Interim Report Q1/2018

Wednesday, 25th April 2018

Transcript produced by Global Lingo
London - 020 7870 7100
www.global-lingo.com

Q1 Report

Magnus Welander

CEO, Thule Group

Q1/2018 – Solid start to the year

Good morning everybody, and welcome to our Q1 2018 conference call. As always, it is good to get off to a good start to the year, and we have had a solid start of 2018. We have grown our sales in line with our expectations, with 5.6% – 5.5% if you exclude the currency effects. And if you look at what we have delivered in terms of EBIT, we have grown our EBIT to SEK309 million, which is then delivering an EBIT margin of 19.2% for the quarter, versus the 17.8% we had first quarter last year.

So a strong start, and the main reason for that pickup on margin is the combination of currency and the fact that we are selling higher-margin products. I will come back to this when I talk about region Americas. As we all know, you have seen our patterns for many years, we are a company that in this quarter will spend a lot of cash, because we are building up ahead of the peak season, and that is also true and valid for this year. We had a negative cash flow of SEK214 million. We are ending the quarter with higher inventory than last year, and Lennart will come back to that, but in short you can say that the main reason is we are confident that we will have a good season, and we have decided to make sure that, on the high-volume products, we had enough product in stock to handle a smooth peak season.

Q1/2018 – Net Sales and Underlying EBIT development

If you go to the next slide, you can then see the numbers in more detail. As we can see on the EBIT effect, we do see a currency impact there where our reported growth was 14%, while the constant currency growth on EBIT was 8.4%. A strong euro is, of course, always very good for the Thule Group, as we have a lot of our costs in the European and Rest of World category in Swedish krona and zloty, while we sell a lot in euro, and that is the main contributor to why there is that currency boost. So, overall, solid start for the year.

Region Americas – Slow start due to expected decline in low-margin OE

Known and communicated phase-out of low-margin OE programmes in the US reason behind decline

And if we look at the two regions, starting with region Americas on the next slide, we knew that we would decline in some contracts that we had with OE, and we communicated that during last year, in the second half of the year, that we decided in 2017 to not actively pursue growth and, in fact, rather pursue a steady phasing out of low-margin OE contracts in the US. They are not huge, but they are big enough that the entire decline in the quarter for the region Americas was due to these contracts being phased out. And they are associated partly with, then, the business associated with pickup trucks that was not sold off when we sold our pickup truck toolbox business, but it is also within the bags and case business. These two types of product categories had by far our lowest gross margin. That, of course, means that we have had a mathematical margin-enhancing effect of having growth in higher-margin products and decline in lower-margin products.

Cautious Outdoor Retail sector impacts end of Q1

What is worth to note also in region Americas, as the rest of the region was flat, is that clearly in the biggest market for the region, which is the US, there is still a very cautious retail sector. I am sure you have heard and listened in to, and I am sure there will be a theme in many consumer goods companies speaking about the late spring. I know that, for example, Husqvarna noted and commented on that recently. It is true that a late spring has meant that a lot of retailers were cautious with their purchases at the end of quarter one. We are generally not worried about things like this, because over a total season those one or two or three weeks moving back and forth does not normally have a major impact on the business. But it is clearly the case that retail sector is cautious in the US, not only due to a late spring, but generally we all know that there has been a lot of turmoil in especially the brick-and-mortar retail in the US. Overall for the season, we are positive and confident that we will pick that up during Q2 and Q3.

Active with Kids continue to grow at fast pace

If we look at the category that we were most satisfied with in region Americas in the first quarter, it was the Active with Kids category. And if you look at it, a key launch was our upgraded stroller, the Thule Urban Glide 2, which has been very successful in both regions, and also in region Americas we continue to have a very strong development of our child bike seats business.

Region Europe & ROW - Strong start to the year

If we then turn to the next slide and look at the biggest region, region Europe and Rest of World, we continued the very strong momentum we have had now for a long time in region Europe and Rest of World, with a 9% growth in constant currency; a very strong start to the year.

Strong start in Sport & Cargo Carriers

The biggest category, Sport and Cargo Carriers, was a key driver in this where we have had both very successful sales growth in our roof rack category and in our roof box category. Some regions that stand out are the Nordics region, France and Australia. As always, this is also partly due to how well they did in 2017 versus 2018, but generally these are the regions that have showed the biggest pickups, with both key new listing and very strong sell-through in the quarter one.

Packs, Bags & Luggage OK start

Within Packs, Bags and Luggage, we had an okay start to the year. We do know that we have some legacy products here, but they have been offset by growth in our growth categories, luggage and smaller everyday bags and technical packs. Now we enter the much bigger season for those type of products, so the year is still exciting ahead.

Active with Kids continue to grow at fast pace

As I mentioned, Active with Kids did very well in the US and in region Americas overall. It was the same case also in region Europe and Rest of World. And also here it was the successful launch of the upgraded stroller, the Urban Glide 2, that was the biggest driver, but also the launch we did last year of the Thule Chariot bike trailers was continuing to deliver a good growth. And even here, the very broad portfolio of child bike seats continues to develop well. Especially we saw, which is something we always like when media does, there was a very big test done in the biggest market, in Germany, on child bike seats, on how safe they were, and our child bike seats were the clear winners, and some of the large players in the market actually came out as not recommended to be used due to unsafe conditions. Those type of things, especially in a market like Germany, helps your sales.

RV Products continues to grow at fast pace

Finally on RV products, I think it is worth mentioning and clarifying something, because at the capital markets day last autumn we commented to the fact that, in general, this is one of the few categories where you can track the development of the overall market by looking at the registration statistics of motor homes and caravans. That is normally the case, but actually in quarter one in 2018, if you would have tracked those numbers, you would have been amazed how fantastic the motor home vehicle market was, because there was a registration growth in the high 20s.

In reality, though, what has taken place during the first quarter this year was that the extensions that had been given for registering and selling vehicles of an older emission class – an emission class, actually, called 5b plus – like commercial vehicles had already had to move to emission class 6. This sector of RV was given an extension period, as they are rebuilt vehicles, and that extension ended at the end of February this year. That meant that a lot of dealerships that had purchased vehicles in the past needed to either sell them, or they would not be allowed to sell them at all. They needed to register before this date.

So what a lot of dealerships did around Europe was that they registered these vehicles in their own name, rather than selling them to a consumer, and thereby they can now sell them as a second-hand vehicle, although not driven, to a consumer during the year, or they can, as in some cases are done, start renting them out for a rental vehicle. That artificially, in a more administrative way, then inflated the registration numbers significantly for motor homes. Our estimation is that it is around a 10% true consumer sell-through growth, which is still a very good number, and we continue to outpace the market. If we then move over to the income statements, I will let you talk about that, Lennart.

Financial Review

Lennart Mauritzson

CFO, Thule Group

Q1/2018 – Reported Income Statement

Thank you very much. So, looking at slide 6, I will comment on some of the items in the income statement. Gross margins were at 41.6%, versus prior year 40.9%, helped by favourable currency development, which was 0.4 percentage points, and the remaining improvements in gross margins of 0.3% were driven by positive product and customer mix, as Magnus mentioned, and combined with normal price increases we are doing, mainly within Sport and Cargo Carriers, somewhat muted by continued negative raw material prices in Q1, primarily plastics for us. Financial net was minus SEK16 million in the quarter, versus prior year minus 11. Negative FX effect, revaluation on FX accounts for loans and cash in local entities, is the region for the higher financial expenses this year.

If we look at our pure external cost of debt, the expenses were actually slightly lower than prior year, so we had 10 versus SEK11 million. If we look at the SG&A, we are slightly higher than prior year, but it is driven by higher product development spend, as planned and as we have communicated we will have an increased effort on product development during this year. The effective tax rate in the quarter was 25.1%, versus prior year 24.2.

Q1/2018 – Operating Working Capital and Operational Cash Flow

This quarter we ended with approximately SEK1.3 billion in operating working capital, which is 21.4% of last 12 months of sales, versus 22.7 last year. So a decrease in percentage. However, as Magnus mentioned, we have an increase in inventory as we follow the plan to smooth out our seasonal ramp-up and enter Q2 with more finished product in order to meet expected sales growth.

If we look at our operational cash flow, we do have the same pattern as prior years, for many years, with a build-up of working capital preparing for the high seasons in Q2 and Q3, so we had a negative cash flow in the quarter of SEK90 million, versus prior year minus 69, but, as I said, we will see an improvement during Q2 and onwards for the year. Thank you.

Outlook for Rest of Year

Magnus Welander

CEO, Thule Group

Q1/2018 – Performance vs. Financial Targets

Thank you, Lennart. If we go to the next slide and look at, then, the financial targets and our performance against those, as I have already mentioned, a solid start to the year with an organic constant-currency sales growth of 5.5%, which is higher than our 5% target. We had a strong improvement of our EBIT margin, where we moved from 17.8 to 19.2. More importantly, maybe, is to look at then the rolling 12 months, which means that we are now at 18.6% rolling 12 months EBIT margin. Our net debt to EBITDA is 1.6 times, which is well in line in our span that we assess as a target. And later today, we will have our annual general meeting, where the board has proposed for approval at AGM a fixed Swedish krona per share ordinary dividend to be split out in two payments, which then equals 87% of our net income. So overall, moving very well with our long-term financial targets as presented.

Focus areas for coming months

If we then look forward to what is a very exciting few months coming ahead. As we understand from our business and, looking at next slide, you can see that we are now in the peak of what this company is most busy. We are starting to have peak output from our plants, sales are really starting to kick in as the spring season comes, and we are in the last few months ahead of showing new products to all the trade fairs for 2019 launches. So I can promise you, there is a lot of busy people in Thule Group at the moment.

Sales & Marketing focus

We also, on top of that, of course, have launched a number of new products that are really starting now to be hitting consumers, being shown in stores and being purchased online in online stores. Now we will really see the key telling points of how well those new launches truly sell through. We have good feedback. Initial, early days, but very positive feedback on the 2018 launches. We have a very exciting launch coming up later on, where the first Thule Sleek strollers will be hitting the shops in quarter three this year, and that will be a key addition, of course, in our product portfolio going forward.

Operations focus

So we are working, as I said, hard in all the factories in ramping up production. We have a continued focus on a high on-time in-full delivery performance. We know that with a cautious retail sector not wanting to have things too much on stock, one of the ways we can secure that we do pick up all the opportunities that are there is our capability of serving them well with next-day deliveries. We are working hard in our newly opened plant in Pila in Poland, where we will do the Thule Sleek assembly. And we have started our building works on a CAPEX investment of expanding our eastern European distribution centre, in line with the plans that we communicated in the past.

Of course, also, I think all of you will have noticed some very volatile raw material developments in, for example, the aluminium, considering some of the things that have happened in that market. And, of course, key for us is to keep on top of that and track what is going on. We are hedged in aluminium, so we are not too worried, but it is of course something we need to be looking and tracking. Generally, it is a high raw material cost structure we still see. We are therefore confident and happy that we did the necessary price increases, and also that we have a good product mix as we grow with high-margin categories and reduce and decline in low-margin categories.

And not to underestimate, we are now at those levels as communicated in the capital markets day of around 6% of our spend on product development. We are hiring more new engineers than ever. We are tooling up to more new products than ever. It is a buzzing, exciting feeling in the company, working on products in all the new product categories. Therefore, some very exciting months ahead, and look forward to have some new cool stuff to show you at the next quarterly call. With that, we leave the floor for questions.

Q&A

Daniel Schmidt (Danske Bank): A few questions, and I think, Magnus, you mentioned that when it comes to the decline in the Americas, it was entirely self-inflicted on the back of the phasing out of these contracts. And so, first of all, are you basically saying, then, including those phased out, you were trading sideways in Americas?

Secondly, what should we expect to see – should we expect the same impact in terms of phase-out for the coming quarters as we saw in Q1? I think we start there.

Magnus Welander: Yes, you are right. We were flat if you excluded those conscious decisions of phasing ourselves out of low-margin products. The main reason was, as I mentioned, there has been a very cautious retail sector in the US with the late spring. If you look at the effect of what you should be expecting, as communicated, we will be phasing these out until the beginning of next year, and the monetary amount of that decline similar to what was the decline as is. It is relatively similar, not exactly, but relatively similar by quarter until, we can say, quarter two 2019, when they will be fully phased out.

Daniel Schmidt: All right, good. And you do sound – even though you had, of course, a poor quarter in Americas even excluding this phase-out, you sound a bit optimistic. And of course, you had the late spring issues and cold and so on. Does that mean that you have seen any sort of change to the retail environment for your sake, entering so far into Q2?

Magnus Welander: We never comment looking forward, but generally you are listening to my voice and saying that I feel relatively confident. I do feel relatively confident. We have to say, we have an extremely short order book, and we always comment on that. We sell things for the next day, which is a lot of benefits. There is also then that we do not have a brilliant or exact track record of what we will be able to say we can sell. But we have good confidence that our new products have hit off well. We do not believe the cautious US retail is really matching what the consumer in the US is looking at, so we are hoping and expecting that that should materialise in growth also in region Americas.

Daniel Schmidt: Good. And then, just finally on RV, where it sounds like you were maybe up 14, 15% or something like that in the first quarter. And as you know, there has been a lot concerns when it comes to RV demand, especially in the US, and you have most, or almost entirely your operation in Europe. Given the visibility that you have and what you hear in the market, is there any sort of feeling out there that that will be something similar happening in Europe that we have in terms of figures when it comes to the US market? Sort of any general reflections on RV in Europe?

Magnus Welander: I think the general reflection on RV Europe is that it is a very healthy market, which we say if it is 10 or 11 or something like that. It is that type of range in our estimate, if you take away this artificial effect. And there is still good confidence if you look at the large RV manufacturers they have very nice order books. They are optimistic.

My view is that, and talking to my experts in our team that work with these big manufacturers all the time, it is clearly the case that I think everybody in the industry is expecting a very good market, at least until after this summer season. And then that is the time when I think a lot of people in the market will step back and look at did that nice, very strong growth pattern continue throughout the season, or did there start to be some people starting to cancel orders? There is no signals of that yet, but I think everybody is cautious of seeing will it continue into the later half of the year.

Daniel Schmidt: All right, okay. Good. Thank you.

Gustav Sandström (SEB): Morning. Congrats. A solid report again. My first question is regarding the Urban Glide 2 launch, which apparently was a major success driving that category. Can you draw any conclusions from that when looking into your next big launch, being the Thule Sleek? And do you have discussions with retailers already regarding volumes for Thule Sleek so that you already now know any type of volume impact we should expect from stocking up Thule Sleek in this year? Thanks.

Magnus Welander: Thanks, Gustav. Generally you can say what was key for us is, due to the positioning of the Thule Urban Glide 2 as a much more urban position, both in styling but also in some of the feature sets, it was of course a good indicator of getting into the right juvenile channels and a door-opener, a precursor, to what is definitely a stroller that really only fits in the juvenile channel with the Thule Sleek. So what it has done for us is shown that the brand carries in a more urban stroller. It has enabled us to get some very strong listings with some of the key retailers around the world; actually, all they key retailers we targeted in the major markets.

But that, once again, does not mean that we get huge orders. As I said, one of our key things is what we do know is we are going to get listed, and we are going to be shown, in a lot of cool stores all over the world. That is a great start, but then consumers need to buy it to create any significant volumes that have any impact on our numbers. But what the good thing is, a very good listing reality has been a little bit a consequence of the success of Thule Urban Glide 2, and of course that the Thule Sleek stroller is a fantastic-looking stroller. But that combination makes us more confident now when we look at which type of listings we will start with in Q3.

Gustav Sandström: So no material impact from stocking that today, that we should look forward to in Q2/Q3 from Thule Sleek, is that correct?

Magnus Welander: No. What will have any material effect is actually the sell-through that we, of course, hope to generate already from the starting points on that in Q3, but which really starts happening as you come a few months into the whole – so it's the sell-through that will generate significant numbers.

Gustav Sandström: Right. And a similar question regarding the Revolve hard case luggage that you are about to launch, too. Is it the same story there, that we should not expect any destocking, and do you any discussions on that end with retailers that you can share?

Magnus Welander: Yeah, same thing there. The success which we definitely have had with Thule Subterra, which continues to do really well, is of course a key, then, to open the door, to say, 'Here we have another collection.' So we feel better than when we entered with just Thule Subterra, because then there were completely new doors to open. Now, many of those are already open to us, and they will list a second collection.

So that means, 'easier' is maybe the wrong word, but definitely it makes it for a higher likelihood of rollout effect. But it is the same thing, actually, also there, that it is really the sell-through that drives significant numbers for us. It is not pipeline filling thousands and thousands of shops. That does not come with one go. It is spread out over time. So it will be also there in six to nine months into it, you can start to see significant volumes from those new collections.

Gustav Sandström: Great. And regarding the Pila factory in Poland ramping up, could you share how big of a fixed cost base you have there, and if utilisation rate was a factor in this quarter or will be going forward, with the price under- or over-absorption?

Magnus Welander: We normally do not comment on specific fixed cost by plant, but you are very astute in guessing, Gustav, that we have been very inefficient from a costing structure in that factory, because we have, of course, had all the senior management in place for some time. We have purposely brought in all the shift leaders and trained people, and we are plus – generally not nearly up to the volume utilisation of that capacity of that plant yet. We are on top of that, doing two brand new assembly lines for two completely different products from the past, which we, of course, want to ensure we get off the ground really well, so we have started very early to spend a lot of time and money on that. It is an inefficient plant from that perceptive at the moment, and will really be so for quite a long time, which is included in our estimates of going forward, because it needs to get up to those bigger sell-through numbers of both the new stroller and the new luggage to start compensating for the fixed structures we took on already as of Q4 last year.

Gustav Sandström: Great. And then finally from me, are you confident now that the US retailers are low, or perhaps too low, on inventory, and there is a less likelihood of them destocking also for the remainder of this year?

Magnus Welander: I am very confident that they are too low at the moment. Our sales team in the US had a lot of discussions with some of the retailers, and this is something we have to say. We are always worried when they get a little bit too low, because although we have a fantastic track record of high, on-time in-full, if they are very low, that still might mean that they leave money on the table at times, when the customer came in and – I wished I could love it to say that everybody plans their purchases of their next Thule bike rack months ahead. Generally it is not like that. They come in, and they realise they want it on the Saturday. And if, in that case, that retailer had sold the few they had in store and had not ordered new ones, we potentially left money on the table.

So we are not 100% happy with that, I have to say. I cannot see them destocking more from that perspective, because then really they are jeopardising, which I think they realise, leaving too much money on the table. So I do not foresee any logical reason why there should be a destocking in the US retail.

Gustav Sandström: Great. Thank you for taking all my questions, and, again, congrats on a solid report.

Magnus Welander: Thank you.

Stellan Hellström (Nordea): Thank you. Yeah, wanted to ask, just looking at your OPEX relative to sales going down in the quarter, just in perspective of your increase in product standing; how that is possible, and what you have done.

Magnus Welander: If you look at it, as always, there are some quarterly phasings at times depending on which fairs you go to, which products you launch within the marketing spend. I would not say that that is true saving. There is a little bit of phasing effect, and if you look over the year that is going to smoothen out. So, from a perspective of that, that’s more of a quarterly small phasing effect on marketing.

Stellan Hellström: Okay. Then just also your favourable effect here of currencies. I would think that, given the weakness of the Swedish krona, you are in a favourable position also when we look at coming quarters, given that you produce a lot in Sweden, have a lot of cost base in Sweden.

Magnus Welander: You are absolutely right. If currencies stay as they are at the moment, we will definitely be seeing positive FX effect for us.

Daniel Schmidt: Given that you already alluded to the RV growth in your statement, could you give us some sort of ballpark figure when it comes to the development of the other three segments in Q1? It sounds like Packs, Bags and Luggage were down in the quarter.

Magnus Welander: You astutely have mathematically tried to create a model while we are discussing. So, yes, I think if you look at it and listen to our comments, you will understand that due to the OE projects and contracts that we are phasing out in the US, that is pulling us down in Packs, Bags and Luggage, because there are some cases and bags we do there. And, on top of that, we do have still the decline, we have to admit, in CD wallets and other things. That continues. And as we did not have the same type of growth in luggage like we had in – because we really did a big launch last year, we do continue to do well; that was a small decline in Packs, Bags and Luggage. We have the highest growth rate in Active with Kids, and we have a solid growth in Europe and Rest of World in Sport and Cargo Carriers, while relatively flat, if you exclude the OE contracts, in the region Americas.

Daniel Schmidt: All right. But given that mix and what we have talked about in terms of FX, your manufacturing base in Sweden and also in Poland, and the currency has continued to weaken, of course, and the mix between these segments, is it ruled out in any way that you would be approaching your 20% EBIT margin maybe a bit quicker than what you alluded to in connection with the CMD in September?

Magnus Welander: I think the key thing is we do not do the currency aspect when we talked about our 20% margin, because that would be highly difficult speculation work. So when we presented the 20% margin, and when we presented in fact that 2018 would not be the year that you should estimate that we should do the biggest pickups to reach the 20, we did not speculate on currency. If then currency comes in and helps us, that will of course move us closer. Potentially, currency could come in and be detrimental. But that statement, then, in the capital markets day was associated with assuming that the currency did not help us. And if you take that, that might be what makes the difference, then, this year. If the currency continues to help us, yes, we would by mathematical point, so to speak, move forward to it.

Daniel Schmidt: But in adding to that, has anything changed in your view in terms of product development spending? Have you changed your plan in any way, if you look ahead in the coming couple of quarters in 2018? Will you go above the 6% for some reason in some quarters? Or is there any reason to change the modelling around that?

Magnus Welander: No. I mean, it is not an exact 6% that we have defined. It is 'around 6%', and we feel very confident with that plan that, if you look on a rolling 12 months, we are around 6. It can be slightly above or marginally below. It is going to be around 6% now for a few quarters to come, as we said during 2018. So I think, in a modelling, 6% is a correct number to use.

Daniel Schmidt: Thank you. That is all from me. Thank you.

Magnus Welander: Thank you. I thank you all for listening in and wish you all some fantastic spring weather, which has come to Europe at least, and some super-active vacations with lots of Thule products. And we will talk again in July. Thank you very much.

[END OF TRANSCRIPT]