THE WATCHES OF SWITZERLAND GROUP

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WATCHES OF SWITZERLAND GROUP Q3 TRADING UPDATE

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Q3 TRADING UPDATE

TRANSCRIPT

Brian Duffy: Thank you, Emily, and morning, everybody. Thanks for joining us. You've all got our trading update, so I'll not go through that line by line. Just want to give a wee bit more colour to our performance. We are very, very pleased at what our teams have delivered for Q3, who've been facing gale-force headwinds overall, UK lockdown. Clearly, we were closed for November, we were closed for January, and as we reported, only open 37% of the hours overall.

Our international business, which has been a headwind throughout the year was, again, only 6.6% of our sales, compared to over 22%. In the US, all of our shops are open, but traffic remains a challenge, down 30/35%, and clearly, people not travelling to Vegas and New York. Manhattan is the same as London. People are not working there, they're not shopping there, and they're not travelling there as tourists.

And then those circumstances, to deliver US, tremendous performance at 19% year on year. UK online, super-strong, 121% up. We could call out some real notable successes within that. Tudor, as a brand, came online with us only in December, and off to a tremendous start. Brands like Panerai, who came online with us, lockdown one, have had a tremendous year. But overall, big brands online, Tag, Omega, Breitling and Cartier, done fantastically well.

We've had in place our luxury concierge, fully trained salespeople. Actually, our teams from Heathrow have been fully equipped now to handle, give advice and help to folks that are online, and whenever they do, they have a tremendous level of conversion. So, bring all that together, the UK coming out at 1.5% in all those circumstances, and, I think, it's better to compare Q3 to Q1. In Q1, we had six weeks of a lockdown, a complete lockdown, as we know, but in Q3, we've, effectively, had eight weeks.

In Q1, the UK was down 30%, and Q3 was actually positive 1.5%. So, very clearly, we know how much better to handle these extraordinary circumstances. The customers are getting used to it, but in particular, our salespeople, getting very skilled at handling clientele. And we are getting, clearly, better and better at everything we're doing online, digital marketing, social media, service levels and so on.

And it's all delivering, and our teams in the US just doing, continually, an amazing job. So, based on all of that, we are confirming our guidance, and I'll just let Anders talk through the details of guidance. Anders?

Anders Romberg: Yes, thank you, Brian. So, again, we are reiterating our guidance that we provided on 17th December. Obviously, when we did that, we weren't expecting to be closed as long as we have been. As we said then, we had expected to be closed January or February. Right now, we're thinking, the earliest we're going to see an opening is end of March, probably going into April. We're still, in spite of all of that, seeing the team responding, as Brian pointed out, positively.

Generated good top-line and good flowthrough on that. So, no change to our guidance, so we're sticking with our 900 to 925, and our EBITDA margin, as we pointed out, is coming in at about 11.1 to 11.6. We probably have a higher degree of comfort on that than the higher end of our sales guidance, given, if we're close throughout the financial year. So, that's where we sit. Debt-wise, cash generation is strong, so the guidance between 60 and 80 million still holds up really well. So, no change whatsoever.

Brian Duffy: Thanks, Anders. And with that, Emily, we'll pass over to Q&A, please.

Operator: Thank you very much. So, ladies and gentlemen, if you would like to ask a question, please press star followed by one on your telephone keypad now. If you change your mind, please press star followed by two, and for those of you who have joined online, please press the Flag icon. When preparing to ask your question, please ensure that your microphone is unmuted locally. Our first question comes from Thomas Chauvet of Citi. Thomas, your line is now open. Please, go ahead.

Thomas Chauvet: Good morning, Brian, Anders, Allegra. I have a few questions on the end of tax-free shopping, please. Firstly, what was the share of tourists, do you think, that used the VAT-free scheme as a percentage of UK business in a normal year, so before the pandemic, obviously? And how much do you think you'll lose of that business with the end of tax-free shopping in your budget, in your best guess?

Secondly, in the new release, you talk about your efforts to have the UK Government change that policy. What's the latest discussion you've been hearing about this? I think, last December, the High Court rejected a claim brought by Harrods and a few other companies. And, thirdly, a slightly different angle on the UK outbound travel. How are you evaluating the risk that UK residents shopping in the EU will claim the VAT reformed on a Rolex, but might not declare the item to the customs on the way back to the UK?

And maybe as a comparison, how much do you think you were losing in the UK with local residents when those were buying in Switzerland on a business trip, on a ski holiday, to take advantage of tax-free shopping? Obviously, all this before the travel disruption caused by the pandemic, would be really useful. Thank you.

Brian Duffy: Thanks, Thomas. Historically, so pre-pandemic level of tax-free shopping, tourist shopping of our total group was 17%. 7 of that, of the 17, Chinese, and 10 other, so that was our historical percentage. Obviously, during the last 12 months, the percentage has been very, very low overall, because there just hasn't been the tourist traffic, clearly.

The discussions with the Government, there have been no discussions recently. So, all of the discussions led up to the Government confirming that decision, I think, it was last November, but there is clearly work getting done to evaluate the impact, now that it's actually been implemented overall. And there's clearly going to be further lobbying. And our hope and expectation is that at some point, this will get repealed, and it will go about to a VAT-free situation, not in calendar 21, but possibly calendar 22 and beyond. But clearly, that involves us and others convincing the Government overall.

How this is going to impact our business, the most important thing for everybody to realise is that so much of our business is supply-driven. It's not about price. And we have proven that no international business, very little airport business. We can redirect our product towards domestic customers here in the UK, and the numbers that we're delivering for this year have very, very low numbers of international business, of course.

So, we can cope without it, and similarly, your point about, will people be shopping around to get better prices on a Rolex internationally, honestly, to the extent that that is happening, it really won't impact, because getting Rolex and the Rolex business is about availability and supply. It's not about price, and if you just look at the secondary market for Rolex products, you will see that people are willing to pay significant premiums well beyond the VAT differential just to get hold of the Rolex business.

So, the critical thing for us for people to understand is that so much of our business, Rolex, Patek, Audemars, is driven by supply rather than demand. We've got a tremendous domestic clientele, and what we've done in this year has proven that we can really pivot our business towards the domestic market, which we've, obviously, successfully done. So, we're not anticipating a big recovery of international.

We think there will be a traffic increase in the second half of the calendar year at the airport in particular, that we'll get some degree of business from. Not as much as it would have been if tax-free had continued, of course. But nevertheless, it will be incremental on this year.

Thomas Chauvet: Thank you very much. Thank you.

Brian Duffy: Thank you.

Operator: Thank you very much, Thomas. Our next question comes from Karina Shooter from Goldman Sachs. Karina, your line is now open. Please go ahead.

Karina Shooter: Hi, Brian. Hi, Anders. Thank you for the colour. Just following on from your last comment on being a supply-driven business model, I was just wondering whether you could give a couple of words on the supply outlet, particularly for Rolex and the prestige brands, and also some colour on how your wait lists look today versus before COVID?

And then, secondly, just on the US, could you give us some colour on upcoming projects, the American Dream timing of the opening, and also on your recent ecommerce launch? Thank you.

Brian Duffy: Okay, and I should apologise from my dog in the background, by the way. My wife's obviously gone out, and the dog's gone nuts. But thanks for your questions, Karina. The supply situation, we have our usual visibility on supply overall. Feeling pretty positive about the calendar year ahead, UK and US on supply. The production has been uninterrupted since the factories reopened post the spring lockdown. We think, they've been in full production more or less since July onwards, so that's good.

And we are not anticipating any disruption, certainly within this fiscal year, of production from Switzerland. At the same time, at a global level, traffic, travel, that hasn't recovered. So, the circumstances, hopefully, favour the strong domestic markets like we have in the UK and the US. So, generally, the Rolex, Patek and Audemars, we're feeling positive about the supply situation overall. And clearly, it's a critical factor as we do our plans and work out our guidance and so on.

With regards to the wait list, there are more products on the wait list today, the new products that were introduced by Rolex, more or less Oyster Perpetual and Datejust products, which were not previously on waiting lists, now are because of the developments that they did, the colour dials and the new movement. So, there's actually more products on the waiting list.

And overall, we're nowhere close to addressing the needs of the waiting list. And our feeling is that it continues to grow. The disparity between supply and demand continues to increase overall. So, Anders may want to comment on the specific numbers, but overall, our feeling is that the wait list is probably continuing to grow, and certainly from a product standpoint, that it definitely is.

Anders Romberg: No, as… Sorry, Brian.

Brian Duffy: Go on.

Anders Romberg: No, as we've always said, we, essentially, don't add people to the wait list in many cases because, clearly, once the wait list gets to two years or more, the point is, we don't really want to collect names, and we want to sell products. So, at the end of the day, it's very intact. Let's call it that.

Brian Duffy: Your last question about the US, we did get the ecom up and running October and started putting marketing money behind it. It's gone fine. It's achieved the objectives that we had set. We'll be setting, clearly, more ambitious objectives for next year. So, that's off to a good start, but clearly, online either takes time for you to build your momentum and client base and awareness, and/or you spend money to, effectively, do it. We, obviously, will look to get that balance right. But in the years ahead, online in the US is going to make an important contribution.

The other thing that I should have mentioned, actually, is, we got a mono brand programme up and running in the US just before Christmas. Herculean task for our team, and just amazing that we did it with all of these extraordinary conditions we're dealing in to get these stores built. They recruited completely new teams. We've used some management from the Mayors group who'll be located and taking opportunities.

But most of the teams, we had to go out and recruit them. We had to train them, had to secure all the products and the marketing, and they did all of that in the middle of the pandemic and have actually got the mono brands off to an encouraging start. We opened eight of them, Breitling, Tag and Mayor, and we think, that's going to offer a really good growth opportunity in the future.

Karina Shooter: Perfect. Thank you very much.

Operator: Thank you very much, Karina. Our next question from Kate Calvert. Kate, your line is now open. Please go ahead.

Kate Calvert: Morning, everyone. Hopefully you can hear me, because that was a bit crackly.

Brian Duffy: Can hear you fine, Kate.

Kate Calvert: Perfect, thank you, Brian. The first question is, what is the deferred revenue balance looking like at the end of the quarter? And my second question is, your thoughts on innovation coming through in the fourth quarter and into next year. How's that pipeline coming through? And the timing of them, roughly, are they falling this year? Thank you.

Brian Duffy: I'll take the second question, and Anders might want to comment on the revenue. And on innovation, we think, it's going to be a really good year on new product development. We were surprised at how much new product we got for last year, but our expectations were very low once lockdown had been announced and all of the watch fairs had been cancelled. But nevertheless, there was product development deferred from last year into this year.

Plus, we expect a full programme of new product introductions, so it should be more than a typical 12 months with a new development. Unfortunately, we were all really looking forward to the watch fair, which was planned to take place in Geneva this year. Would have been the first year when you've not had a global event in what is the home of Swiss watches, Geneva, of course. But that's been cancelled because of the pandemic.

We don't think that will impact any of the planned introductions, the brands, as we've already had some meetings with some of the brands about their new product introductions, and others are being planned. There's going to be a virtual Watches & Wonders again, and we think, there's going to be a lot of other virtual presentations. One way or another, we think, the new products are all going to get presented. Like I said earlier, production has been good. Therefore, the scheduled delivery times for these products should be on schedule.

So, that means that from March/April, we start to see new products coming into a mix overall. Some brands, we're very into a brand like Omega, for example. We think, are clearly going to have a very strong year from a new product standpoint. They were hit last year with the cancellation of the Olympics and then the cancellation of the Bond movie, both of which are scheduled again for this year. The Bond movie, I'm sure, will happen. Olympics, we'll see, but, I think, there's quite a lot of new product development to come from them.

So, I think, it will be a strong year, and new products are a big stimulant in this market, so, I think, it's going to be an area of positivity. The deferred revenue question, Anders?

Anders Romberg: Yes, on your question there, Kate, on the deferred revenue, obviously, what we experienced in December post-lockdown that we saw come through in November, there is an acceleration of sales once you open up. We haven't really quantified, but through appointments, we have better disability or what is coming our way, which we clearly are benefitting from, because conversion on those types of visits to the stores is tremendous.

On the deposit programme, difference between what we experienced in lockdown one versus where we are today is that we have this click & collect service that's going on today, which is really a deposit, and then they come and collect it in the store. Not everybody chooses to do so. Some people pay the deposit, and then wait until the stores officially open up to collect. So, during a lockdown, there is always a component of deferred revenue that's coming through.

And then you have the jewellery sector, which is probably more store-dependent debt than our watch businesses. So, yes, there is a component of that element that's expected to come through once we open up.

Kate Calvert: Great. Thanks very much.

Operator: Thank you very much, Kate. As a reminder, ladies and gentlemen, if you would like to ask a question, please press star followed by one on your telephone keypad. And for those of you who have joined online, please press the Flag icon. My question comes from Greg Lawless from Sure Capital. Greg, your line is now open. Please go ahead.

Greg Lawless: Morning, guys. Just thinking about FY22, how are you thinking about planning the business, given the kind of volatile trading conditions through FY21? And just on mono brands in the States, see you've, obviously, opened eight and flagged that. How many do you see as a potential opportunity? Thanks.

Brian Duffy: I'll take the second one first, Greg. We are doing a complete review of areas of growth in all the markets, European and US. That, obviously, will include planned rollout of mono brands. And once we've done that and settled on a number, we'll update the market on it. So, at this point, I think, you'll know that what we've said in the past, mono brands are great in the UK. We have a great pipeline of mono brand development in the UK, some of which we included on the release.

In the US, we've committed to this programme of eight or nine, and then wanted to see the experience and the performance. But clearly, if it works well, there's significant potential, and we've clearly proven again, we can move pretty quickly, in terms of executing deals. Obviously, there's going to be better deals available in the US market as well. So, early indications, and it's still early… We only opened in November. Most of them opened in December, and really just at the start of Feb, but the early indications are encouraging.

And our team's ability to execute is especially encouraging. So, it will offer a good direction of growth. And we'll update you on the specifics, the outcome of our plan, when we've been through and had it all approved by our board and so on, which is a couple of months away yet. FY22, our feeling is that, certainly, the disruption we're experiencing now continues. We don't know when stores will reopen. We've said in the release that the earliest we expect it to happen is the end of March.

What we think, after that is, there's still going to be a period, in which we'll all continue to be cautious. Now, our stores will be open, we think, from the start of the new fiscal year, but we do expect traffic to still be subdued. And, therefore, the importance of appointment-taking, clearly, the importance of social distancing, the importance of online interaction, all these things, we think, will continue to be important. We think online will continue to do well in these circumstances.

And we are thinking forward to September period for the autumn, where we might get back to a full quote press, if you like, of us doing events and traffic picking up again, and something feeling more like normal. But we honestly think that there'll be a degree of social distancing and disruption that'll pretty much happen throughout the calendar year. But from April onwards, we think there will be a gradual improvement, and these two phases, stores open, subdued traffic, little socialising events, but all that, we hope, will start to kick in from September. But by this point, we're expecting our stores will be open for 52 weeks of the year in UK and US, and that there won't be any disruption on supply.

Greg Lawless: Thank you. Good luck.

Brian Duffy: Thanks, Greg.

Operator: Thank you, Greg. As a reminder, ladies and gentlemen, if you would like to ask a question, please press star followed by one on your keypad. If you change your mind, please press star followed by two. We have one more question from Edouard Aubin from Morgan Stanley. Edouard, your line is open. Please, go ahead.

Edouard Aubin: Yes, good morning, guys. Just one question, actually, from me. going back to supply/demand and just more specifically on the US, what are you seeing, in terms of rationalisation of capacity at competitors, of all of these independent multi-brand stores? are you seeing an acceleration or not of the rationalisation of capacity there?

And in terms of US demand, some observers are quite optimistic about the appeal of Swiss watches, going forward, in the US market. If you could comment on these two things, supply and demand in the US? Thank you.

Brian Duffy: Thanks, Edouard. Our contention all along is that when we first analysed the US market, 2015/16, our view was that the market was significantly underdeveloped and that the main reason for that was a lack of investment in retail. And I think, we'll have quoted to you and others, it's in our documentation, that when we looked at the US market per capita, it was 40% of the UK. So, the UK, 2.6 times the US market, whereas, if you went back to 2005, not so long ago, these numbers were actually comparable.

And what's happened in the intervening period is great investment in UK retail and just simply not enough of it in the US. So, that's been our contention throughout, and, I think, we've proven that to be correct with the success that we've had with investing in stores that we've acquired and opening the stores in New York that we've done. The performance since then has exceeded our expectations from when we put the plan together. So, we're absolutely convinced of the potential in America.

I think, there's a general consensus in the world of Swiss watches that the American market is outperforming and will pick up momentum. And, I think, we'll see that, in terms of supply and support overall from the brands.

There is potential, clearly, for bigger, more urban stores of the kind that we do, and the likelihood is that that would be at the expense of smaller regional small-town distribution overall. It's been the trend. If you look at the authorised distributors of all other brands, the trend has been to reduce doors in favour of more big city presence.

And, clearly, that's where we are focused. So, I do think, whether it's accelerated during COVID, you could speculate. We have evidence of that we haven't seen yet, but it's an underlying trend, and it supports our growth scenario for the US market.

Edouard Aubin: Okay, wonderful. Thank you.

Operator: Thank you very much. We have one question from John Guy from Jefferies. John, your line is now open. Please go ahead.

John Guy: Yes, good morning, Brian and Anders. Hope you can hear me. Just got one question, please, just on the price mix dynamics that you see in the market at the moment. Could you just comment on that in relation to some of the new products that have been coming through? That would be great. Thank you.

Brian Duffy: The underlying reality now for many years has been a continual increase in our average selling price, which has been a combination of price increases.

So, for example, at the start of this calendar year, all these price increases from Rolex in the UK, around 7.5%, around 3% US, the increases in Omega and Patek as well. And if you go back over a long period, there's an underlying [unclear] of 3% pricing on average, which has continued. And then in addition to that, our move towards luxury, now 86% luxury watches, of our total business, has given us an inherent ASP growth as well.

And then when you look within the brands, then a move more towards gold and precious is evident as well. So, you could add three dimensions, if you like, overall, to what has been a continual increase in the ASP. And this year, no different at all overall. I don't know, Anders, do you want to add anything on this?

Anders Romberg: No, I think, you're right. Obviously, the total ASP is not really that relevant because it's, obviously, skewed by mix within the segment. And what we see is, obviously, that the strong brands that perform really well, so the ones that we've able to clientele and so forth, have always been disproportional, and they've performed well this year. So, that skews it a bit. But you're right. It's pricing, it's mix and it's product content that's driving it.

And overall, it's been around 10% growth in ASP throughout this whole period, going back to 14 in the UK, until today. So, that has been an important component of growth, but that is, obviously, mainly driven by product mix where Rolex has outperformed the rest of the markets throughout that journey.

John Guy: That's great. That's very clear. Thank you very much.

Brian Duffy: Thanks, John.

Operator: Thanks very much, John. And we have no further questions, ladies and gentlemen, so I will now hand you back to Brian. Thank you very much.

Brian Duffy: Thanks, Emily. Thanks, everybody, for joining. Hopefully, you found that useful. Once again, we're really pleased with the performance that our team's delivering. They really are the best at what they're doing, and they're just running very hard to keep up with the demand that they're putting in us, in terms of systems and support. But they've been very adaptable, very resilient, and they're the guys that are producing what we think, under the circumstances, was a hugely positive quarter.

So, we'll look forward to updating you next when we have our end-of-year results, and thank you for joining.

Anders Romberg: Thank you.