SMCP – 2020 H1 Results

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SMCP - 2019 H1 Results

Operator: Hello, and welcome to the SMCP H1 Results Call. My name is Courtney, and I'll be your coordinator for today's event. Please note that this conference is being recorded, and for the duration of the call, your lines will be on listen-only. However, you will have the opportunity to ask questions. This can be done by pressing *1 on your telephone keypad to register your question. If you require assistance at any time, please press *0 and you will be connected to an operator.

And I will now hand you over to your host, Célia d'Everlange, to begin today's conference. Thank you.

Célia d'Everlange: Thank you. Good morning, everyone. This is Célia d'Everlange, Head of IR of SMCP. Thanks for being with us today for SMCP H1 results. I'm here with CEO, Daniel Lalonde, and CFO, Philippe Gautier.

As usual, we will go through the presentation, and then we'll have the Q&A session. Before I hand it over to Daniel, I invite you to go through our usual disclaimer on page 2. Please note that unlike otherwise stated, all results reported in this document, so for H1 '19 and H1 '20, are under IFRS 16. And I think Daniel that we can start now. The floor is yours.

Daniel Lalonde: Thank you. Thank you, Célia. Good morning, everyone. Thanks for being with us today for our H1 results. I'll begin with a quick overview of the H1 results, and Philippe will detail this before we conclude.

So as you've seen from the press release this morning, H1 results were meaningfully impacted by COVID-19 pandemic. However, the operational performance was above our expectations, thanks to better-than-expected sales performance and a stronger impact from our cost savings plan. Back in July, you saw our sales numbers. As a reminder, we talked about a minus 33.1% of reported growth and a minus 33.5% in organic growth. Once again, organic growth is excluding De Fursac and at constant currency.

This performance includes:

- a gradual improvement throughout the second quarter on the back of store reopenings from 20% of stores opened at the end of April to 97% at the end of June;

- also from the continued recovery in mainland China, which returned to positive growth in June.

- And last, a strong acceleration in e-commerce in Q2 with a 32% growth in sales.

In terms of profitability, the adjusted EBITDA stood at €55.1 million, i.e., a 14.8% margin while adjusted EBIT came in at minus €29.7 million, which is the result of a drop in sales combined with a reduction of gross margin. This was particularly offset by a strong cost saving measures, which generated more than €60 million in savings versus LY and enabled us to rapidly variabalize more than 50% of operating costs on a comp basis.

Net income stood at minus €88.5 million in H1 versus €17.2 million in H1 19. This result includes €42.6 million of goodwill impairment on Other brands, the division which includes Claudie Pierlot and our recent acquisition De Fursac, impacted by the pandemic.

Pre-tax operating Free cash flow came in at minus €49.4 million, including a reduction in CAPEX versus last year and a relatively limited increase of our operational working capital.

And finally, net financial debt stood at €455.1 million, representing a leverage ratio of 5.5x excluding IFRS 16. Importantly, we secured our liquidity position with €219 million of cash at the end of June following the negotiation of €140 million state-guaranteed loan and a reset of our covenants for 2020 and 2021.

Moving on to page 5. I just wanted to quickly remind you of our H1 numbers by region. In France and Europe, sales were down respectively minus 33.8% and minus 33.5% on an organic basis, in line with the Group average. The performance reflects a gradual improvement throughout the second quarter in line with stores reopening even if tourism flows remain largely absent.

In the Americas, sales were down 45.5% on an organic basis, showing a greater impact from the crisis as most stores remain closed in that region until the end of June.

And finally, in APAC, sales were down minus 26.6% on an organic basis showing a sequential improvement throughout the second quarter. This performance reflected a good resilience – strong resilience in mainland China, which returned to positive growth since June and this trend continues, and some contrasted trends in the rest of Asia.

And now let me turn over to Philippe, who can take you through the numbers in more detail.

Philippe Gautier: Thank you, Daniel, and good morning, everyone. So moving to slide 7, let's focus on our operational performance.

Our adjusted EBITDA decreased from €141 million in H1 19 to €55.1 million in H1 20, performance above our expectations. On the one hand, we saw a drop in sales combined with a reduction of 4.8 points of the gross margin to 71.5% due to an increasingly promotional market, and to a lesser extent some inventory depreciation.

On the other hand, we managed to partially offset these impacts through strong cost saving measures, which generated more than €60 million of OPEX savings on a comparable basis, i.e., not counting De Fursac. Here, we are talking about our operating costs excluding the effects of the IFRS 16 restatement.

This means that with a minus 33.5% organic sales in line and a reduction of 19% of our operational cost, meaning store costs and SG&A. We have been able to rapidly variabalize more than 50% of our expenses. As Daniel mentioned, it is better than what we were expecting in terms of adjustments of our store costs in particular during the lockdown period.

It has been achieved through the renegotiation of commercial leases and minimum commissions with department stores, in all regions, the use of temporary and unemployment measures, a strict optimization of working hours in our network and SG&A optimisation (overhead costs and discretionary spending).

Now if we move to the net income on page 8. You have an overview of the main components of the P&L for H1 2020. Starting with the adjusted EBIT, which stood at minus €29.7 million versus €66.5 million last year.

Second, non-recurring expenses, they reached minus €46 million. And it's primarily due to a goodwill impairment of €42.6 million on the Other brands division resulting from the current

COVID-19 crisis. This depreciation concerns primarily our recent acquisition, De Fursac, and has been caused by the timing. The COVID-19 pandemic arrived just a few months after the acquisition. And then a more prudent approach adopted by the Group for its investment and its international opening plans over the coming years.

Financial charges were down from minus €28 million in H1 '19 to minus €14 million in H1 '20. If you remember last year, financial charges including minus €12.6 million of one-off repayment charges. Excluding as well IFRS 16, our cost of debt was down from €9.1 million in H1 '19 to €6.5 million in H1 '20 showing a continued optimisation of interest cost from 4.1% last year to 1.8% this year.

Finally, income tax stood at plus €6.3 million, taking into account the non-deductibility of the goodwill impairment charges and part of the LTIP charges. Consequently, our net income stood at minus €88.5 million in H1 '20 compared to plus €17.2 million in H1 '19.

If we talk about cash, and this is on page 9. In H1 '20, our pre-tax operating free cash flow stood at minus €49.4 million. This result is better than our expectations and comes from three drivers. One, an adjusted EBITDA of €55.1 million and a lease payment of €61.3 million, i.e., net minus €6.2 million. Then CAPEX stood at minus €29.1 million in H1 '20. As you know, as part of our COVID-19 action plan, we have decided to reduce significantly our CAPEX. They were reduced from minus €33.9 million last year to protect our cash position.

Now H1 is still impacted by timing effects, so the CAPEX reduction will become increasingly visible in H2 '20.

Finally, change in working capital was relatively limited at minus €9.3 million. This is based on an increase of our operational working capital from 16.8% of sales in H1 to 22.3% of sales in H1 '20. Thanks to the strong effort to manage inventories, we recorded a moderate increase of 12.3% versus H1 '19 of our inventories and plus 6% versus December '19 if we consider the sales deterioration during the half year.

Again, all the actions we have taken, setting up to control our stocks in H1 '20 should be increasingly visible in H2 with the last reduction of our merchandise purchase for winter '20 season.

Moving to slide 10. Few comments on our debt. You can see that our leverage ratio increased clearly from 2.2 times in H1 '19 to 5.5 times at the end of June '20. Net financial debt stood at €445 million versus €387.4 million at the end of December '19 impacted by the operating free cash flow of minus €49.4 million.

As you know, in H1, we strengthened our cash position and increased our financial flexibility with the negotiation with all our bank partners of a state guaranteed loan of €140 million, a suspension of financial covenants for fiscal year '20 and that's a holiday covenant. And the easing of financial covenants for fiscal year 2021 as well.

So with this financial structure in place, we have today a very comfortable cash level €219 million at the end of June to face the current context.

On slide 11, you have highlighted the main impacts of IFRS 16. As of June 2020, we record on our balance sheet an impact of €492.4 of lease commitments and our P&L reintegration of up to €61.3 million of lease charges in our EBITDA.

Daniel Lalonde: So, in conclusion, I am strongly convinced that we are today well equipped to face this challenging period. We benefit from the well diversified business geographically with strong brands showing a solid traction with the Chinese consumers. We are well positioned to leverage e-commerce, a key area for us, one that we've been investing in since 2015.

We've quickly put in place an action plan to mitigate the effects of COVID-19 as the benefit shows in H1. We can rely on a solid financial flexibility to continue to weather the storm. And finally, we are an agile organisation, leveraging what makes my team unique: a truly entrepreneurial spirit.

In parallel, we continue to pursue our journey focusing on key priorities and shaping SMCP in a changing world, which includes enhancing the desirability of our four brands, accelerating sustainable fashion, creating one unified channel by right-sizing our brick-and-mortar network while boosting digital and omnichannel services. And last, strengthening our unique business model.

So, thanks for your attention. And we are happy to take questions.

Célia d'Everlange: Thank you, Daniel. Operator?

Questions and Answers

Operator: Of course. So as a reminder, if you would like to ask a question on today's call, please press *1 on your telephone keypad. Please ensure your line is unmuted locally and you will be advised when to ask your question. So *1 on your telephone keypad. Our first question comes in from the line of Chiara Battistini calling from JP Morgan. Please go ahead.

Chiara Battistini (JP Morgan): Good morning. Thank you for taking my questions. The first one is if you could actually make any comment on current trading on the trading of the last couple of months, so Q3 so far?

And the second question is on the cost savings that you have achieved in H1. How much would you say we can expect to be repeat in the second half of the year and how much is more structured, or said in another way, are there any measures you took [inaudible] from placing the linear cost structure going forward? Thank you.

Daniel Lalonde: Okay. Thanks Chiara. Listen, I'll take your first question, and Philippe your second. What I can say about current trading, I think it's the question today. I'll just say a few words. Let me say about four or five quick points.

So first of all, I can say we have a sequential improvement in sales since April, which means that July is better than June and August is better than July.

Secondly, mainland China has been positive since June every week and this trend is also improving. I'd like to say also that we had a positive like-for-like in mainland China since June.

France has been more resilient, much better than the trends in Q2, so that's good news. There has been a calendar change as you know on the sales period, which were pushed two weeks this year versus LY, starting in mid-July versus end of June last year.

Europe is more contrasted. We see some – Germany is resilient on a better trend and continues to outperform markets like Spain, the UK and Italy. And last, North America is still very tough market, given the current climate, particularly in the US versus Canada. So that's what I can share with you. And Philippe, I'll let you answer the second question.

Philippe Gautier: Sure. Hello Chiara. So, in terms of cost savings, as you saw, we have reduced our cost – our opex by 19% on a comparable basis, so that both on our store cost and on our SG&A. So, I would say there are probably three main components in there. You have one-third or a bit more, which is like rent release negotiation or reduction in commission, including negotiation of removing any minimal guarantee or the commissions with department stores, so that's a bit over one-third.

And you had everything related to temporary unemployment and adjustment of our network, so that's another third. And then the rest is all the other measures, structural measures in terms of reduction of SG&A, be that on overhead compensation, hiring freeze or discretionary spending. So, what I would say it's a very large reduction in H1, also considering they are variable cuts, which are reducing with very large reduction of the sales.

If we project to H2, we probably will have as much savings in terms of store costs on some of the variable elements and particularly on the temporary unemployment, which will be much less significant. But then we will continue to see savings on the – more on the SG&A part. So we will continue to see savings but not obviously at the level we saw in H1 as the topline improves.

Célia d'Everlange: Operator, do we have another question?

Operator: The next question comes in from the line of David Da Maia calling from CIC. David, please go ahead.

David Da Maia (CM CIC): Yes, hello. Thank you. So, my two questions are already asked by Chiara. So, I have no further question. Thank you.

Célia d'Everlange: Okay. Thank you, David. Operator, do we have another question?

Operator: The next question comes in from the line of Kathryn Parker calling from Jefferies. Kathryn, please go ahead.

Kathryn Parker (Jefferies): Good morning. Thank you for taking my questions. So, my first question is on the department store commission. And I wondered if the decline in the commissions paid is in line with the decline in sales, or if you manage to maybe renegotiate for a lower proportion or commission and whether the department store concessions performed in line with the freestanding store.

And then my second question in on the inventory write-down versus the impacts, of greatest discounting and whether you could – just give a bit more clarity on how much of the write-down occurred and which collection did it apply to? Thank you.

Daniel Lalonde: All right. Thank you, Kathryn. Like the first question, like Chiara's question I'll take the first part and I'll let Philippe answer the second. So regarding department stores, as you know, we're all in variable commissions with department stores. It's an important channel for us and worldwide, and we typically are in the accessible luxury segments of department stores, the big traffic drivers and the leaders in practically all the department stores in the world in our segment. So it's an important channel.

The question was do we have new rates essentially. I'd say it's something that we do on a regular basis. So, we've been negotiating – we continue to negotiate with department stores even before COVID with some good results actually. So, we've set with some of our key department stores new commission structures that were already in place prior to COVID. I don't think that we accelerated that in COVID because we were already on this prior to COVID. We have – as Philippe mentioned earlier, we have very, very few guaranteed margins with department stores. It's mostly a variable business for us.

In terms of performance versus freestanding stores, I'd say we had slightly lower performance overall in department stores, mainly because a lot of the business from our department store channel comes from big department stores in key cities, which were more meaningfully impacted by the lack of tourism. So, I'd say slightly less than freestanding stores, mainly due to tourism. Philippe?

Philippe Gautier: Hi Kathryn. So to your question on the gross margin, as you saw, we had a reduction in the gross margin of 4.8 pts points versus last year, which was a bit better than our expectation actually. Two components in there, the most important one is clearly the discounting. We had higher discounting – discount rates around 35% over – a bit over 35% in H1. Clearly, the market is much more promotional, and we did also more digital, which is a more promotional channel. So that's quite logical and it's like really unprecedented times.

And then in terms of inventory depreciation, it's roughly 1 point of margin on inventory depreciation the impact on this year. So what I would stress like we're on track in terms of inventory, our stocks is pretty sound. As you know, we have taken some strong measures, so the impact is significant but it's not that huge in terms of inventory depreciation.

Kathryn Parker: Thank you, Philippe.

Célia d'Everlange: Operator, do we have another question?

Operator: The next question comes in from the line of Geoffroy Michalet calling from ODDO BHF. Geoffroy, please go ahead.

Geoffroy Michalet (ODDO BHF): Hello. This is Geoffroy from ODDO. Thank you for taking my questions. I have two. The first one relates to the impairment on Claudie and De Fursac. I was wondering why this impairment is mostly to Claudie and De Fursac and not to the other brands, since in H1 at least the growth trend was quite similar on all the older brands. So, is it an expectation of a slowdown in those two brands?

And the second question is on the promotion rate that you expect in H2, because I've seen on the many websites that the promotions are quite aggressive. I don't know if you could comment a bit on that? Thank you – and for the gross margin. Thank you.

Philippe Gautier: Sure. Maybe on your first question, I would say, the impairment relates mostly to De Fursac. The key difference with the other brands from an accounting point of view is that the other SMCP brands, they are valued based on the acquisition price defined by Ruyi in 2016, whereas De Fursac is valuing our books based on the acquisition in September 2019.

Therefore, at high value. So, we did not have time yet to develop De Fursac before the COVID-19 pandemic started, which is different from Sandro and Maje, where we had several years of growth in the meantime. So that's the major difference.

Daniel Lalonde: Promotional rates?

Philippe Gautier: In terms of promotional rates, yeah, I think this year is really peculiar with very challenging context in general. So, we can expect that all the players in the market they tend to have higher inventories compared to what they would wish. So that is to clearly a more promotional market. And I think the customers, they are responding to it. Also this combined with higher activity on e-commerce, which is more promotional. So you could expect this promotional activity to continue, now maybe it was a bit high partially in H1 but that will continue.

Daniel Lalonde: And maybe just to add a point Geoffroy to this. Our strategy is very, very clearly to sell more at full retail. That's the path we were on prior to COVID. That's the path we're going to get back on as soon as we can.

In terms of calendar as well, I can share with you a few things. In terms of the promotional calendar on a regional basis, it's not different than last year. Maybe the deepness of some of the promotions or the discounts are a little higher, but in terms of promotional cadence and calendar in terms of days, it's identical to LY. And again, I repeat, our goal continues to be with all my CEOs and company all the brands, is to sell more at full retail. That's our company goal.

Célia d'Everlange: Thank you. Operator?

Operator: The next question – of course, the next question comes in from the line of Murielle André calling from HSBC. Please go ahead.

Murielle André-Pinard (HSBC): Thank you. Good morning, everyone. Most of my questions were asked but maybe one more on working capital. Could you give us a bit of colour on the impact of the payment delay in terms of potential charges in France? And what we can expect on the side for H2?

Philippe Gautier: Right. Yeah. That's a very granular question. Maybe what I can do, I can answer to you in terms of the trade payables in total. We have seen a trade payable reducing significantly, therefore they did see the impact on our working capital. This relates to the very big adjustment we do on our merchandise structures for H2 and for the winter '20 merchandise. So with a negative impact on our working capital clearly.

And then I would say you have different impact on the other assets and liabilities and non-operational working capital, which is fairly stable versus last year. So, if I look at the various components in terms of working capital, so I talked about inventories, which is up 12% versus June last year or at 6% versus December. And here we did some progress particularly in Asia for example it's the inventory is less than last year, so we're given happy about that.

This is despite considerable timing impact in France because you have the shifts of the sales period which only occurred in July. And we still have actions on that. Other items, trade payables, we have been quite successful in there, reducing our – sorry, our trade receivables, sorry, we have been successful in reducing our trade receivable even in a tough context. And then as I mentioned, negative impact on trade payable due to the reduction in purchase.

Célia d'Everlange: Operator, do we have another question?

Operator: The next question comes in from the line of calling from Alexander Casas Associates. Alexander, please go ahead.

Speaker: [Foreign Language]

Célia d'Everlange: [Foreign Language]

Speaker: [Foreign Language]

Célia d'Everlange: So, the first question is related to the split of the goodwill impairment between Claudie Pierlot and De Fursac. Do you want to answer?

Philippe Gautier: Sure. So one comment that we are reporting on the "other brands" division that our segments reporting and that is composed of De Fursac and Claudie Pierlot, so that's the choice that has been taken in terms of reporting to the market and then we can't change that. To answer to your question, let's say, you had about three quarters of the effects which relates to De Fursac and the rest is Claudie Pierlot. Clearly we had a timing effect, we could not anticipate the COVID-19 pandemic when we did the acquisition of De Fursac.

And I would say the situation is we're taking a more prudent approach in terms of international rollout and in terms of investments, that's what we do in general in the Group, given the pandemic, but it impacts more De Fursac because that's where we have the most significant expansion plan. So, we continue to have the expansion plan, the things is that they are a bit delayed in timing. And that's where – there's an impact on the DCF calculation and the goodwill.

Speaker: [Foreign Language]

Célia d'Everlange: Unfortunately, we cannot communicate that because it's not in the press release. What we communicate is, "other brands", what we can say on De Fursac is that the performance for H1 was below SMCP performance due to the strong exposure to the men category, which has been a bit more affected than the women category, and to a lesser exposure, to e-commerce. So the only thing that we can give you is a qualitative comment, the decline is more important for De Fursac than the rest of the Group.

Daniel Lalonde: And maybe on the last – listen, the last question, if I heard it correctly, about the network. A few words on the network, so where we're at today, is as I mentioned earlier, our plan going forward will be largely based and focused on investing to develop like-for-like growth. We will continue to space growth but at a lesser pace than in the past.

If I look at it by region, I'd say in France we're still on the working on in fact day-to-day on the optimisation of our network. We've had some net closures this year. We'll continue to have some net closures. So we've done a bottom up approach for France as if we had started today, what would be the ideal distribution and we're working towards that. So it will be optimised which means less stores in France.

On the international front, so we're pursuing a selective opening programme in Europe, in the US and with the big focus on continue to develop our network in mainland China, where we see a lot of potential and opportunity.

Célia d'Everlange: Okay. Thank you, Daniel. I think we have some question. Operator, two last questions.

Operator: The next question comes in from the line of Marie Fort calling from SG. Please go ahead.

Marie-Line Fort (Société Générale): Good morning. Just a quick question on CAPEX. Could you guide us for the CAPEX spent for the year, please?

Philippe Gautier: Sure. So as you saw, in general what we expect is to have a reduction of CAPEX around 30% for the full year. We have a little bit of timing because the decision we took, they are impacting more H2. So that's why you don't have too much of the benefit yet on H1, then you will have the biggest part of the benefit on H2.

And just to mention, this is a rreduction in CAPEX which touches a bit all our CAPEX. So obviously reduction in our expansion, in number of new stores in the year, as well as a reduction in terms of different projects even if we continue to prioritise the very important ones mostly related to digital.

Célia d'Everlange: Thank you, Philippe. Operator?

Operator: The final question comes in from the line of Chiara Battistini calling from JP Morgan. Please go ahead.

Chiara Battistini: Hi. Sorry, just a very quick follow-up question on your comments on promotional activity in the second half of the year. Did I get it correct that your second promotional activity to stay elevated by not as much as H1, or should it be similar to H1? Thank you.

Philippe Gautier: I think the environment is going to be similar to H1 [inaudible]. I mean, [inaudible] exactly to what's going to happen. So but I would say in general we will continue to be quite promotion. But then you have technical aspect which is the shifts of the sales period in France from H1 into H2.

Daniel Lalonde: Yeah. So Chiara, again it will depend a little bit by region as I announced the trends on your first question on current trading, we're seeing some positive like-for-like in China, which is since June which is very encouraging. Listen, we won't – we'll – we won't have a more promotional calendar than LY in terms of dates, etc., etc. In some markets, I think we'll have slightly deeper discounts. But really the – so I think this is what you can expect a little bit the same in H1 with maybe the caveat that in China a little bit less.

And quickly we're resuming back to our overall – one of our overall strategic points is to sell more at full retail which is really, really important for us.

I think that's it Célia from a questions point of view. So we have no more questions.

Célia d'Everlange: No.

Daniel Lalonde: So we'd like to – listen, we'd like to thank everyone for all your questions today. And listen, we wish you a very nice day, very nice weekend.

Célia d'Everlange: Thank you. Bye-bye.

Operator: Thank you for joining today's call. You may now disconnect your handset.

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