Currys – Conference Call

Pre-close FY 2022/23 Trading Update

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Transcript



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Alex Baldock: Good morning, everybody. I'm going to give a quick intro with Bruce and then we can dive straight into your questions. So FY23 was a better than expected performance in what was a tough environment with a poor Nordics performance being offset by solid Greece and a strong and strengthening UK performance. We've been quite attentive to mitigating downside risk and, as we'll talk about, we're pretty prudent on the outlook.

 Let me start with the Nordics, which was a bad year in a very tough market with demand down, inflation up, and vicious competition, and I think it's true to say however we would've responded profits would've been sharply down last year, still we believe we could and should have responded better. We could've spotted those market trends a little faster, costs could've come out sooner, and we could've got the balance of our trading response with a benefit of hindsight a bit better. Now it's still tough in the Nordics, but we're responding better now with decisive action. I'm pleased with the clarity, the grip, and the energy of the new leadership team, we've got a better balance of our trading response between volume and margin, and some good margin boosting initiatives are underway alongside some decisive action on costs, both some in-year tactical cost out as well as some more structural cost reduction which will benefit in future years.

 So a poor year in the Nordics, but a much stronger year in the UK. A strong and strengthening performance, in fact, with profits up over 40% year-on-year and trading better than expected, especially in the last couple of months of the year. That's despite sales being down 7% like for like in the year and market share for the full year did slip more than we would've liked, it was 120 basis points down in the first half, we made some adjustments and it was better in the second half and we did still manage to protect our number one slot, but the big story has been on gross margin and on cost. Gross margins have improved again, I think we said 160 basis points up in the first half, it'll be similar for the full year that after 110 basis points improvement last year, and we can talk to what we've been doing there, doing a better job of selling margin accretive services, especially online, monetising an improved customer experience, not chasing less profitable sales and good progress on supply chain and service operations costs.

 And that's part of a broader story on costs where we're nicely in line with our £300m cost out target and good progress right across, supply chain and service operations, but also store costs, GNFR, and IT and central. So really good performance on costs and on gross margins, a performance that we intend to keep improving. Greece had another strong year, which is a nicely profitable and cash generative business.

Bruce Marsh: Thanks, Alex. Good morning, everyone. I'd like to spend just a moment focused on the balance sheet which remains healthy. In terms of working capital group stock finished in a good position down 10% year-on-year despite high single digit cost of goods inflation. In terms of net debt, last time we guided to between £100-150m of net debt. I'm pleased to say we expect to come in at the positive end of that range at around £100mn. The number was helped by the stronger UK trading that Alex described, which impacted positively both free cash flow and conversion of stock into cash. Average net debt of the year is similar to the year-end balance and we expect that to be the case going forward, and it is worth reflecting on the strength of our balance sheets compared to pre-pandemic, our net debt at £100m compares to £204m 3 years ago.

 Today we have no working capital facilities, our pension deficit is more than halved and our lease liabilities have reduced as we have fewer stores and lower rent. A recent topic of discussion with both shareholders and investors has been our banking covenant fixed charge cover ratio. We expect to finish the year with a fixed charge cover of about 1.9 times for FY23. That gives us a headroom of £40m compared to the covenant of 1.75 times. However, to avoid any concern over future headroom, particularly whilst we get our Nordic business back on track, we've had productive conversations with our very supportive lenders and they've agreed a covenant relaxation for the next three measurement periods. So for October 2023, April '24, and October '24, our fixed charge cover ratio will be 1.5 times and will then revert to 1.75 in April 2025 and that increases our headroom by a further £75m. So our balance sheet's in a healthy place, we want to strengthen it further and in July we'll talk about our cost and CapEx plans for the year ahead.

Alex Baldock: Thanks Bruce. So in a volatile and challenging environment, as Bruce says, we are taking plenty of action to minimise downside risk, which we think is prudent given a still uncertain outlook and we might be surprised on the upside, but we're preparing for another tough environment in FY24. We're not planning on any tailwinds, we're prudently assuming a market that declines for the year ahead, and so our focus in the year ahead is to protect against that downside, risk, to continue the very encouraging UK trajectory, and to get the Nordics back on track. And longer term, if we do all of this, we'll be in good shape. We're standing by our targetof over 3% EBIT margin by FY25 as the Nordics has achieved only last year and the UK is getting close to achieving on an underlying basis now.

 So if we do what we say we do, get that EBIT margin over 3%, keep the balance sheet strong, and that'll leave us in a position to give healthy shareholder returns. But fair to say for the year ahead, we're not counting on any favours from our environment. Laura, with that, we're going to pass back to the group for some questions.

Michael Benedict: Morning all, thanks very much for taking my questions. Just a couple from me, please. Firstly, in the UK mentioned that the performance there has been better than expected, particularly in the last couple of months, I wondered if that's a function of the environment or you're stabilising your market share here, please. And then the second one in the Nordics looks like top line momentum has slowed further, is that a sign of the environment getting increasingly difficult or is that the local team there focusing on stabilising profit? Thanks very much.

Alex Baldock: Thanks, Michael. Let me start and then Bruce may have a couple of builds. The short answer on the UK is it's not attributable to the environment, it's got everything to do with the actions that we've taken. We have stabilised market share since the 120 basis point decline that we flagged in the first half, but the big story has been on gross margin improvement and cost reduction. We've done a better job of selling margin accretive services like credit and care and repair, especially online, we've been able to monetise and improving customer experience especially in areas like delivery charging and NPS has been up again in the year just past. We're not chasing less profitable sales and so things like digital marketing efficiency has significantly improved and we've much more selective on our promotions and we've taken cost out in supply chain and service operations, that in addition to the other cost efficiency measures that I talked about.

 So I think it's been a story of self-help in a tough environment in the UK, which is encouraging because it leaves us in good shape to benefit from any recovery in the macro, not that we're counting on one. In the Nordics, I think, again, I wouldn't say that we're counting on any improvement in our environment, the market still remains very tough. We're still seeing depressed demand, cost inflation is still high and the competition is still vicious, and so we're not waiting for any improvement and we've made the changes that we've talked about in leadership, in getting the balance right, in our trading response between volume and margin and taking decisive action on cost.

Bruce Marsh: The only thing I would add to your question regarding Nordic top line performance, I would say that has been caused by some softening within the macroeconomic environment. Clearly it's not one country, it's four and we are seeing particular softness within Sweden and Denmark which is impacting the group top line and therefore dropping through to profitability. But that is, however, being offset by some great work that we're doing, on the cost base within the Nordic business and some slight improvements that we're starting to see within our gross margin, but the overall trends that are bottom line are consistent with what we saw in the first half because of the slower top line sales.

Operator: Thank you. We'll now take our next question from Nicolas at BNP Paribas Exane. Your line is open. Please go ahead.

Nicolas Katsapas: Hi. Thanks for taking my question. I'm standing in for Warwick Okines at BNP Paribas Exane. I just have a couple of questions. I'll start with Nordics. You've flagged restructuring costs there in FY23. Is there anything to flag for FY24 that might feed into there? And maybe if there's a cash and PBT impact split you could give us, that would be great. And then just on your opex base, how are you seeing the inflationary trends impact your opex for the year ahead? Are you seeing any disinflation, basically, or anything to call out here? Thank you.

Bruce Marsh: Thank you, Nicholas. So in terms of the restructuring, the number that we're talking about when we're talking about restructuring in the Nordic will, from a cashflow perspective, will impact both years. So roughly a third will impact the current financial year. Two thirds will flow into next year when it comes to redundancy payments, et cetera. In relation to inflationary trends, there has been some reduction within inflation, particularly around shipping costs, for example, that were particularly high last year. We've started to see them normalise, but they're still at a high base. We clearly continue to see high levels of inflation within, for example, energy. Although we do hedge forward between six to 12 months on our energy costs, the flow through of increased wage costs continue to impact us. And as we described cost of goods sold, inflation has been a particular challenge, in particular within our Nordic markets, who continue to see weakness within the NOK and SEK currencies against the euro and the dollar. So I'd say those are the key inflationary impacts.

Operator: Thank you. We will now move on to our next question from Simon Bowler at Numis. Your line is open. Please go ahead.

Simon Bowler: Thank you. I'll take them one at a time, I think. Firstly, can you just add a little bit of colour on the mobile debtor revaluation? What drove the best and expected performance there and how are you thinking about that for next year?

Bruce Marsh: Yeah, sure. So the overall debtor revaluation, it is roughly £10m up year on year. So when you look at our profit progression year on year, roughly 10 upside in the UK is coming from the debtor revaluation. The key thing that we're calling out is that, of the value, there's £35m that won't repeat into next year. And there are two reasons for that, Simon. The first is that there's a chunk of it that relates to RPI. So this is where the networks have put up their prices and that creates incremental value downstream for Currys and we expect RPI to normalise going into next year.

 So that is one of the reasons we expect to step back, but there's also a set of the legacy contracts that we have that came through the Carphone estates when it was open. Those customers are now reaching two, three, four years of tenure and they're starting to fall off. So that will mean that there is less value to come from revaluations going forward. In relation to the delta between maybe our expectations, if you assume that there was roughly mid single digits of incremental value that came through network debtor that has caused some of the beat that we're talking about that, that would be roughly right.

Simon Bowler: Okay, great. Thank you for that. And then secondly, just noting on the progress on inventory, can you just add some colour around where that inventory is located? I'm assuming UK is in a very good shape and Nordics would remain overstocked. Is that a fair assumption or is it more balanced across the estate?

Bruce Marsh: No, it's definitely more balanced, Simon. So you'll remember that we talked at last year end about some significant investment that the Nordic business had made and I think we called out £100m of extra stock year on year. Now, that has more than fully reversed. And therefore, when we're talking about a 10% reduction overall, actually, there's a significantly larger reduction within the Nordic compared to that. UK stock holding at last year end was relatively normal, but nevertheless, we've seen that stock continue to fall. Within our Greek business, as you've seen, our like-for-like within Greece has been very healthy. Actually, we've built stock year on year.

Simon Bowler: Great. And then, without meaning to be too greedy, just one final one. And you haven't explicitly repeated your CapEx guidance for fiscal '23, but by indication, does that mean you've come in somewhere around about the £120m you have been guiding to?

Bruce Marsh: Yeah, it's broadly there, maybe a fraction less, but it's broadly there.

Operator: Thank you. We'll now move on to our next question from Adam Tomlinson at Liberum. Your line is open. Please go ahead.

Adam Tomlinson: Morning, all. Just three questions from me, please. I'll give you them all at once. First question is on the UK and noting the improving trends you talk about, particularly in March and April there, just the consistency of those trends, the exit rate, any comment around that, and your overall confidence that the underlying profitability improvement in the UK can be sustained, please. Second question, just on the Nordics, you've previously talked about the situation there in terms of the challenging market being temporary, albeit visibility low on when that recovery comes through. So has anything changed in terms of your view that this should prove temporary over time? The final question, just on the balance sheet, the fixed charge cover covenant renegotiation there, sounds like that's happened in pretty short order. So just any comment you can give around how smooth those discussions with the banks were and a reminder of how many banks are in the RCF that would have agreed to that renegotiation. Thanks very much.

Alex Baldock: Thanks, Adam. Let me lead off with the first two and then Bruce can take the third. We are quite pleased with the recent months trading in the UK, yeah, and that's evidenced in a market share decline that improved during the second half. So we're happier with the market share trends. But again, the big story in the second half, as for the full year, has been on the gross margin improvement and the cost outside.

 Are we confident we can keep the underlying improvements going? We are because we see a lot more mileage, both in the big picture, which we can come back to in July, the continuing improvements in colleague engagement, and customer satisfaction, and retail fundamentals, and in the big differentiators of omnichannel and services, but then in the specifics of we see a lot more mileage in doing better at selling services, especially online. And we've got the platform to do that now. We intend to continue the improvements in the customer experience and give us further scope to charge for them, as we get a better understanding of end-to-end profitability. So we'll be less and less tolerant of chasing any unprofitable sales and we've got significantly further mileage to go on supply chain and service operation cost efficiency. So we're confident of that.

 We're also confident that we're at least in line with the £300m overall cost target. We expect to beat the £170m cumulative cost out for FY '23. And whether you look at supply chain and service operations costs on continuing store cost efficiency, on better improvements in our procurement for GNFR, or an IT and central cost efficiency, we see further scope with all of those. So we are confident we can keep that progress going in the UK, even without any help from what's been a pretty challenging environment.

 On the Nordics, with the benefit of hindsight, I probably wouldn't use that word temporary again. I think we've seen a really tough market right the way through the year and we're not calling an improvement right now. Equally, do we see anything structural and permanent in these market challenges? We don't. These are fundamentally healthy and wealthy markets. The fact that consumer confidence is currently at a 40-year low across these markets, do we expect that to continue? We don't. The excess stock from some competitor buys is selling through and, at some point, economic gravity will reassert itself and these competitors will need to make some money, which none of them are at the moment. Are we calling a time on that? We're not. And we're being more prudent in our expectations there. What I am pleased with is the energy and the clarity and the grip that the new leadership team have shown. I'm pleased we're getting the trading balance better between margin and volume. And I'm pleased that the cost out, in particular the structural cost savings which will flow through into FY24, have been well delivered. But we're not giving a particular time on a Nordics recovery, no, Adam.

Bruce Marsh: Morning, Adam. So in terms of the banks, we have eight banks within our banking syndicate who provide our revolving credit facility. And I'm sure you can imagine we provided them with comprehensive information about current performance and outlook. There was a robust set of questions as they went to their investment committees for approval, but we got unanimous support. So there was no challenge to that.

Adam Tomlinson: Great. That's very clear. Thank you very much.

Operator: Thank you. We'll now move on to our next question from Ben Hunt of Investec. Your line is open. Please go ahead.

Ben Hunt: Morning, there. Sorry, most of my questions have been answered, but I just wanted to retouch back on the last question regarding the exit rate and the gross margin in March and April. I don't know if I've got my maths wrong here, but I think you alluded to sort of 160 basis points after the second half, and if I remember rightly, at peak it was up 240 I think. So it feels like you've lost a bit of a momentum there in the final few months. Is that correct or, if so, why? Or anything you can sort of give any colour there.

Alex Baldock: Yeah, the short answer, Ben, is we flagged for the whole of the first half 160 basis points up, and we're flagging the similar for the second half. So no, we're not concerned about a loss of momentum. In fact, we're pleased with the progress that we're making on services, on the customer experience, on chasing less profitable sales and on supply chain and service operations costs, and we're confident that we can maintain that into FY24.

Operator: Thank you. We'll take our next question from Richard Chamberlain at RBC. Your line is open. Please go ahead.

Richard Chamberlain: Morning. Yeah, just a couple from me please. I just wondered what your thoughts are on the Nordic competitive environment right now. So any sense we've passed the worst? I guess we've had some belated support from the government coming through for consumers and so on for energy and so on, but how do you see the competitive environment there? And then back on the UK, I appreciate this is only a sort of pre-close update, but can you give a bit of colour on mix effects on UK margins or either store recovery versus online, or indeed product mix? So if either of those two things had a significant effect on the UK margin. Thanks.

Alex Baldock: Bruce, do you have anything to say on the second of those questions today?

Bruce Marsh: No, we're not going to talk about channel mix today overall. We'll come back and talk about that more in July, Richard.

Alex Baldock: And on your question on the Nordics competitive environment, the short version is it remains vicious and we're not calling it getting any easier right now. The competitors vary a bit, market by market. As Bruce points out, there are several markets in the Nordics, but whether you are looking at people like Bilka using Apple products as loss leaders in Denmark, whether you are talking about POWER apparently not caring if they make any money or not in the Danish market, or whether you're looking at NetOnNet, Komplett, and now POWER again in Sweden, or Verkkokauppa in Finland, the short version is that the market profit pool ex Elkjøp in the Nordics, has gone to zero. And those listed competitors who are reporting, that's what you see in their results.

 Now at some point, as I say, economic gravity will reassert itself and whether they're private or public owners, will presumably want them to make some money at some stage. But we're being pretty cautious about calling a time on that. I think what we are focused on is what's within our control. And what's within our control is making sure that our trading response is well-balanced. Bruce talked about some of the margin, some of the very early green shoots that we're seeing on margin. Again, we're not getting carried away with that, but we are doing a better job of selling higher margin accessories and services in the Nordics, just as we are in the UK. We're monetising a better customer experience with things like delivery charging. We're not chasing less profitable sales in the Nordics, just as in the UK, with our better understanding of end-to-end profitability. We're not having to, and we're also taking supply chain and service operations costs down in the Nordics.

 On the cost side, we've taken some tactical initiatives, whether it's taking marketing down and promotional intensity down, or getting rid of contractors and outside consultants, and making circa £25m a year of structural cost improvements that we would expect to see flow through. So those are the things that are within our control and that's what we're focused on doing. What the competitors do is ultimately up to them. But we're not calling an easier competitive environment, no.

Operator: We'll now move on to our next question from Tony Shiret at Panmure Gordon. Your line is open. Please go ahead.

Tony Shiret: Thanks very much. Morning, Alex. Morning, Bruce. It's just a quick question for Bruce. Just circling back round the question on the mobile debtor re-evaluation. I must admit I was under the impression that that would normally be classified as an adjusting item rather than the headline PBT item. I just wondered is it equivalent to the £22m last year, and if so, is it included in the headline PBT guidance or is it going to be an adjusting item this year?

Bruce Marsh: No, this is an underlying item, Tony. So we do have very clear accounting distinction between those network debtor items that go through non-underlying versus those that go through underlying. All the items that we're talking about today are part of underlying and they all relate to customers who are live and have live contracts with us, which by definition means they're part of our underlying business, and does equate to the £22m we talked about previously.

Tony Shiret: Sorry, it does equate to the £22m?.

Bruce Marsh: Yeah, it's comparable.

Tony Shiret: But the £22m was an adjusting item last year.

Bruce Marsh: No, if you look back through the waterfall, unfortunately there were two £22s. There was one that was showing us underlying and there was one that was showing us non-underlying. So apologies, I misunderstood which one you were talking about. But no, this is definitely underlying.

Tony Shiret: Okay, thank you.

Operator: We'll now move on to our next question from at HSBC. Your line is open. Please go ahead.

Paul Rossington: Good morning. Thank you. I'm sorry to labour the point about the Nordics, but I was just wondering what would actually need to happen or how bad would it need to get in the Nordics for you to consider whether you actually need to be in that market anymore or not? Is there a point, or where do you potentially draw a line or might you kind of consider drawing a line and simply exiting the market because it does otherwise distract from the investment case? Thank you.

Alex Baldock: No, we're nowhere near that point, Paul. If we step back, it's important to remember that bad though this year has been in the Nordics, that this is a fundamentally very strong business in a fundamentally very attractive market. In terms of spend per capita, Norway, Denmark, Finland and Sweden are some of the most attractive, and have been for decades, some of the most attractive markets in the world. And yes, consumer confidence is going through a particularly torrid time in the Nordics at the moment, not helped by the fact that two of those countries share land borders with Russia and the third's just joined NATO. So you can see the geopolitics of what's going on.

 But I don't think any serious commentator expects consumer confidence to stay at a 40-year low. No serious commentator expects the current pressures on consumer spend from inflation and from unprecedented interest rates to stay as high as they are. We expect these fundamentally healthy and wealthy markets to come back, and when they do, we'll have a healthy business. Deeply disappointing, though these results in the Nordics are, we are the only player making any money there at the moment and we've got over a quarter of the market. So I think there is an element of nerve holding here that we need to believe that we've got a fundamentally healthy business that's going to come back to make the very material contributions that it's made to the group for over a decade previously. Now, that said, we're not just sitting waiting for that to happen, and that's why the leadership changes, the actions on margin, the actions on cost are so important to take control of our own destiny here rather than sit and wait for the markets to improve. So, no, to answer your question Paul, that's not under consideration.

Operator: We'll now move on to our follow-up question from Simon Bowler at Numis. Your line is open, please go ahead.

Simon Bowler: Hi. Thank you. Sorry, me again. Two quick ones. I'll, again, just take them in turn. First one, Bruce, just coming back to that idea of rolling off of some of the Carphone, old legacy Carphone contracts, is there anything from a working capital perspective that we should be thinking about across fiscal '24 as that dynamic works through?

Bruce Marsh: Simon, there is detail we can get into, but I'd prefer to leave that till July. And at that point of course we'll be providing you with a breakdown of our working capital year-on-year. You'll see the movements in the network debtor, and it'll be much more straightforward to describe at that point.

Simon Bowler: Cool. That's fine. And then the second one was, could you just comment the relaxation of covenant, does that come with any restrictions around dividends? And I guess either way, in the context of, as you mentioned, strengthening the balance sheet, can you just talk about how you feel about shareholder return as the Nordics works through its challenges?

Bruce Marsh: Yeah, so there is no restriction within the change to the covenant, and we will come back and talk again regarding the dividend in July. The board will make a decision on what our strategy with dividend is at our July board meeting. So we'll come back to you at that point, and at that point we'll talk more broadly about returns to stakeholders.

Simon Bowler: Great. Thank you very much.

Operator: We'll move on to our next question from Nick Coulter at Citi. Your line is open, please go ahead.

Nick Coulter: Hi, good morning. One left from me please. On the UK consumer, could you talk about how you see the UK consumer and how the behaviours evolved since you last updated? Any colour around pricing points and the consumer's acceptance of pricing will be helpful. Thank you.

Alex Baldock: There's a few things in there Nick. The big picture on the UK consumer is that they remain hard-pressed by the cost-of-living crisis and that's playing through into relatively depressed demand for discretionary and big ticket products. And that's placed downward pressure on the technology market, and that hasn't changed, and we're still seeing consumers being very careful with their spending. Consumer confidence may be up on where it was a couple of months ago, but it's still at historically pretty low levels, and the consumers remain cautious about dipping into what are for this stage of the cycle, still quite high levels of retained savings. So we're not seeing the consumers open their wallets in a carefree way at all, which is one of the reasons that we are remaining cautious in our outlook. As I mentioned, we're assuming that the next 12 months see the tech market in the UK continue to go backwards, and we might be pleasantly surprised on the upside, but we're not depending on it.

 So that's the big picture. Specifically what are we seeing? We're seeing consumers lean more on credit to afford the technology that they need. We'll give some more detail on that in July, but we've had a strong year with our credit offer, is the first thing. The second, the consumers are certainly chasing a deal and they're looking for help with the affordability of their tech with mechanics like trade-in. Consumers are concerned to see their expensive technology last longer, which is where our big repair business has had another strong year. Again, we'll give more colour on that, more detail on that in July. And getting into a bit more detail in, and to give one example out of the world of TVs for example, we're seeing a squeezed middle, relatively healthy sales of the entry level under £500 TVs, healthy sales of the premium large screen TV over £1,200, both of those have been in good shape, but in between, the £500 to a £1,000 mid-market has had a tougher time both across the market and we've seen that reflected in our own sales.

 We've seen consumers buying more of energy saving devices, whether it's heat pump tumble driers, whether it's more energy efficient washing machines, whether it's microwaves, or air fryers, we've seen all of that. So those trends remain constant. So the UK consumer is still in a cautious space and we remain cautious in our outlook.

Nick Coulter: That's helpful colour. Thank you.

Operator: There are no further questions. Thank you. I'll now hand it back to Alex Baldock for closing remarks. Thank you.

Alex Baldock: Thanks Laura, and thanks everyone. Just in closing, this is a better than expected performance and a tough environment. We're pleased by the progress and the continuing momentum in the UK. We're determined to get the Nordics back on track after a poor year, and to continue the strong momentum in our Greek business. And for the year ahead, we're going to continue that momentum in the UK, we're going to get the Nordic back on track. We're going to do all the things we've talked about in a volatile and challenging environment to mitigate any downside risk and build financial resilience, continue to build financial resilience into the business facing an uncertain year ahead. But we stand by our long-term ambitions and remain confident in delivering them. Thanks everyone, and have a great day.