall, very pleased with the results.

Brian Duffy: Yeah. Okay. And so with that, very happily move on to your questions.

Speaker 1: Thank you very much, sir. Ladies and gentlemen, if you would like to ask a question over the phone at this time, please signal by pressing star one on your telephone keypad. Please note, if you're using a speaker phone, just to make sure your mute function is turned off to allow your signal to reach our equipment. So once again, ladies and gentlemen, that is star one on your telephone keypad to ask a question, and we'll pause for just a brief moment to give everyone an opportunity to signal for questions.

I will move to our first question over the phone, which comes from an Anne-Laure Bismuth from HSBC. Please go ahead. Your line is open.

Anne-Laure Bismuth: Yes, sir. Good morning. I have two questions. The first one is on the US. Is it possible to have an idea of the speed between like-for-like and store expansion. The reason why I'm asking is that last year, around Christmas, you added a lot of [inaudible 00:08:50], so I'm just wondering if you can give us an indication on that. And the second question is around the commerce, maybe if you can give us some comment about-

Speaker 2: You can give us some comment about how the eCommerce development is going in the US, as you launched the US eCommerce in the last [inaudible 00:09:08]. thank you very much.

Brian Duffy: Laurie, I hope we heard all that okay, the line wasn't great. I think you were asking first of all, but like for like, which we don't report anymore, we get so many activities going on and investment in projects. But overall, we haven't hugely increased our space in any significant way. We've invested in it, we've added model brands as you know. But proportionate to our big multi-brand stores, the contribution there is less. So we get a bit of added year on year, but it's really not that significant. The underlying driver of business is demand that there, market share we're gaining because of our confident buying, or investment in technology or increase in marketing, and the supply situation. As you know, half of our business is supply driven, and that is what it is regardless of the network situation overall.

So like for like really isn't honestly that relevant for us, and I think it's just about impossible to calculate. So we haven't really been reporting on that for some time. Ecom in the US is off to a good start. We're pleased about the progress, but it takes a combination of time and money. We are spending behind the business in the US, and driving traffic to our site. We've increased the centralized stock to provide a

better service to clients and pleased that the progress, our biggest business of course in eCom is the UK.

The number of year on year growth that we're reporting in eCom of 28.7 is predominantly the UK success story, but a small contribution from an increase in the US as well. So confident that in the years ahead eCom in the US is going to be big, but it takes time to really build up that positioning and the awareness, and even the support structure and so on, to take advantage of the potential market that's there.

Speaker 2: Thank you very much.

Speaker 3: Thank you. We'll now move on to our next question over the phone, which comes from Flavio Cereda from Jeffries. Please go ahead, the line is open.

Flavio: Wonderful. Thank you. Morning, morning, Brian. Two quick questions here, both on, I guess, fundamentally on Rolex. But generally speaking as we sort of normalize as it were, and travel restarts, a gradual process. We saw yesterday travel to the US restarted from the UK and stuff. These stores that you have [inaudible 00:12:10] are you able to supply these stores as business restarts? Do you have the product to supply these stores, given that the dynamics have shifted so much in the last two years?

My other question was on pricing, which I guess is number one on Rolex, still no news of a price increase, I guess. So maybe if you could tell us anything about that, but generally speaking on pricing for the brands, are you seeing anything in particular that we should be aware of? Thank you.

Brian Duffy: Right. Thanks Flavio. So what we're seeing in the airports is increased traffic and a good level of spend per passenger. There was an uptake on leisure travel with the recent reopening of holiday destinations and the half term here in the UK. So we saw a nice trend of improving business there. As you say, now that the US is opened and business travel will step up as well, anticipating improvement from that too of course, there's a real willingness to spend. Obviously the environment overall is strong. Heathrow is a great place to shop, it's convenient, It's also, I think very enticing from the great luxury lineup that's there including us.

Our overall feeling is and how we've sort of planned it is that we think the business will come back at the airport. But with the absence of duty free, it won't come back in any foreseeable period until that changes to the level that we had kind of pre-Brexit, pre-COVID. So we're assuming, I don't know, 60 to 65% potential once traffic is back up again, and assuming that the no tax free situation remains. [inaudible 00:14:12] our recent experience is a wee bit better than that actually, and I think that just talks to how attractive the category is overall.

So people are spending, your point is right. If there's incremental business there, we'll have to find a way of getting incremental stock for it, and of course, it's something that we're openly discussing with our friends at Rolex. But generally whatever we do at the airports [inaudible 00:14:41] next to nothing on last year, via the four terminals are open, and we're assuming that remains the case for the foreseeable T2, T3 and T5.

So we'll see, it's positive, you're right, we do have to get more stock to take advantage of it fully, but encouraging. On pricing, I think your question indicates that the conditions would support price increases. The inflationary economy that we're in globally, increase in Swiss Franc, increase in commodity prices and so on, would all underpin a pricing review. So I don't think it's crazy to assume that that would come at some point, but we do not have anything specific from any of our brand partners. You know, as much as we do as to whether or not a price increase will come and when.

Flavio: Okay. Thank you.

Brian Duffy: You're welcome.

Speaker 3: Thank you. We'll now move on to our next question over the phone, which comes from Andrew Gullane from Lombard. Please go ahead.

Andrew: Hi, Brian, it's Andrew here. Could I just ask please for a little bit of color, both in the UK and in the US, on what other brands are particularly doing well, and what brands you've got effectively better supply on? Because the situation is you're kind of selling everything you've got, so what are you getting more of? Then the second question related to that, obviously, can you give me a kind of a ballpark guide? Obviously we know the margins are a little bit lower on the Rolex, but what the differential is, what the spread is, it's 500 basis points, 1,000 basis points on some of the brands you've got better supply on, versus a Rolex, which is a bit more constrained?

Brian Duffy: Okay. I'll let Anders comment on the margin situation. In terms of brands are doing well, we're having a great period with Omega. We've got Commander Bond to thank for part of that. There's been a huge reaction to the movie. There's a special James Bond watch. It's been very popular, in our experience, the most popular ever. I don't know if it's the case globally or even nationally, but in our case it

is, was more expensive than typical Bond watch, was the best part of £8,000. It continues to sell very, very well.

Then Omega, in addition of course, they play a major part in the official time keeper and sponsors at the Olympics and the Paralympics over the summer, they got the winter Olympics coming next. It's a very kind of high profile investment period for Omega, and the brand is, is really enjoying the benefit of that. Cartier are also doing super well with us, both in store and online. I think all of the new product activity that they've launched over the last couple of years has generally always been successful, notably Santos and the Tank Range doing well. We are chasing supply on these, but generally getting good support from these brand partners. Breitling also doing well, same again, great marketing.

Breitling also doing well, same again, great marketing, good new product introductions. TAG Heuer doing well, and Tudor doing particularly well and being very clever about frequency and excitement around their new product launches, one of which just launched yesterday, a new Pelagos, which immediately we'll sell everything that they supply us with. And actually, Tudors are a brand where we could be selling more if we had better supply, and of course, we've got to continue to chase that.

I also mentioned jewelry. Our jewelry business is up 50%, so it was a good market for jewelry, our buying team doing a fantastic job and selecting the right product or approach to the market, which is a branded approach. We steer clear of promotional activity and protect our margin, but more than anything, protect, I think, the status and the quality of the product that we're selling, and that's working very well, again, in store and online.

So it's a very broad-based success story from a product standpoint, and generally, we're getting good supply. And buying early and buying bold, I think has clearly put us in a very, very strong position for what we've delivered this half and what we see coming in the holiday season.

Anders Romberg: So within the watch category, the margin structure is very formalistic. The higher productivity, the lower your intake margin is, essentially. So it ranges from the mid-30s to the mid-40s. So that's the range in the watch category. Jewelry comes in at north of 45, so obviously it's a bit better margin than jewelry traditionally. So that's the margin structure within our business.

Speaker 4: Great. Thank you. Thank you. As a reminder, ladies and gentlemen, it is star one on your telephone keypad to queue for a question on today's call. We'll now move to our next question over the phone, which comes from Catherine Parker from Jeffreys. Please go ahead.

Catherine Parker: Good morning, and thank you for taking my questions. So my first question is on market share, and I wondered if you could give us an update on overall market share in the US and the UK, and maybe the share of Rolex agencies in the US once your new stores have been integrated. And then my second question is just on the net margin. So obviously you've had a nice uplift in H1, and I wondered if you could give any comments on what to expect for H2 and whether there would be a similar uplift and if that's contained within your guidance. Thank you.

Brian Duffy: Yeah, not going to be particularly helpful, Catherine, on your first question on market share. We're not quoting market share, and our reluctance is just reliability of data. The folks that were tracking the market in the US no longer do, so we don't even have market data to look at. For our annual report and so on, we do try and calculate and adjust for information that's out there, but we don't do it on a regular ongoing basis, so can't really help on market share. [inaudible 00:21:33]?

Anders Romberg: Yeah. So in terms of our margin guidance, yes, it includes the balance of the year, obviously, and what we're seeing in the first half, we do expect similar trends to prevail through the second half. And obviously, as you know, we were close for about five months in the UK last year, which then automatically leads to higher penetration of hard-to-get products because we were clientele-ing and selling on waiting lists and so forth. So we think the product mix in the second half is going to be similar to what we experienced in the first half.

In addition to that, obviously, if you look at the government support schemes that we enjoyed last year, the skewness towards the first half is where you had the biggest benefit going through because we took the furlough and we had the PPP. It's all in the disclosures. And then we reversed it out in the second half, right? So obviously we had a charge in the second half. So net result of all of that is obviously that you would expect the leverage to come through on the store cost and the overheads a bit stronger in the second half.

Brian Duffy: I think if you work through the maths, the year-on-year profit growth will be relatively similar first half to second half. I think if you walk through the math on it, I think in the first half we've quoted the adjusted EBITDA estimated number between 81 and 83, so a midpoint of 82. I think year-on-year would be plus 57, and we'll be just a wee bit ahead of that for the year if you work through the improved profitability in the sales guidance that we've given.

Speaker 4: Thank you. We'll now move on to our next question over the phone, which comes from Frank Manduca from UBS. Please go ahead.

Frank Manduca: Good morning, team. Thank you for your time. Two quick questions. One is, could you give us an idea of what the proportion of Rolex sales are within your UK business and what you'd expect that to settle down at in terms of percentage of overall sales going forward. And secondly, I just wanted to see what your thoughts are on some of the online retailers. I think people like Chronext made quite a lot of noise recently, when they were looking to float, about the discounts that they can get on things like TAG and Breitling, and I wondered whether that had had any impact that you'd seen in the UK, or whether that is just a European thing, and indeed, whether that could affect your business in the US.

Anders Romberg: So, typically, we don't disclose brand-specific sales by market or anything, but as I've quoted, for the group, as such, as I said, the supply-constrained brands, which contains Rolex, [Automa 00:24:37] and Patek, represents about 60% of the group's revenue in FY '20, and going into last year, obviously since we were working the waiting list and so forth, that penetration grew to around 69%, and this year it's back down to 59% of our business. So that's how we previously disclosed our sales mix, and we'll stick with that rather than giving specifics by market.

Generally speaking, you could say that historically, Rolex had a bigger portion of the US business because they could actually impose investments into retailers, which other brands didn't have the leverage to do. We can see that that is getting more balanced as we invest into our store network in the US, so the penetration of Rolex in the US is actually somewhat descending.

Brian Duffy: On your second point, Frank, I honestly didn't see or read anything specific on Chronext that indicated that they were acquiring product at discount, which would really very much surprise me. Obviously, the IPO got pulled reasonably early on and didn't happen. And certainly from our standpoint, Breitling and TAG, along with the rest of our ranges of our discount, is less than 1%. It's almost nothing overall, and these brands are doing very well for us at full price UK and US. So I can't quite reconcile any comment about acquiring product through discounted prices.

Frank Manduca: Thank you.

Brian Duffy: Okay.

Speaker 4: Thank you. We'll now move on to our next question over the phone, which comes from Rodrigo Fujimori from Stiefel. Please go ahead. Your line is open.

Rodrigo Fujimori: Oh, hi. Good morning, everyone. Thanks for taking my question. I was just wondering if you could talk about the contribution to growth that you see from new versus existing customers for your non-supply-constrained brands. I believe that consumers historically have been more repeat customers, but I was wondering if you see luxury watches attracting more new customers in the US and UK, and what you've seen in terms of purchase frequency profile based on your CRM data with the shift to online and as you come out of-

...on your PRM data with the shift to online. And as you come out of the pandemic, thank you.

Brian Duffy: That is a great question because we actually don't have those stats exactly. But that's something that we should get. Our feeling is there's a lot more new clientele in the market. And I think your comment in the US made clearly with very, very good growth we're experiencing in the US.

We obviously have two big, beautiful stores that are very, I think, incremental to the whole profile of the watch retailing and Manhattan that are definitely attracting new consumers. I mean, and money we're spending on marketing online. So the number of impressions that we're reaching runs into billions, that the number of PR impressions we're making in the US runs into several billions.

I think we are certainly very, very visible to a very broad audience. And so our feeling is that we are attracting new and younger consumers. The big change, obviously that I referred to earlier that's been made is our consumers today are all domestic. Whereas, historically, we had a bigger proportion of international.

Our feeling is well on giving feelings rather than statistics. Our feeling is that we have a higher proportion of the female consumers. We have a

higher proportion of people buying self purchasing rather than gifting. I think a lot of very positive trends for the industry overall that we've delighted to be sharing in. And I think gaining share on.

Rodrigo Fujimori: Very helpful. Thank you.

Brian Duffy: Yeah.

Andrew: We'll now move on to our next question over the phone, which comes from Karina [Schutte 00:28:52] from Goldman Sachs. Please go ahead.

Karina Schutte: Hi, Brian. Hi, Andrew. Thank you for taking my question. Just a little bit of a broader one from me. Obviously, you've benefited quite strongly from very robust domestic demand in the UK and the US. And presumably, have received a better supply allocation because of that as tourism has been more constrained. As we see the world opening up, do you have any color on how the brands are thinking about their geographical allocations and how that would potentially impact your business? Thank you.

Brian Duffy: A great question, Karina. But really, as I think everybody knows, that information is a lot less available in this category than people would logically think it should be. I mean, and you would be reading the global trends as well as we are. Bit of a slow down, people are seeing in China, which was the fastest growing market. I think probably still is for luxury watches. Hong Kong is still subdued. US really powering ahead as a leading market. Along with Dubai, maybe, which I think has continued to be strong overall.

I was actually at an industry event last week. I was a juror on the GPHG, which is the Grand Prix d'Horlogerie in Geneva. And the feeling overall was very upbeat from the industry. And I think people were generally enjoying a very good trend, surprisingly good was the impression from all the Swiss brands that I interacted with.

But I think those are the big trends that China has been quite positive, very positive but maybe slowing down a little. And maybe as you start the anniversary as well, there'll be a natural slow down on it. Hong Kong, still subdued. And I'm repeating myself now. Dubai and US very strong. UK has been very strong, I think within Europe and better than the main European markets. Main European markets have more of a tourist dependency. I would include in that Switzerland. And so, clearly, those markets haven't seen the degree of recovery and don't have quite the same opportunity to focus on domestic like that we do, I think, in the UK and US. But I think that's all fairly public information that's out there and typical of what's happening in the whole luxury category.

Karina Schutte: Thank you.

Andrew: It appears, there are no further questions queued at this time. Mr. Duffy, I would like to turn the conference back over to yourself, sir, for any additional or closing remarks.

Brian Duffy: Okay. Well, thanks, everybody, for your questions. A big thanks to our team as well for continuing to exceed everybody's expectations, including mine. The enthusiasm and dedication of our team I think is fantastic and a huge part of our strength. I'm sure as comes over from the RNS and the comments that we made today we're confident in our model. We're very confident in this category.

We're looking forward to a positive holiday season, which we think is underway at the moment. And just generally very pleased with our results and appreciate all of your interest and support. So thank you for joining us.