Electrocomponents Trading Update - 11 January 2022

David Egan:
Thank you very much, and good morning, everyone. This is David Egan, Chief Financial Officer of Electrocomponents PLC. I'll be hosting the pool today. Lindsley is in the U.S. at present, with time zones making it 2:00 a.m. in the morning. We do hope that you had some quality downtime over the festive season and that you and your families remain safe and well.

Welcome to our Q3 trading update covering our performance during the three-month period ended 31st of December 2021. Trading during the third quarter continued to be strong and ahead of expectations. We outperformed our markets as our offer continues to resonate. We provide security supply which is critical to many businesses. The market has been supported too, especially in our electronics product range, but our performance has been strong with our industrial product ranges where we are delivering robust market share gains.

Firstly, I want to thank our people for their ongoing hard work and enthusiasm. Our teams, especially those within our distribution centers, have been delivering strong volume growth while navigating all the challenges the pandemic, Brexit, and industry supply shortages have brought. Our people are the number one reason we are generating this strong performance. We have seen a significant change in culture and mindset within the group and we also know how hard everyone has worked. And to that end, we gave all permanent employees a well-earned one-off bonus in December.

Moving onto the details of our third quarter. Our like-for-like revenue increased by 21 percent, with acquisitions contributing a further 5 percent, trading days 1 percent, and foreign exchange a 4 percent headwind, to deliver total revenue growth of 23 percent. In the first half of this financial year, we focused on reporting two-year like-for-like revenue growth, as this stripped out the negative impact of COVID-19. However, we've now annualized against positive growth, with last year's Q3 delivering 8 percent like-for-like revenue growth after a 7 percent decline in the first half. And so we will revert back to reporting one-year performance. For your reference, however, our two-year like-for-like revenue growth in Q3 was 31 percent. We are outperforming the industrial market and growing our share, which we measure through industrial production figures, supplier information, and results reported by peers. Our industrial product ranges, which accounts for circa 75 percent of our group revenue, grew Quarter 3 like-for-like revenue by 20 percent.

We believe our outperformance is due to working closely with our suppliers to ensure we have appropriate levels of inventory and the range breadth to provide alternative products, our omni-channel offer for customers to order any which way they want, and an industry-leading customer service despite all the challenges from external supply constraints. Our main own-brand product range, RS PRO, grew revenue by 11 percent, reflecting very strong comparatives last year when the brand was growing at broadly twice the rate of the group, minimal participation in the Americas, a much smaller participation in electronics than automation control product ranges than the group, and did delay in supplying some of our best sellers due to strong demand, although product is due to land later this month. Web revenue, which excludes e-procurement, and so is a truer representation of our digital demand, grew revenue by 27 percent like-for-like. Total like-for-like digital participation was 64 percent.

Our omni-channel proposition has been a key differentiator during the supplier uncertainties, as our customers have wanted to interact and talk to our sales team to ensure supply continuity, and if need be, discuss alternative products. We are focusing on maximizing the return on our marketing investment towards organic rather than paid advertising and away from low returning visitors. As such, we've seen an improvement in both conversion and average order value through this channel, driving better returns. At the start of COVID-19, we saw a significant increase in B2C customers which are less profitable than B2B. We have focused across all regions on higher value and higher returning customers. This has led to a slight slowing of our rolling 12-month total customer growth rate, but an increase in our average order values, frequencies, and returns.

So moving on now to the regions. EMEA, which is roughly 62 percent of group revenue, saw like-for-like revenue grow 14 percent in the third quarter. The U.K., which accounts for roughly 40 percent of the region's revenue, performed well. We saw market conditions strengthen as customers returned. Business confidence rose and new business grew. However, manufacturing backlogs were at record levels. Exports into Europe continued to suffer from post-Brexit challenges and there were some signs of labor shortages dampening customer demand. Germany continues to deliver very strong growth and significant market share gains. This is being driven largely by the new management team, a more focused sales-led approach, and a higher exposure to electronic products than the remainder of EMEA. We completed the expansion of our German distribution center at the end of September. Early-stage commissioning has been successful, and we are now gradually increasing our inventory holdings so that we can support and enhance service offer to our European customers going forward. As with our D.C. expansion in America, we are bringing in new product ranges in a measured way based on customer data and demand. IESA has expanded its integrated supply offer further into Europe, a result of major client wins over the last year. Implementation has taken longer than normal due to COVID-19 restricting on site access and a function of us building out our integrated supply operation within Europe organically. Now that the groundwork has been done, we're able to accelerate the rollout of our more recent European client contract wins. The pipeline remains very strong, and IESA is working in partnership with Synovos on some global contracts.

Turning to the Americas, which is roughly 28 percent of group revenue, they delivered a 37 percent like-for-like growth in the third quarter. Investment into our proposition continues to drive market share growth. We have a more targeted sales and service focus, strong product availability, and improved digital marketing campaigns, which are delivering our outperformance, supported by a strong market. Over 80 percent of our industry segments grew by double digits, with all industrial product categories strong. Our proposition is starting to benefit from a wider and deeper product offer being stocked within our enlarged distribution center. But we have much more opportunity within the facility to drive further operational upgrades and increase capacity. This should help drive a larger RS PRO contribution which accounts for under 1 percent of the Americas revenue currently. Web revenue continues to grow as participation within the region, a result of ongoing optimization of both our paid and organic digital media channels, plus new customer acquisition. Synovos continues to win new clients, including a global contract with a major healthcare provider. Implementation of a couple of our more recent contract wins were delayed but have since been resolved. We're looking at bringing the Synovos operating model more in line with IESA and are excited about the opportunities Synovos is already bringing to our Americas business.

Asia-Pacific, which is circa 10 percent of group revenue, grew by 25 percent like-for-like in the third quarter. Asia-Pacific has benefited from a changing culture and mindset as the team has focused on more profitable opportunities and customers. The electronics market has been strong, but more importantly, we have delivered robust growth in our industrial product ranges and have been taking market share. Performance within the region has been varied, depending on COVID-19 restrictions within each country, and the electronics exposure. However, all four subregions delivered over double-digit growth during the quarter. Our digital business has increased its revenue participation materially within this region and this has been driven by a strong performing organic marketing which is delivering improved returns.

So moving onto gross margin and costs. Product inflation, driven by commodity price increases, has been offset by price rises, which has only contributed low single-digits to our revenue growth in the quarter. Our gross margin has benefited from a tighter discount and pricing policy and greater product elasticity work, especially on our tail-end products. However, we remain mindful of ensuring our customers receive ongoing value and that we remain competitive. Some of these gross margin benefits are being offset by regional and product mix dilution, inbound freight inflation and dilution from last year's acquisitions. Cost inflation continues to put pressure on the business, but we are looking to mitigate as much of that as possible. Labor pressures have become more challenging over recent months. Lindsley, I, and the leadership team have worked hard to drive a culture within the group to train, promote, and reward our people, which has resulted in lower-than-average employee turnover. However, we are mindful of the general employment shortages and how hard our existing teams are working to deliver our growth. We awarded a pay rise earlier in the year, have given a one-off bonus in December totaling circa £5 million, and improved our benefit schemes even further. We're trying to remain an attractive employer but are mindful of external pressures.

Freight rates remain elevated. We've been working hard to redirect our transportation away from air and onto sea and minimize freight miles by buying and storing products closer to the customer. This is a fundamental part of our "For a better world" ESG Action Plan for 2030. We're hopeful that these and other initiatives can offset some freight inflation, but it will take some time. We continue to invest in our operating model to support current strong volume growth and ensure our platform is well positioned for the future opportunities we see. This includes strengthening our expertise, technological capabilities, product and service capacity to improve our operating basics. Our RISE program to simplify the group remains on track. However, we see opportunities to unblock profitable growth further and move from being good to great operationally. We have a program of activity underway across our group to identify how well our processes work, where we can operate better, what the bottlenecks are, and what is required for us to become a great business. This has incurred some additional operating expense during the course of the current year.

Taking a quick look at cash. Cash generation continues to remain strong despite ongoing investment in our inventory position as we bring forward orders to mitigate some of the supply shortages within the industry. This has meant that our availability rates to our customers have been only marginally affected and remain industry leading. We are targeting a higher inventory position as we invest further in product, in our American and German DCs. We continue to work on inorganic opportunities that will accelerate our growth strategy. Many of the opportunities we are looking at have been identified by our management teams and are not in an active sale process, meaning the timetable may be longer but potentially more rewarding. Our corporate development team is very busy. The pipeline is full. But we are retaining our strict cultural, strategic, and financial criteria.

So looking forward, our Q3 trading performance was stronger than expected, and thus we anticipate full-year profit to be slightly ahead of consensus estimates. However, external challenges look likely to intensify in the fourth quarter due to rising cost inflation, ongoing supply chain shortages, and potential trading disruption due to COVID-19 variants on our customers, our suppliers, and potentially even our own DCs. Additionally, our comparatives toughened further. Despite this, however, we remain confident of our own abilities to drive further market share gain, increase operating efficiencies, deliver ongoing adjusted operating profit margin growth towards our destination 2025 mid-teens target, and generate long-term value creation through organic and inorganic growth.

And with that, I'll be happy to take Q&A.

Male Speaker:
As a reminder, if you'd like to ask a question, please press star followed by 1 on your telephone keypad now. Our first question comes from Rory McKenzie of UBS. Rory, your line is open. Please go ahead.

Rory McKenzie:
Yeah, morning, all. It's Rory here. Hope all is well with everyone. A few questions on growth, please, first. I know it's time to move away from the two-year stack analysis soon, but for now, it does suggest that activity accelerated with that Q3 up 31 percent, after H1, 21 percent. So firstly, how much of that revenue growth can you attribute to the new product range expansion in the DCs, and would you say that's one of the most important drivers, and then also, what's the pipeline for further introductions? And secondly, you mentioned the continued challenges in getting product from suppliers. So are there any areas where you think you're, you know, losing out on business or not able to deliver to customers? Or is it just trying to get customers to understand the longer lead times in those areas? Thank you.

David Egan:
Thanks, Rory. So in terms of new products and really the growth, we've seen very good growth being delivered in Q3 both on a one-year and also a two-year basis, 21 percent on a one-year, 31 percent on a two-year basis. For us, you know, that growth has been delivered across all three regions, more pronounced in the Americas. In the Americas, that growth has been delivered by a combination of factors, and that's really, you know, the initiatives and the activities that have been brought into play over the last couple of years. You know, it's a change in leadership team, a refocused sales force that's focused on new customers as opposed to farming older or existing customers. We've seen a significant improvement in our digital performance. And then finally, we've also then seen an improvement and increase in our new product ranges within the stopped category. And that's really off the back of the DC expansion. So in terms of new products, we've added about just over 30,000 new products during the course of this financial year in the Americas. The revenue that's been generated from that is, you know, is less than 20 million. You know, so it's important and will continue to be important, but it does take time to generate revenue from those new product additions.

As we look forward, the pipeline for new products remains very robust, both in the Americas and then also in Germany. Germany has only now just gone live. So we would see, you know, a good strong pipeline of opportunity to introduce new products, new suppliers, and ultimately over the median term to generate improving revenue generation.

With regards to suppliers and supply challenges, what we have seen is that, you know, some of our key metrics, you know, have continued to deteriorate during the course of the quarter. So, you know, we have seen lead times from suppliers continue to increase. We've seen our backlog of orders to our customers increase. We've also seen, you know, some challenges with regards to the availability of product from certain parts of the world depending upon their own lockdown restrictions. I think we are in a fortunate position. We have low inventory turns. We tend to have quite a lot of inventory in stock and so that does give us a safety buffer even though those metrics have deteriorated somewhat. So, you know, we are working with our suppliers. We tend to pay a sensible price to our suppliers, so we tend to come, you know, further up the curve in terms of availability of product when that becomes available. So we're working hand in glove with our suppliers to try and drive as much momentum as possible from our suppliers, and then ultimately driving revenue to our customers. We would say that we are certainly outperforming, you know, our competitors in this regard, and that is really a competitive advantage.

Rory McKenzie:
Yeah, definitely. And then just lastly, if I can, on operating margins. You delivered 12.0 percent margins in the H1. But I think at the interims, you did expect H2 margins to come back slightly given the rising cost inflation. Just wondering if that's still the case given that the revenue growth has been, you know, a good bit stronger than expected so far.

David Egan:
Yeah, we've continued to invest in the business in the second half of the year, you know, Q3, and we'll continue to do so in Q4. As we called out in the script, we paid the one-off bonus to our

staff, about £5 million in Q3. We're continuing to invest in the business with regards to people and driving operational efficiency and all of that. So we're putting a bit more costs into the business. Our best view at the moment is, you know, second-half margins are probably going to be just a tad below where they were in the first half. But overall, you know, for the full year, very, very high elevens is where we view at the moment.

Rory McKenzie:
Okay. Thank you very much.

Male Speaker:
The next question is from Kean Marden from Jefferies. Kean, please go ahead.

Kean Marden:
Thank you. Morning to you, David. I've got three or four. Do you want to take them one by one or just in a long list?

David Egan:
Let's go one at a time.

Kean Marden:
Okay. Cool, thanks. So firstly, on RS PRO, how much inventory arrives in January and what sort of impact would that have on revenue growth just when we think about comparing last quarter and Q4, please?

David Egan:
It's not material in the scheme of things, but for RS Pro it's, you know, we've had -- we've seen sort of a longer lead times for some of those products, and also some of those products coming out of Asia Pacific. So, overall, in the scheme of things, not material in the overall revenue -- sorry, overall inventory side of things, but for RS Pro, it will make a difference. So, we would expect to see some, you know, I guess a bit of an optic in terms of momentum in RS Pro in Q4.

Kean Marden:
Okay, so maybe not impeded organic by 2 to 3 percent in Q3, but provides a bit of a tailwind in Q4 just for RS Pro, year-on-year growth?

David Egan:
Yeah, for RS Pro, there'll be a little bit of a tailwind as we get that inventory in.

Kean Marden:
Yeah. Okay. And then secondly, have you learned anything from ramping the U.S. distribution center that will allow you to ramp Germany more rapidly, or will it have a similar profile?

David Egan:
Look, we've learned -- we've learned a considerable amount from the experience in the U.S., and

there's been a huge amount of shared learning that's being passed over to Germany, both in terms of the build but also in the commissioning and then ultimately then bringing products into the range. So, look, I can't promise at this point time, we're only a couple of months into the commissioning, but we are gradually bringing product into the new facility, or the new part of the facility, and we would look to accelerate as much as we can, but at this stage, it's too early to promise an acceleration over and above what we've done in the U.S. But certainly, that's our desire.

Kean Marden:
Okay.

David Egan:
But I can't promise it yet.

Kean Marden:
Yeah, okay, it makes sense. Thank you. Then Synovos, you mentioned bringing the operation or model more in line with IESA; in practice, what does that mean?

David Egan:
We want to -- we want to have a more consistent go-to-market approach to our customers. We also then, we want to look at the technology that we use, and ultimately then have one operating model, you know, for the business in due course. You know, that will still -- that will still mean there will be, you know, some degree of their own models within the countries in which they operate, but there is operational leverage in just driving some efficiencies across the businesses, and giving the customer, you know, really that one face, that one approach as much as we possibly can. So, it's an ongoing program. The teams are working very, very well together, and more and more customers are looking for the global approach and that global offering, and we believe that we are the only ones that can actually offer that in the marketplace.

Kean Marden:
Okay, thank you. That's -- and my apologies, just on inventory, and I appreciate that this is an INS role that's been sort of pre-close. So, you added about £40 to £50 million worth of inventory sequentially in the first half. Obviously, your organic has run a bit faster than expected. Presumably, there's an inventory impact for that as well. How much more should we expect to be invested into the business in that inventory line in the second half, please?

David Egan:
I think it's going to be sort of around, you know, £30, £40 million in the second half.

Kean Marden:
Okay. Thank you very much. Very clear, thanks.

David Egan:
Thank you.

Male Speaker:
As a reminder, that's star 1 on your telephone keypad. The next question is from Henry Carver from Peel Hunt. Henry, please go ahead.

Henry Carver:
Thanks, yeah, morning David. Just a -- I think you might have touched on this really answering Rory's question earlier, but in terms of the market share gains, I just wanted to get a feel for whether you are enjoying a kind of trend where the bigger players generally are taking share from the mom-and-pops, or whether you're seeing gains versus, you know, the larger peers as well as the rest of the market. And I suppose more specifically, U.S., but also generally across the business would be interesting to get a feel for that. Thanks.

David Egan:
Sure. So, perhaps I think, you know, we view that our market share is being captured across each of the different customer types that we have, both small and large, and also, you know, from a competitive set, you know, we would say that you know, our model is resonating from an end to end perspective and across-the-board, whether that be offline or online, and also the breadth of our product in services that we offer. So, there isn't sort of one, you know, particular sort of silver bullet, Henry. For us, it's very much it's across-the-board all the small elements matter, and it's being able to provide that consistency and continuity of supply through an omnichannel approach with breadth product that's really sort of winning out, and that's what we expect to continue to see going forward as well.

Henry Carver:
That's great, thanks, David.

Male Speaker:
Our next question comes from David Brockton from Numis. David, please go ahead.

David Brockton:
Good morning. Actually, my question is very similar to the last one in terms of market share gain. Just in terms of the split between industrial and electronic components, I was just wondering if you could say whether you think you are now taking share in the electronic space or whether you think you're still trending in line with the market there? That's the first question. Then the second question, just in relation to the total customer numbers, I think you said that that's started to sort of tail off as you're now, you know, the focus is still on sort of the business customer. I'm just wondering, and obviously, the consumer pick up that you saw through the pandemic sort of eases the way. I was just wondering if you could just say whether you still think you're still adding business customers at a similar rate to what you've been doing more recently. Thank you.

David Egan:
Sure, thanks, David. So, industrial growth in Q3 was about 20 percent, plus 20. Electronics,

excluding OKdo, was sort of a bit higher than that. OKdo because of lack of product and single-board computing, was negative growth. You know, so you can probably do the math there. In terms of the market share position for electronics, we're probably trending on tracking the market with regards to electronics at this point in time, but significantly outperforming on the industrial side.

In terms of customer numbers, we're focused on the quality of the customer, not just the absolute customer number. So, last we did see growth in B2B customers, it was single-digit during the period, you know, mid-single-digit is the growth that we saw in B2B, but for us, it's, you know, the important part was that we did see AOV and AOF improving on top of also customer numbers growing. So, it's quality of customers, not just absolute customer numbers, that's important for us.

David Brockton:
Understood, thank you very much.

Male Speaker:
I think further in the queue are present, but as a reminder, that's star 1 on your telephone keypad to ask a question. We have a question from Rajesh Kumar from HSBC. Rajesh, your line is open; please go ahead.

Rajesh Kumar:
Hi, good morning. Just looking at the growth rates, even if you strip out inflation in product, there is an underlying degree of volume growth which seems to be ahead of quite a lot of industrial production figures or compared to what some of the other distributors are selling in the industrial supply chains are in turning. When you deliver better than your peers' volume growth clearly, it has a cost implication but also for the service element, there's an implication for your customers and suppliers. Have you seen any change in the discussion around how people think of outsourcing to you guys based on your performance during the pandemic, or is it -- is it more for longer-term stories?

David Egan:
Sure. So, just in terms of the growth in the price effect, you know, we grew like for like 21 percent in Q3. Within that, about 4 to 5 percent was price-related, and the balance was volume-related. As I said, that was both across the industrial and also the electronics piece. With regards to, you know, what are our customers doing and the impact of our suppliers, we have not necessarily seen a lot of impact from our suppliers, even though the ratio, as I called that just before, has deteriorated. The fact that we've got long inventory or broad inventory levels and low inventory turn is also, you know, a significant benefit to retain and maintain as much as that continuity.

Our other key objective is to offer alternatives, so if there isn't a product that's available that the customers are looking for, as much as possible, we have alternative or multiple alternatives available. And then the third piece for us is maintaining very strong supplier relationships where we become, and hopefully, try to get to the front of the queue when product does become available. We can actually then get that product as quickly as possible. So, we haven't -- there isn't a silver bullet in terms of what we're seeing with customers. What we are seeing, though, is that customers are looking for consistency. They're looking for some continuity of supply as much as possible and they're looking for ease of business. And you know, our objective is to offer as many of those consistently and as much as possible all the time. And that's really why customers are resonating towards our model. And that's why we continue to see customer growth, AOV [spelled phonetically] growth, AOX [spelled phonetically] growth across each of our three regions.

Raresh Kumar:
Understood. Very clear. Are there any assets out there which can help you accelerate the process, either on the supplier side or on, you know, in terms of customer market share? Or you can do it organically, pretty much?

David Egan:
Well, I think, you know, our strategy is very much one of both. You know, initially very much focused on the organic growth story. You know, our market share remains very low. Opportunity set remains very high. But equally, you know, we are we are very focused on the inorganic story. We're focused on services, extension, product extension and market share growth. The pipeline for those opportunities remains very strong. But equally, our discipline around those opportunities is very, very strong as well. So, you know, we're not just going to spend the balance sheet willy-nilly. Our objective is to drive real value from those inorganic opportunities and use those inorganic opportunities to accelerate the organic growth that we have within the business.

Raresh Kumar:
Thank you very much.

Male Speaker:
Nothing further in the que. As a final reminder that someone in the telephone keypad to ask a question.

David Egan:
No further questions?

Male Speaker:
No further questions.

David Egan:
Well, thank you very much for your time this morning, this evening, wherever you are in the world. Appreciate your support and we look forward to updating you with regards to our Q4 performance in due course. Thank you and good morning.
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