AO World PLC FY21 Results script

1. John Roberts, Founder and CEO: Introduction

Good morning and welcome to AO's full year results presentation.

It has definitely been a very different year for all of us. At AO, we've seen significant strategic, operational and financial progress. A real step-change year.

And we're updating you differently today as well.

We think understanding the AO journey is really important. So Mark will run through the financials in a moment and then you'll hear more from me.

At the end of the presentation, we'll be hosting a Q&A - so please stay on and don't be shy with your questions!

2. Mark Higgins, CFO: Financial Review

Good morning and thank you, John. This has been a phenomenal twelve months, and one that has accelerated the strategic and market progress we've made over the last couple of years.

Total group revenue grew by 62% to £1.7bn.

This came mainly from product sales which increased as we all switched to online shopping when non-essential stores were shut.

The mix of products in high demand changed through the year, with freezers being the first hot product as Covid hit, through to gaming and consumer electronics and major domestic appliances in the run up to Christmas.

I was incredibly thankful to all our AOers, particularly those in our logistics business, who stepped up to the plate in the early days of Covid and continued to deliver for our customers.

Our UK business grew 59%, generating sales of £1.4bn.

Our newer categories including Small Domestic Appliances, Audio Visual and Consumer Electronics all more than doubled their sales.

Gaming, DIY and mobile handsets also had a great year, although from a smaller base.

We saw strong growth in Germany, where market share doubled to over 3%.

Revenues grew 81% to £226m, and we achieved a breakeven adjusted EBITDA run rate through our peak period.

That is a great milestone and shows what we can accomplish with our One AO model.

More broadly, on a Group basis:

Product revenues grew by 74% as the electrical market shifted further towards online.

Service revenues, comprising installations, premium delivery and so forth were up by 51% -- slightly behind product revenues as Covid restrictions on entering people's homes and social distancing meant that we had to pause these services at certain times over the year.

Commission revenue grew modestly but was impacted by adjustments in Warranties and issues in mobile, which I will come back to explain in more detail later.

In third party logistics, we prioritised deliveries to our regular partners and AO customers during Covid and put new growth on hold.

Recycling volumes were particularly affected by Covid restrictions, about which John will speak shortly.

Despite the volume volatility, Recycling reported a 32% increase in revenues.

Operationally, we opened our plastics recycling facility during the year, further increasing our credentials in this area.

Whilst this has been a great year for us, don't forget – we've delivered 25% compound annual growth since our IPO eight years ago.
And, over the past 5 years, Germany has grown at 37% on a compound basis.
That means that our high growth strategy has been successful through many market cycles and so this year shouldn't be seen as a one-off.

Moving on to gross margin, which remained consistent at 18% for the Group.

It's in the business units where positive movements become clear.
UK gross margin fell slightly as a result of category mix, with newer categories typically having lower gross margin than mature categories and this is compounded by the challenges in mobile and warranties.

Despite this mix effect, margins in all categories on AO.com improved in the period.

The huge inflection point is in Germany where gross margin has moved from a loss of 2% in 2020 to almost a 9% positive margin this year.

This mainly came from the steady improvement in
- our supplier terms,
- aligning pricing with the UK, and
- the increased product sales driving scale efficiencies through our logistics operations.

What does that mean for the bottom line?

Our primary focus remains revenue growth, but adjusted EBITDA has continued to grow, doubling at Group level from 2% last year to 4% of revenues for this financial year, or £64m.

We've seen headwinds and tailwinds throughout the year from Covid, so we won't try to quantify them all;

That said, to call out just a few - in the UK, we've increased our warehouse capacity by over 80% with all the associated costs to mitigate supply chain disruption and serve customer demand.

We've created 1,200 new roles across the Group to meet this elevated level of sales and to bring in the skills to help us achieve our next phase of growth.
Our margin and marketing costs benefitted from capacity restrictions in the market when stores were closed.

And, finally, we saw lots of new customers buying our category online for the first time whom we hope will repeat purchase, time and again in the future.
UK EBITDA was £67m, an increase of 68% which was a great performance given the mix of headwinds and tailwinds we managed over the year.

Losses have further reduced further in our German business as gross margins improved and we have also reduced overhead costs and improved marketing effectiveness

In the third quarter, our run rate breakeven performance demonstrates the potential of the business to deliver profitability and underlines the confidence we have in our model.

As we look through the key line items in SG&A,
- we saw marketing costs increasing as we ran a number of campaigns to build longer term brand awareness.
- We welcomed 1.9m new customers and increased website traffic by over 80%.
- As I've already mentioned, we added around 600,000 sq.ft. of warehousing space which worked to our advantage when supply chain disruption hit, and customer demand soared.
- We were able to support our supplier partners, as we took on their stock in transit when stores closed, and we were able to meet the demand from our customers who relied on our next day service of essential electricals.

- The increase in administrative costs were primarily related to the recruitment of people across IT and the People Function to support the continued growth of our business, as well as an increase in incentive payments reflecting our performance and the introduction of the Value Creation Plan. As a percentage of revenue, these costs overall reduced from 10% percent to 8%. The strong growth helped us to achieve Group Adjusted EBITDA of £64m, up over 190% on the previous year.

Although this has generally been a great year for AO, there were some challenges.
As previously reported, our Mobile Phones Direct business was impacted by shifts in customer behaviour during the year under Covid, with much higher levels of cashback redemption and contract cancellations than our model predicted.

We acted swiftly to move to a higher upfront cost model, which reduced monthly network costs for customers and removed cashback as a sales proposition.
We've seen an increase in warranty plan cancellations partly due to household financial uncertainty under Covid restrictions.

Following a full review of the customer contract base, we have made a cumulative adjustment to reserves at year end of £11.1m with a one-off charge in the current period of £8.1m to align our on-going assumptions and estimates for the warranty contract asset.

We've finally ended our onerous contract with Payback in Germany resulting in a £2.2m adjustment to EBITDA this year.

Moving on to cashflow - EBITDA delivered in the period was a key driver of our strong performance.

Working capital inflow was then partially offset by the repayment in the ordinary course of borrowings and lease liabilities of £45m and capital expenditure of £9m.

During the year, we refinanced our debt facilities by consolidating our £60m RCF with the £20m Term Loan into a new £80m RCF. This matures in April 2023, resulting in total liquidity headroom of £143m at the year end.

Looking now at working capital:

- As you can see from this chart, inventories have increased significantly to serve strong customer demand and mitigate supply chain disruption.
- Stock holding in both the UK and Germany roughly doubled compared to last year. Inventory days increased slightly to about 30 days versus 28 previously. We anticipate that stock levels will remain higher than normal until our supply chains normalise.
- The increase in trade payables reflects higher revenues compounded with increased credit limits from manufacturers.
- Commercial income, mainly rebates from suppliers, has increased with revenue.

Looking forward, our plan is to build on the strong momentum within AO and invest in our long-term vision.

Over the next 12 months:

- We aim to lap the volatile Covid comparatives with double digit growth.
- We will invest further in marketing and digital content, particularly in the UK with a total of about £30m incrementally planned for FY22. About £5m of this is capital.
- We will invest about £30m in support systems and process improvement. Roughly two thirds is capital.
- We continue to investigate a mega recycling centre as John will talk about – the capital costs would be in the region of £20m.
- We will continue to grow our German business as quickly as we can at roughly EBITDA break even, plus or minus 2%.

We will invest sensibly in our UK business for growth, but we'll constrain these investment opportunities to within plus or minus 1% of revenue.

Our firm view is that the shift to online retail, accelerated by Covid restrictions, will continue, but we're conscious that markets are volatile and forecasting the next 12 to 18 months will remain difficult.

We continue to focus on revenue growth and taking market share; becoming the recognised category leader in electricals and giving us real scale.

To sum up, we have a strong business model built up over 20 years which is underpinned by

- our vertical integration,
- our One AO centres of expertise and,
- our clear vision for high growth potential in newer categories.

We are continuing to build scale which drives profitability and our flywheel. It is these factors that give us confidence in our strategy and our vision. And we remain cautiously optimistic about the coming year. And finally, our people have done a great job this year under extraordinary circumstances, and I would like to thank them for all their hard work.

3. John Roberts, Founder and CEO: Strategic overview

So, I'm delighted to talk to you today about what we've achieved.

But more importantly, I wanted to talk you through our strategic plan and why we're so excited about the next chapter of the AO story.

Our mission is to be the global destination for electricals and the migration to online is firmly in our favour. The plan I'll set out later will bring some scale to the opportunity ahead of us. And we intend to realise it.

In five years' time we aim to have expanded into five territories with a turnover more than double what it is today and we'll be operating in a total addressable market of some £118bn.

But before I explain more about the strategy to get us there, let me take a second to remind you quite how far we've come since Christmas 1999 when I bet my friend
Alan Latchford £1 that washing machines really could be sold on the internet.

Five months later we were registered with Companies House and selling our first few products.

More than 8m customers have now experienced the AO way since launch, with 2m choosing us in the last year.

We make around 14,000 deliveries a day across the UK and Germany and we have 1.8m sq ft of warehousing.

We employ around 4,400 AOers and have about a thousand vans a day on the road; we recycle hundreds of thousands of appliances, and we sell products across 9 categories, and we maintain industry leading NPS scores well into the 80s in both the UK and Germany.

It really has been an incredible two decades.

As I said before, this has been a significant step-change year for AO.

We're proud to have risen to the challenge for the people who matter most - our customers - and we've relished the opportunity to impress two million more of them.

Testing times are an opportunity to deepen relationships and I'd like to thank all AOers for their efforts and of course our trading partners, who've been shoulder-to-shoulder with us throughout.

This year has also been one of uncertainty for all areas of life and business.

Our immediate response to the pandemic was to invest early and boldly; to seize the opportunities created by the temporary closure of physical retail during the pandemic - and prove to new customers there really is a better way to buy these categories.

The investment in our capacity, infrastructure and people set us up to serve customers brilliantly when they needed us most.

Our culture is to treat customers as if they were our own gran, and to make decisions that would make our mums proud.

We lived this in spades and at times it had meaningful costs attached - but costs that we view as great investments in customer lifetime value.

It was certainly a time to have a well invested culture and not a time to start building one.

Our swift response to COVID and our platform - designed for scale leverage - delivered transformational results on growth, cash and profit.

Our Group revenues were up 59% with profits up 191%.

In the UK,

- We made an incredible 8% market share gain in major domestic appliances, giving us an average of 23% share across the year.

- Our share in small domestic appliances was 2% pre pandemic and rose to peaks of 5%, albeit it has settled back a little.

Consumer electronics was similar.

- This shows the sheer scale of opportunity here and that customers will vote to buy these products in some categories that are new to AO, given the right range, price and delivery proposition that we are always working to improve.
- Mobile remains a great opportunity; a more dysfunctional market I haven't seen - but the fog is clearing and the customer direction of travel is firmly towards disaggregation of handset and SIM, as we hoped, and away from contracts.

In Germany:

- We reached a profitable run rate and we expect to maintain this level give or take a 2% margin tolerance as we grow.
- We deepened relationships with suppliers and our input prices are now at near parity to those in the UK.
- We re-organised our logistics to operate on a model we had proven in the UK, with the financial output that will drive scale efficiencies now as we grow.
- Our centres of expertise, led from and largely based in the UK, now deliver virtually all the marketing and e-commerce operations to increase sales while reducing marketing costs.
- We removed or prevented complexity and management layers to the tune of about £5m of overhead annually.

At Group level we:

- Accelerated our investment in tech, innovation and improving the customer journey including a full site-wide rebrand and the launch of personalisation, with the benefits realised in the second half of this year and the years ahead.
- We've refined ways of working that will allow us to repeat and scale our model from Germany into more European territories.

- We've created around 1200 new roles and built a programme of leadership training and development as we reinvigorate a high-performance culture.

The leadership team has discovered new ways to operate and integrate new talent with deep experience.

The challenge of Covid of course brought with it headwinds and tailwinds. But one of the most important aspects was the speed with which the world, governments, customers and business had to adapt. This wasn't like a huge peak trading or Black Friday that you plan for all year. This was several Black Fridays one after another with limited planning.

Our priority therefore was to keep our people safe, while serving as many customers as possible.

We saw about 10 years of change accelerate into the last year on all levels and the overall shift of customers online, I believe, will stick.

I believe that a tipping point has been reached and we expect it to settle at around 60-65% on UK MDA, and then start to grow again, frankly, as it has every year for the last 20 years.

There's still loads of opportunity to show people a better way to shop.

I also think working from home is here to stay for lots of people.

And even just one day a week is a significant increase in appliance usage.

We're anticipating more and faster replacements and product upgrades, while investments in home improvements and a reinvigorated housing market will also fuel demand.

However, Covid working practices have been expensive to operate, particularly in our logistics business.

But our structural investment has created long-lasting scale advantage.

Our recycling business in the early stages of covid suffered from famine, followed by the expensive indigestion of feast when we were able to resume normal collection services.

But it could have been much more costly if we didn't have it in house.

Changing legislation in recycling also creates lots of opportunity for the future.

As such, we now need to invest in bigger capacity with a long-term time horizon in mind.

Global manufacturers, many of whom had resisted the migration to online for the last

20 years, are now viewing the world with a digital first lens.

We are passionate - as we always have been - about being their long-term partner of choice.

Of course, there's still uncertainty and there will be volatility, but the direction of travel is firmly with AO and the business model we've spent more than 20 years building.

It's worth remembering that the store shopping experience is about as good as it's ever going to get.

And the online experience will never be worse than it is today.

I expect, with our growth mindset and focus on scale, we'll continue to be a double-digit growth business in the year ahead, even as we lap the early stage of volatile Covid comparatives from last year AND now with physical retail having re-opened.

We have an opportunity to continue to drive further growth, the ability to reinvest in our flywheel and a firm belief in the scale we can achieve.

And scale matters.

Because centrally, we are a high fixed cost base business and our structural advantage is our ability to leverage that investment over a greater addressable market.

We are already proving our ability to leverage our capability and retail platform very effectively into new market segments such as housebuilders, B2B, social housing, SMEs, even kitchen retailers, and we're also able to test convenience stores within Tesco as well.

The same is true with our logistics model where we now make deliveries for a whole host of other companies that are proud to have their goods delivered on a AO green van because of the quality of our service and the efficiency it represents.

We are already proving this in Germany where we've repeated our relationship with Aldi from the UK and we're also now making furniture deliveries for other retailers.

I believe this is important evidence that our logistics infrastructure is not just regarded as best in class for quality but that we've got the economics right so that we can serve these contracts profitably in Germany.

Every one of these opportunities leverages our infrastructure, it drives our flywheel and if successful are repeatable playbooks that we can roll internationally.

But scale doesn't happen overnight. It needs investment in capability and time and experience to learn what works.

So, to our strategy.

First, a reminder of the opportunity:

I've been saying for more than 20 years that the market is going to migrate online.

Even before the pandemic, we were growing at 9% and that has just been turbo charged.

In the UK and in Germany, and in fact globally - we've become ubiquitously connected, importantly including demographics that might have been much slower to adopt online shopping pre-Covid. We are truly blessed to have such a long runway of opportunity ahead of us, crucially by repeating and scaling what we already do. It enables us to continue to invest aggressively to expand and leverage our customer base, our brand and infrastructure.

We've worked hard to create a business model that is cash generative and very capital efficient. The opportunity in the UK and Germany is huge. We believe there's also huge opportunity for us in Europe right across the electricals categories, well beyond the bedrock of MDA.

The AO flywheel is the reason we're able to do the things we do - and do them brilliantly with confidence. It makes us uniquely placed to grab the opportunity ahead. Building a winning customer proposition really is at the beginning, middle and end of everything. We believe that doing hard things well, repeatedly and without fuss, builds trust with customers over time. By obsessing about customers and making things ever better for them by innovating and investing bravely, we increase sales at strong growth rates in each of our markets. We grow repeat and recommendation business to build lifetime value while also finding ways to reach and delight even more customers.

And through that growth of sales, we get operational gearing. We get scalability. We get efficiencies. And because we're vertically integrated, that flywheel really does start to turn faster and faster and it makes the business more profitable.

And that profitability gives us choices. And in those choices, who comes first? Well, of course, the customer. So, we obsess about how we reinvest those profits for our customers and we drive to grow sales. We believe deeply in sharing that lifetime value that customers help us to create with them, always with the long term in mind. This takes many forms but our focus is to be quicker, easier, cheaper, more convenient - and all with the cheeky little AO smile. What I love about all these ingredients is that there's no destination, they'll never run out. They can always be improved to give us greater advantage, and we'll continue to invest to realise the long term prize.

By driving sales harder, we'll grow a bigger business over the long term, which will mean we choose to invest profits in the short term.

We're investing to reinvent the customer journey with a focus on how capabilities like AI and machine learning can leverage our vertically integrated supply chain, providing a totally personalised experience.

We're also investing in bringing product to life and being the true global leader for customers to explore products, and for global manufacturers to best present those products. We'll be opening a new London-based creative centre with the brief of doing to product content what Pixar did to animation. We're starting that with a commitment of around £15-20m. My belief and hope is that manufacturers will love what they see through their now digital first lens.
For now this is an investment that we make alone, but my expectation is that over time this will be a foundation of our partnership together.

We're also making significant brand investment of circa £15m a year in the UK. Unprompted brand awareness is only 37% and yet our share of the MDA market is over 27%. The opportunity here is clear and we've learned a lot of lessons over the past few years. The biggest probably being that there is no quick fix. But I believe deeply that people forget what you tell them but they remember how you made them feel. We want customers to love AO as a brand and that going to take time, it will, critically, require customers to experience The AO Way or to have it recommended to them.

We have a number of exciting plans in this area that drive engagement and activation, and have a long term lens. We're excited about the platform the AO Arena gives our brand; Bear, the AO Teddy, has been received really well by customers and our drivers are creating thousands of moments of magic every day as they hand them out. Critically, the kids - the target audience - love them!

We're driving the customer proposition hard through the benefits of our new scale, especially in logistics: premium fleet, faster deliveries and more convenient delivery slots.

We're also innovating with our B2B channel offer as I mentioned earlier, and we see significant opportunity ahead with housebuilders, kitchen manufacturers and retailers and housing associations through our rental model.

And we also look forward to repeating the lessons from all these areas internationally.

For those customers who don't shop online, we'll find new and different ways to experience the AO way.

An example is our trial of five 'store within a store' partnership with Tesco.

Although these stores have been largely closed due to Covid, the trial is raring to give customers the convenience of browsing and ordering large appliances for delivery while taking away smaller appliances with their grocery shopping. Customers are going to be met by the same passionate AO customer service we're known for online, but with the convenience of being located where they are already shopping - and with the UK's biggest retailer - we think this has far superior cost dynamics than a standalone store.

I'm super excited by the capabilities we're building whilst also investing significantly in our foundation system technology to the tune of about £30m a year for at least the next 3 years. This is about building bullet proof, stable back end systems that enable new geographies, and allow us to plug and play the elements we need with improved internal tools. This will also facilitate more automation and the ability to scale seamlessly to support our growth ambitions.

These foundation systems really are the root system of an oak tree, a solid base that grows and strengthens over time. So if you think about the trunk as our flywheel that drives the capability and learnings into the branches. Those branches are the part that the customers see and value; increasing our reach and flexing in the winds to meet changing needs and our ability to disrupt on their behalf.

We'll be able to apply our model globally. In some markets, this will involve us taking full control as we do now in the UK and Germany. Further afield though, this might involve a partnership, enabling others access to some of our capabilities to disrupt their local markets for customers.

Our optimism and determination is underpinned by the stat that Mark gave you earlier, that we've had compound annual growth since IPO - 8 years ago - of 25%. Europe is still in its internet infancy in many markets. Germany has taught us valuable lessons and now provides a template for expansion. We need to repeat, not reinvent, the UK business in each country.

We can leverage our knowledge and centres of expertise such as logistics, customer services, web platform, ecommerce capability, amazing content, consistency of what we sell, how we sell it and how we deliver it…the list goes on.

Our ambition is to be in 5 countries in 5 years - capitalising on that total addressable market I talked about …and that can grow one hell of an oak tree! Our focus in Germany is now about growth with discipline.

And our ambition is to enter the next European territory towards the end of FY23 and we'll give you more information about where and when in November at half year. But in terms of a European roll-out, we believe there's all to play for in the big markets of Italy, France and Spain. We believe that we'll be able to achieve break even in approximately three years at a sales rate of around £120m with cumulative losses not exceeding around £30m per territory.

This compares to our German journey that took six years, over £150m of investment, and we've now reached a profitable run rate which we expect to maintain at this level give or take a 2% margin tolerance as we grow. The difference now is that we took time to learn the lessons in Germany, where in new territories we'll be applying those learnings from the start.

Our approach will be to roll out the proposition by population density this time as well, rather than nationally from day one. This enables us to concentrate our key commercial dynamics into a profitable business to then drive that forward. It is a much more replicable model, using proven centres of expertise, with a much lower cost base - rather than layering in new overhead per discipline for each territory. These investments will give us a capability to really accelerate our growth and therefore the long-term potential revenue and profitability potential of the business. For new categories and territories, we'll drive to profit quickly, but sensibly, and then drive for scale at around breakeven, continually reinvesting until the scale ultimately drives the profitability from the model.

Let's be clear, the next 12-18 months are going to be really difficult to forecast precisely.
And the timing and impact of what sticks and what doesn't has varying degrees of clarity, as does the lasting impact of the pandemic and the response to it from Governments in the UK and Europe.

However, over the next five years we can be more confident with our predications, and we expect growth on average to be in excess of 20% Compound Annual Growth, with an EBITDA margin of 6-8% in our UK business. We expect margins in new territories and categories to perform at least as well as the UK, once they reach maturity in a market.

As I say, we pay attention to what our customers want, need and really care about.
And they care that we are a responsible business that plays its part in the issues that matter to us all. It's great to see, I have to say, investors' focus on ESG issues converging with that of customers. Because, the great news is, customers got there first, this is an area where we're already well ahead of the game.

And we've believed for many years, as many investors now do, that doing business the right way is a better long-term investment - and great fuel for our flywheel.

We believe that customers increasingly care about this area of business and legislative direction of travel certainly now supports the investments we've been making for many years - all on the basis that it was the right thing to do and it would make our mums proud.

So, in addition to online shopping being more environmentally friendly in the first place:

- We're also ahead of legislation in our recycling operation and capacity.
- We're now working with manufacturers as well on using our output recycled plastics in their products.
- We're working on the efficiency of our vehicle fleet.
- We launched an ambitious VCP scheme to ensure that all AOers share in the value we create together.
- We're actively recruiting to encourage talent from all different backgrounds because we believe in the value of diversity, particularly diversity of thought.

What is good for customers is good for our people and I believe is good for our share owners too. We'll always take the long view and invest to drive our flywheel harder and faster for long term benefit. All whilst, over-time, building huge customer loyalty moats right around our business.

So, that's the AO story and strategy.

In five years, we plan to be in five territories with more than double our current turnover.

We'll continue to invest to drive the customer offer through range, services and proposition AND the territories we can serve.

We'll continue to obsess about cash generation forever, which will fuel our growth capability - and that ultimately drives our business forward to deliver brilliantly for customers.

All of this positions us to become the global destination for electricals.

The choices we make will create incredible long-term value for our share owners.

So, thank you for your support.

It really has been an incredible journey over the last 20 years, and we're only just getting started.

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