Watches of Switzerland Q3 FY23 Trading Update

Thursday, 09 February 2023

Brian Duffy Good morning, everyone. Welcome to our call. Thanks for joining us. I'm Brian Duffy, the CEO of the Watches of Switzerland Group, and I'll be adding some further commentary to the Q3 fiscal 23 trading announcement that we made this morning. Bill, our CFO, will then add some comments, and then we'll both be happy to take your questions. I'm very pleased with our strong performance in Q3, delivering sales growth of 17% in the quarter, 12% constant currency. It's in line with how we had guided to the quarter at the half year. Sales growth in the US remained very strong at +36 reported, +22 in constant currency. UK, Europe sales were also very good at +7. Q3, which includes the holiday Christmas season, is the most traffic dependent, and compared to a quarter for the Group, we're really delighted with the outcome. Our model prevailed, and our teams, once again, excelled.

When we reported our Q1 and Q2 figures, we said that there was potential for more challenging trading conditions in the second half, due to cost of living pressures, interest rate increases, and so on, all impacting consumer confidence and sentiment. Looking at Q3, the macro backdrop has been more challenging, as we expected. However, despite these conditions, we've continued to trade very strongly, and we exited the third quarter with good momentum. Luxury watches grew 22%, and our market information shows that we've, once again, gained share, both in the UK and the US. Growth was driven by both increases in the average selling place, as well as volume. Demand for luxury watches continues to outpace supply. We have added to the net registration lists at the same rate as we've done in recent quarters in both the UK and the US. We receive weekly anecdotal feedback from our stores, and they continue to report definitely good conversion levels from the wait list clients.

Our stores report that there has been some incidence, in recent weeks, of some customers deferring buying opportunities within a very small assortment of products that were only recently added to the registration lists. However, as I say, conversion remains good, and the lists, overall, are growing. Luxury jewellery was down 2%, and that reflects our focus on full price sales, which has been our strategy ongoing. And overall, our ASP increased high single digit, as we merchandised to higher price points, and reduced promotional activity in the UK, and discounts in the US. Group e-comm sales at plus 5% were very good and ahead of market trends. We also enjoyed strong sales growth on preowned products, both in the UK and the US, with continued good margins, no pressure on pricing. And we are preparing for, and looking forward to, the introduction of the Rolex CPO programme some time later in this calendar year.

We continue our expansion into Europe, and our new stores in Stockholm and Copenhagen are doing well and trading in line with our expectations. Consumers in these markets are responding well to elevated showroom environments and client service. We're really pleased with the flagship Watches of Switzerland's showroom, plus the four mono-brand boutiques that we opened in Battersea Power Station in October. We are delivering, overall, good performance. We have an exciting pipeline going forward of new showroom openings, including the American Dream in New Jersey, and the flagship Rolex boutique on Bond Street, and a full programme of showroom refurbishments. Since we last spoke to you at our half year results in December, we now have a greater visibility of supply for the calendar year, and obviously, the price increases that have been announced for January / February.

Taking all that together, we are pleased to confirm our previously issued guidance for the year. We remain confident in our markets, and the competitive advantages of our business model, and we remain committed to and confident on our long range plan objectives. And with that, I'll hand over to Bill.

Bill Floydd Thanks, Brian. Morning, everyone. So, just a couple of extra bits of colour for me on the guidance. So, this is now at an exchange rate of $1.24 to sterling, which is the rate at the end of the quarter. So, a little bit of a headwind, compared to the 1.20 we previously had. So, revenue still between 1.5 and 1.55 billion, EBIT at 163 to 175 million, and on free cash conversion, maintaining the 70% guidance that we gave at the half year, with inventory levels coming down in the quarter in line with the seasonal pattern. Harry, over to you for Q&A.

Harry – Operator Thank you very much. If you'd like to ask a question please dial star, one on your telephone keypad. If you change your mind, please dial star, two. And when preparing to ask your question, please ensure your phone is unmuted locally. And our first question of the day is from the of Antoine Belge of BNP Paribas. Antoine, please go ahead.

Antoine Belge Hello, good morning again. This is Antoine Belge from BNP Paribas Exane. Three questions, if I may. First of all, can you comment a bit on current trading, maybe for the key regions? And so, overall, would you say that you are more confident or less confident, compared to last time we spoke in December? Point number two, in terms of the mechanics of the waiting list, what are you seeing there? Different patterns or attitudes of consumers? And then point number three, with regards to what you said in Q3 and the start of Q4, any comment on some of the moving parts of the profitability of the company? Thank you.

Brian Duffy Thanks. We're only just into our quarter. We had said that we exited the quarter strongly, we entered Q4 strongly. We are not more or less confident, we're confirming our guidance, and obviously, there's less time to go. But we're really not seeing a change. I guess it's worth just pointing out the second half - Q3, Q4. Q3 is the quarter, it's the one where you would say that you would have had more potential volatility with the Christmas season, some more competitive. Jewellery is not a big part of our total business at 8%, but it's a bigger proportion during Christmas. So, looking at the second half year, Q3 was likely to be the most volatile, potentially. And I do think it was a time, as well, when market sentiment or economic sentiment was pretty negative. So, very, very pleased that Q3, and very confident and comfortable at the guidance that we've given for the year.

So, not more or less confident, but obviously, with less time to go, we have a very good feeling about the year overall. In terms of waiting lists, there isn't really any change in attitude. The fact that I commented on some customers deferring is just really full transparency. We're regularly asked, has there been any change at all? And anecdotally, a few customers on a few products that were recently added to the list. Nobody's wanting to come off the list, by the way. They're simply saying I still want the product, but can you give me a call in a month or six weeks' time, and then we go to the next customer, who then buys. So, we're increasing our lists, UK, US, and really, we're not seeing any significant change at all, overall. The moving parts on profitability.

Bill Floydd Morning, Antoine. So, on the profitability, no material change. The most meaningful headwind is the interest free credit cost. Not in terms of the volume of people taking up interest free credit. That's in line with normal levels. But the interest rates going up increases the cost of that for us. So, that's the most meaningful thing in there. Elsewhere, we've got a bit of inflation in things like IT costs. But overall, no meaningful changes in profitability.

Antoine Belge Just a follow-up. There have been a few price increases for the main brands. Is it good for you because your purchasing price has also been adjusted? Or is it having a slight impact?

Bill Floydd It is beneficial for us. So, we operate on fixed margins with the brands, so as the wholesale price goes up, the RRP goes up by the same amount. What we have got going against us is the FX headwinds. So, it's marginally positive for us, but not meaningful.

Antoine Belge Thank you very much.

Harry – Operator Our next question is from an honour Kathryn Parker. Kathryn, please go ahead now.

Kathryn Parker Good morning, and thank you for taking my questions. My first question is on brand performance and whether you've seen any changes in relative brand performance outside of the super high demand brands. My second question is on Rolex supply. I believe you have been given your allocation for this year, and I wondered if those were aligned to your expectations. And then thirdly, just on the US gross numbers. There's been a slight deceleration in the growth ex acquisitions, and I just wondered if you could comment on any reasons for that. Thank you.

Brian Duffy Thanks, Katherine. Brands, something that's really characterised this last couple of years has been an overall strength of the luxury watch world, which we think is very, very positive. And a lot of our brands are doing fantastically well for us, Cartier, OMEGA, other major global brands. Tudor's doing fantastically well. But in addition, regarding the smaller brands, they've had a very good period as well. Some niche brands, like MB&F, H Moser, Girard-Perrigaux. So, there has been a really good spread of business, and nothing's really changed over the year. I think it really talks to the strength of the category, overall. And obviously, we represent pretty much everybody in the industry. Any brand changes that we have experienced are down to things like supply, or anniversaring of new introductions, or whatever, this year versus last year, but nothing to do at all with the overall demand for the brands, which, as I say, has been very strong.

Rolex, most people that follow us know that we do get a number at the start of the year, in terms of units, for Rolex UK, in the US, we've had those meetings, they take place in January, and those numbers on never missed, in our experience. They only ever go upwards. And they were in line with our expectation, so no issue for us there. And it obviously helps underpin the balance of the year's guidance that we're giving. The US, as far as we're concerned, is very strong. We're doing very, very well. There are some things that impact our net sales that don't necessarily reflect consumer demand. Overall, the timing of supplies, the management of stock levels. For example, we did increase stock levels instore, in conjunction with Rolex, just simply to give a better consumer experience.

So, there are things like that, that impact our sales overall. When we look at a quarter and compare it to two years ago, it was +76 in the US, excluding acquisitions, +50. And it was exactly in line with where we had guided. It would have been our forecast, that it would have been. So, the US is still very, very strong, getting great support from all of the brands, getting a really good level of investment in the market from the brands and from retailers. So, we see it as a strong quarter that's part of what's been a really strong year-to-date, market performance.

Kathryn Parker Great. Thank you very much.

Harry – Operator Our next question is from the line of Daria Nasledysheva of Bank of America. Daria, please go ahead now.

Daria Nasledysheva Hi, Brian. Hi, Bill. Thank you for taking my questions. I have three. The first one would be could you please help us quantify a bit of a weakness in the US between weakness comps in jewellery versus performance of watches? And can you please remind us of what percentage of your US sales actually come from jewellery? And also, are you starting to see any discounting in the watch channel today, versus what we have been seeing over the past couple of years? Obviously, the discounts, broadly, in the wholesale channel, have been narrowing and generally disappearing. Has it changed now? And a bit more sequentially, within the quarter, how does January trading compare to November December? If you can give us a bit of colour on that, Thanks a lot.

Brian Duffy So, not in the order that you asked, I'll answer. No discounting at all. We don't discount luxury watches, and we don't see any pressure on that at all either. Either from us or others in the market. We haven't split out jewellery by market, overall, but with regards to the US, there has been, historically, a tendency of an element of discounting. We experienced it when we acquired Mayors, and eliminated it pretty quickly. We've now acquired Betteridge, and we're going through the same process. So, our hope is actually to eliminate discounting, and we're doing that and getting a really good response overall. But we've never given the split of jewellery and watches. And overall, both markets in the US are good.

And with regards to jewellery, as I said, we've got our different positioning from a strategic standpoint. We have commented that we exited the quarter strongly, so that gives you an indication of January. Obviously, the biggest part of the quarter, and the most volatile part of it is the holiday season, and we're pleased, overall, with how we managed to perform during that.

Daria Nasledysheva Thank you.

Harry – Operator Thank you. As a reminder, if you'd like to ask a question, please dial star, one on your telephone keypad now. And our next question is from Richard Taylor of Barclays. Please go ahead now.

Richard Taylor Morning, all. I've got three questions, please. Can you give us some colour on the jewellery split as a percentage of revenue in Q3? I realise it's higher, given the Christmas gifting, but to know the rough Q3 split versus a typical quarter would be useful. Secondly, given your comments and focusing on full price sales on jewellery, can you comment on how margins performed in the quarter, please, versus your expectations? And finally, any comments on the M&A pipeline would be welcomed for US and Europe. Thank you.

Brian Duffy Bill will give you the split.

Bill Floydd Richard, on jewellery, in Q3, it's 10% of the business for jewellery. And in the year, on average, it's 7% to 8%. So, it ticks up for the holiday season, for fairly obvious reasons. I would expect it to be the normal proportion going through the rest of the year.

Brian Duffy And we have improved margins on jewellery, particularly in the US, as I said in answer to the previous question. Eliminating any element of discounting, we have improved margins, exactly as planned. And I'm sorry, what was the third question, Richard?

Bill Floydd M&A.

Brian Duffy M&A, yes. We remain as active as we've been in the US and Europe, and we've always said these deals aren't over until they're over. We get various stages of discussion. And you know we never give any speculative element in our guidance. So, we remain as active. It remains a key part of our strategy, it's a key part of our long range plan, in both the US and Europe. Nothing's changed. And as soon as we have anything done and dusted, obviously, the market will hear about it.

Richard Taylor Thank you.

Harry – Operator Thank you. And our next question is from the line of Natasha Brilliant of Credit Suisse. Natasha, please go ahead.

Natasha Brilliant Hi, thank you. Good morning. Three questions from me, as well, please. Just back to the waitlists, you said there have been some examples of deferral. Can you give us just a bit more colour on these customers, what sort of products or price points they're looking at? I think you said they're recent additions to the waitlist, so if they're getting the call already, does that suggest they're not the most supply constrained watches? That's the first question. The second question, if you can tell us what the overlap is between customers buying both watches and jewellery? And in the short term, if customers are price driven and are, perhaps, shopping elsewhere for jewellery. Is there any risk to the non-supply constrained watch sales? And the last question, you mentioned the Rolex certification programme for pre-owned watches. Can you just tell us a bit more about what the opportunity might be for you in that context? Thank you.

Brian Duffy On the wait list, as I've said, it's just in the interest of full transparency that I've made the comment. We get asked all the time, is there any change? There is this very small change of some customers deferring. They are the products that were most recently added to the list. I think, as everybody knows, with Rolex, there's been this succession, steel professional products, your Daytonas and Submariners that have always been on waiting lists, and then all other professionals, steel products and so on. And the last category that went onto a waiting list was, typically, a ladies' product. So, it is the products that went most recently on the waiting list that are the ones that the guys are making one or two calls about. But just to emphasise, every product that goes in the store is out of the store in very short order.

And I just simply, again, full transparency, wanted to say there's been that very small, slight change that's been reported by some other stores. Watch and jewellery overlap, it's not it's not a big deal at all. Here, in the UK, particularly, not, but in the US, we have some great jewellery businesses, great jewellery clients. And the clients, from time to time, will be buying watches as well. But it isn't really a big deal. We just have some great client relations that we sell the full assortment of product to. And there's no negative impact of jewellery overlap and watches. CPO, we're very positive about the principle and the programme, and what Rolex has done to organise, bringing, I think, discipline, control, and confidence to the category by introducing this certified programme, only available to authorised retailers. like us.

And we think it could be very big, but if there needs to be a scaling up of capacity for servicing, refurbishing, and authenticating product between Rolex and ourselves, that will determine, I think, the pace and the extent of the growth. And we're still working through that detail, but we expect to be fully operating as an authorised CPO seller for Rolex sometime later on this calendar year.

Natasha Brilliant Thank you.

Harry – Operator Thank you. Our next question is from the line of Samson Edmunds of Redburn. Samson, please go ahead.

Samson Edmunds Good morning. Just a quick question. You make a reference, in the statement, to not having seen much of a recovery in the tourist business in the UK, which I find slightly surprising, given where currency was and for the US travellers. I'm just wondering if you could flesh that out a bit. And also, your thoughts as we go through the year, in terms the potential return of Chinese consumers, and where that business stands relative to pre-COVID levels, and what you've assumed in the revenue guidance in terms of recovery in that business. Thank you.

Brian Duffy Good questions, Samson. We obviously have this situation in the UK of no Duty Free shopping. And we can see, very clearly, and we know, and we hear it from all the brands, the evidence that tourism has recovered. But it's particularly recovered in the EU. The big groups that have been travelling and buying are American and Middle Eastern clients, but we know they're choosing to buy in Paris, Frankfurt, and Munich, rather than buying here, in the UK, because of the fact that we're not offering VAT. So, for that reason, we think, more than any other one, we think that it hasn't been a big deal to date. And until the VAT situation is resolved, we are not really including any significant return on tourism in any of the numbers that we're guiding to.

The Chinese business, historically, for us, so the year pre-pandemic, pre-Brexit, the Chinese business was 7% of total Group. It's been nothing since, and it will have been totally domestic. And our sales, around 97% of our sales, UK and US, have been to domestic clients. Once again, the Chinese tourists do plan their itinerary with shopping in mind, and without any doubt, they will plan to spend more time in European cities than the UK, because of the VAT situation. But some will come, of course, and some will shop, of course, but we haven't really included anything of that increment in our guidance at this point.

Samson Edmunds Thank you.

Harry – Operator Thank you very much. As a final reminder, if you would like to ask a question, please dial star, one on your telephone keypad now. And our next question is from the line of Kate Calvert of Investec. Please go ahead.

Kate Calvert Good morning, everyone. Just two for me. The first one is can you give some thoughts on the number of mono-brands openings in FY24 you expect to do in the UK and the US? And the second question is just coming back to the certification of Rolex pre-owned watches. Are you, yourselves, going to be certifying those for Rolex.

Brian Duffy We haven't given the number yet for fiscal year 24. We will do it a quarter from now, when we do our year end update, as usual. But mono-brands remain a part of our strategies, UK, US, and Europe, and we have good momentum, good pipeline, and good discussion of opportunities going on with our brand partners. The CPO question was?

Bill Floydd Are we doing the certification?

Brian Duffy So, initially, and for the foreseeable, Rolex will do the authentication and refurbishment in the UK. It's looking like we might be able to do it slightly differently in the US, but we'll be doing the refurb, they'll be doing the authentication. Rolex, of course, is offering a guarantee on the product, so quite rightly, they are seeing every product. And so, yes, that's how it will be initially. And that's why I said, in answer to an earlier question, we are just working through the logistics of the capacity, the volume, throughput, and so on. There'll be no issue here at all with demand, is our view. And our business will be whatever logistically we can manage through all those processes and get out into our stores. But that's how it's starting out.

Kate Calvert Thanks very much.

Harry – Operator Thank you. We have no further questions in the queue for today, so I'd like to hand back to Brian Duffy for any further remarks.

Brian Duffy Thanks, Harry. Thanks, everybody, for your questions and for joining us. In summary, we really are pleased with our strong performance in Q3. We remain confident in our fiscal year 23 guidance. We're also, going forward, seeing the economic outlook as more positive. And I think the second half year of the calendar year will certainly be brighter overall. Our brand partners continue to invest in product development and marketing. We continue to invest in retail, as do others. We think the category is in great shape. Our team is doing fantastically well. We're all looking forward to Watches and Wonders in March. We think it will be a very positive watch fair all round. And as I say, we’re happy with the quarter and happy with where we're heading for the year, and our big thanks to all of our teams.