The Watches of Switzerland Group

H1 FY23 Results | Webcast Q&A

14 December 2022

Transcript

Operator: Thank you. Ladies and gentlemen, if you wish to ask a question at this time, please signal by pressing star one on your telephone keypad. And please make sure the mute function on your phone is switched off to allow your signal to reach your equipment. If you wish to cancel your request, please press star two. Again, it is star one to ask a question. So the first question comes from Karina Nugent of Goldman Sachs. Please go ahead.

Karina Nugent: Brilliant. Thank you very much for taking my questions. My first one is on the current trading environment and you've been very clear that Q3 trading to date has been in line with your expectation. I remember you saying back at the full year results, that the guidance that you've put out embeds a degree of caution, particularly as you go into the second half of the fiscal year. Does that mean that more cautious scenario that you were thinking about is actually playing out, and are you seeing any changes in consumer behavior in and any differences between high end versus low end spending, particularly within the core watch category?

And then my second question is more longer term in nature. We've had recent newsflow on Rolex and their work in the secondary market on authentication. Can you talk about how you think that might impact Watches of Switzerland going forward? I see you're opening a repair and servicing center next year. How big do you think secondhand could be as a part of your business over the medium to long term? Thank you.

Brian Duffy: Thanks for your question and yes, our trading is in line with the expectations that we had and therefore implicitly in that, is the fact that we are experiencing market conditions less bullish than were in the first half. So pretty much as we've predicted overall. In terms of you said changing consumer behavior, high end, low end within the core watch category, the answer is not really, but there's no discernible consumer trend within watches. The jewelry category which is obviously smaller for us, it's less than 8% of our business, it's a bigger percentage in this quarter obviously with Christmas, but still relatively modest. But that's got more impact on traffic and so on and consumer sentiment. So we may be seeing an impact so far in Christmas in that category.

But even taking that into account and what we're experiencing with everything else that we're doing, there's lot things. The amount of traffic in London and New York is up verus what it was before, airport business is up. So there's a mixed list of things that are going on but when we fit it all together, it leads us to say that we're okay with the guidance that we've assumed previously.

On your question on certified pre-owned product, we think it's a very, very positive move from Rolex overall for the industry. We're very positive about it. We've been interacting with Rolex for the best part of the last year on the subject. We are looking to get active in the program as quickly as we practically can. We're working through with Rolex, the quantity of products that we have or that we regularly bring in. And so we're very positive about it. It will bring, I think discipline and credibility to the pre-owned category. It will mean that authorized retailers are clearly advantaged in the category because this option's only available to authorized retailers. We can sell the product online which obviously isn't the case but with the new Rolex.

So we haven't put a value on it yet. Generally we haven't started, we're not saying what it is but we are working our way through what is something new and exciting and as soon as we have figured out the full impact of it, of course we'll update your accordingly.

Operator: Thank you. We'll now move to our next question from Jon Cox from Kepler. Please go ahead.

Jon Cox: Yeah, good morning gents. Jon Cox, Kepler Cheuvreux here. A couple of questions for you. Just back to what my colleague was saying in terms of more recent trading, I wonder if this is more prevalent in the UK. It's interesting you rolled Europe into the UK. I know it's early doors as it were at the moment, but I guess that Europe would've added maybe a point or so to the UK and so the annual growth is maybe around 7% or so. And I know the medium range plan is higher than that and just versus the U.S., that looks obviously very, very robust there. But can you try and strip out the impact of M&A in the U.S. and maybe the new store openings versus just renovations? That might just be helpful for us. That's the first question.

Second, just on Europe. You're talking about the average ticket is far higher than the UK and the U.S. which is a pretty interesting comment. I wonder if you can just elaborate on that and what it may mean in terms of payback on the openings there and as an add, can you just remind me how much roughly when you open a store versus a renovation, the difference in the cost profile? I wonder if you can just remind me on that. And then a couple of questions. One on the free cash flow, obviously a lot of stuff going out in terms of working capital. Just wondering what you think will happen there in the second half of the year. Will that just unwind or will you continue to build that inventory as you've mentioned? And then lastly on the tax side, you've alluded to higher UK taxes coming up and also obviously selling more into the U.S. Should we expect for FY24, a tax rate may be closer to 25%. Thanks very much.

Brian Duffy: Okay. Thanks Jon. You've got a lot of questions there, some of which we can answer and some we'll obviously give you our best shot overall. Europe in the half year wasn't 1% overall the openings, we've only just recently opened in Copenhagen, we just opened an OMEGA in Stockholm. We're a bit later on the openings than we originally had planned but since the stores have been open, they've been trading in line with the expectations that we had, which were reasonably ambitious. But we are trading in line and we're very pleased with the experience. And then just jumping ahead, we are pleasantly surprised at the appetite for higher priced products in the market. Again, it's very early days. Craig mentioned in his has piece on the video, but it's a positive surprise. It's a confirmation of our analysis of the market, that there's the money and the interest there in these markets if you clearly give a beautiful store presentation and great client service, but we hadn't predicted that the average price point would be as positive as it's so far been. Too early to say that as a result, we're calling the trend any differently.

We haven't split out Europe but obviously as time goes on, we eventually will, but we're managing it as all part of one division, UK and Europe together. In terms of recent trading, you said UK, U.S. I think it's fair to say that there's definitely more gloom around in the UK overall. The U.S. does seem to be handling this period of high inflation and impacting the economy certainly than we've been able to do in the UK. So given that we have responded to predicted macroeconomic conditions impacting consumer sentiment, I think it is fair to say that's more of an obvious issue in the UK than it is in the U.S. Added to which, the impact in the UK of the rail strikes and whatever economic. So that's quite a bit of disruption overall in the UK, all of which we've taken into account and concluded that we're okay in our guidance overall. The impacts of acquisition in the U.S. I think we disclosed. So we have 60% constant currency growth in the U.S. if we take out the acquisitions, it's 44. We don't ever take out the impact of refurbs and whatever and mono-brand openings, we have a lot of activity going on, we have a lot of programs and projects. So it’s very, very difficult to see what would you call like for like. It’s never been anything that we’ve focused on at all. Acquisitions fair enough, we are reporting the number before and after acquisition, but everything else we don't report on. So there's questions on cashflow and taxes, Bill?

Bill Floydd: Yeah Jon, a couple you picked out on the cashflow. So on the working capital, I'm expecting that to come back in the second half of the year and we're guiding to free cash conversion around the 70% level that we achieved last year. On the tax, we're not giving guidance on future years at this point but you're aware of the tax rates globally and can work that out. But we'll be giving full year guidance for next year as we get to the end of this financial year.

Jon Cox: Great, thank you.

Brian Duffy: No problem.

Operator: Well, our next question comes from Kathryn Parker from Jefferies. Please go ahead.

Kathryn Parker: Good morning, Brian and Bill. Thank you for taking my questions. So my first question is on the opening of your third store in New York and I wondered if you could share any more details on the timeline, possibly the size of the store and what attracted you to this location in particular. Then my second question is on the confirmation on entry to Germany in Craig's section and are you able to share maybe what type of store you're opening? Is it a mono brand or multi-brand? And further details on that. And finally, I just wondered if you could give us an update on the refurbishment program in both the UK and the U.S. How many stores have been done and how many are still remaining? Thank you.

Brian Duffy: Thanks, Kathryn. We love this location that we're opening and it's a brand new building. Number One Vanderbilt, so effectively connected to Grand Central Station. So that's where we get three quarters of a million people daily effectively passing this location. This amazing new building that's been built is up to the best part of a 100 stories and on the top of it, they have a tourist attraction called The Summit where you can go. It is really very well done. It's obviously glass all around, you see all over the East River, you see all over Manhattan. It's fantastic. And then you can actually take a glass elevator going up a few floors, if you can stomach it. But overall, it's a great tourist attraction. It's hugely passing commuter traffic. You probably know all the traffic that comes in from Connecticut in particular. So we love it and we love the space that's there.

It's not a huge store, it's around 3000 feet. It will be anchored as we've said, with Cartier and OMEGA. Other luxury watch brands have been agreed as well and we're still working on choosing one final brand, that will occupy a key space there. We'd also have our pre-load presentation in our workshop. So very positive on it. We're signed up on it, which is why we've announced it obviously. And our goal would be to get open in calendar of '23, which means it's got to be open by October. So that's our goal. I don't see there being anything obvious that would slow us down on this. The spaces is there, the gray box, we're getting things worked on by the landlord of course. And then our brand partners are developing their furniture as well. So very positive about it. Firm statement from Watches of Switzerland in Manhattan. High, high visibility in and we think good traffic and business as well.

Bill Floydd: Kathryn, on the refurbs in the UK. We've already opened four in the half, we've got three more to come. There's one in Mayors, which is Dadeland coming up in the second half. In terms of your question of when will we be done, I wouldn't think about it like that. This is an ongoing program, but when we've finished going around once, we'll go around again. It's really important that we keep the client experience at a really high level across the estate. And so I think the level of spend we're making and investment we're putting in this year, you should see as an ongoing investment to keep the estate where it needs to be.

Operator: Thank you. We'll now take.. Pardon? Please go ahead.

Kathryn Parker: Oh, thank you. I was just going to say I had another question on Germany. If you could give more detail on the entry to the country. Thank you.

Brian Duffy: Ah, yes. My apologies. I did note it and then managed to ignore it. So my apologies. It's a mono brand store that we're opening up. I think in Berlin. We've been pretty clear in saying that we're looking at Europe and particularly Northern Europe to getting more specific geographically, looking at all of the appropriate shopping environments to do our thing. And we have a lot of encouragement and support from our brand partners in what we're looking at doing. We're looking multi brand, we're looking mono brand, we're looking for acquisition opportunities. So it just so happens and we've always said we will announce whatever we've done a deal and given, I don't think we'd normally put a big highlight in one mono brand that's opening. But given that is a new geography, overall a new country, we thought we would just mention it but relatively small. But our ambitions in Northern Europe remain very strong and positive and our experience so far as I've mentioned, Scandinavia is very encouraging.

Kathryn Parker: Great, thanks very much.

Brian Duffy: No problem.

Operator: My next question comes from Kate Culvert from Investec. Please go ahead.

Kate Culvert: Good morning, everyone. Three from me please. The first one is on the UK, the profits are down obviously year on year and you highlighted the 5 million of rates. But could you talk us through the impact of opening Europe on the numbers? Is it quite small in the context of things? And also, are you expecting Europe to be loss making on a full year basis? The second question is also slightly connected and on the UK. The 5.4 million of UK showroom opening costs, does this include Battersea within that, or should we expect quite a significant amount more for Battersea opening in more the second half? And my final question is back to Germany. Could you give us an idea of how big the German mono brand opportunity is given I think Germany is Rolex's second largest market in mainland Europe. Thanks so much.

Bill Floydd: I'll pick up the UK related ones. So yeah, we have got European startup costs in the UK and Europe disclosure. We need to invest in the right level of backup to make those store openings a success. And so there is a bit of a headwind in there, but it's not massive. And in terms of the full year, I'm expecting it to be there or thereabouts on break even. But we're not hung up on that in the short term. The important thing is that we build the right platform for us to grow across the medium term. In terms of Battersea showroom opening costs, that's in the first half. There will obviously be more showroom opening costs in the second half, but that's related to the other stores we've got and Battersea is in there.

Brian Duffy: You know, Kate, we have-

Kate Culvert: Sorry, you've got some Battersea in H2?

Bill Floydd: No, no, Battersea's in H1.

Kate Culvert: It's all in H1. Okay, cool. Thanks. Sorry, Brian.

Brian Duffy: Yeah, sorry. We genuinely haven't done a number. We've said to you in the long range plan that we did in summer of '21, what our range of ambitions were in Europe overall, but we've never broken that down by country. The process we go through is we look at the market, we look at where we believe brands are underrepresented, we look at them as our property consultants and opportunities for investing that we give back to our brand partners and kind of one by one we move on. I think Germany is a good market. There are some very good retailers in Germany, but certain brands, brand partners we believe are underrepresented there overall. And so we are quite actively looking for and discussing negotiating specific opportunities that are in the country. So generally, we don't have a number to say overall, but as we do projects for it, we'll update you accordingly.

Kate Culvert: Can I ask a question in a different way. Perhaps given the logic in terms of size of population of Germany versus the UK, would it be logical to assume that you could get a similar number to what you've got in the UK at the moment, or even more?

Brian Duffy: I think that honestly, who knows, we clearly have a huge presence here. We've been at it for a century or so. There's opportunity in the US, like you've seen the pace and the way we've gone about executing it. There's opportunity in Europe, it's some respects more complicated than the US. We deal with centralized organizations that cover the entire market, of course, in Europe or some mosaic of structures in countries and whatever.

But what I'm delighted with, I must say, is that the way have team prepared for entering the European market. We have all of our systems in POS and Danish and Swedish and now German. We've done a great job of recruiting and we bring teams over here for training and our teams in the UK then go over and help in the early phase with direct training within the store. I think it's all worked really, really well.

So I think in terms of how we execute, I feel very good. So I feel good about the market opportunity that's there, but we've got to find the spaces, we've got to find the deals, we've got to negotiate the support with our brand partners. It all takes time and, as with everything else, so as we close on deals and specifics, we'll update you. Clearly when we do the long range plan, we'll, as opposed to when we did it in '21, we've now got actual experience of Europe and then we'll hopefully have more by then and we'll give you an update on our ambitions then.

Kate Culvert: Super. Thanks. Have a good Christmas, everyone.

Operator: Thank you. As a reminder to ask a question, please signal by pressing star one. And we have a follow-up question from Jon Cox from Kepler. Please go ahead.

Jon Cox: Yeah, thanks very much. Just a bit of a question on the European expansion, and you're expanding mono-brand stores, they're not necessarily Rolex at the moment. What happens as you go into Europe? Do you actually have to acquire dealerships or will Rolex turn around and say, "Okay, we're going to offer you something in some city somewhere." Or will it be more you have to do M&A of dealerships in Europe to get Rolex on board to roll out the model in the way maybe you've done in the UK, with a multi-brand store with Rolex as the anchor, and then start to add mono-brand stores onto the side of it and stuff?

Brian Duffy: Yeah. I mean, if you look at our experience in the US, which obviously is a blueprint for how we're then going to approach Europe, most of the representation of Rolex have been through acquisition. New York was different. New York was completely new stores that we opened. Since then, we've identified an opportunity and agreed with Rolex that we'd open up a multi-brand with a major featuring on Rolex in Cincinnati. But the majority of it has come through acquisition, and in Europe we don't see opportunities, obviously, like we did see in Manhattan. So I think it's likely that even more of the representation would be dependent upon acquisition.

Jon Cox: Okay. And do you find that hinders, I'm just talking about the sort of organic rollout with the new stores, they are strategic partners which are great brands but maybe not quite as coveted as Rolex, Patek, and AP.

Brian Duffy: Yeah. Yeah, I mean, I think definitely you've got different timings, you've got different constituent parts, and the mono-brand option also, but some multi-brand options as well. I think we could, I know we could get agreement and execution quicker. Everything else takes time. But, listen, we're working on it all and I do think looking at our US experience as a good reference to build what you think we could do in Europe. And what we said in Europe is that by fiscal year '26, it would be between 5 and 8% of the total, and that included an assumptions on acquisition and mono-brand, and some element of e-com, and so on. And I think that that remains your best indicator from us at this point, and we'll update you on it all early next year when we do our plan through to fiscal '28.

Jon Cox: And just on sort of M&A, generally, in the cash flow statement, I must admit I wasn't aware of the acquisition, I just see it in pop into the cashflow statement. But you've done now 60, 66 odd million of the minimum 150. Do you have much more you may do already this year, or is it going to be more spread out or is it going to be more front loaded just compared to the original midterm plan as it were?

Brian Duffy: Yeah, we're ahead of schedule, I think it's fair to say, and hopefully, we remain ahead of schedule, but in all these deals, they ain't over until they're over, and we've got to be patient and considerate to vendors when we clearly have to interact and with the brand as well. So they all do take time, but we are, to your point, ahead of that schedule at this point, and we make no secret of the fact that we are active with various potential deals at various stages of likelihood.

Jon Cox: Great. Thanks very much.

Brian Duffy: No problem.

Operator: Thank you. As there are no other questions in the phone queue, I'd like to hand the call back over to Scott Bannerman for any webcast questions. Over to you, Scott.

Scott Bannerman: Oh, thanks for that Serghei. We've had a few questions in from the webcast. The first question is from Melania Grippo from BNP Paribas, "Good morning. You confirmed your FY 2023 guidance, which are the risks that you face, what concerns you most? And then Rolex pre-owned project, are you joining the project? Could you please expand on why you expect it to be positive for the brand sales and what kind of profitability this could generate?"

Brian Duffy: So for Melania CPO I mentioned earlier, yes, that we are enthusiastic about it. We think it's great. We haven't genuinely got numbers on it yet. Obviously we're working through some options. We still have some questions that we need answering, particularly on capacity and the speed of throughput. Rolex are examining, authenticating all of the products and guaranteeing them, and that takes up, obviously, a flow through and we're just working out all of those logistics at this point. But we think it's great and it gives a big advantage in this category to authorized retailers like us and others. It gives I think, a great deal of credibility and confidence to consumers to know that they're buying a Rolex that's been certified by the company, being Rolex, being guaranteed by them and then retailed by an authorized retailer like us. So very, very positive about it overall.

Risks and opportunities, whatever, and the guidance. We are okay on supply. We'll get confirmation of the calendar year supply in January, I believe. We're always conservative in our estimation, and the supply for the remainder of this calendar year we're totally confident of, as we've been, and I think we've been appropriately conservative on our expectations for the first four months of the next year.

We're also confident of our ability to gain market share. We've been doing it, we have external evidence and confirmation of our market share gain. We've continued to invest and support our businesses at every level, store investment, marketing, technology and client experience and are therefore gaining share overall. Our consumer is less affected by the cost of living aspects overall, so the category in that sense will be less impacted. But it's not without risk, of course. If there was a massive downturn in consumer confidence and so on then I guess everybody would be impacted, we are anticipating that consumer confidence and therefore consumer discretionary spend, whether it be negatively impacted and we've built that into our assumptions at this point. As I mentioned earlier, probably more UK than US but I think certainly both markets.

So we try and be as thoughtful on our guidance as we can and with the best part, just over four months ago, we're feeling confident enough to make the statement that we're confirming our guidance.

Scott Bannerman: That's great. Thank you for that, Brian. Next question is from Richard Taylor from Barclays. Within the inventory increase, thank you for your detailed breakdown. In addition to what you have disclosed, how much is from pre-owned watches within inventory, and how are these watches valued? I was thinking about this against the recent decline in secondary market values and what you pay when acquiring pre-owned inventory.

Bill Floydd: Thanks Richard. So on pre-owned that is included in the numbers. Obviously it's a relatively small component of the increase in the like-for-like inventory and we find that the biggest inhibitor to growing the pre-owned part of the business is the availability of inventory and bringing that in. So I don't have concerns around are we at risk on inventory valuations on pre-owned? We buy them at a discount, they're valued at cost in the balance sheet and we make a decent markup on them. It's less than the overall margin but it's still a good margin and so I'm very comfortable with where we sit on pre-owned inventory valuation.

Brian Duffy: And just to add to that Richard, we haven't seen any pressure on pricing or margins on the pre-owned. It’s been a good and growing business for the UK and US.

Scott Bannerman: That's great. Thank you very much. We've got no further questions at the moment so I'd like to pass back to Brian for any closing remarks.

Brian Duffy: Okay, thanks Scott. Thanks everybody for joining us. A big thanks to my colleagues for putting together the presentation, the video you all looked at earlier. Thanks for your questions, everybody. You helped us get through it. There's a lot of moving parts but we feel pretty good trading so far in this quarter and what we've experiencing in Christmas, not without its challenges but I think we've anticipated most of them and clearly incorporated them into our thinking. Colleagues are doing a tremendous job as they always do. This is a really hard working time for them at Christmas, but they're all out with the usual enthusiasm and professionalism and I think doing a fantastic job. And to the rest of you on the call, just wishing everybody a Happy Christmas and good New Year and we'll look forward to speaking to you again when we give our quarterly update post January. Thanks everyone.