Dr. Martens FY22 Results

June 1, 2022

Kenny Wilson:

Good morning, everyone. Thank you for joining us today, both in person, it's great to have an in-person audience again, and on the webcast. I'm Kenny Wilson, the CEO of Dr. Martens, and I'll be joined today by Jon Mortimore, our Chief Financial Officer. Also, in the audience we have Paul Mason, our Chairman and Emily Reichwald, our Chief Legal Counsel. I'm sure that most of you know Bethany, our IR Director. Well, Bethany is off on maternity leave in just a few weeks. So, I'm also pleased to welcome Mark Blythman today as our interim Head of Investor Relations. And if you've got any questions in the weeks ahead, then please reach out to Mark.

So, our agenda for today. I'm going to talk us through the key takeaways for financial year '22, and then Jon is going to pick up and take us through a detailed review of our financial performance. I'll come back to talk about strategic performance, but probably more importantly, why I feel really confident about financial year '23, the year ahead, and even more importantly, our confidence in the years beyond.

So, the big takeaways from the year. Financial year '22 demonstrates that our DOCS strategy is delivering. We're selling more pairs of boots, shoes, and sandals to more consumers through our own channels in our key priority markets. Our growth, as we've always said, is direct-to-consumer led and our DTC revenues, so ecommerce and our own stores, are up 38% in constant currency. Overall group revenue is up 18% or 22% in constant currency. And that's compared to the high teens growth that we gave as guidance at IPO. And our EBITDA performance is actually ahead of market expectations. So quite simply we have done exactly what we said we would do one year ago, despite all of the global challenges.

I always say within our organization that brand equity is my top priority because fundamentally sales and margin follow brand equity. Later, what I'm going to do is I'm going to share some numbers with you from our global brand survey. And these demonstrate that the Dr Marten's brand is stronger than ever around the world. Our brand and our business are in really good shape. Whilst the consumer backdrop right now isn't without its challenges, what Jon is going to show you is that we've got very high visibility of the year ahead. And that means that we are very confident in our business and our ability to capture the vast untapped potential that exists for Dr. Martens around the world.

For those of you who followed us since IPO you'll know this slide very well. It's our custodian mindset. This is about making long term decisions to drive sustainable growth. It's about never taking shortcuts. I could give you many examples of how this helps us to run the business and all of the people who work at Dr. Martens, but I'm just going to give you a few examples.

The first is our scarcity model on how we operate our wholesale business. In taking orders for autumn/winter '22, we significantly scaled back the demand from our wholesale partners. We want to make sure that we can manage the marketplace effectively, and we continue to be a DTC first company.

During the pandemic, several of our suppliers were heavily impacted by COVID 19. They had shutdowns in their manufacturing facilities. What we did to support them is that we accelerated payments to ensure that they could pay their workforce effectively, could look after their people and build that spirit of partnership.

Another area of the custodian mindset is our increased investment in marketing, which Jon is going to talk about, to build our brand for the future. And also the investments we're making in retail to build the brand out in the marketplace. In the last financial year, we opened 24 new stores, and today we are increasing our guidance to 25 to 35 new stores for the year ahead.

Finally, we are announcing today that by the end of financial year '23, we will transfer around half of our Japanese franchise stores to company own stores, which will increase our DTC presence within the market, and more importantly, will increase our brand control. And we'll talk about that a little bit later. With that, I'm going to hand over to Jon, who's going to walk through our financial performance.

Jon Mortimore:

Good morning, everyone. It's nice to have some people in the room rather than the last time we did this it was all looking down a screen, which was tricky!

So we had a very strong financial year to end of March '22. We delivered our IPO year one guidance with a small beat to EBITDA. Growth was bang in line with the DOCS strategy. It was volume-led DTC first, and it was highly cash generative. This was against the background of unprecedented supply chain challenges. Our three factories in south Vietnam were closed for just over three months, which represented approximately a third of supply for that period. Shipping times were extended, nearly doubling to 90 to 95 days from Asia to the west coast of the US. Looking forward, we do have really good visibility or FY'23. The wholesale order book is strong with autumn/winter prices sold in. Factory prices, which represent our largest cost item, are fixed for the full year. We have accelerated our dividend payout and we now view our medium-term guidance metrics as more milestones than ceiling targets with potential to exceed longer term.

In the year, revenue grew by 18% and was up 22% on a constant currency basis, with EBITDA also up 18% and up 28% on a constant currency basis. Revenue growth was underpinned by selling more pairs of boots, shoes and sandals, to more people, with pairs growth of 10%. Gross margin grew by 23% representing a 2.8 percentage point expansion of gross margin, primarily from stronger growth, from a higher margin own retail and only ecommerce channels. The expanded gross margin funded all investment needs in the year, and also resulted in EBITDA margin improving slightly by 0.2 percentage points to 29%. Of note, a new accounting standard was applied in the year in relation to the treatment of accounting for cloud-based software development costs, principally from Capex to Opex recognition and resulted in a small adjustment to the prior year, increasing Opex by 1.3 million pounds with a similar reduction in Capex and a similar cost in the current year. This adjustment was non cash.

Our direct-to-consumer channels grew revenue by 34% to represent 49% of revenue compared to 43% mix in the prior year. Ecommerce was up 11% compared to last year, which was plus 14% on a constant currency basis, with good growth across all our markets in an environment when consumers steadily rediscovered the delights of old school shopping. China was the exception where we experienced declining revenue, primarily due to lower volumes on the TMall trading platform, which hosts our website.

We saw a very strong retail recovery, which was led in the UK and the USA, with retail growth of 86%. During the year stores were open for the full year in the US, with stores in the UK open from mid to end of April last year. Both countries experienced a traffic led recovery, albeit December peak was weak in the UK due to Omicron concerns. Traffic in these markets is still below pre COVID levels and only partly offset by strong in-store conversion. Continental Europe stores had a slower recovery profile due to later reopening through last summer and stricter social distancing rules in place for longer periods of time, which particularly impacted the pace of recovery in Germany.

All our stores once mature are profitable, with average four wall EBITDA including rent in the mid 30%. I believe retail traffic will recover to pre pandemic levels within the next 12 to 18 months across all of our core markets and, with only a small mathematical dilution in conversion, will drive profitability further. Wholesale had a strong Q4 shipments as we caught up with orders, which we deferred from Q3 as we prioritized capacity to DTC during that peak trading period.

During the year, we made good progress in focusing on quality wholesale partners. At the end of March, we had around 2000 wholesale accounts. If I exclude the wholesale accounts we brought in, when we converted Italy, Spain and Portugal in the year, the number of wholesale accounts would've been nearly 30% lower than at March '21.

The DOCS strategy is volume led with DTC first and revenue growth followed the strategy. Total revenue was up 135 million pounds in a year, volume growth generated around 80 million pounds and the DTC mix improvement at 6% to 49% roughly generated the balance. Full price mix improvement generated revenue of 19 million pounds. In the prior year, working together with our wholesale partners, we agreed to cancel certain seasonal orders due to the impact of COVID. This enabled us to manage our brand by clearing this product via our own ecommerce channel. This was not repeated in the current financial year and resulted in full year full price mix increasing to more normal levels, around 90%. This reflects the high level of continuity product we sell and our strategy of not discounting our core iconic products. We believe full price mix will broadly be maintained at around 90%. And therefore this improvement is not expected to reoccur.

Gross margins improved by 2.8 percentage points to 63.7% primarily due to stronger DTC revenues. Given the context, the scale of the supply chain challenges that we faced combined with higher inflation and logistics costs, holding on a constant currency basis, COGS, cost of goods sold, per pair to an increase of only 1% was very good. We achieved this through three main actions.

Firstly, we've been on a journey to diversify production away from China to reduce our volume production exposure to that country. This also had the benefit of reducing duty costs since China is a higher duty attracting country than all our other production countries. Reducing China source product reduced cost. Secondly, we negotiate prices with our third party factory partners a season at a time and around six to nine months before that season begins, with prices then fixed. The biggest season is autumn/winter, with prices fixed autumn/winter '21, late 2020, early '21, when inflationary pressures were a lot lower than today.

Thirdly, we have a very strong working relationship with all our factories, which is a true partnership approach. For example, during the year when certain factories had cash flow problems due to COVID, we temporarily accelerated payment terms. In addition, the unique nature of the production process and our willingness to co-fund new lines, has meant that when factories have allocated labor or made difficult decisions, we have tended to be best treated.

EBITDA margin improved by 0.2 percentage points with the gross margin improvement from stronger DTC mix funding all investment needs. We typically generate stronger margins in the second half than the first half due to the weighting of higher margin DTC revenues in that period. In addition, while we plan to increase marketing spend by 0.5 percentage points of revenue every year, as we've seen in the year under review, the majority of this increase did and will occur in the back end of the first half ahead of the peak DTC trading period. I expect both of these trends to strengthen in relation to the first half, second half patterns as we continue to implement the DOCS strategy.

We have significant white space growth opportunities in all our regions with immediate opportunities in the large geographies of EMEA and Americas. And they dominate our revenue profile with 86% of revenue generated in those two markets. We have the biggest opportunity for DTC expansion in the USA, with the conversion market multi-year growth opportunity driving EMEA. Asia Pacific is our smallest region and was most impacted by COVID restrictions in the year. Australia is now following the Western world in learning to live with COVID. Japan and South Korea are slowly coming to terms with living with COVID, whilst China remains in a lockdown mode, though China only represents 3% of our global revenues. The UK is our home market with the highest brand awareness globally. That said we generate 83% of revenue outside of the UK, with our largest market being the USA, followed by continental Europe or Euroland, with the UK in third place. We are not a UK retailer.

EMEA had a strong year with revenues up 19% and EBITDA up 25%. DTC revenues were very good with retail more than double last year, led by UK recovery with traffic still behind pre pandemic levels and steady ecommerce growth. Wholesale grew in line with the global average. During the year, we saw a step change improvement in the quality of our wholesale account base, following the successful conversion of Italy, Spain, and Portugal from distributor to directly controlled basis. We reduced the account based by nearly two thirds for an inherited 1400 accounts.

We opened 13 new stores and closed one store in the year. Of the new stores opened, 11 were in continental Europe, where we expect to open the vast majority of new stores in the future. Here we opened five new stores in Germany to 15, three in France to 14, our first store in Spain, in Barcelona, and two in Italy to three new stores. We very recently opened our fourth store in Italy in Turin.

Conversion markets represent a multi-year growth opportunity for us. It's not just the year one in-market margin capture that more than funds infrastructure investment, but the more exciting ability to fully implement the DOCS strategy and take advantage of the significant growth opportunity the markets present. Across the last three years, revenue from conversion markets have increased from around 16% EMEA revenue mix, represented mainly by Germany, to 37% in FY'22 represented by Germany, the Nordics, Italy, Spain, and Portugal. In each period, the primary focus markets of Italy and Germany have significantly outperformed the growth of EMEA average. The only exception was Germany in FY’22, where growth was in line with the average. If Germany had followed a pattern of restrictions being lifted similar to the UK, retail recovery would've been much stronger and Germany would've had a third consecutive year of out-performance.

Americas had a very strong DTC performance from both ecommerce and retail. Total revenue was up 29% with EBITDA 31%. Americas has the largest DTC opportunity across all our markets and the DTC mix improved by seven percentage points in a year, which was ahead of a global average increase, with a total mix in this market still behind the average at around mid forties.

We opened a new third party operated DC in Los Angeles in the year, to complement the east coast 3PL (third party logistics) we opened in the prior year. The new west coast facility is currently packing only ecommerce and retail, and will begin to distribute wholesale from late summer. We opened this DC as our own facility in Portland has come to the end of its lease. Transferring wholesale to Los Angeles will improve shipping times by around two weeks and more importantly, secure capacity to support our future growth in that market.

During the year we open seven new stores to 41 stores, with a good proportion of the new stores in those locations where we have zero own physical presence, but do have strong ecommerce trading and good wholesale sell through. Given the size of the US opportunity, we have increased our store rollout guidance from 20 to 25 stores to 25 to 35 new stores principally to reflect the opportunity to open more stores in the US.

Japan is our largest market in Asia Pacific and around a third of total region revenue. The market is mainly retail led. And during those few months of relaxed COVID rules, we saw steady retail recovery resulting in high single-digit growth for the year for the total constant currency revenues from that business. We have 22 owned stores in Japan and also 31 branded franchise stores, so to a consumer, we have 53 Dr. Marten's branded points of sale. Japan has some great growth opportunities, and Kenny will talk about these later. Asia Pacific is the final region to have the global ERP solution implemented and Hong Kong was successfully plugged in December. Japan is next to follow with plan go-live in the autumn.

For those accountants out there, basic earnings per share increased by 417% to 18.1p. For those of you who want to truly understand our financial performance in the year, we have also calculated earnings per share on an underlying basis, which excludes prior exceptional items, which were all related to the IPO, excludes the higher cost of preference share funding arrangements, which were typical of a private equity funded business and fully repaid IPO, and also excluding the current year tax deduction taken, following tax counsel advice that the all staff bonus that we paid at IPO was deductible. Excluding these items, underlying earnings per share was 17.4p and grew by 21%, which I believe is a good result.

The DOCS strategy is highly cash generative and in the year we doubled cash to 228 million pounds after payment of the interim dividend of 12 million. We have proposed a final dividend of 4.28p per share, which results in a total dividend of the year of 5.5p. This represents a full year payout ratio of 30%. We are delivering on our progressive dividend promise.

As I've said, we are a highly cash generative business, and M&A activity is not on the horizon. Our first priority of cash is investment in the business. This is mainly inventory followed by people in marketing. From a Capex point of view, we have a funding need for new stores, store re-fits and IT systems and tech functionality. To reflect our increase in store opening guidance and tech timing, we have increased Capex to between 4-5% of revenues. The second priority is funding our progressive dividend policy of between 25% to 35% of earnings. And we are now at 30% payout with 32% payout ratio in the second half.

Finally, as I've said before, given the challenging economic climate we live in today and also the very real supply chain challenges we have recently faced, having a balance sheet that carries a higher amount of inventory - which in a pre COVID world would've been considered conservative - is, I believe, appropriate. Our assessment is that we will have excess cash when we have average gearing, including leases, consistently less than one times, and at that time we'll consider further returns to shareholders. We will keep this target ratio under review as appropriate.

We have a high level of visibility in our supply chain. As of today, all our factories are open and operating at 90 to 95% capacity. Inbound shipping times are steadily improving to all of our DCs and we are on track to have fully caught up with supply chain production delays from last year by the end of the summer. The left-hand box shows manufacturing country of origin. Two comments. Firstly, we have continued to diversified manufacturing away from China, moving from 27% in Autumn Winter 2020 to around 10% Autumn Winter 2022. Of note, our two remaining factories in China, a few days apart here or there, have remained open.

Secondly, as I mentioned, we have benefited from lower duties. This was mainly due to moving manufacturing away from China, which attracts a duty rate of 18% to the USA and 24% to Japan, to countries which attract duty rates between zero and 8%. Whilst there are some further duty related efficiencies available to us, our primary focus is building volume capacity, and I do not expect further material savings for a few seasons yet.

Approximately 95% of our supply chain cost space is fixed for each season six to nine months before the season begins. We have fixed factory price increases at plus 6% for autumn winter '22 and spring summer '23, which will take us through to June 2023. The only variable element is freight, which is at 5% of total cost. And before last year shipping inflation and congestion, this cost represented around 2.5% of the cost mix. We expect this higher cost at 5% of the total cost mix to remain for at least 12 months.

We believe the risk of material country wide factory lockdown to be low. We have a high level of vaccination rates across our factories. As a result, we believe we are more likely to experience short term disruption as workers who may test positive are isolated, production lines are temporarily closed for deep clean, and then reopened.

As at today, our wholesale order book represents 85% of the full year target and is locked in. It is up on last year and better quality. I would expect to be at a hundred percent of orders for FY23 in September. As Kenny said, we operate a scarcity model in wholesale. This manifests itself in a number of ways from closing non-brand enhancing accounts, as I said earlier we closed 30% in the year, to restricting volume requests. We could have sold more wholesale in FY22 and could have accepted more orders for FY23, and this is after the price increase. Demand is strong.

The DOCS strategy is volume led in DTC first with price to fund inflation. The bigger growth opportunity is to take advantage of our white space growth opportunity, and therefore we do not want to take price materially ahead of inflation. The price increase we implemented this year will take effect from the Autumn Winter season, which begins through July. The season price increases are 8%, which annualizes at 6%, such that price funds inflation across the year, though recognizing we have a price inflation timing mismatch during the first half. I believe we'll have a high inflation environment for a few more years to come, and we will therefore be looking to increase price to offset cost increases across future seasons. Kenny will talk more about our approach to pricing a little bit later.

Our year has two principal selling seasons, spring summer which is from January to the end of June and autumn winter which is from July to December and is our largest season. Q1 is the smallest quarter representing the back half of the smaller spring summer season, and in FY22 represented 16% of full year revenue. As a result, Q1 is not a forward indicator for the rest of the year. In addition, you'll have seen the non-linear nature for wholesale shipments with Q1 and Q4 very high and Q2 and Q3 lower than would be typical. As we emerge from COVID impacts, I would anticipate Q1 and Q4 to normalize to be slightly lower, and Q2 and Q3 to normalize to be slightly higher in respective mix.

For DTC, the first half represents around a third of full year DTC revenues with wholesale roughly 50/50 H1/H2. The first half therefore represents around 40% of total revenues. Due to this profile, the second half will always have stronger EBITDA margins than the first half due to the higher margin DTC weighting. The significant opportunity we have in sandals will, to a degree, mitigate this weighting, however, given the superior margin power of DTC and our DTC first strategy, I would expect the second half to continue to become more prominent.

Finally from me, guidance. For FY23, we have increased revenue guidance from mid-teens to high-teens to reflect higher price increases than originally anticipated in the IPO guidance. Volume expectations are unchanged. For the first half, as with the full year, we expect high-teens revenue growth. However, the Q1 / Q2 shape will be influenced by the Q1 / Q2 shape in the prior year.

As higher price funds higher inflation, we are not changing EBITDA guidance for the year with a caveat that the beat to EBITDA in FY22 will flow through into FY23. I anticipate EBITDA margin for the full year will be broadly level with FY22 and the lower margin guided for H1 due to the timing of the price increase, marketing investment ahead of peak trading and DTC weighting H1 / H2, will be offset across the year.

For the medium term, we have left guidance unchanged, but make clear that we view these figures as milestones rather than ceiling targets and see potential to grow beyond these metrics in the years ahead.

Whilst I'm cognizant of the global economic climate and consumer spending squeeze, at this moment with all of the data points I can see including those I shared with you, I'm confident for FY23 and beyond. Thank you. Over to Kenny.

Kenny Wilson:

Brilliant. Thank you, Jon. Before we do the strategic review of the year, we're going to take a look at a little video, which is going to give you some of the highlights from the last year at Dr. Martens.

As you just heard from Jon, the DOCS strategy delivered a record year for Dr. Martens. We did exactly what we said we would do at IPO. Our brand is stronger than ever, and we are very confident in the year ahead. So let's go into a bit more detail.

This is our DOCS strategy. Every year we review it to ensure that we align with the market conditions and we provide absolute clarity to the people of Dr. Martens. Every year we make small modifications, but DOCS is tried and tested, it's been pretty much unchanged now for four years and that's because our strategy's working.

The full strategy with the detailed focus areas is in the appendix for those of you who really want to dive into the detail. But at the headline level, the D is direct to consumer first. This is about increasing our own stores. It's about growing ecommerce. It's about developing the omnichannel capability of the company. And then the new addition, it's about building a profitable repair resale and end of life business as we focus on circularity. The O is about organizational and operational excellence. This is about making investments in people. It's about investing in our supply chain. And as Jon said, it's about investing in technology.

The C for me is the most important pillar, which is consumer connection. This is about product. It's about marketing. And it's about sustainability through durability of our product and innovation, which I'll talk about. And then finally S which we've refined based on feedback from our teams. This is about supporting brand expansion through business to business, which is wholesale. Our strategy here is about partnering with fewer and better wholesale accounts so that we can reach more consumers in our markets, and also this includes our very important conversion market strategy.

My number one focus area is the brand, because as I said in introduction, strong brand equity is a leading indicator for both sales and profit. I just want to share some headlines with you from our comprehensive annual brand survey. The global results are extremely encouraging. Global brand awareness for Dr. Martens is up four points to 72%. Global familiarity, so “I kind of know what DOCS is doing”, is up six points to 47%. And then last 24 months purchase is up two points from 6% to 8%. Clearly that gap between familiarity, (“I know what's going on”), and recent purchase demonstrates what we've said all along since our IPO, there is still a significant growth opportunity ahead for Dr. Martens.

If we look at that growth opportunity in a different way, at the time of our IPO, we showed this data, the data that's in the black part of the bar charts, and it demonstrates pairs sold per thousand people. And we've updated it here for financial year '22. And before I go into the detail of the numbers, it's important to remember that these last two years have been all about COVID. But during that time, we've seen brand awareness grow by six points, and all of our priority markets now have more than 55% brand awareness for Dr. Martens.

So, if I start with the UK, which is our most developed market, penetration here has grown from 31 up to 32 per thousand, but I think we still believe that we've got real opportunity for growth and probably the biggest opportunity for growth here is not in brand awareness in the UK, but it's in range awareness. It's getting people to really understand the full breadth of our assortment.

Then, if we take a look at the next two on the bar chart, these are markets that we've really focused on in the last 12 months, and that is the United States and Germany. The USA, as you can see, we've made significant progress in per capita consumption as we've implemented the DOCS strategy, but we're only at half of the UK penetration. What an opportunity. Germany, we took it back in 2018. We have doubled penetration in the last two years. But once again, we've got real possibility in relation to the United Kingdom. We only recently took it back, so it's ‘watch this space’ and see what we're going to do. And France, pretty much like Italy, has significant room for growth and requires some focus.

Japan, our biggest market in Asia, has low penetration. The transfer of our franchise stores is an important step in starting to unlock the potential of the Japanese market. And then China, obviously our penetration is negligible with 1.4 billion people. And as you know, we haven't implemented our DOCS strategy yet in the Chinese market.

Much like DOCS, our product strategy is unchanged. It is led by timeless, iconic product with the 1460 boot at the absolute bullseye of everything we do. Originals and Fusion account for 87% of our total revenue. These are our most profitable, and probably even more importantly, our most brand distinctive categories of product.

If we go into a little bit more detail on our product strategy, as we said before, it's all about icons and innovation. Our three most important icons, the 1460, the 1461 and the 2976. Our job at Dr. Martens is to keep our icons front of mind for consumers. We also try to innovate around those icons to drive brand heat and product freshness. So in the pictures, you see some examples on the 1460 there, a mono execution and a collaboration print execution. On the 1461 3 eye shoe, you see a collaboration and the ice sole, which has been really successful for us this year. And then on the 2976, the Chelsea Boot, once again, a collaboration and a piece of sole height innovation. This is all about keeping the iconic product highly relevant, so ultimately we sell more pairs of black Dr. Marten's boots and shoes.

I also wanted to talk about our performance in sandals, because this is one of our fastest growing categories around the world. I think one of the things that makes our brand relatively unique is that we've got authority across different footwear categories. We're number one in boots. We're big in shoes. And we're emerging in sandals. Sandals is a real medium term growth opportunity for Dr. Martens, and it's a real opportunity in our smaller spring season. In the pictures, you see some examples of different sandal interpretations. But the most important thing here is they're all clearly Dr. Martens sandals infused with our DNA.

Still in the consumer connection pillar, to underpin that product strategy is our compelling marketing campaigns, I'm going to call out two from the last year, which I think are very important. The first is WinterWair. Obviously winter season, our biggest season of the year. Here, we're focusing on true winter products, so our winter grip sole which you see in the pictures, fur lining for warmth or waterproofing. And then our unpublished icons campaign. So I talked about the importance of icons from a product standpoint, but this is about supporting them and continuing to raise awareness and familiarity with consumers. And we will continue to support both of these campaigns in the year ahead.

I'm also delighted to inform you today that Meg Johnson joined us in April as the company's first ever Chief Marketing Officer. Meg's got a great marketing pedigree. She started out at Proctor and Gamble, and then she gained five years of footwear experience at New Balance, so she understands our industry. She's also lived in North America and she's lived in Asia Pacific. So Meg will help us to further unlock the brand opportunity for Dr. Martens on a global basis.

Jon talked about pricing earlier and at our half year results back in December I shared the price increases that we are putting through in autumn winter '22. Given the inflationary environment we are facing globally, I wanted to share our longer-term thoughts on pricing. We said all along that we take a consumer led approach to pricing, and our autumn winter '22 price increases were taken as a result of the in-depth study that we did last year, looking at value for money perception of the brand around the world and also elasticity of demand. We didn't put through the full extent of price increases that we could have taken for this year, as we wanted to maintain headroom. We will repeat the pricing study again this summer to inform our autumn/winter '23 pricing ahead of November.

I think the final important thing to mention though, is that, in times of tight spending, consumers turn to brands they trust, icon brands. If you buy a pair of Dr. Martens, you know if you wear them in two years, three years and four years, they will be as stylish then as they were 10 years or 20 years ago. Also, if you buy a pair of Dr. Martens, they are high quality and their durability means that they are an investment purchase. Also, from a wholesale perspective, right now, what we're seeing in the marketplace is our wholesale partners reducing the brands that they're working with. And as a consequence, in difficult times, they're turning to iconic brands like Dr. Martens.

Moving on to our regions. So just a few highlights around each. EMEA, well, conversion markets, as Jon has said, are a primary growth accelerator for the EMEA region. The UK will always be important to us from a brand perspective, it now only accounts for 17% of group revenue, but it does continue to grow nicely and we've got more headroom in the UK.

For the United States, the real opportunity is around growing our direct to consumer business. We've also got a very strong wholesale business there. And as I'll discuss in a moment, we're really taking a state-by-state approach in the US. It's such a big country, that where in Europe we go country by country, in the United States, our focus is state by state. In Asia Pacific, Japan is in excellent brand health and we will be executing the franchise store transfer at the end of this year. China, we've had a lot of COVID challenges in the last year and we are taking a disciplined approach and building the business for the long term.

Just taking a look at some of those in one more level of detail, so looking at European conversion, we took the Italian market back in June 2021. We also took back Spain and Portugal, but the market we really focused our attention on and the one I want to talk about is Italy. We'll be hosting a detailed conversion market teach in on July 6th and we'll be at a much lower level of detail there for those of you who want to attend.

However, in the last year, we opened three stores that you see pictured here in the Italian market in Rome, Verona, and Milan. And as Jon mentioned, last week, we also opened in Turin, which is off to a great start. As we've built the brand there and invested in marketing, our brand awareness has grown by six points and familiarity is up seven points. We've also significantly improved wholesale presence with the branded shop-in-shops you can see in the pictures there and we've dramatically reduced the number of doors that we deal with to really focus on the right wholesale partners in the Italian market. We've also significantly expanded the product range in Italy. One thing that characterizes a distributor business is they tend to buy very narrow, a few products. And what we've done is we've broadened out the product assortment. So, to give you a real example, the 1460 Black Smooth, our most important product, used to represent 40% of revenue in Italy. It now represents only 17%, but of a much faster growing business.

If you look at the United States, it's all about state by state. So turning to Texas, we started a few years ago really focusing first on New York, then we focused on California with a real focus on Los Angeles and, in the last 12 months, we've really focused on Texas. For us Europeans, putting that in perspective, there are 29 million people who live in Texas, so that one state is half of a big European country. So it just shows the scale of the opportunity in a market like the USA.

In the last year, we opened four stores in Texas. You can see them there, Houston, Dallas, San Antonio, and Austin. Probably, I think for me, the most important strategic point, though, is actually the impact on ecommerce. So if you look at the bar chart, what you see is the impact on ecommerce sessions one year post-opening, in Dallas and Houston. And you can see that sessions in Dallas are up 56% and sessions in Houston are up 88%. And this is exactly what we've seen across the United States, but also globally, that every time we open a brand beacon Dr. Martens store in a city, it helps the ecommerce business, which is the company's most profitable channel.

So, overall, as we've opened the four doors in the last six months, familiarity is up nine points in Texas and ever purchased from the Dr. Martens brand is up 10 points. And that is quite simply because, with the new stores, the brand is more visible and it's more available.

Moving on to Asia Pacific, Japan, our biggest market, it's our most important market in Asia Pacific. We already have some great Dr. Martens stores in Japan, as Jon talked about, but we're also building a quality wholesale presence here. There's just a great shot on the slide of a sandals popup store that we opened in Isetan Shinjuku Tokyo. As we've announced today, we will be transferring approximately half of our 31 franchise stores in Japan to company-owned stores at the end of financial year '23. We've got great franchise partners in Japan and they've done a great job running those stores for us, but transferring them will continue to support brand control in Japan and it will ensure we benefit from the profitability dynamics of the direct-to-consumer business.

I think the other thing which is super important here when we look at Japan is that, by the end of FY '23, Japan will be 75% direct-to-consumer. Now, I don't want people to rush off and say, "That says we're building 75% DTC," but what it does do is it gives you a vision of where this company is heading in building its direct-to-consumer business.

Lastly, on the consumer connection pillar, the continued investment in sustainability. You'll be able to read an in-depth review of everything we're doing around sustainability in our annual report, which will be published in just a couple of weeks. Over the last year, our teams have been working to create detailed roadmaps to deliver on the commitments we made a year ago with shorter-term targets and clear metrics of what we're going to do.

One of the key areas of focus, from a product perspective, is the work we're doing on materials of the future, so bio-based materials. Here, we've been working with innovative startups with a view to launching some trials on bio-based uppers next year in calendar year '23. And lastly, I wanted to talk about our repair and resale trial. I'm really excited about this because I believe it's got huge potential for the company in the long term. If you think with that custodian mindset, there's long been a secondhand market in Dr. Martens and we believe that we can play a much more active role in this market with our consumers. So back in April, we launched a trial where we were selling reconditioned Dr. Martens on Depop. It's kind of like ‘more to come’. It's too early really to share the results, but that's a picture of a real example there, where you see the pair on the left with the creasing, the fur looks a bit worn, and then you see them reconditioned and someone else can then take them on the next stage of the Dr. Martens journey because of the incredible durability of the product.

So that was a quick review through our strategy. Just to conclude, most importantly, the Dr. Martens brand is stronger than ever. Our proven DOCS strategy is delivering around the world. And I think, as we've demonstrated today, we continue to have vast untapped opportunity for growth. As Jon and I have both said, we have really good visibility of the year ahead, financial year '23. And that gives us real confidence in our ability to deliver the year ahead successfully and also build the Dr Martens brand for the future.

So with that, we're going to open it up for questions. If we could take questions from in the room first, please, and then we'll take questions from the webcast. And could we ask, please, that you state your name and the name of your organization? Thank you so much for listening to us and giving us your attention, whether you're on the webcast or here in the room. Thank you very much.

Kate Calvert:

Morning. Kate Calvert from Investec. Two questions from me. The first one is, how much sales do you think you left on the table because of the Vietnam shutdown? My second question is, what do you think you couldn't implement in the last year or had to deprioritize because of COVID, which you had planned to do?

Jon Mortimore:

So on the first one, sales left on the table, that's an interesting question. I'll start by saying we could have taken more orders for last year and we, therefore, could have sold more, but we decided not to, which is the scarcity model that we operate. And with regard to the question is probably around shipments, as I've said and you've seen, they are incredibly lumpy. On a full year basis they're pretty much there or thereabouts, so I don't think there was materially more to land, Kate, if I'm being honest.

Jon Mortimore:

The quarterly profile, as you've seen, was a bit up and down. I think it's more around we're looking at wholesale. It's more, what is the quality of the order book? Is the order book good? Are shipment times improving? Are your factories open and are sell through rates good? That's the best way to look at wholesale. The answer to those all questions, sell throughs and shipment times through last year were good. Sell throughs will continue to be good and shipment times are steadily improving. And we expect to be fully caught up by the back end of this summer.

Kenny Wilson:

I think the only thing I'd add, Kate, is I know it was a deprioritization, we had to make the choice before Christmas, we focused inventories on the DTC business rather than wholesale and, clearly, that meant that we missed some opportunities in November and December. I think the other thing is, when you've got challenges, as every brand did in the supply chain, it just takes attention on that. I think the benefit in the year ahead is, as Jon said, we don't expect that disruption and, therefore, we'll be able to focus that attention on further growth opportunities.

Melwin Mehta:

Thank you very much. Apologies for not wearing Dr. Martens this morning.

Kenny Wilson:

You can change that, though, you can always buy a pair!

Melwin Mehta:

That change will be made soon!

Melwin Mehta:

Thank you. Super performance, really. This is Melwin Mehta from Sterling investments. Two quick questions. One is that I like the word scarcity. You're trying to become Rolex, probably, trying to create that artificial, mental, psychological shortage. And how are you moving different products across different wholesalers and even across your markets, really? And the second question is around Japan. We've gone the halfway of the franchise transfer. Was there any cost to buying those franchises back, number one? And the second question is, why not go Full Monty and take the whole market?

Kenny Wilson:

So why don't I start and then Jon can build? In terms of the point around scarcity, yes, we always want demand to be greater than supply. So we scaled back. And we do this every season, and for autumn/winter '22, which is the biggest season in the year ahead, we scaled back the requested demand from wholesale by double digit amount. And that is a very, very conscious choice. You gave the example of a luxury brand like Rolex. I think that's an important way of how we manage the brand for the long term. So that's sustainable growth.

Kenny Wilson:

In terms of your question around different products to different doors, yes, all of our regions operate on a segmentation model. So, we divide our distribution into different tiers of stores, effectively, and we offer the right assortments for the consumers that shop in those doors. So we use the breadth of an assortment within a region to service the number of doors. And that's pretty much the same all over. In terms of Japan, there isn't a cost to taking the stores back because, fundamentally, those stores that we're taking back are at the end of an agreement. I don't know if you want to add anything about that Jon?

Jon Mortimore:

They're at the end of the agreement. There's multiple agreements, multiple partners, and there is a chunk of them that have come up. And we took the opportunity to look at them and have conversations with those partners and explore the opportunity to transfer them back. With regard to cost, they won't be material, in terms of the scale of our group, there won't be material costs because it's the end of a contract.

Melwin Mehta:

And where are the other half coming on?

Kenny Wilson:

So we're not at the point yet where we've got plans to transfer any more stores. Japan's, it's a long country - apologies to those people on the webcast as I stretch my hands out - but obviously, you go to Fukuoka in the south, Sapporo in the north, and I think there's operational challenges, as well, that need to be thought through. So right now, circa 50%.

Melwin Mehta:

Thank you.

David Roux:

Hi, Kenny and Jon. It's David Roux from Bank of America. Also, congratulations on the results. Just two questions from my side, in terms of the potential from unconverted markets, a bit of a tricky one, but could you perhaps give some sort of indication of how much of the group's revenue mix today is still from distributor channels or unconverted markets versus at the time of IPO? And then the second question is, just on China, could you perhaps talk a little bit about your thinking around the future strategy here? I think the backdrop has changed there quite a lot since IPO and also TMall has become a bit less relevant. So just how you're thinking about future growth in that market. Thank you.

Kenny Wilson:

That first question's a really difficult one for Jon to answer, but I think that the thing I would say is that, with the markets that we have converted, there is a huge amount of good growth there. I don't know if Jon knows off the top of his head, but if not, we can come back to you.

Jon Mortimore:

We'll have to get back to you. I think we've gone from about 10% at time of IPO to mid-high single digit, but we'll have to get back to you on that one.

Kenny Wilson:

And then, in terms of your question around China, we've said previously that we haven't implemented the full DOCS strategy in the Chinese market and it's currently only 3% of our global revenue. Just before all the lockdowns that we've seen this year, we did open a couple of owned and operated stores in the Chinese market, which was the first step to trying to implement DOCS. Obviously, those stores have been shut. So at the moment, we're just taking a very cautious approach and we'll see with how things evolve in China over the year ahead. But fundamentally, the DOCS strategy is the DOCS strategy around the world. So that is the strategy for the organization.

John Stevenson:

Hi. John Stevenson at Peel Hunt. A couple of questions, as well, please. Just following on from Kate, I guess, just looking back to last year, what do you carry in terms of exceptional operating costs? Freight is the obvious one, I guess, you've baked into the guidance going forward, but interested just to know what you're carrying, if there's anything there at all. And secondly, on marketing, you talk about how it splits between above the line and digital, I guess, the rationale behind the 50 BPS increment a year, is that enough to support the sort of market growth you're targeting and penetration in those markets?

Jon Mortimore:

Okay. If I do the first one, firstly, from an accounting point of view, there were no exceptional costs in there. From an operational comment, to be perfectly honest, you're right, freight was probably the only one that comes to mind, but if you believe freight costs are going to be high for another year to come, it's part of the noise now. So I don't think there's anything, if you'd like, from a cost point of view, that will be a one-off that will drop out next year. Freight's going to be there. Eventually, I think, when supply starts increasing the shipping capacities, it'll tend to come down, but that's beyond the next 12 months.

Kenny Wilson:

I think, in terms of your marketing question, Dr. Martens is a very democratic brand. It sells across all age groups, but if you look when most people buy their first pair of Dr. Martens, they're aged somewhere in the 15 through 25 age bracket. And if you look at that demographic and you go ... they've usually got a mobile phone pinned in their hand. So without giving out all the detail, which we don't give out, but the vast majority of our marketing spend goes in digital channels because that's where we engage them first.

Kenny Wilson:

As you saw in the marketing slide that I put up, we do spend some money on outdoor, for example, because we know that has a proximity effect where we have Dr. Martens stores in terms of driving up conversion. In terms of the quantum of 50-basis-points-per-year growth, we think that will enable us to continue to move the brand metrics up. And as you've seen today, we're managing to grow awareness, we're managing to grow familiarity, and we're managing to grow the people who purchase Dr. Martens. So we think we've baked in the right level of investment in the go forward.

John Stevenson :

I think it's too early to ask what the CMO has plans to do?

Kenny Wilson:

Yeah, Meg's in her early days, our CMO. One of the things we believe in is listen, learn, lead. So she's traveling at the moment. She's soaking up, meeting a lot of people around the organization. And clearly, she comes with a really good marketing pedigree and understands this industry. So I think she'll learn quickly.

Richard Taylor:

Morning. It's Richard Taylor from Barclays. Just a quick question on the sandals product, please. You said it's now around 6% of revenue. Just interested in what it was last year and also what the sort of wider strategy is there. It sounds like you're quite optimistic about it. But are they available in all markets? Are you fully satisfied with the product? If we're sat here in three years' time, what proportion of the business could be from sandals? Thanks very much.

Jon Mortimore:

Sandals, this year it was 6%. Last year, it was about four-ish percent. The growth has obviously over indexed the average.

Kenny Wilson:

In terms of the performance, obviously, we're in a spring season at the moment, Richard. I can see members of the Dr. Marten's organization nodding there, because we just don't have enough. I mean, the honest answer is that the demand is way outstripping the supply. That is true in every region. We don't know how big is big, at the moment. It goes back to the scarcity model question. As soon as we put some of our best selling products, like Blaire or Gryphon on the website, they're just selling through immediately.

Kenny Wilson:

So I think as you look forward, what are you going to see? You will still see sandals with Dr Marten's DNA. I mean, the really important thing for me is that when you look across the street and you see someone wearing a pair of Dr Martens sandals, the sole construction, the yellow stitch, you know it's a Dr Martens product. But I think there's opportunities within sandals for color and material innovation that will enable us to build that business out. We're number one in boots, but we're not in sandals. So that gives us something, as an organization, to really go after in the spring season. So I can't quantify it, but we know from today we're nowhere near meeting the demand for our sandals business.

Richard Taylor:

Sorry. Just to follow up that. How deliberate are you being on scarcity there or do you also wish you made loads more?

Kenny Wilson:

I wouldn't say we wish we'd made loads more, because back to we operate a scarcity model, but in the spirit of full transparency, they're selling out so quickly that we effectively just haven't made enough pairs this year. We could have made more and still had headroom, is the honest answer to the question.

Richard Taylor:

Thanks very much.

Karina Nugent:

Thank you. Karina Nugent here, from Goldman Sachs. I can attest, it's very hard to get a pair of Blaire sandals! A couple of questions from me, please, mainly focused on the store rollout acceleration that you've highlighted. So, the first one is just how that plays into the guidance for 2023 and the medium term. You referenced that high teen's growth versus the mid-teens that you referenced previously was predominantly due to price. But if you could just talk about how space fits into that, that would be great. Then, in the past, you've also talked about strict payback rules when you have open view stores, can you talk about how that situation is evolving and whether you're seeing sort of better payback periods, easier situations when looking at new lease contracts, et cetera. Then finally, just a very quick one on collaborations, some very nice pictures in your slides. Collaborations still account for 1%. Has that changed in terms of how you're thinking about that going forward? Thank you.

Kenny Wilson:

Thank you. Okay. So why don't I take the collaboration one and Jon can provide some color to some of the financial questions on payback of stores and then I can come back on stores if required.

Kenny Wilson:

In terms of collaborations, yes, you're right. They're in the 1 to 2%. The goal here is brand heat and brand energy. It's all about people buying one of those collaborations, or even just seeing one of those collaborations, and saying, "I'm going to buy a pair of 1460 black smooth," off the back of it. So the collaborations are less about us driving volume. They're more about product scarcity. They come in, they sell out, like the one we had just recently with Supreme. And then fundamentally that makes someone go out and say, "I'm going to buy a pair of Originals or Fusion products." So that's the sole purpose. So don't expect to see a massive increase there, because it goes back to the earlier question on scarcity. This is really about brand heat and brand energy.

Jon Mortimore:

On the stores, it takes about two years for a store to hit maturity. So, increasing the store openings from what 28, 25 to 30, 35 will take a couple of years before these mature stores start really kicking in. Whilst, the incremental revenue from retail is nice, the big prize is driving e-comm, awareness and e-comm traffic. We talked earlier about formalizing the fact that we see our metrics, say 60% DTC, as a milestone, rather than the target. It's small factors like this, that drive the DTC mix to be more than 60%.

With regards to payback, other thing I said before, payback is two years. It has been two years. We're not going to make that any easier. A store, when mature, has got to have at least a 25% return on sales with rent. We're not going to change that. To make these work, it means we go back to the landlords and say, "This is the rent we can afford. We'll pay this, or we'll go somewhere else." Being one of the few brands opening stores at this moment, it does mean we are getting stores in locations where previously we couldn't afford them. The stores in Italy were great examples of that, actually. Really good examples. Are things slowly, slowly normalizing? They are, because traffic is coming back, but we're still getting really good deals and we will not make store opening financial targets any easier - we'll keep opening stores in the right places.

Kenny Wilson:

The only thing I'd add is the purpose of stores for Dr. Martens is they're brand beacons, they increase brand visibility, they increase range awareness, and they help us sell more online. That's our strategy.

Andreas Inderst

Andreas Inderst from Railpen here. A question on your pricing. £10 hike, maybe more to come, with no impact on volume expected. Why are you so confident? You mentioned, also, additional headroom, so maybe you can elaborate a bit more on that. Thanks.

Kenny Wilson:

So the question is really why do we feel confident that we can raise the price, in July, by £10? I mean, the first thing I'd say is we haven't raised price in two years. So that's, I think, very significant. This is based on a pricing study that we did in 2018, where there was indicative price increases that we took back then, and we measured elasticity on demand and the model was extremely accurate. When we ran the study again, last summer, it basically said that we could take this £10 price increase with no impact on volume, which is why we've modeled it. So we've done it once before, it gave us an answer. We've used exactly the same database to calculate the answer again. I think that we feel very confident that we will take that price increase and have no impact on volume. The other thing, as Jon mentioned earlier, is that we have the wholesale order base as well. So we have our customers who wanted to buy even more than we would allow them to buy. So again, that also gives us confidence. Do you want to add anything?

Jon Mortimore:

I think the last thing is we also, as well as the same database, we trialed the higher price of one style in the US, in our own stores and there was no dilution in volume. So we just double check this. And this was since November. So we had the wholesale sell in, we had the pricing survey for the second time and we trialed something. Thank you.

Kenny Wilson:

I think we can take any questions that anybody may have on the webcast as well. Because it looks like the questions have slowed down in the room. So is there anyone on the webcast who would like to ask a question?

Operator:

We will take our first question from Doriana Russo from HSBC. Please go ahead.

Doriana Russo:

Yes. Good morning, everyone. Congratulations for the good results today. I've got a few questions, if I may. First of all, on the level of inventory, you said in the past that you have very good visibility in the different markets and inventories at the end of Q3 were very low. Can you give us an update on where do you see inventory levels within your DTC channels, as well as the wholesale channels, post FY22. Second question is on the changes in the supply chain in the US that you have announced ... Apologies if I missed a few points. What exactly is going to be the impact in terms of speediness of supply chain deliveries. Also on a cost basis, is there anything that would benefit you in the medium to long term?

Finally, in China, did you have any disruption in your supply chain in the Q4 time period because of COVID? What is the situation right now? Sorry, my very last question, if I may, it's on your full price percentage, I think you mentioned 90%, which is higher, relative to what it was historically. I think if I remember correctly was in the 80%. Now that extra 10% of full price sales, shall we assume it's a new target or ... Just to try and understand whether you have deliberately limited the seasonal lines to less than 20% that there used to be pre COVID. Thanks

Jon Mortimore:

All right. We have obviously good visibility of DTC inventory, because we know what's in our own warehouses and stores. We have said that we are targeting carrying slightly more inventory than one would have done pre COVID, because we think it's the right thing to do. I heard someone describe this as, rather than old supply chains were 'just in time', it's now, 'just in case'. We think that does describe what we're trying to deliver. We'll have caught up the supply chain disruption by the end of the summer. Our inventory in-market, you are right, we have very good in visibility of our wholesale in-market inventory. That is also very good quality. So from an inventory point of view, we feel good, but we're playing a little bit of catch up, and will have caught up by the end of the summer.

Jon Mortimore:

With the supply chain within the US ... Are there any material cost impacts from having 3PL versus the historical leased model? No, not material. I mean there's a few puts and takes here and there, but nothing material. The main reason we have gone to a West Coast 3PL, apart from the lease was up on Portland, was the bigger space and the flexibility it gives us to distribute e-comm, retail and wholesale on the West Coast to compliment the East Coast 3PL facility to fulfill growth going forwards, because the facility in Portland was getting to be too small. The immediate impact we'll see from the end of the summer, when we've moved all wholesale is an immediate improvement in wholesale lead times, approximately two weeks.

On China disruption and supply, as I said supply for autumn winter is about 10% in China now. We have two factories in China. Apart from a few days here or there, where the factories were out for a couple of days, but that was a couple of days, nothing more than that. Not months or weeks. We have not seen any material disruption from our factories in China, this year to date so far. That's this calendar year, I should say. Do you want to do the full price?

Kenny Wilson:

I mean the point on the full price is that it was 90% full price, 10% seasonal markdown, before COVID. As Jon mentioned, it was a little bit higher last year, which is why we've called it out. We'll now back on the 90/10. I wouldn't confuse the fact that 86% of our sales come from Originals or Fusion with the full price markdown mix. Because obviously whilst we might display an array of seasonal product, either on our website or on our stores, the purpose in doing that is to generate consumer interest and excitement. But most people don't buy the pink one, most people buy the black one.

I think that's a core part of Dr. Martens is, black is an important color for this brand. It's iconic, it's timeless. Fundamentally, it means we've got a high percentage of continuity inventory, which means, from a financial perspective, we've got very low levels of markdown. That's what we'll plan to do going forward. So on the 90/10, fundamentally that's what it was pre COVID and that's what we'll be planning to.

Kenny Wilson:

Thank you for your question.

Doriana:

Okay. Okay. Thank you very much. I think I got confused. I remember that the seasonal that were probably more about 20%, but that was my mistake.

Kenny Wilson:

The product codes are about 70/30. So we have 30% new product codes, but we buy them in a lower depth, which is why you get the difference between the number of product codes and the percentage of revenue.

Doriana:

Okay. Thank you.

Kenny Wilson:

So I think that there are no more questions

Just to conclude, as we said, our brand's stronger than ever. Our tried and tested DOCS strategy continues to deliver. We've got real, untapped opportunity for growth around the world. Jon and I feel that with the visibility that we've got into the year ahead, that gives us real confidence in our ability to deliver FY 23 and, even more importantly, build a brand for the future.

Thank you very much for giving us your time and attention today. We really appreciate it. Take care.