S&P Global
Market Intelligence

NEXT plc LSE:NXT

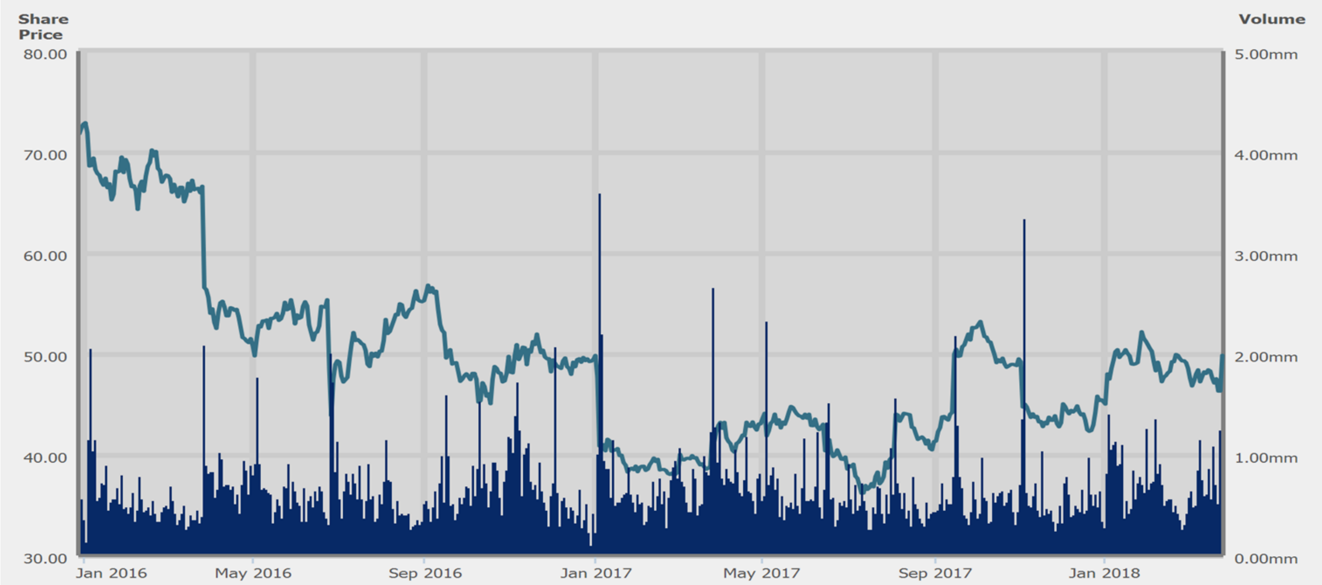
FY 2018 Earnings Call Transcripts

Friday, March 23, 2018 12:00 AM GMT

S&P Global Market Intelligence Estimates

	-FY 2018-	-FY 2019-	
	CONSENSUS	CONSENSUS	GUIDANCE
EPS Normalized	4.12	4.11	4.12
Revenue (mm)	4122.05	4156.99	4190.70

Currency: GBP
Consensus as of Mar-22-2018 11:18 PM GMT



- EPS NORMALIZED -

	CONSENSUS
FY 2015	4.03
FY 2016	4.33

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Call Participants

EXECUTIVES

Michael J. Roney
Non-Executive Chairman

Simon A. Wolfson
CEO & Executive Director

Presentation

Michael J. Roney
Non-Executive Chairman

Good morning, and welcome to the NEXT group results. I joined the board of NEXT just over a year ago and became Chairman in August 2017. And during that time, I certainly have been very impressed by the passion and commitment of all the executives at NEXT. In that vein, I would really like to thank all the 40,000-plus employees of NEXT for their hard work and commitment, which really comes through in the financial results. Michael Law, our Group Operations Director, has been with NEXT for 23 years. He will retire from the board in May. Michael has made a huge contribution to the group and a huge contribution to the board. Michael has been very effective in handling issues in the area of warehousing and logistics, some of the most complicated issues that NEXT faces. And he's been very effective in handling those issues and solving the problems.

I would like to welcome Richard Papp to the board. Richard is the group Merchandise Director with over 25 years’ experience at NEXT, and he'll be a successor to Michael. There's certainly a lot of change in the retail sector. And one of the things that you'll see today that comes through in the presentation is that NEXT has not stopped in looking at all the problems, but really is focusing on a number of new initiatives to try to face this new and challenging market. I believe that the leadership team of NEXT is very strong and is going to execute the correct measures to really build shareholder value in the future. So now over to Simon.

Simon A. Wolfson
CEO & Executive Director

Okay. Thank you, Mike. I have to say that I 100% agree with that last statement about management team and leadership being very strong.

Looking at last year's numbers. Top line -- total sales down 0.5%, full price sales up 0.7%. This is all about the fact that we were less effective at clearing our sales stock last year than we have been in the past.

Operating profit, down 8.2%. So -- and this is a story that, throughout the presentation, we're going to try and sort of elucidate exactly why that was, why it -- how is it that the top -- a stable top line turns into a negative bottom line. We're going to go through each of the reasons for that but in summary, poor clearance rates; fixed costs in retail, which is a declining business; variable costs in Directory, which is a growing business; a step-change in our cost base in Directory in order to invest in the systems and marketing that we think is needed to drive the business forward. And those are the main things that are -- and also the -- sorry, final thing is the loss of margin as a result of us selling more branded stock rather than NEXT stock online. And I'm going to go into each one of those later on, but that is the sort of big picture set. If you want to go now, you kind of have most of the presentation.

Interest benefit of GBP 4 million here. This is -- we had a bit of double running between our bonds. We had one bond that hadn't expired, another one where we have the money in the bank. We've got the money and so we had some double interest costs last year.

In terms of tax, lower rate this year. There is a one-off credit level. We expect the rate in the year hence to be broadly in line with the year just gone. And profit after tax down 6.8%. Earnings per share boosted slightly by the buybacks we did right at the end of the year and also in the previous year. Dividend maintained despite declining earnings per share, but still very healthily covered at 2.6x.

Cash flow. Capital expenditure, down last year. There is only one reason for this really, and that is that the amount of money we spent on the stores reduced significantly. Around GBP 12 million of that reduction was stores that we aimed to open last year that were delayed and opened in this year. So the final bill for those stores won't come in until this year. So there's a little bit of an imbalance there. But I think, generally, the amount we're going to spend on new stores over the next 4 or 5 years will obviously be tempered as we raise the bar in terms of being sure that those stores not only make a profit on the first day, but they'll make a profit at the -- on the last day at the end of their lease as well. So that will impede the rate of growth in the space going forward.

Cosmetic refits. A much bigger number than usual, I think. Of that GBP 22 million, around GBP 12 million was in 1 store in Arndale, which was an experiment that I'll come onto later. GBP 50 million on head office and systems. A whole host of small items here, 2 worth mentioning. We've spent around GBP 3 million developing new accommodation for new starters. One of the big issues we have is when people first come to Leicester, it can be a bit intimidating. This is sort of people just come from university graduates, so we have set some accommodations up where they can come and live for 6 months in a sort of safe and very nice environment in order to find their housemates move on.

The other issue -- the other item, big-ticket item is GBP 4 million on new RFID handheld terminals in our stores.

Warehouse, much less than last year. Last year, GBP 28 million. The lion's share of that was building of our new automated storage and retrieval warehouse for sofas. Of the GBP 11 million, about GBP 3 million or GBP 4 million that was actually finishing that project and some of the other projects that we started in the previous year.

Looking forward to next year. A little bit more space opening, again, boosted by the space that moved from this year into next year. A more normal figure for maintenance CapEx, around GBP 15 million in the stores. Head office CapEx, around GBP 12 million. There's no single item here. We are talking about head office and systems, just lots of small investments. And a step-change, another big increase in warehouse CapEx. In terms of what -- we're spending the money here.

As we ran into Christmas, we ran up against the capacity constraints of our Directory warehouse or online warehouse. We were able to cope with that operationally in terms of our service to our customers. We've got all the stock out of the warehouse. It wasn't the problem that affected our customers, but it was a problem that affected our costs because as the warehouse becomes more crowded and you begin to take capacity, costs go up. So we're going to need to spend GBP 35 million on that. Of that, half will be automated storage and retrieval of returns. So the returns processing was the big sort of rate determining step that affected us last year. We're spending GBP 3 million more increasing our forward capacity for Directory.

What's interesting about -- if you look at the total stock holding online, we don't anticipate that, that will grow enormously. But what will grow is the amount of different options we have, particularly as we're adding other people's branded stock. And as we take advantage of the opportunity that online gives us to have smaller buys so we're -- and the addition of additional -- the addition of those extra item options means that you need more forward location. You've got to have one of each item forward. So it's the forward locations, the picking locations where we're going to need more capacity in Directory. It's relatively cheap. It's floorspace and racking and that -- we'll spend about GBP 3 million on that.

And the final thing we're doing, which is interesting, is that we are taking the retail warehousing that we've currently got in a building that also services our online business and condensing it into the existing retail warehouse. So we are, in fact, using surplus retail capacity to hand over to Directory.

You'll notice also throughout this presentation, I'll refer intermittently to Directory as online and Directory. In the new sort of world, we've rebranded Directory online, and that's because we think it's much cooler. But as we go through the presentation, I will continue to make the mistake of referring to it as Directory, so please bear with me on that. Working capital. Big swing in working capital. Two items here: stock and Directory debt, around GBP 115 million of extra Directory debt. And on stock, we had GBP 35 million more stock at the end of the year than last year but last year, we had GBP 35 million less stock than the year before. So the swing in working capital is around GBP 70 million.

Tax paid. There was a tax credit here as a result of us closing previous year's tax returns. Cash flow before distribution to shareholders, down 47% -- GBP 47 million. And it's just worth stressing that the reduction in cash flow is less than the reduction in profits. There is a temptation in difficult years for companies to ensure that, that is the other way around. And I just want to reassure you that the quality of our earnings, in terms of our provisioning, is as robust as it has ever been.

In terms of distribution to shareholders. This -- the distribution to shareholders was larger than the cash generation, and that was as a result of us bringing forward this year's buybacks into January.

Net cash flow, GBP 141 million. That's about GBP 130 million less than last year, and that's all about 2 things: Directory debt and stock.

Balance sheet. Still robust. Stock, up 8.6% at the year end. This isn't because we expect our sales to be up by 8%. And we expect there to be less stock going into the end-of-season sale than we had in the summer sale last year, so we're not overstocked. This was all about 2 things: partly timing of Chinese New Year and the timing of deliveries, and partly, it was because we carried over more stock from the last phase of the winter season last year into spring in order to give ourselves more warm weight stock as we went through January and February, which, in hind sight, turned out to be the right decision.

Debt of GBP 122 million. This is Directory -- all driven by Directory debt. You can see that the debt is up 12% on sales that look like they're only up 6%. So it looks as though customers are spending -- taking longer to pay off their debt. That isn't what actually is happening underneath it. If you split it out into the 2 halves, you'll see that, in the first half, Directory debt was broadly stable on credit sales that were broadly stable. And in the second half, the online debt has increased pretty much in line with the credit sales. And the reason that in spring, the growth is lower; and in winter, the growth is higher is because people tend to increase their amount of debt in winter and reduce it in summer. So increase in and around of Christmas, pay it off in the summer. So that's the reason for the difference between those 2 numbers but broadly, debt is now increasing in line with credit sales.

In terms of net debt, just a quick walk forward on that. We generated GBP 335 million of surplus cash off to paying dividends, CapEx, tax, et cetera. Special dividends are GBP 256 million. Towards the back end of the year, we were -- that GBP 256 million, you'll remember, was the amount of cash we thought we would generate at the bottom end of our guidance range. So there was always going to be a little bit of surplus cash if we hit our midpoint. We spent that on buybacks, GBP 79 million on buybacks. We then spent some of next year's cash flow in January to get GBP 105 million of buybacks. We then increased Directory debt by GBP 115 million.

Looking forward to next year. GBP 300 million of surplus cash at our central guidance point. Buybacks of GBP 275 million. This is not the same as the operational cash flow because the amount we borrowed from this year, we're paying back next year. So that GBP 25 million we spent in January we won't spend again. Online debt, up another GBP 110 million. And as we increase our Directory debt going forward, we will finance that with debt rather than capital.

In terms of our funding, still very well financed against our peak debt requirements, GBP 1.2 billion of peak debt versus GBP 1.4 billion of bonds and bank facilities. But what you can see is that we're now a long way into our bank facilities. And at some point, between now and May next year, we will look -- or we intend to look at issuing another bonds to replace some of that bank debt with more secure longer-term debt.

Just moving on to the detail of the business, starting with retail. I think it is very important to make sure that our retail accounts accurately reflect and the store-by-store profitability accurately reflects the actual profit the retail is making because if we don't, we could end up shutting shops that are actually making us money. There's only one item here that we've really transferred and that is the cost of servicing Directory orders through the stores we had underestimated in previous years. We've gone back and looked at the actual costs to retail as a result of servicing all those direct orders and it's around GBP 14 million higher than we thought it was.

All the numbers you'll see in the Directory and retail accounts that I'm about to go through have been restated to account for that GBP 14 million swing in both this year and last year. Full price sales, down 7%.

In terms of sales from new space, we opened around 50,000 square feet in the year. That was -- in terms of stores, we lost 10 stores, closed 14. I think store closures are going to become an increasing part of the retail landscape. And I think it's worth just talking a little bit about the stores that we've closed. On the face of it, it looks like we're being too aggressive because the stores are making 12%. In reality, one of the stores we shut was a compulsory purchase of our shop in Eastbourne for redevelopment. If you look at the stores that we actually shut, they're around 10% profit. And there are 2 things we look at when we decided whether to close the store: one is the profitability and the other is the actual quantity of cash profit that it's making because there is a cost in servicing a shop as well, getting the area manager there, display team. All the costs that we don't necessarily load into the branch appraisal we need to account for. So if a store is, on average, making less than GBP 200,000, it goes on the watch list. And the other thing is as much as we wouldn't go out and choose -- actively choose to shut a shop that was making 10% profit. Equally, we would never sign a new lease for a store that is only making 10% profit. And all the -- so -- and of the 14 stores, 11 of them had reached the end of their lease. So we're not -- we're basically -- the landlords then got a choice. They can either take the keys back; we can hold over with them, in which case, we just carry on paying the existing rent. And there are a large number of stores that are doing that now. When we can't reach an agreement with the landlord for a new lease but -- we just carry on paying the old rent until such time that one or other of us wants to shut the operation, the landlord or ourselves. But we would never sign a new lease at just 10%.

In terms of performance of the new store portfolio. Missed its target slightly, which isn't a surprise or shouldn't be a surprise given the performance of our ranges in the first half. Pay back, just slightly over our 24-month criteria but the profitability of those stores still healthy at 21%. What we're now doing is when we appraise a new store, we are looking at what the -- not just what the profit will be day 1. In the good old days, you'd say, it doesn't -- we look at the profit in day 1, and then it might go up as time goes on. Now I'm afraid we have to take the opposite view. So every new appraisal we're doing, we're saying, what is -- what will the profit of this store look like if the worst comes to the worst and there is minus 10% like-for-likes until the end of the lease. And then we look at the internal rate of return on the capital invested over that term and what the year ex profit is when the lease term ends.

In terms of profit analysis, a big drop in profits. Bought-in gross margin was fine, a lot -- a big loss from markdown. And this is all about -- it's not about the amount of stock we put into the sale. We actually put significantly less stock into the end-of-season sale than last year, 9% less stock but sales were down 16%. We think that there are 2 things going on here, and we don't know how much is one phenomenon and how much is the other. Generally, sort of the chat in our industry is that markdown has become less effective. I think there's a good reason for that and that is that you can now go on to pretty much everyone's website and their clearance operation is also on their website, including ours. So people have always got access to the last season sale in the sort of clearance, in effect, the online clearance store that is a tab in most people's websites. And that'll be a sort of rational reason. There was also an awful lot of stock generally that went into sale last year as a result of the environment being difficult.

And the final thing is our range in the first half we know weren't right. So it shouldn't be a surprise that if we couldn't sell it at full price, we had difficulty selling it at half price. In terms of stock loss. Interesting thing here. Stock loss actually as a cash figure remained broadly the same. The amount of stock taken from our stores has remained the same but obviously, the store sales went down. So markdown costs, as a percentage of sales, went up marginally.

Store payroll. A potentially surprising gain on store payroll, and this is basically because the efficiency measures and productivity measures that we introduced into our stores outweigh the inflationary costs of both general inflation and the national living wage.

Store occupancy costs went up as a percentage of sales. That's all about falling sales. Underlying rent and inflation was much less than 1%. So in terms of actual rent reviews, we're not seeing much inflation coming through.

Warehousing and distribution. Again, this is the deleveraging of fixed overheads in our warehouse in the distribution operation where, I think, we probably haven't moved fast enough to cut back on some of the costs that are semi-fixed, and I'm going to come on to that later.

Central overheads. Again, it's all a story really of fixed overheads at the center and declining top line sales.

In terms of online. Much happier picture. Sales up 9%, 11% full price. In terms of how that was made up, in terms of the makeup of that, 9% of the growth which -- from the U.K., of which only a very small amount was NEXT branded stock. You can see that our LABEL stock, the third-party brands we sell through NEXT Directory was much, much bigger growth. That isn't quite the whole picture. The picture becomes much clearer when you look at it by half. And you can see in the first half, the NEXT branded stock was significantly down in the previous year. And in the second half, it was up. We don't think that we will not grow Directory-branded stock online in the year ahead, so apologies for the double negative. We think we will grow NEXT branded stock online in the year ahead and by more than 2%.

We think that the underperformance of the NEXT branded stock was more to do with the stock that we produced than the competition it was facing from the LABEL brands. There is inevitably some cannibalization in the LABEL brands, but we think last year's performance in the first half was about ranging errors.

In terms of overseas. 26% growth in sales. Sounds brilliant. It's not as brilliant as it sounds. At constant currency, it's around 10%. We would expect about 10% in the year ahead.

Customers. You can see that overseas, the sales growth is being driven by customers. And in the U.K., it's being driven by sales per customer, particularly credit customers. So you can see that credit customers last year increased sales by 9% on flat numbers of customers. And this is all about the improvements -- we think this is all about the improvements that we've made to our website, things like NextUnlimited where you spend GBP 20 for unlimited free deliveries to home. And all the other initiatives we put into improving our website, services and broadening our offer, we think, is what has driven the credit sales forward.

In terms of credit customers. You'll remember that 2 years ago, we faced a little bit of a crisis in terms of our credit numbers. Jan 2016, there were 5% -- nearly 6% down on the previous year. Last year, the situation had improved. As we stand in January, credit customers around 0.6%, up on the previous year. And we think that at the very worst, we will stabilize the credit customer numbers now. We don't anticipate that those will decline in the year ahead. Possibly, they might move forward slightly more than that.

In terms of profitability and margin and assets. 0.6% erosion in gross margin. Biggest issue here is the difference between the margin rank on third-party stock and NEXT stock.

Markdown. The same effect in Directory that we had in retail, where the increase in sales stock wasn't matched by an increase in sales.

Interest income. Although interest income grew, it didn't grow as fast as sales so that reduces margin. Catalogs and mailshots. We've done a lot to reduce unnecessary spend on catalogs and mailshots. That gave us a 1% improvement in margin. A lot of that money we invested in online marketing and systems.

Central overheads. A slight gain as we get positive leverage over fixed costs in the online business. In terms of the outlook. This is a graphic that explains just how we felt throughout most of the year. And really, I think it's worth just going through all the pressures that we felt last year and what they -- what we think will be their effect in the year ahead. So cost price inflation was a big issue for us. We said this at the beginning of the year. The devaluation of the pound meant that we had to put our prices up by 4%. Interestingly, I think we were one of the very few, if not the only retailer, that said we were going to put up our prices. But miraculously, if you look at price inflation in the clothing sector, generally, it went up by almost the same amount. Just to point.

So -- and I think the point there is that actually, we don't feel that the raising of our prices left us in a significantly worse competitive position than we were in at the beginning of the year. And we're comfortable with our competitive position about prices at the moment. In terms of U.K. consumer, we've had pretty much a whole year of negative real income.

And the final thing is the sectorial shift, and this is something that we first started talking about nearly 2 years ago, October '16 we first mentioned this. But we are still seeing innovation in streaming, the opening of new pubs, restaurants, bars, film, so research into film. All of those things we feel are taking money out of the clothing sector. And we have no signs that there was any reduction in the pace of that change yet.

Finally, we got a structural shift online and this is -- of these 4 issues, this is, by far, the most important because it is structural. And finally, just to make things worse for ourselves, at the beginning of the year, we had a marked product accident. So I think you can sort of characterize these headwinds into 2 types: cyclical which, at some point, they will work their way through the economy; and structural, where actually it is a profound change to the nature of our industry and we need to work out how the company is going to cope with this change going forward.

And it's just worth talking about the profitability of the different income streams. This is the 8.2% decline in group profit compared to stable headline. So you see, overall, our sales went up by 26%.

But if you look at the profit performance, retail lost GBP 86 million as a result of lost margin on sales, minus any variable costs we were able to save. If you look, and there's a little bit of fiction here, but bear with me because it explains the nature of the profit erosion that we're seeing at the moment. If you look at the growth in profit that we would've got from exactly the amount of sales that we lost in retail, if you look at the profit that we would've made on that, had it all been not NEXT stock, that would've been GBP 68 million. So the act of transferring sales from retail, Directory branded sales from retail to Directory creates a gap. That gap was GBP 18 million around -- sorry, went a bit -- 13p on the pound. So the actual -- if you like, the structural cost of the change in the 2 functions is around 13p. That's not because Directory makes less profit than retail. Actually, it makes more profit than retail at a net level. It's because so many of our retail costs are fixed and so many of our Directory costs are variable. The change creates a loss. Actually, we did slightly better than that. We overachieved in Directory. We gained more sales in Directory than we lost in retail, so that sort of reduces the structural cost around GBP 6 million. But not all of the stock that we gained online was NEXT branded stock. A lot of it was LABEL stock and the margin on that is lower, so there's a GBP 30 million attrition as a result of switching stock -- switching sales from NEXT branded stock to online stock. Some of that was down to the underperformance of our own ranges, and we wouldn't expect that to recur in the year ahead. So in your mind, so you can see there are 2 different losses going on here. The structural costs, around 13p on the pound. And then there's GBP 30 million branded cost.

Cost savings didn't quite match cost increases. These are the costs -- the changes in our fixed cost base, the ones that don't directly relate to growth or decline in sales. And the big issue here has been the step-change in Directory cost base. The GBP 11 million we invested in revenue costs to build new systems and marketing capabilities, which was more than paid off but which cost us profit last year.

The final actually was clearance rates. The degradation in our clearance rates cost us GBP 22 million. And so what you have there in that 1 graph is an explanation as to how top line sales of roughly flat delivered profits down 8%. Or I should just say, sorry, for the group, profit and markdown sales have put the figure at the bottom. Markdown -- total stock for sale was down 4%, total markdown sales were down 10%. That's what generated that GBP 22 million loss.

So in terms of the year ahead, and we've changed the graphic here, to give you not a beautiful sunny day but perhaps to give you an end of the storm in sight. In terms of the cyclical pressures, some of them are definitely reducing. We know that cost price inflation is going to work its way out of the system by the end of the year and potentially reverse as we go into next year.

So view the economy. If you look at Bank of England's central forecast for inflation and their central forecast for average earnings, they anticipate that we will see a return to real income growth in the middle of the year. Actually, that's what they do think. Last week, they issued their latest figures, and you can see that the inflation figure came at right end -- right at the bottom end of their forecast fan, and earnings moves forward slightly faster. So it looks we're now in a position where already averaging comes moving forward. A caveat there, it will take, in my view, at least 6 months for that to really hit the consumers' consciousness. It took a while for it to work the other way through the system. It will take a while for it to work back, but there's a reason to be slightly optimistic on that. And the sectoral shift we think is still there, in force, and we see no -- we can see very little evidence of it abating in the year ahead.

So cyclical pressures, moving back. The permanent challenge of structural shift to online remaining. And that -- really, those -- that fact drives the agenda for the business in terms of what we have to do. Product remains at the heart of our business, and you can see the power of getting it wrong from our figures last year in the first half. I'm not going to talk at length about product because I feel -- chief executives always sound a bit silly when they're talking about production. You never really fully explain yourself because it's a sum total of lots of individual decisions that are being made with individual suppliers. But just to give you a sense of what went wrong, this was the 6th page of our tailoring section in the February brochure that we issued last year. It's called New Romance and it should have been called Bad Romance, clearly. It's not necessarily heartland stuff. This was the 6th page this year. And you can just say, oh, there she is. NEXT lady is back with us. And if you're looking at the improvements in our range, it really is best demonstrated by these 2 graphics.

In terms of what we said, time scales improved. This is what we said at this point last year. We said quarter 1, double cross; quarter 2, single cross; a bit of improvement in quarter 3; recovery in quarter 4. It pretty much panned out as we expected, and the sales by quarter kind of reflects the steady improvement in the ranges. One note of caution is please remember, I know that you will all -- you won't forget this, but please remember that first quarter was that bad when we announced our quarter 1 sales because our quarter -- our performance in the first quarter is likely as a result of [indiscernible] comps to be significantly better than the rest of the year, so don't do the old straight line on the graph.

I think -- in fact, we've drawn a graph for you. You can't get your -- we're fading it, so you can't get your rulers out and measure exactly where the -- we expect each quarter to fall. And of course, we don't know so those rulers won't be much use anyway. But broadly, we're expecting the first quarter to be between 1.5% and 2% better than the remaining quarters.

I should also say actually that, although the first quarter -- a lot of people are talking about that very bad week we had in February. We did have 60 shops shut on days in that week, so that did affect us. But overall, we picked up some of those sales the week before and after. Overall, we're still on track for this sort of number in the first quarter.

Defending retail sales. We're not just sitting back and doing nothing and waiting for shops to shut. The most important thing we're doing, which we are really excited about is a bit techy and therefore may bore some of you, but we think it could be really important.

If you look at a customer sitting at home, ordering NEXT Directory stock, what they will find is that on average, around 10% of the items that they're looking for are completely sold out in Directory. And 20% of the items that they're looking for are on a delay. This is be -- either we're expecting returns back from customers, so we've sold -- in effect, we've sold and anticipated return or more often, it's because we're anticipating a delivery or a predelivery from a supplier.

When you look at the stock that customers can't find in Directory, which represents around 30% of our demand, 10% of it is available in a store. And we've estimated -- this is not just in any store. We estimate that 10% of it is available in the average customer's local store. 40% of the items on the delay are in a store that is close to -- local to the average customer. And that gives us an opportunity. We started to fund that opportunity just for Christmas with a Find In Store button. Find In Store button just tells you if the item is in store. Unfortunately, because stores can't really put stock aside, it's not much help. It will tell the customer if it was there this morning, but it won't tell them if -- it's almost impossible for us to find it and put it aside at the moment. So it's just a -- it might be there if you get there in time to [try out the] thing.

Going forward, we're looking at [increases] in proper click and collect. And that will be live, I think, in September. And certainly, we have 2 calendars in NEXT. We have a calendar that works -- it's a bit like Gregorian and Julian. We have a calendar that works for the whole business, and then we have a systems calendar. And the systems calendar is always 1 or 2 months in advance of the actual. So our systems calendar is telling us that we're going to deliver that in sort of July, August. We've -- in sort of normal speak, we say that's probably going to be September. This new system will allow us to -- allow customers to go online, to buy the item online. We will pick the item, scan it, put it aside in a store. We enter that within 30 minutes, text the customer to let them know that we've got it before they set off and the customer will then be able to pick it up. We think -- we don't know how big this is going to be. We know that the demand is there for that stock because we can see the lost demand in Directory. We don't know people's willingness to have the [hassle] of going to pick it up. But what is interesting about this is -- it's the first time that we've had an initiative in the last 10 years where retail can do something that Directory can't.

Directory cannot get their stock to a customer same day. Retail can, and it will obviously be a retail sale.

Store orders. We're doing pretty much the same thing. At the moment, customers, if they find an item they like in store but the size isn't there, they can order it at the till, either for delivery back to the store or delivery in home. At the moment, all of that stock comes from the warehouse. We will be opening up the store -- other stores' stockpile so that any stock that is -- if that stock is available in another branch, it can be transferred back to the ordering branch within 2 to 3 days, or sent to the customer's home. We'll also be clever about it in order to minimize costs to make sure that if it's in a local store, it doesn't have to go back to a central warehouse but will go back to a local depot. So it will be store-to-store, transfers within depot group. We think that 17% of the stock can be done that way, so it's very cheap. And obviously, it can go to the customer's home as well.

Retail credit. At the moment, we do about GBP 1.6 billion with the sales on our Directory account. It's often assumed that all of this business is online business. In fact, around GBP 240 million of it are customers using their Directory account to pay for goods that they're buying in store. So we do have a sort of retail credit business. Currently, we only offer that to its active Directory customers. We've made a few changes to the offer to make it compliant with store credit. We've got 700,000 names, addresses and emails of customers that we know are regular customers in retail that aren't active customers in Directory. And we will be promoting a credit offer to them, initially online, so they'll be able to get access. They'll, in effect, be able to open a retail account rather than a Directory account. We've got no idea how big this is going to be. It won't be enormous but what we do know is that the customers -- when we give Directory customers the access to their Directory account in stores, we know that their sales go up by more than 10%. And this is mainly -- and this will be mainly about the sales generation rather than interest income, although it will obviously give us an interest income and will be at the same APR as our Directory account.

In terms of costs. I have a myriad of cost-saving initiatives as usual. And the question I have been asked for the last -- about 7 years is surely there's nothing left in the tank to save now. You've done your red pen, you're fist banging in a boardroom and really, there's nothing left. And what I want to stress is that the cost savings that we made in the business and are making in the business are not sort of red pens, people sitting down and saying cut that out, cut that out. We have been very careful not to damage our -- quality of service or damage the future of the business through underinvestment through saving money. So the -- all the savings that we're making are driven either by technology, rightsizing our Directory business, better negotiation, and making sure that expenditure in the past that was relevant, we are cutting out now that it is no longer relevant. And I'm just going to talk about 4 little examples of that very quickly to give you a flavor of it.

Retail man-hours. We expect to make GBP 6 million saving in retail man-hours. One of those projects is a GBP 2 million saving in scanning costs. At the moment, we scan every single item on our shop floor every week to ensure that we've got the correct balance between stockroom and the shop floor and stock it in the stockroom, make sure there aren't any sizes missing in the stockroom. That cost us a lot of money but it is worth it because generally, if this item isn't there, the customers won't ask for it.

We've replaced all of our handheld terminals, and we're now replacing our security tags with an RFID-enabled security tag. So we're not tagging every single garment with an RFID tag at source. We're tagging it in the store when we put the security tag on it. And the main reason for that is because the cost is so much lower. If we RFID tagged every item at source, it would cost us at least GBP 8 million of additional revenue cost every year. So we're not doing that. We're doing the tags. We will be able to scan at least

5,100 items an hour, and that will give us a saving of GBP 2 million. And I actually think that, that 5,100 scans an hour is a low figure. I think it should be much higher than that.

In terms of retail deliveries. Again, this is just all about rightsizing the apparently fixed costs of the retail business. So delivery network, depots, all those things look fixed. But actually, when you look -- if you look at this graph, what this shows is the retail sales in red and the number of deliveries that we're making in blue. And you can see that we just haven't anticipated aggressively enough the reduction in retail sales. So we think there's a GBP 4 million saving in rightsizing our delivery network.

Rent. This is interesting. These are the stores where we've succeeded in renegotiating the rent with a landlord at the end of a lease. Obviously, you don't get rent reduction at review, but at the end of the lease you've got an opportunity to renew. 19 stores were renewed last year. The average rent saving in those stores was 25% on the rent, and GBP 5 million capital contribution. You shouldn't count that GBP 5 million capital contribution as a profit to NEXT because we spend more than all of it, making sure that those stores are fit for purpose for the balance of the lease. So we're not -- we are reinvesting that money in the stores, but the 25% reduction in rent is a real cost saving.

In addition, where we are refitting the stores and using that capital contribution, we'll take the opportunity of putting concessions in. And so we've got -- we've generated around another GBP 170,000 worth of revenue from new concessions, which takes the -- if you got the net rent, down by 28% in those shops. It takes the rent, as a percentage of sales, down to 7.5%. Those -- the portfolio of stores renegotiated have an average profit of 21%, and a lease term of 7 years, an average lease term of 7 years. So what you can see is that we are no longer automatically signing 10-year leases. We're beginning to sign more and more leases for 5 years, and in some cases, only 2 or 3 years.

Looking forward to next year. We have an awful lot of shops up for renewal. Of the 29 that we think we can and will renegotiate, and these are estimated numbers, we think that we can take the rent down by around 22%. We think we should be able to achieve around GBP 7 million of capital contributions, and we think we can get concession income of around another GBP 370,000 of concession income. What's interesting when you look at those stores is that whereas in the previous portfolio, the occupancy costs, the rent costs, the net rent were GBP 7.5 million. Year ahead, we're looking at GBP 6.5 million. Every appraisal we look at, we are looking at what the profitability will be at the end of a lease, assuming minus 10% like-for-likes. So that means we're often able to -- we're unable to offer landlords the same length of lease that we were offering last year. And the average lease length we expect on these stores will be around 5 years, same level of profitability around 21%.

In terms of concession income, we expect to get GBP 5 million more concession income next year. That is not quite right. We expect to open concessions next year whose annualized contribution will be GBP 5 million more than previous year. Because some of them will open halfway through the year, we won't necessarily get the full amount of the benefit in this current year. We'll get it -- some of it we'll get in the following year.

Just in terms of concessions, we -- NEXT, in the past, I have noticed, has been criticized for not wasting money on grandeur schemes. We -- happily, we put that criticism to bed. In Arndale, we spent GBP 12 million and introduced what will be used as an experiment. We introduced every concession that we could think of. Scene one is would they be successful? Two, would they pay us enough rent to justify their place in the store? And thirdly, will they bring more people to the shops? So we're looking at -- we've got a restaurant, a spa. And bridal shop, we're still in negotiations for those. We have a barbers; Paperchase; kids' activity center, which is basically making mugs with your handprint on it. That's a thing. We've got a car -- a very small innovative car showroom and a new and extended café. All in all, those -- we expect those to generate around GBP 800,000 worth of rent, which is around 40% of the rent in that store.

In terms of the restaurants, we've opened 2 restaurants so far, one in Arndale, the other one in Hull. They are 50-50 joint ventures with a restaurant group, with Gino D'Acampo's Restaurant group. When you look at the appraisals, they are not as good as a retail store. We've used an IRR rather than a payback because the payback doesn't look good at all. So -- I mean, the IRR is acceptable but not brilliant. And I think we have work to do on improving the profitability and payback in these restaurants as we move forward. And we're looking to buy thing -- shop fitting items from China rather than Italy, all those sort of things we can do to make them more profitable going forward. But we don't anticipate they're going to be a huge source of profit. We only get half the profit anyway. The real test for us will be what do they do to the footfall in the shop. Do they make the shops more relevant, interesting, exciting places to go? We've got 4 more planned, and we will see how those 4 go before we commit to many more.

A final thing on costs. This is about the cost of print. Now what we haven't done, NEXT doesn't take big strategic decisions. So it would be very easy for us to say, let's just stop producing the catalog, save GBP 70 million. We would definitely lose money if we did that because we constantly measure the return on the amount of money that we invest in catalogs when we send them to customers in terms of the sales increase that they generate. And we know that for a very large number of our customers, catalogs are still extremely relevant and definitely generate much more profit than their costs. However, there is an increasing number of customers who trade online-only. And for those customers, we need to make sure that we are not sending them catalogs. So we're constantly testing the free catalogs to see which customer segments respond, which don't, and where we can cut them back. I'm also looking at things like photography costs.

What's interesting about photography is that photography has become, I think, much more accessible but that makes it cheaper. If you look at photography sort of 5, 10 years ago, it was all very perfect. People that you would never ever see in real life made up without a hair out of place and makeup that no human being can really do in a half hour before they run to work. And that's definitely changing as a result of the style of photography you see on the Internet, blogs, Instagram. It's all much faster, quicker. In changing the style of our photography, we have saved a lot of money taking those photographs as well without, we believe, in anyway reducing the quality as far as the customer is concerned of the photographs.

Final sort of leg of our plan is to maximize the potential online. And I would say that at this point, I wouldn't want you to look at these, the things that I'm talking about, either last year or next year and assume that they are a definitive closed list. We have done far more than we can possibly talk about in a reasonable time, but I'll give you a flavor of the main ones we've done. And we think -- what we saw is an acceleration of growth in both retail and online. I say acceleration of growth. Obviously, retail it was a decline in the rate of moving backwards but you can see both businesses improved but online improved much more. And we think that is in a large part, down to the changes that we've made.

One of our advisers was very worried that in putting this graph in your pack, you would do the straight line extrapolation of Directory performance. Please don't do that. We're not intending that -- that line really shows a step-change rather than a progression. Don't straight line that forward. Just in terms of the projects that we've done. I just put sort of a list in your pack. You can see nextpay, a much more effective mobile site; NextUnlimited, where customers can sort of pay for all they eat with GBP 20 for free delivery for the rest of the year. International mobile sites, faster registration and check-out, intelligent recommendations, what is -- what we found fascinating about all these changes is that when you measure the return that each one of them gives us, it's tiny. You introduce it and you have kind of intelligent recommendations. And the people who get shown them versus those who don't increase their sales by 0.2% or 0.3%.

And when you look at the increase that we've got, it's much greater than any one of the initiatives has delivered on its own. And we think that there is a cumulative effect here. We think if you've got intelligent recommendations and faster checkout and you're showing a customer more relevant profit, and they can all return. Put all those things together, the sum total of all of them put together is greater than the individual benefits you get from each one of them because the whole shopping experience just becomes much easier.

Looking forward, we've still got massive to do. In fact, we've got more to do than we can program. There is so much to do. Targeted marketing will be a big focus in the year ahead, using data that is all legitimate and required, in the right way, et cetera, et cetera. But in essence, we now have -- we've spent a lot of money last year developing a data marketing platform that combines all of the information that we know about our customers, including their recent browsing history, purchase history, average spend, where they live, demographic, all the rest of it with the information that we can get from Google when those people are searching and recognizable when they're going around the Internet. What that means is that we are able to make our digital marketing much more effective. So just to sort of explain the effect of this, this is a real case study. Here is a fictitious site, where we would bid for customers in that manner. The higher the bid, the more of the customers you get. Has 10 million customers a month. Put it in the past for this particular website, the demographics of those people looking at the website fall into 3 different categories, in terms of their propensity to buy NEXT's stock, low, medium and high. In the past, all we've been able to do is to bid for that group of people with 1 price. So we bid GBP 7 per 1,000. And as a result of that, what you can see is that you end up getting slightly worse mix of customers because you're paying the same for actually the best customers as the worst customers. Your best customers are reduced from 10 to 7 that you see, and the low customers increase. And actually then, they remain the same. It's just sort of balance the medium and lower the changes. But it's those high customers where you get all the money. What we're able to do going forward is to bid different prices for each segment. So if we spend exactly the same amount of money but pay GBP 11 for the best customers, GBP 7 for the medium customers and GBP 3 for the low customers, what we have experienced is a significant improvement in the quality of the customers we get back without any increase in the cost of acquiring them. So you see, we get 22% to the customers. That's your adverts are in the high category and that's the category that counts. In this particular example, that resulted in 12% more sales per advertising pound spent. And an uplift in the internal rate of return of the investment of 75%, so a very significant improvement in the rate of return on the investment in digital marketing. And it is the return on the marketing that drives the levels of investment we put into it.

Another small initiative. We -- at the moment, we only have one credit offer, which is a traditional style account -- for younger newer customers, online-only customers, people who've never had a catalog. That -- those accounts seems rather old-fashioned and not relevant. We're introducing a product that we call three-step. It's a product that's available with various other online retailers. It's a very simple product. 3 core payments: nothing to pay today, 3 equal payments, no interest to pay if you pay each installment off on-time. The cost of financing that is relatively low because it's a declining balance and we're borrowing money at relatively cheap rates. The cost of financing that is relatively low. And customers also have flexibility that if they don't want to pay off the full amount at any point, they can pay off the minimum payment. So let's say it's second payment, they pay half of it, the balance goes on to an interest-bearing account. So there will be some interest income from this, but the main purpose of it is to turn customers that we characterize as cash customers into behaving more like account customers, because we think that they -- the provision of an ability to spread their costs in a way that's relatively simple. And if they pay all of on time, has no cost to them, will drive additional sales and drive interest in an account in a customer group that simply isn't interested in an all-star mail order account. If that works, and there's a big if there, we will look at introducing that credit offer as a retail offer as well.

Finally, product personalization. This is a business that we started. You all have seen this at Christmas. You all have received personalized gifts, with your name emblazoned on them. It is absolutely true. I've received -- over the holiday period, I received 3 identical cheeseboards, all with slightly different variations of my name and address on them. And I don't really like cheese but it's a -- I can tell you that it is a big trend in that product category that we ought to be in. It's all third-party suppliers. It's very easy for us to provide this service. We're providing -- it's just -- these are just web pages on our site. We estimate that we'll total around GBP 7 million in the year ahead, assuming that we don't move the product offer forward, which we hope to. The interesting thing about this product category is that it's all direct dispatch. It goes directly from the supplier to the manufacturer. And that's a problem because -- for 2 reasons. The first is that if a customer orders several different personalized items, they all go from different suppliers. And so the cost begins to ratchet up of the delivery cost. You just ratchet it up because you can't consolidate the orders. And if you go into other sites actually, the customer pays for those separate deliveries, so you can go on to -- on some sites, you can actually -- the customer end up paying 3 delivery costs on 1 basket, which is not the way we operate. It also means that we can't deliver to store. What we've worked out is that in the -- for these suppliers, every day, we will have a van that delivers next-day to store Directory orders to every single one of our stores. So when we looked at these suppliers, there aren't many of them. Almost all of them were within 2 miles of a reverse leg of one of those vans. So at very little cost, we can pick up their stock, and inject it into our network, which means we can send it directly to the customer which should reduce costs, possibly consolidate that stock with other similar stock or with their own held orders. And we can -- it opens it up for delivery to all of our network. So what we end up with is a much more sort of comprehensive network of stores. And I think this is a theme that we will be developing going forward, and is potentially important. And that is that -- when you look at all the projects that I talked about today and the ones that we haven't talked about today, a lot of them are about turning the stores into distribution points, whether it be distribution points for other third-party suppliers' products, for our own warehousing products, for product that is already in those stores, either to other stores or to customers at home, or to customers on the same day. What you can see is that we are beginning to build -- to treat the stores in a very simple way as a sort of distributed warehouse really, where you can order stock from any parts to any other. And going forward, we think that will become more and more important. And it's potentially a bit of a lifeline to retail businesses. And the thing that we hold onto is that still 50% of our orders, even after introducing NextUnlimited for our best customers, still 50% of orders, around 50% of orders are going to store. 80% of our returns come back to stores. So there's definitely a role for stores. Part of that role, we think, is joining them up and getting much better and much more effective use of the stock that we have already distributed around the country. And that is a theme that you will see us developing over the next few months. And I suppose I do take some courage and encouragement from the fact that a little known retailer in America has huge online, has just started to open shops, and we're way ahead of them.

So if you like, that is the happy thought. So there we are, happy thoughts. The stores all won for their distributed network of -- sort of distributed warehousing and it's all wonderful. However, I don't think that we have lost our reason and that we haven't lost sight of the dark side, which we're fond of anyway because as effective as those stores may be as a distribution point for Directory stock and as distributed warehousing, they're very expensive. And what happens if we carry on seeing negative like-for-likes? We presented 6 months ago what we thought was a worst-case scenario of our stores declining at 6%. Since then, we've come in at minus 9.5% like-for-like in the last year. So that pessimistic scenario looks now slightly optimistic, and it was only for 10 years. So we've rerun the exercise using the same assumptions that we used last time and that is that we don't open any new stores. There's no additional profitable revenue from new stores, that unprofitable stores are closed, on lease expiry. That profitable stores -- and the profitable stores are held over until such time as they become unprofitable, if they're anywhere near the negative level. So using those assumptions, we've walked forward at a minus 10% like-for-like scenario for 10 years. And in the tenth year, you can see that actually is a significant cost to the group, around minus GBP 74 million but we still accumulated GBP 300 million of cash. Take it forward another 5 years, and you get sort of a good news and bad news effect. The good news is that actually you lose a huge number of the liabilities. So the ongoing cost of running a retail business is GBP 19 million rather than GBP 74 million, but the net cash that you've generated over those 15 years in your retail shops is only GBP 86 million.

What that says to us is that whilst this, we think, is worst-case scenario, it doesn't account for a number of other profit revenue streams. First of all, we talked about the interest sales in retail. Those are actually -- although they're Directory profit, they are generated by the stores. Add that into the mix, you generate another -- you get the cumulative cash up to GBP 253 million. If you assume that in the stores that were new, we are able to get a 15% reduction in rent, which is 10% less than we're achieving at the moment, and in this scenario of minus 10% like-for-like for 15 years, we think that, that is a conservative assumption. Then that puts more cash in the tail. And most importantly, if you see any transfers of sales, if you look at the stores which are close to other stores and assume that where we shut them, we transfer our 15% to the retail sales. When we do it the other way around, if we open new stores, we tend to see cannibalization of between 20% and 25%. If you open a new store near an existing store, normally on average, 25% of the additional sales from the new store will come from an existing store. We've assumed reverse cannibalization of 15%. That gives you around GBP 431 million of cash over the next 15 years. And a year -- 15 drag on the business around minus 8%.

There are 2 things also that this doesn't account for. It doesn't account for any concession income. You will see in the year just gone, we're adding GBP 5 million concession. In the year coming, we're adding GBP 5 million of concession income, and it doesn't assume any gain from other retailers who are shutting shops. So we think that it's a relatively conservative model. It's not what we expect to happen but realistically, we think even in a minus 10% like-for-like scenario, we will generate around GBP 430 million of cash from the stores, be left with a negligible cost at the end of it. The big assumption we've made throughout all this model is that the fixed costs that are shared with Directory are paid for by Directory at -- and the assumption is that Directory online has grown as fast as the retail has declined in pound terms. Obviously, as time goes on and the retail business gets smaller, you only need a very small growth in the Directory to pay for the big decline in retail because the numbers become -- the numbers diverge. So we think that's a very conservative element. And I guess, the point we would make is that this is clearly a problem, one, a big source of revenue for us in this scenario, will dry up over the last 15 years. But it does not, in any way, detract from the value of our online business. So that -- it's not a lead weight around the neck of an online business and doesn't in any way, devalue it. And as long as we got stores open, actually having those stores enhances the value of the online business because we can deliver and return through them.

So what feels like a very long presentation, we're just coming to the end now. This is the good bit. Looking at next year's forecasts, this is taking central guidance and making ridiculously accurate forecasts, the numbers we can't possibly know. So don't panic if one number is higher and the other one is lower. The best number is probably the 1% growth in group sales. But assuming that we get 10% growth online, 7.5% decline in retail. In terms of what happens to profit, we would lose GBP 76 million of margin less variable cost saved in retail. If we were to match that number, we would gain GBP 66 million from full price Directory sales. So the structural gap in the year ahead is around -- remains around GBP 10 million. And in fact, we think, we'll take more online than we lose in-stores. That pushes it up to GBP 83 million. That is all at NEXT margins. We will lose some. We think that the cost of lost -- of margin erosion will be around GBP 23 million in the year ahead. Remember, it was GBP 30 million last year, so a better -- we think it will be better next year not because we won't grow our LABEL business but because we think we will get a lower decline -- or a better performance rather, in our NEXT branded business.
Cost savings. Pretty much matching each other. We haven't got the big step-change in Directory expenditure this year. I should stress, we're not -- that step-change will remain, so we're not spending any less on Directory but we're not having another GBP 11 million increase in expenditure. Clearance rates. We are not expecting to decline in the year ahead. That may -- of all the things we're forecasting, that may prove to be the most optimistic because it may just be that sales actually are going out of fashion and that we still -- we see a continued loss of clearance sales. I think that's the area of vulnerability there. What that gives us is GBP 705 million of profit, growth in EPS of around 1.4%. I think, I again, I think that's important is that at a time of structural change, a time when retail is moving backwards, we still think -- on our central guidance, we still think we will be able to maintain our earnings per share, which is -- means that on a straight sort of total shareholder value basis, we don't think our shares will be worth any less profit at the end of the year than they will be at the beginning of the year. We'll pay a dividend, which equates to 3.2% of GBP 48 share price. So the total return of growth in underlying profit per share and ordinary dividend yield with around a 4.6% return in the year ahead if we hit our central guidance. And whilst that is a long way off the best performances that NEXT has delivered over the years, we think in the current environment, with the challenges that we faced, that will be a reasonable result for the group.