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Watches of Switzerland's Q4 FY22 Trading Update

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Speaker Key:

BD	Brian Duffy
BF	Bill Floydd
OP	Operator
KN	Karina Nugent
AB	Antoine Belge
ER	Erwan Rambourg
DA	Daria Nasledysheva
KC	Kate Calvert
RT	Richard Taylor
FC	Flavio Cereda

BD Good morning, everybody. Welcome to the call. Thanks for joining us. I am assuming that most of you will have been through the RNS that we issued this morning, so I'm not going to repeat all of the detail that's there. I'll just give a bit more colour to the results and then I'll pass over to CFO Bill Floydd who will take you through our guidance for fiscal year 23.

We're very pleased to report a result of 48% sales growth in Q4, 40% for the year. I think some important points I'd want to make in interpreting these numbers for you, sales were almost entirely to domestic clients. 97% domestic. Pre-COVID fiscal year 19 international sales, and by that we mean the combined tourism and the airport sales, were 32% above group. Fiscal year 22 it was 3%, so a lot that we had to overcome in that loss of our base.

The brand mix has changed significantly. Super High Demand brands, and by that we mean Rolex, Patek and Audemars, are all sold now to waiting list clients. Our Super High Demand stock is used for client demonstration purposes only. Growth for these brands was completely in line with our expectation, although significantly lower than the average growth that we had for the group overall.

On the other hand, the other luxury watch brands grew by more than double in the year and clearly that was the most significant contribution to our growth. There is great dynamism, innovation and investment throughout the luxury watch markets in the UK and the US. Luxury watches grew overall by 36%. Luxury jewellery has also been very strong, growth of 86%, and we have in that group a renewed focus on the jewellery sector.

The Watches of Switzerland investment-led model of scale, technology, in-house resources and expertise has enabled our group to make good gains in the market from both our existing network growth and from incremental projects. Profitability improved. Our EBIT profitability margin improved between 180 and 210 bps and cash generation for the year has been very good.

So we are carrying strong momentum into fiscal year 23. Some very exciting projects ahead for us. Our team are doing a fantastic job. They are the best and deserve credit for the success that we are reporting. Just before handing over to Bill, I want to mention our foundation that we are very proud of.

The Watches of Switzerland Group Foundation was formally registered in fiscal year 22 and became fully active during the year. The group has paid 4.5 million into the foundation in fiscal year 22. We have a great board of trustees, all fully engaged in what we are doing, and they have approved donations to homeless charities, food and fuel banks, and The Prince's Trust.

Our colleague engagement and volunteering has been great. Our US registration of the charity has just recently been completed and they are progressing projects with partners in the US and, once again, we are planning to fully engage our American colleagues. So, all in all, we start a new fiscal year with positive and optimistic energy and have confidence in delivering our long-range plan goals. So I'll now pass over to our CFO Bill Floydd who'll take you through our guidance.

BF Thanks, Brian. Good morning, everyone. So in terms of the guidance for FY23, we are presenting this on an organic basis with committed projects only and we go into the year with good momentum. We anticipate that the disruption from the pandemic is now largely behind us and we are seeing good recovery in footfall and airport traffic as well.

In terms of the numbers, we are guiding revenue to between £1.45 and £1.5 billion. Adjusted EBITDA on an IAS 17 basis of flat to plus half a percent. EBIT in the range of £157 to £169 million. Capex stepping up to between £70 and £80 million, but that will still leave us with year-end net cash of between £35 and £45 million.

BD Okay, and with that we'll happily move to your questions.

OP Ladies and gentlemen, if you would like to ask a question, you may do so by pressing star followed by one on your telephone keypad now. And if you change your mind, you may press star followed by two. When preparing to ask your question, please ensure that your phone is unmuted locally. We have our first question from Karina Nugent from Goldman Sachs. Please go ahead. Your line is now open.

KN Hi there. Thank you very much for taking my questions. I have two. So the first one is just about the demand dynamics as we go into the next fiscal year. You have already called out continued strength in luxury watches and jewellery. I just wanted to confirm that that was the case in the first two weeks of this fiscal year and if there's anything to call out in terms of changes to consumer behaviour. For example, have you seen anything in the fashion and classic segment? I realise it's a small part of your business, but it would perhaps be one of the first to show any sign of weakness if there's any macroeconomic uncertainty.

And my second question is on supply. As we look ahead into FY23, what are the supply dynamics like broadly? But then also, do you think there's any possibility to benefit from supply reallocations from the brands, particularly given the situations in Russia and China, and would this represent any potential upside to your guidance? Thank you.

BD Thanks, Karina. We honestly haven't seen any change in the dynamics that we experienced throughout fiscal year 22. As Bill mentioned, we are seeing a return of traffic in some areas that will obviously be incremental, like the airport that was very, very small. We are seeing return of traffic in London and in New York and, again, that traffic, particularly folks working in the cities, have been slow to return but it's happening now.

Vegas, the overall hotel occupancy and whatever has been good, but the convention calendar hasn't been as complete and attendance hasn't been what was typical either, so we're now seeing that return as well. So there are specific areas that we'd point to of likely improvement because you are physically going to have more people in these towns that we're doing business in, but overall the dynamics haven't changed.

We are two and a half weeks in actually and honestly no change overall in the market dynamics that we're experiencing. What did you call the group of consumers actually that you said would be the first? Something about fashion and…

KN Just the fashion and classics, that lower end segment. I realise it's a small part of your business.

BD It is a small part of our business. It's predominantly part of our online and I'm unaware what the impact has been in that category either. Our jewellery business depends more on traffic out there but, again, it's remained very strong. So, honestly, at this very early stage of the new fiscal year we haven't seen any difference. The markets are very, very strong. We would love to have more product fundamentally, which takes me onto your second point.

I was in Switzerland last week and seeing many of the brands there directly and obviously they are all experiencing a downturn. In China, it's pretty public. Now, what's happening particularly in April, the first quarter wasn't what everybody was hoping for. But April there's been a much more negative impact with the lockdowns in Shanghai and clearly the overall distribution and logistics are all getting hit. Should that result in more product being available for the non-Chinese market? Logically, yes. Again, we haven't seen any impact of that yet. But, yes, logically you would think there should be some more product around.

KN Thank you. That's really clear.

OP Thank you. We have our next question from Antoine Belge from BNP Paribas. Your line is now open. Please proceed with your question.

AB Yes. Hi, it's Antoine Belge at BNP Paribas Exane. Three questions. First of all, with regards to the outlook for the brands with Super High Demand, what's the algorithm of growth for this year in terms of price and volume? My second question is on the margins. You're expecting between flat and 50 basis point improvement in EBITDA so, yes, what are the moving parts behind that?

I think there were still some one-off benefits of COVID in the base and, yes, any colour on investments that are going to be made this year? And finally, when you mentioned that the guidance is without acquisitions, so how likely are acquisitions this fiscal year? Of course I'm not expecting you to disclose anything, but more like are there a lot of short-term prospects or, yes, so what's the pipeline looking like? Thank you.

BD Thanks, Antoine. On price and value, the dynamics that we experienced this year, as the consumer is definitely open and willing and acting in a way of higher price, we've sold more gold, more complications like chronographs, so the consumer has definitely been happy to price up throughout the year. However, when you then look at the mix of our businesses, we reported the Super High Demand being pretty modest and the increase in the other brands being double. That mix impact by brand leads to a reduced ASP for us. So our volume increase in fiscal 22 was bigger than the sales increase because ASP went down single-digit purely because of mix. Within each brand, ASP went up quite significantly. So going into this year, we have price increases that have all been announced. We're not planning or expecting any more in the calendar year. Somewhere around 4 or 5%.

Year-on-year, will the mix change? Much less so. I think the big year of change will have been last year, but we'll see. As we've said, there's real dynamic momentum across the whole category and these, the known Super High Demand brands, are in a better situation with regards to supply. The margin point, Bill, do you want to comment on?

BF Yes, so margin, Antoine, we're guiding to flat to plus half a percent. I'd look at that in a couple of ways. So, first of all, the margin progression over the last couple of years has been superb. We clearly have ambition to drive the margin higher, but we need to get some time under our belt to be confident in that. But, at the moment, I'm good with the range we've given. There are a few things that still need to wind out from COVID as well. So there's a little bit of a rates holiday and the like in the UK that need to wind out over the course of the next few months. We have had a bit of a margin hit on Rolex in the US, which will work its way through as well, but overall we should make up for a lot of that with volume. But that's the reason for the guidance being where it is.

BD And then finally in terms of acquisition, I think we were very clear when we did our long-range plan that acquisition was a key part of the growth strategy, specifically in the US and in Europe. It remains the case and we remain active. In the year, we acquired businesses, five stores with a combined sales value of around $100 million, all in the US, and we're on it.

As we have continually said, it's family businesses. We understand that things take a long time to resolve and conclude and we have got to be patient. And we have got to get to know people and people have to be very comfortable that their heritage in many ways or legacy will be in our hands, so that all takes time. We never look to overpay of course and it remains a part of our strategy for the foreseeable future.

AB Thank you very much.

OP Thank you. We have our next question from Erwan Rambourg from HSBC. Your line is now open. Please proceed with your question.

ER Yes. Hi, thanks a lot. Good morning, gentlemen. Erwan Rambourg from HSBC. Three questions if I can. I was wondering if you could give us an update on where you believe your market shares stand following this very strong end of the year in both the UK and the US?

Secondly, I understand you have your allocation for calendar 22 from the Super High Demand brands, but the understanding is they will still contribute less as a percentage of sales, as was the case already last year. Is there hope that at some stage you maybe have more production coming or at some stage that those brands can grow at the same pace than the average, or is that just structural?

And then maybe thirdly, anecdotally, as Rolex seems to be out of stock pretty much everywhere, how easy is it to convert first-time purchasers who want a Rolex to other brands? And I don't know if there's a percentage or if you could comment on which other brands might benefit from the fact that there are no Rolexes to buy and so by default where do you try to convert them to and is it efficient? Thank you.

BD Thanks, Erwan. Market share is difficult for us. We've been reluctant to quote it because of concerns about accuracy of information. We have GfK data in the UK, but even then there are adjustments that we know that we have to make where the final doesn't result in the right representative. So we do things like taking the accounts of the companies that give us one source of accurate shipments out from them, and we speak to the brands and try and understand what their overall growth levels are in the marketplace. We know our growth with them and therefore we know if we're gaining share or not. And that's the thing that I probably track more than anything, how is the brand doing overall in the market, if they'll tell us that, and they are normally willing to give us an indication. We know how well we're doing and therefore we're gaining share.

And I think across the other luxury brands, we have definitely gained share, without any doubt, in the UK market. We are the biggest in the UK. That is I think very clear to everybody and we are continuing to gain share. We have the specifics that we are doing of increased distribution. Mono-brands are increasing our distribution and presence. Our online positioning is clearly very strong for us again and that's outperforming. So we have a very strong market share position in the UK and it's improving.

The US situation with market data is even worse than it used to be in NPD tracking the market, but it really wasn't representative at all. It was a source of something, but we really had to constitute market data independently and, again, it's quite a job. It's a matter of getting round to all the brands and looking at distribution, so it's not something that we are, again, fixated with knowing exactly where we are from a market share standpoint.

Again, we do the same thing of trying to understand their trend and ours and know whether we are gaining or losing share. And, once again, particularly in the US, we know that we've made some important strides in gaining share. I would say that our share there in the US is definitely double-digit now, but clearly a hell of a lot to go at, as is the case in Europe.

We do get calendar indications and take, as you know, from Rolex. We get their fiscal year indications from Patek and Audemars, so a slightly different calendar. And my job is to try and continually get more and justify more and look for opportunities, and the biggest justification we have for getting more product is the investment that we make.

In terms of production capacity from these brands, you know they are very, very discreet. They really don't tend to give you market information, so along with everybody else, we are largely speculating on it. The only exception is Audemars have said that they are increasing their production capacity, but even then it's relatively modest, around 10,000 units. So, we'll see. The mix may well change in the same direction that it did this year, but I think the significance of the change might be a little less.

What we do with Rolex is we try and sell Rolex, of course that's our job, but we now have products that we can present to clients in-store and go through the whole selling routine, but we then give the news regarding the wait times overall. But of course if somebody's looking at a Submariner and then told it's going to be a matter of years before they get it, then the next thing we would look to present to them is an Oyster Perpetual within Rolex in which the waiting list will be a bit less.

And so our priority, of course, is always to sell the brand that the client's interested in, but if somebody's in, as many people are, buying for a special occasion and want to buy something that day or short-term, then inevitably they'll look at other products. And I guess it's fairly obvious the brands that we then look upon as alternative, other sport watch brands, be it OMEGA or Breitling, Hublot and so on for men. Cartier would be the next obvious go-to in our experience for women. And it just depends, if somebody wants to buy a watch that day, then clearly we have a huge assortment of product to present to them.

ER Right, very clear. Thank you. Best of luck.

BD Erwan, thanks.

OP Thank you. We have our next question from Daria Nasledysheva from Bank of America. Your line is now open. Please proceed with your question.

DN Hi, good morning. Thank you very much for taking my questions. I have three. So in other luxury watch brands, do you see any risk for a more challenged demand dynamic in light of some deteriorating macroeconomic backdrop given this year was an extraordinary one for the Swiss brands and they recovered from a relatively low base? So do you think consumer sentiment fundamentally changed to non-Rolex watch brands? I just wanted to get your view on that.

The second one would be, could you please discuss the firmness of your waiting list for Super High Demand brands? How likely is someone to actually drop out of the waitlist given the length of the waitlist on some models? And the third one would be whether you could please elaborate a bit more on the inflationary pressures that you are seeing in the business within opex specifically? Thank you very much.

BD I think there's real dynamism with these luxury watch brands we are talking about, Cartier, OMEGA, Breitling, TAG Heuer, TUDOR. Across the whole spectrum, the smaller brands are doing extraordinarily well. Girard-Perregaux is doing very well as a brand with their Laureato range. ZENITH is having a nice success. We can't get enough MB&F. We can't get enough H. Moser. So there's great dynamism and we think the biggest single factor is the market is underdeveloped.

We believe that of the UK. The UK is a very strong market, but we still believe and I think we are proving day in, day out that it's underdeveloped. There's more demand out there. There's more demand that can be stimulated as you know, which obviously we look to do, whether beautiful stores and impactful marketing and the great client service that we give.

The underdevelopment of the US market is even more evident and we did anticipate going into the US that the non-Super High Demand brands would proportionally perform better and what's happened is they have gone beyond our expectation. But, nevertheless, that was the direction of travel that we anticipated and what comes along with that success and momentum is more investment, more support and that's what's happening.

The brands are investing more in product development, in marketing. The retail sector is clearly investing more. We are and others within the market are doing the same. So there is a lot of investment going into the market, a lot of expansion and elevation of presentation of products. So, honestly, we don't think there's anything really shortterm about it. We think there's real positive momentum and all of our experience pretty much underwrites that overall.

We find the waiting lists to be very firm actually, yes, and we experience it day in, day out when we are calling the client saying, good news, you've been waiting for a year, but your product is now available. The clients tend to be in the next day. They make an appointment for as soon as they are available, but they are pretty quick to come to the store to clearly have the pleasure of buying something that they've been waiting for.

So the waiting lists we find are pretty firm. Because it's become such an important part of our business, we're trying to get more methodical on recording, analysis and continual communication with clients on a waiting list to manage their patience overall. But it's firm and defendable in terms of converting it to sales overall. Bill, you want to comment on inflation?

BF Yes, I'll pick up on that. So we are in a position where we are relatively well insulated from inflation compared with most others out there. So in round numbers, 75% of our cost base is the product that we buy and we operate on fixed margins with the brands. So if the wholesale price goes up 5%, the retail price goes up 5% and we honour the price rises that the brands ask us to put through.

On the rest of the cost base, the next biggest component is people cost. That's about 10%. Clearly we have got pressure there, as everyone does, but where we operate we are one of the places I think where people would like to work on the high-street. We already pay people comparatively well and we are always doing what we can to make sure that we make the overall employee value proposition as strong as possible.

After that, rent is our next biggest part of the cost base and that is largely fixed. We have got a few turnover rents, but by and large that's fixed and we're on leases that are five to ten years generally, so we've got good protection on that. And the team have done a fabulous job over the last couple of years of getting the lease agreements in really good shape. And then after that, it's marketing. So we're not immune to inflation, but I think we are in a more isolated place than most other people are out there at the moment.

DN Thank you very much. Very helpful.

OP Thank you. We have our next question from Kate Calvert from Investec. Your line is now open. Please proceed with your questions.

KC Morning, everyone. Three from me, please. First of all, in the US, have you seen any pickup in consumers buying watches on credit? The second question, again in the US, can you talk about where you're up to with the integration of the five stores acquired in the States, mainly with regards to the refurb side of them? And my final question is, what actually is your average selling price of non-supply constrained watch brands? Thank you.

BD Okay, we'll just work out that one while I'm talking about the first two. The US, I'm sorry, US pickup in…?

BF US credit.

BD Credit. I don't think so. I don't think there's been a change. If anything, I think overall the COVID period, the amount of credit sales in the US has gone down overall, yes. So, no, no change and certainly no pickup in credit overall.

Where we are with the five stores acquired, so the three Betteridge stores, the biggest one is in Greenwich, Connecticut and we have signed a lease to expand their presence with the store next-door and just working through exactly how we are going to configure that, but that will expand within this financial year.

We are also looking to expand the stores in Vail and Aspen. We, again, have an agreement to expand in Aspen, not all what we were hoping for, and we're looking for more space there. Vail, we are still working on it, so I honestly wouldn't think that Vail and Aspen significantly impact on this fiscal year, but we'll see. We are working on it.

The store in Plano, if you remember, Plano, Texas we acquired a business that didn't have Rolex, but we had a pre-agreement that Rolex would come with us into the outdoor mall and we effectively have got exclusivity in the mall. So the store with Rolex will open within this fiscal year and we're still working on the exact timing, but it's all designed and that deal is done.

Minneapolis, we have refurbished the store or changed the format of the store, turned it onto watches only, Watches of Switzerland Group is the fascia. The landlord there, who are the same landlord as American Dream, have a really good plan about creating a more destination luxury area that of course we would be a key part of. But that's more in their hands than ours as to exactly when that happens and we're not planning it in the fiscal year. For the ASP, Bill?

BF ASP of the non-Super High Demand is around about £3,000.

KC Great. Thanks so much.

OP Thank you. We have our next question from Richard Taylor from Barclays. Please proceed. Your line is now open.

RT Morning, team. I know you call them non-supply constrained brands, but can you just talk to the inventory situation here? Obviously you have doubled sales in the year, so are there some models within this area where you actually can't get enough stock as well? And related to that, what is your closing inventory position, if that's representative of where stock is in the business overall? Thank you.

BD Yes, a good question. We do have shortages I think across all of those brands. We can't get enough Santos from Cartier. We can't get enough Tank Must product from Cartier. From OMEGA we can't get enough Bond watches. The Moon watch, we can't get enough of the Moon watch. We can't get enough OMEGA Snoopies. We are trying to get more product from all of them. So the shortage overall is a bit unusual with all these brands. I would say we always have some degree of shortage, particularly when new products come in and take off, as they often do, but we are very often chasing supply. On the other brands, Breitling, we can't get enough of the new Navitimers. We can't get enough Endurance Pro, which was a good success. And in TAG Heuer as they've elevated, again, we've been chasing across the board demand.

There was and still is to some degree a bit of a challenge in the industry with the subcontractor component manufacturers and, again, I was there last week and hearing the specifics of what was going on with suppliers of cases and tiles and hairsprings and whatever, and that across the board impacted production capacity. But that's largely improving overall and that definitely impacted in TAG Heuer towards the end of last year and the fourth quarter. We can't get enough MB&F. We can't get enough H. Moser. You name it. We are chasing volume somewhere across all of these brands.

We have been, we would say, maybe bold in terms of our commitments. We could see the way the market was headed. We are very positive about our prospects, so we were very upfront in terms of making our commitments to buy. That definitely favoured us in Q3 and Q4 of the last fiscal year and we remain in that position. We're obviously a very big player for all of these brands and accordingly I think able to secure good supply overall. Inventory at the end of the…

BF Inventory is up at the end of the year, Richard, but partly as a result of the acquisitions that were done earlier on in the year. Betteridge in particular carries a lot of jewellery inventory and we are getting hold of as much product as we can we are getting hold of. If you want to work out a number, I think you've probably got enough component parts from where we have said we have landed on net debt and the guidance on capex that you can probably back into it reasonably well.

RT Okay, thanks. And then just a quick follow-up. So the lack of availability on some of those, is that more to do with some of the production issues and components that you mentioned, Brian, rather than a lack of willingness of those brands to give you stock and keeping it for themselves?

BD Yes, fundamentally it's the demand that's there obviously that's putting pressure on supply. And then, yes, the components, when we all first experienced lockdown, there was big concerns and people were more pulling back than expecting what happened, which was a more positive marker overall. So you had the actual lockdown experience, then you had a bit of conservatism and there's been catch-up getting played pretty much ever since.

But it's definitely a better situation and a lot of the subcontractors have scaled up, a lot of the other movement manufacturers have scaled up and quite a number of the brands have scaled up their production capacity. So it was a bit of a challenge I think for the industry overall over Christmas period. As I say, we got ahead of it and I think we're in better shape than most and the overall situation has definitely improved.

RT Thank you.

OP Thank you. We have our next question from Flavio Cereda from Jefferies. Your line is now open. Please proceed with your question.

FC Hi, morning, guys. Brian, following up from the last questions and on the non-Super High Demand brands, because I guess that's where the focus is. Given that some of them do have their own DTCs, their own retail exposure, do you find that they are…? Is it more of a challenge in terms of getting more timepieces and you need more selling space, you need to do more mono-brand stores, you need to engage with them a lot more?

Because I'm finding that I guess some of them are also starting to play the game, right? If you want to buy a particular Santos watch, you need to be a Cartier client and have other timepieces I believe, so that's changed a bit. And I was wondering if you'd call out any of these brands that you think are doing a particularly good job in probably elevating the profile and the perception of the brand. And also, my other question was, just so we're clear on this, Bill, when you mentioned about the Rolex margin hit in the US, can you explain exactly what you mean by that? Thank you.

BD Yes. Hi, Flavio. There definitely is an elevation of all of these brands going on. As I mentioned earlier, the momentum, the success brings with it really good developments of products and increase in marketing. The infrastructure I think is important, too. More people there that can really help us on logistics and getting distributions approved and stores designed and whatever. One of the biggest areas I think, though, that's very, very clear in terms of investment is within retail.

We're investing more. Our whole formula and success and model in the UK has been through investment, stores, technology and marketing, and that's obviously what we're doing in the US. There's more scope for investment in the US as we contented all along and that's where you can see a really big difference. I think if you looked at distribution in Manhattan today versus what it was five years ago, it's pretty much revolutionised.

So that's why I'm pretty confident about the trends that are there, that they are all now getting supported. These are wealthy groups, as you know better than anybody, and the amount of investment and support that's happening, the amount of products that's now being seen out there in the market, and friends telling other friends about the great timepiece that they've bought, all of that just adds to that natural momentum. So I think it's a pretty exciting time for the category.

BF So, Flavio, on Rolex margins, the margins that we have had in the US have always been higher than we have had here in the UK and elsewhere in Europe I believe. That's because US stores were typically less productive. As time progresses and we get more productive and retail the brand better, we have got more productive.

This was something that was anticipated in the long-range plan, that the US margin would come in line with the UK margin over time and that's what's happened. So it's something that we knew was going to happen at some point. It's probably happened a little bit earlier than we would have liked, but it's come in with effect from 2022.

FC Thank you.

OP Thank you. Ladies and gentlemen, if you would like to ask any further questions, please press star followed by one on your telephone keypad now. And if you change your mind, you may press star followed by two. We currently have no further questions on the line. I'll now hand back to Brian Duffy for closing remarks.

BD Thank you. Thanks, everybody, for your questions and in joining us. So we really feel good about what we reported to you this morning. We feel good about our prospects of the new financial year that we're two and a half weeks into. We feel also good about other things that we're doing in our community. The Foundation that we set up this year, we've paid £4.5 million into that and it's now in the process of getting allocated to good causes.

Our focus of the Foundation is on the cities, the communities that we live and work in, and we have approved significant donations to charities for homeless, food banks and now fuel banks of course, and we continue to expand and work with the Prince's Trust. We have got it up and running in the US, so we feel very good about that and feel great about our relationship with our colleagues who have done a tremendous job for us and continue to be enthusiastic and very, very professional in everything that they're doing. So, again, thank you for joining us and I look forward to seeing you next time.