Hornbach Holding AG & Co. KGaA

Q1 2022/23 Update Call

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Transcript

Speakers:

Antje Kelbert

Karin Dohm

Antje Kelbert

Good morning, and welcome to our Q1 2022/23 update call of Hornbach Holding. My name is Antje Kelbert, Head of Communications and Investor Relations. After our pre-results disclosure on Monday 13th June, we have today at 7AM CET published the full set of figures for the first quarter 2022/23 comprising the period from 1st March until end of May 2022.

Good morning also to our CFO Karin Dohm who will be our presenter today and will also take your questions. Together with us on the call are my investor relations colleagues, Anne Spies and Fabienne Villwock. Before we now take a closer look on the development of the past quarter, please be aware of this disclaimer which is valid for the entire presentation as well as for the Q&A session. And now I have the honour to hand over to our CFO, Karin Dohm.

Karin Dohm

Thanks, Antje, and also from my side a very good morning here for our update call. I'm very happy to welcome you all. A couple of figures summarising our development over the last quarter.

Sales and adjusted EBIT, as you know, have already been published via the announcement on June 13th so that part is unchanged as of today. And we saw robust sales development, in part driven by inflation, but we also continued to see higher levels of demand for home improvement products than in pre-COVID times.

Online sales are at 15.3% of total sales in the first quarter and, as expected, this is lower in a year-on-year comparison as the reduction is mostly related to lower click-and-collect compared to last year when stores were still closed and it was the only way to shop.

So we see here, as said, high levels on an overall comparison to pre-COVID level and a change in mixture in relation to the opening of the stores. Earnings are down from last year but, once again, well ahead in comparison to pre-COVID levels.

When we look into our expansion achievements, in Q1 we have continued our physical store expansion in Europe as we announced together with our plan. In March, we opened two new stores in Slovakia and the Netherlands, and with that including we have now 169 Hornbach stores across a number of nine countries.

We will open two more stores as planned as of today in this fiscal year. One in autumn in Romania in Constanţa and another one in Germany, most likely towards the end of our fiscal year in February. Hornbach Baustoff Union will take over two builders merchant outlets in the southwest of Germany by the end of this week.

As said, customer demand remains steady in the first quarter so far. You see here an 8% growth, which is a great achievement of course on top of the already very strong growth rate that you saw at Hornbach over the last years. The sales of the subgroup, Hornbach Baumarkt, including online retail grew by 8.2% and we had some catch-up effects outside of Germany following sales restrictions at the beginning of 21/22, so the last year quarter, which you will see in more detail later here.

Hornbach Baustoff Union, the subsidiary has grown by 6%, also a further achievement after very strong growth last year by 20.5%. When we look into the region split, sales here is equally split between Germany and the other European countries in which we're active and overall we have a strong performance in the net sell development.

As said earlier, we would like to take a little bit of a deep dive to double-click on the question of outside of Germany development. So the like for like sales, as shown here on this slide, give you a good indication where we especially had strong tick ups. You see that in the Netherlands and Czech Republic, also in Romania and Slovakia.

There were some underlying effects in comparison to Q1 21/22 with some catch-up effects there due to closures in the comparative months of the previous year. In some regions, our spring season was impacted by cold weather. For example, specifically in Austria and Switzerland where the season was, from a weather perspective, not as good as we had hoped for.

E-commerce, as said, has developed strongly. Once again, way above pre-COVID levels. Nevertheless, giving you a good indication about consumption behaviours in times of closures and of non-closures. So, as expected, click-and-collect was used to a lesser extent in Q1 this year since there were no restrictions for our stationary stores.

On the other hand, direct delivery is still very much in high demand as customers have experienced the good service and availability there in our channels and like to take that into their considerations and behaviour on an ongoing basis.

All in, e-commerce share of Hornbach Baumarkt sales, as said earlier, was at 15.3% this quarter. And we think we have here once again reconfirmation of our ICR strategy as we are absolutely convinced that it's best to make sure that customers can choose their channel of preference and act accordingly to make sure that they can move also smoothly between those channels.

When we look outside of Germany, specifically you see here that we have been able to gain further market share in a number of countries. As you know from some of our interactions we had in previous occasions, we are really convinced that that is one of the good bases to make sure that further growth is not only driven by extension of floors and stores and therefore of, so to say, square metres or web shop activities, but also culminates ultimately in a growth of market share.

In Germany, we saw a little bit of a downside development due to the normalisation. Nevertheless, once again, here we're well above the pre-COVID times with now 14.9%. The effect that you see here is that due to the reopening. Some customer flows were going into more local offline business instead of online business and that's then driving that market share in Germany.

Coming now to the cost structure and gross margin as well as some cost item developments when we move further into the P&L, just what you see here is cost ratio with general and administration expenses remained fairly stable.

There was an increased selling and store expenses, mainly due to higher costs for personnel and energy, as well as a deliberate increase in marketing spending relating to our spring campaign where we increased spend to make sure of course that Hornbach has the right visibility, but also very consciously as we had decreased that in the COVID years to make sure we're back to normal levels. On a full year, that is expected to normalize then again.

The gross margin was down by 1.3%. Driving factors here are, number one, of course the rising purchase prices which we partly did not pass on, either because we were not willing to as we're convinced that our all-time low price strategy is ultimately the good basis for customer satisfaction and customer loyalty, as well as some transportation costs which kicked in here. And that all gave us some pressure on the gross margin amongst a challenging market environment.

When we look onto the EBIT, our adjusted EBIT came in well above pre-COVID levels, despite of course being in a lower level compared to previous years. Nevertheless, with 148 still way above what we saw pre-crisis. Margin is now at 8.2% for that quarter, once again, also exceeding pre-COVID time clearly. Let me give you a couple of thoughts on our cash and the funds from operations.

Cash inflow from operating activities in general was now at… With an inflow from funds of operation at 164.4 million, so well above the pre-COVID levels. The change in working capital resulted in a cash inflow of roughly 11.2 million. We have currently still, as you also see on our balance sheet, slightly higher inventory than we would usually do have at this time of the year and there's ongoing challenging logistical times.

We think that's the right way to approach things to make sure that we have availability of goods and as little stock-out as possible. Of course we're monitoring that very closely to make sure that we're not creating any inefficiencies in the working capital environment. But, nevertheless, we feel comfortable with the current development there and the status.

Capex was at 52.3 million in Q1. Approximately 72% of that was spend on land and real estate, as mentioned, mainly for new stores. And allow me to remind you a lot of our other spending, so into IT and components of, for example, our web shop and other capabilities on the digital side is mainly going through P&L directly so you do not see that here on the Capex side to that degree.

When we look onto the financing activity side, the cash outflow totalled 13.1 million in the first quarter. That was partially for the additional shares in Hornbach Baumarkt and we also saw there some cash inflow from the bridge loan (11:45). The debt position has been now, related to that additional share buyback, has now been reduced to 70 million in June, so after the Q1 balance sheet date. And we transformed that into long-term debt by issuing a promissory note of 100 million which are running for five, respectively seven years. Free cash flow ultimately at 126.4 million inflow.

As mentioned, balance sheet structure once again rock solid, very strong, and the structure itself absolutely unchanged to what you saw before. I mentioned the slightly higher inventories already. We had an increase in total by 4.7% and stand now at 4.5 billion with an equity ratio of 41.7%, so very comfortable on that side. And inventories, as said, slightly higher but not any portion of concerns on our side.

Outlook for this year and for the next three quarters, obviously as you also saw in our press statement this morning, we have a couple of months ahead of us where, like every other company, we have reduced visibility of some of those effects kicking in.

We have of course still in all of our countries where we're active high inflation rates. In some, we're moving well towards 20% when you look into specifically Eastern Europe. We have of course the ongoing publication of consumer index and sentiment observing institutions such as the GFK and others who give us an indication that there is of course some gloomy mood amongst customer sentiment.

We have of course summer now with a couple of holidays, which is totally normal in this season, coming in. So I think you need to take into account that, as said, that all gives a little bit of a blurred picture and reduces visibility of course.

Nevertheless, we gave our guidance, a reconfirmation on the sales side. We gave you an update that we expect EBIT to come in lower than the previous year, and then in an area of a double-digit percentage range reduction, and of course we reconfirm also that we keep our investments as planned.

We're opening the new stores. We're also investing in further openings for the next years. Our lead time for new stores is, as said earlier, in some instances more or less between 12 and 18 months, sometimes even a bit longer. So whatever we want to open next and the following fiscal year is currently starting to be prepared, so that is all going unchanged.

We also keep up investments in, whether that's incremental or directly going through P&L, in our electronic side, so to say, into web shops and other capabilities to ensure that we're up to day and well abreast of competition So that is unchanged by the reduced outlook. And maybe we stop there and, as said, I'm very happy to take your questions and look forward to those.

Operator

Ladies and gentlemen, at this time we will begin the question and answer session. Anyone who wishes to ask a question may press star followed by one on their telephone. If you wish to remove yourself from the question queue, you may press star followed by two.

If you are using speaker equipment today, please lift the handset before making your selection. Anyone who has a question may press star followed by one at this time. One moment for the first question, please. And our first question is from the line of Thomas Maul from DZ Bank. Please go ahead.

Thomas Maul

Yes, thank you. Thanks for taking my question. Good morning. Maybe you can, yes, elaborate a bit more on current trading in Germany and also abroad and, yes, which factors or developments give you confidence to reach your sales guidance? How robust is demand at the moment? Yes, thank you.

Karin Dohm

Yes, thanks for that question. So two thoughts which drive our considerations here. On the one side, as you saw, we had good sales in Q1. We also were negatively influenced in Q4 last year, so we also see there a comparative uptick basis for this upcoming Q4, so that means December, January, February.

Nevertheless, we of course see a couple of, so to say, challenges specifically in our Q2 and Q3. So those are the two let's say, yes, big development streams that we see the one obviously in favour, the other more against us.

Thomas Maul

Okay, thank you.

Operator

The next question is from the line of Thilo Kleibauer from Warburg Research. Please go ahead.

Thilo Kleibauer

Yes, hi, good morning. I have two questions. The one is on the sales development. Maybe can you give us a little bit more insight into the 8% sales growth of Q1? So what was the number of customers, of orders, so overall an indication on customer frequency. And how has the average ticket size developed?

And my second question is on the opex development. We have seen a significant increase in selling and store expenses of 10%. Should we expect this to continue for the remainder of the year? And what should we expect in terms of wage inflation in the coming quarters? Thank you.

Karin Dohm

Yes, thanks, Thilo. So I think going backwards, if you allow, wages and potential wage increases. Obviously the majority of wage developments in Germany, where the majority also of our employees by a share number is based, is driven by the negotiations with workers council or trade unions.

So the majority of what we have in this year has been negotiated last year already and so what would come then now would more affect the next year than the current year necessarily. So, therefore, that I don't see as a massive impact for this year honestly.

In some other countries, we had increases actually last year, which you partially also see now in the figures because… Let me take Czech Republic once again as an example where we had already last year inflation. We had some substantial wage increases there which were totally in line with macroeconomic developments, so nothing outstanding.

I would call it more a normalisation actually and I think therefore that is not a major concern from my point because ultimately that as a tendency comes in always a little bit later than the price changes you see on the purchase and on the sales side. So I think that is not something that I would expect to turn the picture substantially.

You also asked about, so to say, the opex, the operating expenses. Of course we had specifically in Q1 the, so to say, the combination of both the classical logistical costs which were increased, as they were for everybody, because due to fuel and other price increases.

We also had of course increases in our own energy bill, although Q1 spring season is not necessarily the season where we need to heat our stores. But of course, as said, as far as logistics is concerned you have that effect. So to that point, I think we will honestly all be in the same boat. That depends heavily on the question of energy prices in continental Europe throughout autumn and winter.

We are of course preparing for any scarcity. We have not only reinforced our anyhow existing plans to make sure we reduce our energy consumption, also independent of the Russian Ukraine war, to make sure we address some of our ESG ambitions. But specifically now of course in this situation to make sure we can go through the next winter with as little energy consumption as possible. Nevertheless, we are there, as said, in the same boat as everybody else ultimately.

Operator

Ladies and gentlemen, as a reminder, if you would like to ask a question, please press star followed by one on your telephone. Our next question is from the line of Ludovic Allegre from Kepler Cheuvreux. Please go ahead.

Ludovic Allegre

Yes, thank you. Good morning, all. So I have two questions. The first one is, is it possible to have a breakdown on your sales development between the pros and the DIY, and have you seen a difference in trends between these two types of customers recently? And my second question is, are you seeing any signs that a rising interest rate is starting to have a negative impact on your business?

Karin Dohm

Yes, thanks for those questions. So on the sales side, pros versus, so to say, full-time retailers, that's roughly one-fifth versus four-fifths. So I would claim around 20% are pros and the rest is really buying for themselves, so do it for me versus DIY in the pure classical sense.

What we see as changes potentially in behaviour, we still have increases in the shopping cart. So people buy still and

	increasingly partially in a project focus. So they buy then more things that apparently match together, so the tile and the glue for the tiles or things like that.
	And we see less just as spontaneous, yes, small things where people just do a little shopping here and there. So it's more that things become more focused and then it's usually a larger bundle of goods than before, and that of course also has influence on the size of the average checkout ball or receipt that we see happening. Sorry, I think I forgot a part on the rising interest rates.
Ludovic Allegre	Yes.
Karin Dohm	Antje just corrected me. Yes, so not yet necessarily because obviously the Baumarkt business is really very, very much in this home improvement. That's not so much related to the building. Building industry of course is affected and starts to become affected. Our main business on the Baumarkt side is really the home improvement, so existing buildings where either individuals or an owner of potentially several flats or whatever is looking into some, yes, ameliorations.
	And what we see, for example, you see of course side-effects of people facing their own increased energy bill, so insulation is currently, yes, grabbed out of our shelves with an immense intensity, so no surprise there. So you see the corelation between what is happening outside and what we observe in the shopping behaviour of our customers.
	Hornbach Baustoff Union, our subsidiary which is more focused on or has a stronger relation, let's claim it that way, to the building industry, they see some effects in some instances of the increased interest rate or the less favourable refinancing for some large building associations or others. So there is a certain connection, but on the Baumarkt side itself not really, no.
Ludovic Allegre	Okay, thank you very much.
Operator	We have another question from Johan van den Hooven from Value8. Please go ahead.
Johan van den Hooven	Yes, good morning. It's Johan van den Hooven from Value8. Two questions, please. Looking at the competition and pricing, do you see competitors move in their pricing behaviour which might affect your pricing policy? And the second question is, the gross margin, we have seen it trending down a bit and now of course we are on 34% due to the pricing impact. What do you see for the longer term for the gross margin as being a sustainable level? Thank you.

Karin Dohm	Yes, thanks for the question. Regarding competition, I mean it depends a little bit on the countries, it's slightly different. But in its difference, I would claim it's relatively unchanged. Fierce competition in Germany as always, less fears in other countries where we're active. Nevertheless, we're still on that path of the journey where due to the logistical challenges, due to the effects of the disturbed chains following the Russian Ukrainian conflict, you still have more scarcity and challenges in obtaining goods than in, so to say, than the other side of the medal. Therefore, you currently do not have any race to the bottom where competition is driving each other into a price decreasing spiral or so. And I think if things would change on that side, then you also would have a relaxation effect on the supply price development. So I think honestly it might come in with a difference on the timeline, but when prices change they usually have a tendency to, on average, change on both sides, so to say, of the building.
Johan van den Hooven	Okay, yes.
Karin Dohm	What I'm trying to say there also is, yes, of course we would like to see the gross margin going up again and there might be, so to say, some unfavourable developments over the next course of the month. But I see that really as a cycle and therefore I think it is something which is not unchanged when you link that with competition. It's just now we're on a certain path and then afterwards comes, so to say, the next wave.
Johan van den Hooven	Okay. Perhaps an additional question on the gross margin, which has gone down a bit due to the higher share of the ICR. How do you see the gross margin developing from the shops and ICR? Can ICR meet the shop margin in the future?
Karin Dohm	Yes, in general, the margin of our online sales is a little bit lower than the margin in our stores. Two reasons for that. Number one, product mix. We sell less own or white label products in the online world than in the stores. Second, logistical costs, which you can't always 100% pass on by sheer nature of the business. That means whenever we, as currently, have a reduction on that side, the average margin is then increasing. On the other side, when the online part grows, you can scale of course the online business way more efficiently than you can scale store business. So therefore that's one of the main reasons why we're relatively agnostic also and say, look, as

	long as we grow, as long as we have good sales, both sides are warmly welcome.
Johan van den Hooven	Okay, thank you.
Operator	We have a follow-up question from Thomas Maul from DZ Bank. Please go ahead.
Thomas Maul	Yes, thank you. You just gave us an update on the basket size. Did I get it right that the basket size is increasing?
Karin Dohm	Yes, it is.
Thomas Maul	Okay, and just a short follow-up. So basket size is increasing and what is actually going on with regard to footfall? What about customer frequency in your stores?
Karin Dohm	Differently. Difficult to really give a straightforward answer. In some instances we have of course, specifically in Q1, in some instances you have of course strongly increased footfall because stronger seasons. Springtime and those areas where we had good weather and no closures in comparison to the previous year there was of course a strong increase. In some areas, specifically currently, not Q1, but what we observe now, we have decreases because parts of Germany, for example, were on holiday two weeks in June so that brings down footfall. So difficult really to give you a clear what's the new normal answer.
Thomas Maul	Okay, fine. Thank you.
Operator	So there are no further questions at this time and I hand back to Antje Kelbert.
Antje Kelbert	Well, thank you very much. Thank you also for all your interest in Hornbach and your time this morning, that you participated in our call. Whenever you have remaining questions, as usual, please do not hesitate to come to us, to contact the investor relations department and we can take that up. And you see here also our financial and upcoming events, so we hope to see you at the next conferences which are more and more now also physical, and we are happy to go once again on conferences and participate in roadshows and so on. So you will always be able to find the latest version of our financials and event calendar on our investor relations website. So, once again, thank you very much for taking your time this morning and I wish you a successful and pleasant day. Goodbye.