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BME.L - Q4 2019 B&M European Value Retail SA Earnings Call

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PRESENTATION

Sundeep Arora *- B&M European Value Retail S.A. - CEO & Executive Director*

Good morning, and thank you for joining us this morning as we talk through the results for B&M for the year ended 31st of March 2019. Good morning to you, all.

Perhaps we'll start with a few highlights from myself. I will then pass over to Paul, our CFO, to talk you through the financial statements. And then I will provide some commentary on the different parts of the business and give you further insight hopefully into how we're performing.

So the headline, of course, is that the B&M Group in the last financial year achieved pretty much GBP 3.5 billion sales, which we're delighted by. Behind that headline, our U.K. business opened stores, as you can see, and we also generated a modest amount of like-for-like. But the year ended very strongly indeed with a plus 5.8% like-for-like in Q4, which actually is nearer 6.9% if you adjust for the fact that Easter didn't fall into that quarter and the previous year fell into week 53.

When I do return to my commentary, I will be talking in some detail about our European businesses, both Jawoll and Babou. I'll be talking about early doors. But the summary in terms of earnings for the group is that we grew our EBITDA by 12% to GBP 312 million. And as a consequence of that, we declared a dividend today at 7.6p as the full year amount.

So Paul, would you like to talk through some more detail numbers, please? Thank you.

Paul Andrew McDonald *- B&M European Value Retail S.A. - CFO & Executive Director*

Okay. Thanks, Simon, and good morning, everyone. No apologies for a very relatively similar set of slides that we normally show. But just a couple of a shout-outs into the overall things that I'd like to mention. Overall adjusted EBITDA for the group, nearly 12%. Gross profit margin grew by 18 basis points overall. And just to mention, the most of the comparisons -- all the sales and EBITDA comparisons I'll be going through will be against the 52 weeks from last year. If you remember, last year was a 53-week year, but the comparisons we've shown go against the 52 weeks, just to make sure of that comparability.

So just in terms of kind of, obviously, revenues, revenues overall grew by 17%. In terms of the, obviously, in terms of the U.K. business new store sales, GBP 182 million in terms of the -- both the FY '18 stores annualization effect plus the FY '19 stores.

Just kind of couple of shout-outs in terms of kind of modeling going forward, in terms of the FY '19 stores, we actually achieved about 50% of the total revenues in FY '19. So therefore, the balance is to come in FY '20. And in terms of kind of modeling for around the FY '20 new stores, we will -- given the phasing of openings, it will be approximately 55% of the sales will come out and will be delivered in FY '20.

The -- couple of things to kind of shout out. You probably see, we did have some wholesale revenue as well last year. We have a small -- we're doing a bit of a kind of wholesale into a small Republic of Ireland retailer, and it's -- that's about GBP 12 million of revenue. It doesn't even feature on the EBITDA bridge because it's a relatively kind of low-margin business.

Couple of other things to mention. Heron has had a good year, nice positive LFL performance. And just to make the point, obviously, we had about GBP 121 million of revenues came from the period that actually wasn't obviously a comparable period and which we didn't actually own the business because if you remember we only acquired the business in August '17.

Jawoll delivered 6% revenues and nearly GBP 130 million revenues from the ownership of [canon] Babou.

Moving on to EBITDA. Yet again, same, same, same features that we normally see. Obviously, in terms of the core B&M fascia, the growth, that's kind of arising from the new store program, the FY '20 batches -- FY '19 batch of stores with another good group of stores. And obviously, we've certainly seen some good performance from them.

In terms of Jawoll, in terms of the delta there, we had a -- last year, you remember, there was nearly a GBP 6 million EBITDA, which has swung to a GBP 10 million EBITDA loss. Simon will give you a little bit more color around some of the drivers around that.

And probably, obviously, Heron with another GBP 8 million, part of that's the annualization part of our ownership and nearly GBP 6 million from Babou.

And probably another kind of key point to mention is if you look at core B&M fascia, our EBITDA margin grew by 45 basis points, so strong performance in the U.K. And probably a good thing to think about, that this is also the point that we're actually at our sweet spot in terms of DC capacity. Basically, we've kind of pretty much maxed out in terms of DC capacity ahead of the new investment that's going to happen this year as we kind of [add] as the new facility comes onstream.

Turning to our moving on to LFL sales for the kind of key B&M fascia. As Simon said, LFL was -- over the year was just under 1%. But if you think -- probably, if you think about the year, the first 3 quarters of the year were a bit more challenging. And probably the big shout-out in that really was probably the performance of homewares, where we actually -- if you set the impact of homewares, which we've kind of flagged before, it was nearly -- it had a drag on the overall year of nearly 2%. Although encouragingly, what we saw in the, I'd say, in Q4 was a strong kind of rebound.

I think you remember back to last year, we obviously, we had that -- March last year, we had the Beast from the East, which certainly impacted sales performance. But equally, if you look at the period January and February this year, which was prior to the Beast from the East, we were still trading 5% like-for-like. So this is just not a factor of kind of you just got some benefit from the easy comparison last year. Really, we were trading very well in January and February.

As we move on to kind of gross margin performance across the group, some kind of moving parts to kind of discuss. In terms of the B&M fascia, nearly 30 basis points higher than last year. Yet again, we still have some of the outburst impact of the mix impact. Grocery and FMCG has continued to perform very well in the year. There's a little bit of drag from [third bee], as I previously mentioned, the wholesale margin. But what this has been offset by is the really good strong sell-through on seasonal products. If you remember last year, the summer, we kind of run out of gardening stocks. And equally, I think we probably flagged it in the current year -- the Q3 call, the other performance of areas like Halloween and seasonal Christmas decorations, where we bought less but we actually achieved more gross margin on those product areas.

Heron, lower gross margins than last year. We have -- they had some strong LFL sales. And actually, a lot of that's being driven by the B&M ambient food offer and it does have a higher mix of branded products, which has a slightly lower gross margin. But we'll see later if it's been offset by some cost savings.

And the other kind of key factors around Jawoll. We clearly flagged that we were in this year of actually clearing old stock from kind of previous years, and the overall Jawoll margins were nearly 400 basis points lower than the previous year.

As we move on to operating costs. Yet again, B&M fascia, in terms of the core B&M fascia, we were 16 basis points lower than last year. Some of the key shout-outs there really. We've largely managed to mitigate the impact of the living wage. The living wage is another 4%, 4.5% increase, cost increase. That's largely being managed by our operations team, have done a great job. And yet again, you're starting to get back the operating leverage effective -- actually, basically, the warehouse basically be gearing much more towards capacity.

I've mentioned previously, Heron's got some lower -- kind of got some operating leverage from some of the new store program. And the other area probably to shout out, which Simon will give a bit more color on, is the fact that Jawoll operating costs had -- are 368 basis points, [fairly] higher than last year.

And one last thing to mention really in terms of kind of modeling, if you're thinking about FY '20, the depreciation rate, kind of 1.5% is the right figure to use in terms of modeling depreciation.

So in terms of kind of group interest expenses, a bit of an increase year-on-year relating -- principally relating to the fact we had some debt to actually acquire Babou. Yet again, FY '20 interest charge will be around GBP 23 million. And the other probably interesting thing is the -- we had to -- remember in terms of the Jawoll minority interest, this is the year which we buy that out. And as the results of the performance, we actually ended with a credit of about GBP 8 million in the P&L, which goes through interest charges.

And in terms of cash flow -- in terms of cash flow, yet again, continues kind of strong cash flow generation from the business. Our net debt-to-EBITDA reduced to just under 2x. And probably one thing to really flag, to date, we spent nearly GBP 80 million on the land and the build cost of the new warehouse at [cana] Bedford. So if you actually allow for that GBP 80 million, our kind of underlying debt is about 1.75 turn. And if you remember, our intention is actually to do a sale and leaseback on the facility.

I think that's probably the key points. Back to Simon.

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

Thank you, Paul.

So let's start with our German business, Jawoll. There are 2 key things to talk about here: first of all, the gross profit percentage; and then secondly, the costs that have been incurred over the course of the 12-month period.

I think we've been very clear for some time now with investors that the business did need to go through a painful process of clearing out legacy ranges; slow-moving products; clothing, for example, that do not form part of plans going forward. And clearing that sort of path is always difficult. It's painful, and that's what's driven the gross margin reduction. We see it very clearly on a line-by-line basis, a category-by-category basis, where it's the direct results of deliberate price reductions to clear out and discontinue product.

The overall health of business in terms of footfall and sales is actually fine, so it generates the positive like-for-like of plus 2.6%. But of course, the year has been characterized by getting rid of obsolete stock that just wasn't selling.

As we look forward, want to share with you that we are going through a lot of learning around what sells and what doesn't sell in our Jawoll stores. On a line-by-line basis, we're having to find out the hard way what is the right quantity buy for that fascia. We are finding that sometimes you're buying too little of something, it runs out too quickly, and we go out of stock. We also find sometimes, of course, that we bought too much, and we've got too many weeks' cover on it. So there is a somewhat ongoing process of refining the product range and getting the merchandising skills and experience together in order to properly implement the B&M model.

The second aspect of the year's performance that I want to comment upon is increasing costs, and I want to share with you that within that increasing cost, GBP 6 million is increased transport and distribution costs. Those are the costs of the business dealing with, for the first year in its history, large peaks of product arriving prior to the autumn/winter season and prior to the spring/summer season of 2019.

What I'd say about that cost on transport and distribution is that the facility that we have in Soltau isn't particularly ideally configured for what we're putting through it in terms of large volumes of containers coming from Asia. As a consequence, we're having to handle the product more times than we should. But the positive in all this is that, once we've got the proposition proven working and the product range properly refined, the nuts and bolts of sourcing out the warehouse operation will follow. There's nothing that we have to do in Germany that is rocket science. It's just all that we need to do is replicate what we do in the U.K. and have been doing for decades, but the reality is that this period of transition is expensive.

What I'd also like to share with you, though, is at a category level, what's happening behind that headline plus 2.6% like-for-like. The first thing to remark on is that the grocery category within the business is pretty stable, just a small negative like-for-like.

But here, you'll see a couple of departments that perform very strongly over the year, where in part because of they've had the benefit of the B&M supply chain and also in part because they had a successful season in one of their core competencies, which is gardening. But you'll see here toys delivering plus 50% like-for-like. That is entirely driven by the introduction of B&M lines to their shelves and those lines being well received by the consumer.

Conversely, one of the large negatives on the slide, the minus 21% that you see like-for-like is entirely deliberate. We are coming out of clothing in that business because for a number of years now, it's being in steady decline. And clothing, of course, is not a core competence or a market that we want to have a significant business in.

Homewares, another key area for us, had positive like-for-like. But as you're changing from one supplier to another supplier, you do have a deliberate one-off process of margin pain as you discount the previous version to make room for the new version.

So what do we think about -- what do we say in terms of our to-do list for Jawoll these next 12 months? The way we think about it is in these 3 different buckets: what we need to do with the product range; what we need to do in terms of the logistics; and then centrally, in terms of management and other functions.

So as you see, we just need to keep learning from what we've been doing over the last 6 months to 12 months. The B&M products started arriving in the business in the middle of last year. We are now in our second season of it. And frankly, the reality is it's going to take us a couple of years to get to the point that we obviously are in the U.K.

One positive is that the old discontinued stock that we inherited and want to discontinue is now largely gone. Less than 5% of our stocks are over 12 months old. So that pain has been taken.

On transport and distribution, the reality is that we're going to have to work with third-party logistic providers to allow us to process our stock flows over the next 2 years to 3 years as we refine the model, as we get the quantities right. And in time, we find ourselves a infrastructure that is fit for purpose and better suited for the type of logistics operation we need as opposed to the type of logistics operation we used to have in that business.

We've been investing in central overheads, but we do have some more recruitment to do, particularly around buying and merchandising. But as a final point of detail, this coming 12 months, we will open only 5 new stores rather than the 10 stores we opened last year, the reason for that being the fact that, as you've seen, our transport and distribution function is struggling with the volumes, and it wouldn't be right to increase the amounts of volumes that they're having to handle as they change their processes and learn how to do the job.

Turning now to Babou in France. This slide, Slide 16, just gives you a summary of the transaction that took place in the financial year. You'll see that over the course of the year, the contribution to the group P&L was GBP 6 million of EBITDA. And the situation in this business is that we need to move again away from clothing, which is the current 41% of the mix, down to more like 20% of the mix.

What have we learned so far in the few months that we've owned this business so far? So we've had some initial promising signs. One department that has deployed from the B&M supply chain into the 94 Babou stores is indoor furniture. You see it there on the top left-hand side. And as we see on the bullet points, the sales of that department have tripled since the B&M products arrived. So very well received.

The reality is that on a weekly basis, right now, over the next 6 months, new ranges like the indoor furniture range will be landing at Babou, and we will be deploying them across the estate. But just as in Germany, the issue is that in order to create room for these new products, we need to clear out the old products that are sitting on that shelf space. And as a result, what we're asking you to think about in terms of EBITDA for this financial year is for the business not to generate any additional EBITDA for the -- for the group but actually the strong contribution we expect to see the following financial year. But every time we speak to you, we will give you some insight into what's happening. So we expect to be able to give you some very clear information around our autumn/winter trading period on how did the B&M Toys perform, how did the B&M Christmas decoration perform, how did the B&M Housewares perform since they landed at store.

I'll now turn to the U.K., which is of course 90% of our group sales. A couple of comments on how we've perceived the market to be here in the U.K. over the last 12 months. What you see here on Slide 18 are some market indicators provided by the British Retail Consortium. It won't be a surprise to you to see that whether you're high street, out of town or a shopping mall, over the last 12 months, the market has not been giving you a tailwind. The market is flat or negative. On a like-for-like basis, 2019, largely negative, occasionally small positives. So in order to gain market share in this business -- in this market, you need to be doing some thing that's going to take customers from your competitors.

What we show on Slide 19 is our view of what the consumer is currently thinking. This is a online survey of 2,000 British shoppers asking them about their shopping habits. And what you see here on the left-hand side of this chart are the sentiments that are being expressed by British shoppers that in essence are all about saving money. The pink bars are around switching either the product that you buy or where you buy it from. The yellow bars are trading down to save money, and the red bar is buying less in order to perhaps waste less. But the reality is if you're a value-led retailer, what we do is going to resonate with those sentiments. And as a consequence, it's no surprise to see that as you look at U.K. retailing, Slide 20, the retailers that are growing their revenues have one thing in common -- they're discounters. They're not the legacy retailers that the discounters are taking market share from.

Paul gave you some insights into our like-for-like by quarter and indeed shared some monthly insights around Q4, the fact that the plus 5% that you've seen has been pretty consistent through the quarter. It's not just a huge number up against the Beast from the East.

What I'd like to do on Slide 21 is to give you some insight by category rather than by calendar.

First thing to observe and comment upon is that whilst over the course of the year, we generated a modest 0.7% like-for-like, the metric that we really look at in our business internally is like-for-like cash profits, and that was a much more healthy plus 2%.

You've heard us previously talk about this product category L -- sorry, category O, the third from the bottom. This is our Christmas decoration range. So we sold 10% less Christmas decorations on a like-for-like basis but made 10% more profit in doing so. It wasn't just Christmas decorations. You'll see other categories, where we had a negative like-for-like sales but a positive like-for-like cash margin if you look, for example, around category M and category K.

We have, however, in our announcement asked investors and analysts not to model a 5% like-for-like for the year. That would not be realistic. It's worth commenting that some of these categories that performed very strongly were hugely benefited by the record hot summer that we had in 2018. Whether that was World Cup or whether it was the hot summer, we mustn't expect that to replicate itself year in, year out. These things come and go.

But what I would like to do is spend a couple of minutes talking about one of the categories that performed very well, up here at the top -- left top-end of the chart, and then I'll talk -- that's the Toy department. And then I'll talk about one of the categories that underperformed and what we've done about it, and that's the home category.

So on Slide 22, we talk about toys, which performed very well, significantly outperformed the rest of the business over the course of the last financial year, and we find ourselves now owning 10% of all off-line bricks-and-mortar toy retailing in the U.K. The fact that we now have 10% of the U.K. bricks-and-mortar sales in toys means that our shelves carry all the latest products. And as we look forward to this year and we look forward to the launch of Toy Story 4 and Frozen 2, 2 very important franchises for the toy market, we will have the right products on shelf from the day of launch as opposed to the situation, shall we say, 4 years, 5 years ago, where we wouldn't be given access to those products on day of launch because we'd be seen as a secondary retailer as opposed to a retailer that should be supported. But a note of caution, please don't model this 5% like-for-like for the year because that strong performance that we experienced last year on toys did benefit from the exit of Toys "R" Us from the U.K., and we are now currently annualizing that strong gain.

Turning to home. So we've shared with you pretty openly that the homeware category, which is very important to us, has been a drag on performance over the year -- financial year that we're reporting on. I think Paul mentioned about a minus 1.8% drag on our company LFL. We took steps in the summer to deal with it. By the fourth quarter, we're starting to move in the right direction, and I'm pleased to share with you that on a year-to-date basis for the current year, the department has moved firmly into positive like-for-like.

But just like the Christmas decoration department, and there's other 2 departments I referenced on the earlier slide, we're focused on good sell-through and achieving margin rather than promotion activity and chasing turnover. So we're not going to go hell for leather for huge like for likes. We want to achieve good high rates of sell-through at full price rather than find ourselves with too much inventory and having to discount it or having to do promotion activity around blanket discounts at a weekend, for example.

We mustn't lose sight of the fact that the main engine of growth in this business continues to be our new store program. You'll see on Slide 24 these store openings for the year. And as you can see, it's both new stores opened in the south moving into new territories, but also plenty of infill opportunity as well.

Slide 25 is a new one that you won't have seen before but we think is really interesting. Because (inaudible) retailers (inaudible) Yorkshire, Sheffield, North Wales, we are still underrepresented. And so as you look forward over the coming year and the years thereafter, we have just as many infill opportunities in those parts of the country as we do in the south or southeast; point being, of course, we ended the year only at 620 B&M stores versus the U.K. store target of 950 that we have published.

I'd like to give you a little case study and insight into what we mean about infill opportunities, because it really is a remarkable feature of the B&M business model. The town of Stoke is in the northwest, halfway between Birmingham and Manchester. And if you look at the map, you'll see that from the town center of Stoke, there are 5 stores within 3 miles. These little orange flags denote the B&M stores. So each of these 5 stores are no more than 15, 20 minutes away from another B&M store. And even though we first went into Stoke 15 years ago, only a few weeks ago, we opened another store in Stoke, our store in Wolstanton, literally only a mile away from the nearest existing B&M.

Having opened 500, 600 of these things, we know within a few weeks of opening how it's going to perform over the course of the year. You can model it really accurately. And we know that notwithstanding having opened the fifth store in the catchment of Stoke, that these stores will together generate a store contribution of GBP 5.7 million, which represents a very healthy return of 17% on sales and absolutely makes sense for us to have opened that fifth store in Stoke.

A comment on rents. So within this store contribution number on GBP 32 million of sales in the region of Stoke, store rents are only 4% of revenues. This is not a business model that is heavily exposed to store rents.

Leaving aside the new store program, let's turn to marketing. We are, we believe, also differentiated from other U.K. retailers because we don't need TV advertising or large volumes of print advertising. Our TV advertising spend in the year that we've just reported on was a big, fat 0. What we believe is the future is using modern-day digital technology to drive interest and excitement online in order to transact off-line in our stores.

You all be aware that Instagram is the growing social media tool at the moment. And absolutely in line with the market, our number of followers on Instagram has more than doubled. Similarly, our website continues to attract shoppers to come and browse the products, to see what's new. And we think that's a remarkable number. For a website that doesn't transact with you, the fact that 1.2 million people come to every single week to see what we've got new tells you how engaged they are by the newness that is a part of our business model. Don't forget, we introduce 100 new lines every single week.

We give here an example of how we engage our customers. Mission Christmas is a great initiative where -- that fits firmly within the sort of values and the positioning of B&M as a family store, something for everyone, lots of toys, lots of Christmas decorations. And our stores act as a collection point for this very worthwhile charity.

We also now have the B&M app, which allows you to see what's new, find out the opening hours of your local store, and indeed barcode-scan a product in your country and find out what price B&M sell it at.

Quick update on Heron Foods. Delighted with the acquisition. It's gone well. Had a positive like-for-like performance, actually better than the B&M one. Opening new stores and plan to open new stores in the coming FY '20 year, another 20 stores.

Quick comments on frozen and chilled because we haven been talking about that in previous presentations. You'll recall that one of the strategic rationales for acquiring the Heron business was to give us a plug-and-play frozen and chilled offer that we could deploy in B&M. The update on that is we're waiting for Bedford to become operational. And at that time, we'll obviously be running the maths, the evaluation between what's the return on space of that frozen and chilled versus return on space on the various different general merchandise categories that would need to come out to put that product in. So we'll be reporting more on that early next year.

On the topic of Bedford, delighted to report that we've started fitting out the facility. You've heard -- you've seen the numbers. We bought the land in the previous financial year at GBP 44 million. In the financial year we're reporting on, GBP 21 million has been spent on building the structure.

Important couple of bullet points here around your modeling for FY '20. When the sale and leaseback goes ahead, the facility will be costing us GBP 6.5 million per annum. We expect that rent charge to start hitting us from September this year. And if you put together that rent charge and the one-off costs for commissioning, recruitment and training, the total in aggregate of rent and setup costs in the FY '20 year is a total GBP 12 million, we think. As a point of -- as an aside, the development gain on the sale and leaseback will compensate us in full for that one-off costs in FY '20. It'll be shown as a exceptional rather as an operating cost offset. But of course, the operational efficiencies of having a DC in the South won't be seen until FY '21. We'll be cutting back by a very significant number the amount of miles we travel in our lorries around the U.K. Because, of course, at the moment whether it's Penzance or whether it's a [stand here], every day, our lorries are having to travel from Liverpool as opposed to a DC in the South.

Few words on our capital structure. Paul has already shared with you our net debt:EBITDA. We ended the year at 1.99, but if you strip out what's been spent on Bedford, that's 1.75x. You will recall that as a Board, we've shared to the market that we're comfortable with 2.25x. And so what that tells you is that once the sale and leaseback has taken place, in addition to the surface cash generated by the business core operation, there'll be the surplus cash that's currently tied up in that bricks and mortar.

So a few comments on the outlook. In terms of the core B&M business, which is together with Heron about 90% of our sales, there's real positive momentum in the business. What we're doing is clearly resonating really strongly with consumers, and there's no dispute about it, we're winning market share.

We just had our best-ever Easter. Absolutely delighted with it, but it really isn't sensible to model those sort of like-for-likes going forward for the full year because that's not how the real world operates.

New store programs, going really well. Really excited by some of the stores that we've got in the pipeline. The reality is that other retailers are going through CVAs. They're closing stores. Developers are coming to us because they know that we're one of the only few shows in town should you need a tenant for a site that you've got, so that's all looking very good. And similarly at Heron, we're asking you to think about ongoing store opening program carrying on.

We do need more time in the Jawoll business. That's going to take us a couple of years. And certainly, this year is all about change at Babou.

We're sharing that we're not currently looking at any M&A. We've got plenty to do across our 3 core markets in terms of organic growth. We don't need to do M&A. And so certainly, after the Bedford sale and leaseback, we have the high-quality problem of having surplus cash relative to what we consider to be an efficient balance sheet.

And so overall, we're feeling good about the world. As we think about FY '20, we're cautiously optimistic that we can continue to generate profit growth and cash generation.

So perhaps, we can turn to some questions.

QUESTIONS AND ANSWERS

Jonathan Pritchard - *Peel Hunt LLP, Research Division - Retail Analyst*

Jonathan Pritchard at Peel Hunt. Three-ish, if I may, involving the sort of fascia, Heron to B&M Express and Jawoll to B&M, I think you've [called] both of those ideas. Where are we on that?

Potential for U.K. gross margin, if homewares does recover, takes a bigger part of the mix, possibly at the expense a little bit of, again, [stefen, CG] and food, should we expect that to be a driver of gross margin? Should we see the gross margin expand?

And just to clarify on -- also on the distribution center, you don't need a new distribution center, it's just reconfiguring that one? There is no argument that you start from scratch somewhere else?

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

Good questions. So in terms of the Heron business, we do have about 20 stores that are being rebranded as B&M Express. What we have found is that, that hasn't materially moved the sales in those stores upwards but hasn't hindered the business either. The current plan is just to pause and wait because we're effectively deciding on a site-by-site basis whether it makes sense to call a store Heron or whether to call it B&M Express, large part driven by what's the proximity of the nearest B&M.

In terms of your question on gross margin and the impact from home performing well and perhaps helping the gross margin, I think we've flagged that some departments really strongly overperformed over the last 12 months such as toys. And you can't annualized at that level of overperformance. So I think it will be offset the other way. So we're not budgeting any gross margin expansion beyond the current status quo.

And then finally, in terms of the question on the DC in Germany, no current plans to change it, but what we will be reliant upon is much more support from third-party logistics companies, which comes at a cost. But certainly, there isn't any large CapEx proposal on the board at the moment.

Simon William George Irwin - *Crédit Suisse AG, Research Division - Director*

Simon Irwin from Credit Suisse. Three for you. Can you talk about Bedford once it's open in terms of the impact of full rental charge, once assuming you do the sale and leaseback and the fact that it's presumably going to be subscale in the initial stages versus obviously the lower mileage?

Second is just on Babou, where it feels like that's another small downgrade to expectations in terms of profitability over the full year. What's changed since you initially bought the business?

And just in terms of the U.K. store rollout, every time you talk, you seem more optimistic about returns and availability of space, but the overall store numbers seem to be kind of slightly less than we expect each time. So kind of what are the dynamics there? Is it just churn?

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

Thank you. So in terms of Bedford, the full year rent cost we've shared is going to be GBP 6.5 million. You can model rates and other property occupancy costs yourself pretty straightforwardly.

The reality is that as you grow a business like ours, you have these step changes in your fixed overhead around warehouse capacity. The reason why our B&M operating margin is at a pretty much an all-time high actually this year is because we're at the limit of the current capacity. And so yes, there are some inefficiencies as you grow into it, but you grow into it over a 2-year period. So there will be some. But don't lose sight of the fact that we will be saving a lot on transport. Of our total transport and distribution costs, half is transport, half is warehousing. So as we reduce the number of miles we drive, you do get that offset.

And in terms of Babou, I think what we're saying is that when you're having to force product off the shelves to make space for the new product, it just comes at a cost. And strategically as a business, we want to demonstrate success in Europe sooner rather than later. And so rather than taking our time forcing that stock off the shelf and minimizing the gross margin impact, we take the view that in the context of a business that makes over GBP 300 million a year of EBITDA, the single-digit EBITDA movements that you might -- the cost -- the additional cost you might take or additional pain you might take to accelerate the process is worth spending.

In terms of U.K. rollout, the only reason is just the fact that we closed 10 stores over the year. But if you look at the EBITDA bridge, doesn't really have an impact on EBITDA, the store numbers, the stores that are closing, unprofitable stores, the stores from 10 years ago.

Couple of rows back.

Adam Gareth Cochrane - *Citigroup Inc, Research Division - Director*

Adam Cochrane from Citi. Three questions seems to be the norm now, so I'll give it a go. Firstly, on Germany, you mentioned briefly the impacts of rebranding B&M Express in the U.K. But what has been the impact in Germany?

Also in Germany, can you give us an -- the German numbers swung around a bit more than I expected. I've been pretty bad at forecasting that. Can you help me for next year what EBITDA might look like in Germany specifically?

Secondly, how do you increase the price messaging in the U.K.? It feels like when I go into a store, it's become a little bit clearer about your price messaging. Is that something you've done deliberately to try and reiterate your value credentials, given what you're talking about in the market?

And then given there's more space, et cetera, available and on that chart you showed to the right of B&M, sadly Home Bargains, are the competitors able to access this new space? And are you seeing a tick-up in the intensity as well?

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

So in terms of Germany, the rebranding, there are only 6 stores out of the estate that have been rebranded as B&M, so it's very much a trial. Where we -- and of those 6 stores, 5 were new stores. So it wasn't rebranding. It's just let's open a B&M to start with rather than do a rebrand.

And for the store that we did rebrand, we saw an uplift. But we -- again, we're pausing because the priority is to get the product range right first before we spend the money in investment on marketing and getting the message out there. So just a lot more work to do around getting the product range right.

And the reason why we're not being more explicit on FY '20 EBITDA is because we're only 6 weeks into the year, and it will be volatile. On a line-by-line basis, we will occasionally strike gold. And occasionally, we will have bought a pop, and that will be expensive to move on to the next situation.

Unidentified Analyst

By volatile (inaudible).

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

Absolutely, yes that would be our expectation. But in terms of -- what I mean by volatile is we can't give you -- we don't have a crystal ball that tells you what is the gradient of the line back to acceptable profitability.

In terms of the in-store observation you make, thank you for making it, because we absolutely have spent more on in-store point-of-sale. We feel that customers come to us through word-of-mouth, the fact that we're a destination now on certain categories like toys. And here we are, we think, the best value in the market. So let's shout about it.

And then finally on your question about Home Bargains being neck and neck with us this year, slightly having [pipses] on the percentage revenue growth, that's because they've got a smaller denominator. That's my competitor's [fruit] coming out, I'm afraid. But yes, no, they're a great retailer. But absolutely, it just validates what we're saying, which is the retailers that are winning are the value retailers.

We'll go to the right in the room.

Tushar Jain - *Goldman Sachs Group Inc., Research Division - Research Analyst*

This is Tushar from Goldman Sachs. Two questions. One is just, can you give us what is the B&M source mix in Jawoll currently? And is -- we can expect this to slow down given the transportation issues you have? Or you're going to keep trying more harder and harder to get the mix right over the next year?

And second question is on Babou. Is it possible to have these kind of transportation and distribution issues in Babou? Or you think the warehousing capability is good enough there?

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

Good questions. So in terms of the mix, in terms of general merchandise, we are probably about 60% of sales on our B&M supply chain. We don't see that increasing materially from where it is.

And in terms of how does the DC cope with that, it's more just dealing with the peaks. The problems are around the peaks, not the day to day. So it's the pre-autumn/winter peak and it's the pre-spring/summer peak, where our costs escalate because we're having to rely upon third-party providers to help us.

In terms of Babou, so far, they've coped well with the flows of product. It is a very different type of warehouse. It is more suited to importing -- they did a bit more importing themselves. And -- but again, as we look forward, it may be that we have costs around 3PL supports as the business gets better used to the amount of change that it's going through.

Unidentified Analyst

It's Greg from Shore Capital. Could you talk a little bit about rent reviews and what you're seeing in your negotiations with U.K. landlords?

Paul Andrew McDonald - *B&M European Value Retail S.A. - CFO & Executive Director*

Yes. I think broadly, I think they're very site-specific essentially. I mean they are some sites which continue to be highly competitive. Equally, there's a number of sites where actually the rent reviews are quite benign. I think so overall, it's relatively kind of flat. I think the key point is to remember the vast majority of our estate was really kind of acquired post-2008. So actually, our rental levels were already at the kind of lower end of the market rates because we benefited from that kind of shift in the market that happened in 2008.

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

In the front here. Thank you.

Richard B. Chamberlain - *RBC Capital Markets, LLC, Research Division - MD of Consumer Retail*

Richard Chamberlain, RBC. A couple for me, please. So first, going back on Jawoll. Simon, I wonder if you can just comment on the performance so far in Q1 of the newer ranges. I guess now that the old ranges have been cleared because it sounds like that was sort of getting in the way of the newer ranges coming through.

And the second one is just a more general question about the buying environment and that issue generally in China, I guess in the light of the recent weaker sterling trend and whether you expect that to lead to a more intense promotional environment in the U.K. later this year or early next year.

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

So in terms of new ranges in Jawoll, what we're finding is that it's very much specific on a line-by-line basis. It's hard to generalize. And so whether it's toys, whether it's gardening, some lines flying, some lines not selling at the rate of sale that we'd had hoped for. So that's really why we're saying that the Jawoll business is going to take longer than we need -- we think, but we remain just as confident that the proposition will work.

In terms of China, Paul, do you want to talk about hedging? Because that's probably the most relevant issue in that for us.

Paul Andrew McDonald - *B&M European Value Retail S.A. - CFO & Executive Director*

In terms of the financial year, we're kind of fully hedged. We took the decision to hedge longer than we normally would do. I mean actually, it turned out to be a good decision at the moment given the rate's around 1.27. So that's been -- it proved to be a good decision to date.

I mean equally, I think there could be some more currency volatility but we don't play; we're just in the business of managing that risk rather than -- it's a key part of it.

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

So China, generally, it's --

Paul Andrew McDonald - *B&M European Value Retail S.A. - CFO & Executive Director*

We're not seeing any impact just yet.

Simon Bowler - *Numis Securities Limited, Research Division - Analyst*

It's Simon Bowler from Numis. So just kind of follow-up from a couple of bits and pieces around Jawoll. Firstly, with regards to kind of logistics, to what extent does that weigh on your ability to actually trade through the ranges if you've got challenges to getting the products through the business?

Secondly, some of the issues have been -- come across with regards to logistics, to what extent could or should they have been foreseen to your mind with the benefit of hindsight?

And then third, I was wondering if you can comment around what proportion of your own time you're spending on Germany or is being taken up by that region.

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

You're absolutely right. One of the consequences of bottlenecks in the logistics flow is that it does have a short-term impact on sales because availability is not great. But those periods tend to be 4 weeks -- 4 weeks to 6 weeks around the peaks rather than ongoing.

And your second question around time. I can share with you where the

(technical difficulty)

trading directors, merchandisers, the Hong Kong office, myself personally, finance, our European businesses are getting the attention they need.

Should we take one in front here?

Tony Shiret - *Whitman Howard Limited, Research Division - UK General Retail Analyst*

Yes, Tony Shiret from Whitman Howard. Just following on from that. I seem to recall you had some -- replaced management in Germany relatively recently. Just wondered if you could give us your appraisal of their performance. And I'm a bit surprised that you're not able to transfer management out of B&M into Germany to sort of address the issues like buying and merchandising. I'm sort of surprised that you're -- they're issues for you.

And an overall sort of question on Germany. I mean you've had it for a while now. It's losing a load of money. Just wondered how long you're going to give it before you decide whether it's worth doing.

And this is a much smaller question. Can you tell us how much the sort of timing of Easter has contributed to your current sales performance, the mid-single-digit like-for-like in the U.K?

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

Certainly. So in terms of the German business, you need to recall that we didn't have management control of the business until early last year. The business for the first 4 years, whilst it's been part of the group, was managed by the previous management team that we acquired the business from and didn't really at pace move towards the B&M sourcing model.

And in terms of your question around confidence in the model and indeed the management, that remains high. This year, the business is lossmaking, but we can absolutely see why. It's because we're spending a lot more in logistics whilst we adjust to a new model, and also it's because we're having to do the one-off clearance activity around discontinued ranges. Certainly, for the 5 years that we've owned the business, this is the only year it's been lossmaking.

And our confidence in the proposition remain, and the verdict will only really come in once we've got the proposition executed properly, once we've had the benefit of 2, 3 seasons refining the product range to understand what the German consumer likes at a line-by-line basis.

In terms of your second question around Easter, Paul, do you want to just -- on that?

Paul Andrew McDonald - *B&M European Value Retail S.A. - CFO & Executive Director*

Yes, in terms of our mid-single-digit sales growth, it's around about 2%, is the kind of impact of Easter within that.

Charlie Muir-Sands - *Exane BNP Paribas, Research Division - Research Analyst*

It's Charlie Muir-Sands from Exane. Three questions if I can, please. Firstly, I just wondered if you could talk about whether you're seeing the supermarkets becoming particularly more or less aggressive on the categories that you overlap on, particularly on branded goods.

Secondly, I very much like that slide on Stoke. I wondered if you could talk more generally about firstly, what was the incremental uplift rather than what is the exposed profit of the town, what was the incremental and what you're generally seeing on paybacks on new stores.

And then the third one is I see you have a small transactional website selling garden sheds, and I've been assuming that's just a stand-alone white-label business. I just wondered if you could talk about what that is, whether you see scope in other product categories perhaps, in things that are too big to sell or take away from the store.

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

Paul, can you take the first question on the supermarket and grocery?

Paul Andrew McDonald - *B&M European Value Retail S.A. - CFO & Executive Director*

Yes. I feel -- the analysis we kind of do our own kind of pricing.

And in terms of our branded ranges, the gap that we see between ourselves and the big 4 grocers, it has remained -- continue to remain pretty consistent. That gap exists.

I think the other key feature around this really, we do -- supermarkets are going at the same products. We've always been very nimble. Being limited assortment, you don't actually have to sell our product, you can sell another one. So the buying teams are always very nimble around making sure we've always got great value products and always look to be cheaper than the competition.

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

On your question around the case that I gave you, the new store will generate actually significantly above the average store contribution of a new B&M store. So these incremental extra stores aren't dilutive at all.

And then your final question around garden sheds, you're absolutely right, it's a white-label proposition. It's not something you need to model. It's relatively low margin, but it's very easy. It's cut a day's work, and it's done.

Very good. We've only got 5 minutes left. So perhaps take a couple more questions if there are any. There on the right, please.

James Robert Anstead - *Barclays Bank PLC, Research Division - Director*

James Anstead from Barclays. Just 2. Firstly, if I believe what I read, you won't let [jeans] come under the auspices of Groceries Code Adjudicator. Was that an issue of potentially how you do business? Or just an issue of not wanting the costs associated with that.

And then secondly, can you talk about the rollout of frozen and chilled being assessed once you've got more capacity? It sounds like you're taking quite an agnostic view of that. But if the view is in the end that, that rollout isn't particularly attractive, is that the end of the justification for owning Heron?

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

In terms of the first question, we weren't entirely happy with the way that we were designated to come under the code, but actually the matter has been settled, and we will be. It wasn't a particularly important issue. It's just a question of some modest amount of fees per year. So again, not something that you would need to model, and certainly doesn't change the way we run our business.

On the question of frozen and chilled, I've perhaps been misunderstood. It's going to be down to the shoppers. It's going to be down to the performance of each department. We sell frozen and chilled food very well. It's worked well in the stores that we've already deployed it in. But the reality is as other departments have performed really strongly recently, be that toys, be that housewares, some of the categories, it's going to be down to the simple math. It's not going to be personal prejudice. We're going to run the numbers and work out what gives us the best return on space, and we'll be doing so once we got the capacity available to do so.

And on your broader question of Heron, it's performing really well. You've seen the numbers. It's generating good profits and very pleased with how it's running.

Last question at the back. Thank you.

Charles Allen - *Bloomberg Intelligence - Senior Consumer Analyst*

Charles Allen, Bloomberg Intelligence. Just talking about France. I mean should we be anticipating that the buy for clothing will be cut back very sharply for autumn/winter and that therefore and that may be one reason why there'll be a big transition in the company?

And then secondly, generally in Europe, are you worried about missing opportunities to fast-growing competing businesses that are similar to the ones you aspire to add?

Sundeep Arora - *B&M European Value Retail S.A. - CEO & Executive Director*

Sure. So in terms of the French business, you're quite right, we are cutting back clothing in order to make physical space in the store for new ranges around seasonal, around home, et cetera. And yes, that will be a drag on like-for-likes over the course of this year as you go through that transition phase. Because inevitably, as you look to cut back on a category like clothing, the way you do so is by slashing the price of it, which necessitates negative like-for-like for a period.

On your second question around competitor activity, I think one thing that I'd really like to emphasize is that we are absolutely convinced that none of the issues in, for example, Germany are to do with competitor activity. It's absolutely nothing to do with that. As you saw, our like-for-likes were a positive set. So this is not a question of us losing market share to a different retailer. It's a question of inside our own business making dramatic changes, a, to the products that we're holding; and b, to how we handle the product. So the point remains that the price points and the type of product we sell are very different to, for example, an Action or the euro shops that sell everything at EUR 1. We're not just in that market. I think I answered both your questions.

Very good. I think we're done, so thank you all for coming out, and we'll see you next time. Thank you.