Transcription for MAVI GIYIM
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Corporate Participants

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mavi

Presentation

Operator
Ladies and gentlemen, welcome to Mavi First Half 2018 Results conference call and webcast. I will now hand you over to your host, Cüneyt Yavuz, CEO and Tuba Yilmaz, CFO. Dear speakers, please go ahead.

Cüneyt Yavuz
Thank you. Welcome to our conference call for the financial results of the first half of 2018. The results reflect the performance of our spring/summer 2018 season, which is from February 1st to July 31st 2018. I will be taking you through our operational and financial results for the period and we will share some insights on the current trends in our operating environment. We have updated our expectations for the financial year 2018. I am glad to share an upward version with you, despite the current macroeconomic challenges we are facing. I will be happy to answer any questions you may have at the end of our call.

Let's move onto slide two and I will take you through the key highlights. In the first half of 2018, our consolidated revenue grew by 28% to TL 1.062 billion. Our EBITDA grew by 39% to TL 156 million, resulting in a 14.7% EBITDA margin, delivering 120 basis points improvement compared to the same period of last year. Coupled with strong top line and EBITDA growth, our net profit also grew by 48%, and reached TL 53 million. Store rollout continued slower this year due to higher efficiency considerations. We opened net seven new stores in Turkey and one in Russia to reach a total of 428 mono-brand stores globally, including franchises. Mavi Turkey retail business delivered another very solid like-for-like revenue growth of 20.9% on top of the strong performance of last year. We acquired 620K new customers in the first six months of 2018 and our loyalty card, Kartuş holders reached 6.9 million customers.

Moving onto slide three, there was strong revenue growth in line with our guidance both in Turkey and international, and in every sales channel. 82% of consolidated revenue was driven from Turkey. In spring/summer '18, global revenue grew by 28% reaching TL 1.062 billion, out of which 67% was in retail, 31% was wholesale and 2.4% was from e-comm. Global e-comm sales grew by 65% above all other channels and in the first half of 2018. Sales in Turkey grew by 29%, mirroring 29% growth in retail, the main driver of our domestic business. Wholesale channel grew by 27% and e-comm sales in Turkey grew by 56%. International growth in the first half was 24%. We are happy to report a very strong growth performance of 80% in mavi.com sales.

Moving onto slide four, let's dwell down a bit more on Turkey and Turkey retail business. As you know, we guided for 25 net store openings in 2018. In the first quarter of the year, we opened nine stores and closed two stores, resulting in seven net additions. Given the current economic trading environment, we will be revising our plans for store openings for the rest of the year, which I will elaborate at our guidance page.

As of end July, we have 294 own-operated stores with over 146,000 square metres of selling space in Turkey. New stores and the expansion of eight stores accounted for more than 7,000 square metres of additional selling space. We continue to open larger stores and our average store size has reached 497 square metres. As a result of selling space growth and our strong like-for-like growth, Turkey retail revenues grew by 29% to reach TL 679 million.

Now, let's take a closer look at our like-for-like performance on the following page. We continue to deliver very strong like-for-like growth with 20.9% in the first half of 2018. Of this like-for-like growth, 13.3% is driven by transaction growth and 6.7% by basket size growth. Mavi, today, is even a stronger leader in the apparel industry thanks to its healthy brand positioning and top-of-mind awareness. We are happy to note that consumer confidence has remained strong behind our Mavi business in the first half of 2018 and we continue to benefit from increases in traffic, new customer acquisition and conversion rates. We believe this is driven by Mavi's right product offering at the right price and, of course, our superior service and quality proposition, which is fuelling increased customer loyalty.

Now, let's take a closer look at our category-based performance and move onto page six. Both our denim and lifestyle categories are performing very strong. We have happy customers shopping across the whole range of products in our portfolio. Our denim category, including jeans, denim shirts, denim jackets, denim dresses has grown at 21% in the first half of 2018. Across the lifestyle category, we again delivered very strong results. The knits category, which consists of t-shirts and sweaters constitute 22% of sales and has grown 37% in the first half of 2018. Sales growth in shirts with 42%, jackets with 73% and accessories with 28% clearly indicate that the appeal and demand for Mavi is on a solid continued growth trajectory.

Let me move on to review our margin performance on slide seven. As you know, we have been guiding for improving margins going forward through scientific volume planning and dynamic markdown management, improving rent/sales ratios and operational productivity rising from economies of scale, especially supported by our like-for-like retail performance. As we started the year, there have been major external economic developments in our trading environment that were not included in our initial budget planning. Nevertheless, Mavi team has been agile and very responsible to deliver the promised margin improvements above its targets in the first half of the year. Our gross profit grew by 33% delivering 180 basis points improvement against the same period last year. It is important to note that the impact of the Turkish lira depreciation on the cost of goods were limited in this period. Our EBITDA grew by 39% and net income grew by 48% in the first half of 2018. Our

EBITDA margin improved 120 basis points and reached 14.7%.

Now, I would like to move on to page eight to take you through our working capital progress. We continue to see the results of our multifunctional planning efforts as we improve our open-to-buy supply planning, become more efficient in inventory management and increase our sell-through performance. Our working capital, as of the first half stands at 4.3% of last 12-month sales. We have generated TL 138 million operating cash flow, and our cash conversion stands at 89%.

Let's now move onto the next slide. We spent TL 33.6 million on capital expenditure this season, most of which was related to new store openings and store expansions. CapEx/sales ratio is now at 3.2%. We continue to guide for below 5% CapEx/sales ratio.

A few comments on our debt mix. With strong cash generation, our net debt level has stayed flat at TL 114 million as of the end of July 2018, and our leverage multiple is lower at 0.4 times of last 12 months EBITDA. In terms of currency composition of our debt, the majority of our hard currency credit on our consolidated balance sheet, which is 28% of total debt is related to Mavi U.S., Mavi Canada , Mavi Europe and Mavi Russia, and are covered by their own sales in their local currencies, resulting in no currency risk. The only portion of our total debt that is exposed to currency risk and is subject to foreign exchange gain/loss is the Exim credits we use for export financing that have favourable interest rates. 49% of our total debt is in Turkish liras.

On slide 10, I would like to elaborate a few minutes on our rent management in Turkey retail stores. As you know, around 60% of our rent contracts are denominated in hard currency, either euros or U.S. dollars. Given the current environment, with ever-moving currency rates, we continuously negotiate the contracts with the landlords in order to maintain and continue to improve our rent/sales ratios at each store level. As you see from the chart, in the last few years including 2018, we have been able to contain and even improve our rent ratios, despite major increases in foreign exchange rate. I am happy to report that as of year-to-date September, Mavi is able to keep rent ratios stable. Going forward, we have decided not to enter any hard currency contracts and we are planning our investments accordingly.

Moving onto the next slide, I am happy to give you some good news regarding our full year expectations. Given the outperformance of the business in the first half of the year and including the macroeconomic developments, we have revised our full year expectations. We are now expecting 30% top line growth versus 25%. This includes our better like-for-like growth projection, which is revised to 20%, versus prior stated 16%. Our traffic and conversion rates are tracking very positively, including year-to-date quarter three. We believe Mavi is well positioned to win in this challenging environment. We also expect higher contribution from international operations in the second half of the year given the new currency levels. We have revised our CapEx plans to open 20 of the planned 25 stores in 2018, considering both the cost of capital and on-going rent negotiations. We will also be expanding 15 of our stores in total. We are continuing to guide for an EBITDA margin target of above 14%. As you know, we are going through tough economic challenges, which require maximum level of attention and hard work from my management team. As of today, our hard work has been paying off and consumer demand for Mavi remains strong. We are delivering 26.4% like-for-like growth in Turkey retail operations in the first 40 days of quarter three 2018, which is strengthening our conviction to deliver our continued profitable growth plans.

At this point, I would like to thank you all for listening to my presentation and should you have any questions, I am more than happy to answer them. Thank you.

Question and Answer Session

Operator
[Operator instructions]

We have the first question from John Tomson, Moon Capital. Sir, please go ahead.

John Tomson
Can you elaborate on the reasons for the expansion of your gross margin, and what would be your guidance for gross margin in 2H? Thank you.

Cüneyt Yavuz
Thank you for the question. As you know, in the first half of the year, we started off with great pricing and great planning for our products and, therefore, we put behind us a very successful first semester.

Into the second half and we look at our margins, as you know, we are not guiding for gross margins, we are focused specifically on EBITDA margins, and we look forward to closing the year with above 14% margin, which means that from the point of view of product acquisition, selling price, mark-downs, sell-through expectations and looking at the current trading environment, we look forward to gliding through a quite successful second half of the year. Thank you.

Operator
[Operator instructions]

[No further audio questions]

Cüneyt Yavuz
What I will do is I will read the questions that have been posted.

Question :
"What is the (latest) share of rent contracts in FX that are on fixed rates/hedged %2B would it be possible to share the average rate at which these are fixed/hedged?"

From the rent contracts perspective, this is a question that is coming from Asli from Goldman Sachs, thanks for the question Asli. The rent ratios, unfortunately, what we are doing is we are managing the rent ratios through our sales/rent ratio KPI perspective, and the contracts themselves are on a floating rate, meaning the process itself is negotiating. Some of them are short-term, some of them are long-term, some do give contracts for a month or two months, or others typically choose to do for a year at a certain fixed rate.

I think what is most important for everybody to understand is that if a store is growing nicely and performing and the rent we are paying is a fair share of the market value, and if the store contribution is at around 20-25%, then we are happy continue our business. But there are, of the 300 stores roughly we have, there is roughly around, I would say, 7-8% of them which are typically pursuing current market rates and hence we have to negotiate harder or keep a closer eye on them. Should they reach a certain red ratio, which is not delivering the profit expectations that we have, then we will choose to take measures, and we make it clear to the landlords accordingly.

I am happy to say that year-to-date as was presented by the chart that I put forth in the presentation, that in terms of rent ratios and moving forward, we are relatively confident and we look forward to maintaining our rent ratios despite the fluctuations that are taking place in the marketplace.

Again, I want to reiterate , individual rent contracts vary from one store to another, and also individual stores performance vary from one to another, therefore, it is not easy for me to come around and say, overall, we are fixing the rate at five to the dollar, seven to the euro etc, because each and every store is unique on itself and, therefore, we have to negotiate, although it is a bit of loss of time and takes a lot of our energy, we have a very capable real estate development team, and we have a very positive working and trading environment with our mall operators, with all the lines being open and channels of discussion being open, and they value our business. I am also thankful for the shopping mall operators and landlords, therefore, we have been able to contain and manage the rent ratios, as more or less what we thought would be a fair value of the market situation. That’s my direction of the question.

Question:

“To what extent is current pricing strategy sustainable? Once start selling inventory purchased post-depreciation would this not have to change? And what impact would this have on LFL growth?
- Could you comment on price increases from suppliers driven by increasing costs as well as competition with other international brands for their capacity?”

A very good question. Actually, one of the key challenges… I think in this kind of uncertain economic environment there are… first and foremost, one challenge is acquisition price of the product. We have been going through uncertain times, therefore it has been quite challenging to identify where the cost of goods sold would rise and where it would end up, and the second question is of course the supply question. Maybe it's not addressed here, but I will be more transparent about it, whether it's because these are also questions that have been passed on to our IR department. The other question is, "How is vendor base doing in terms of supplying our products?" So if you look at our working relationship with our suppliers, we're also in a positive standing in terms of keeping the relationship or putting in orders and getting the cost, and keep the business running. Clearly, moving onto Spring/Summer 2019, the cost base or acquisition base of prices will go up and, hence, we have already started budgeting for a new marketing environment. The benefit we have right now is the import-based brands, which are following global pricing strategies, are taking the prices much faster than we would be taking it and, hence, enabling us and giving us the breathing space to do catch-up, and feel and sense how the consumer sentiment and spending power is behaving.

Moving into next year, there will be a challenge… direction and pricing challenge, but it is too early for me to comment on that. In the first seven, eight months of the year I am very happy to report back that the team that we have, the fact that we are 80% made in Turkey, that we are doing good planning, that we have a lot of open to buys, we have good sell-through ratios, we have good supply chain systems installed, we will glide through this with a clear focus on working capital management and the right pricing. I think there is a Central Bank rate increase coming up tomorrow and there is a bit more time needed before we have a certain idea of where the dollar, euro, TL lands on. I think I will have more visibility in terms of what's to come in 2019 onwards when we are sharing with the quarter three results, as we near the end of the year, but you can all rest assured that we are already taking in, let's say, defensive rates and preparing for a tough 2019. The team here is really strongly embraced and looking forward to tackling and keeping the customers happy and keep the sales going.

At this point, we are prudent, but we are constructively optimistic about what is to come over the next six to nine months.

Question:
"Can we expect net debt to EBITDA ratio to rise above 0.4%?"

Good question. I mean, what we are guiding for, as you know, and we have in our new revised guidance, we haven't changed the net debt/EBITDA ratio.
You will recall that what we are guiding for is less than one. If you're asking… if this question is more about this year, our guidance is that it will remain one and my gut looking at numbers and business as usual, the ratio will remain at 0.4, but may go up closer to one, but it will definitely be less than one. In terms of our debt requirements, CapEx requirements, and product acquisition requirements, when we look at business rolling down the line until the end of the year, I see no reason why our debt situation would tremendously change.

Question:
"Have you seen any positive impact on your store traffic from increased tourism activity?"

I think the overall – and I am very happy to report back that the overall traffic is high. From our tourism activity it's a valid point, we have also benefited in the touristic areas, also from improved tourism situation vis-à-vis the prior years in the major touristic shopping malls in Istanbul, as well as in touristic seaside cities such as Izmir and Antalya in the coastal area. We have seen an increase in tourism and tourist shopping with Mavi. It's a part of our improvements; it's in the improved numbers for our business that we are reporting back.

Question:
"Could you give some colour on what drove the profits before tax on the international segment into negative territory?"

The loss arises mainly from Europe as we have been closing retail stores and there are costs relating to closures. In the European market, especially in Germany, we had a handful of stores which we are exiting. What we are doing is parallel to that we are putting more of our resources behind digitalisation of the European market. Therefore, in this first half there have been some hits coming from there. Also, the Russia business, as some of you will recall, I've been sharing on my road trips in conversation with you, is that the Russia business is in its investment period and at this point in time it's at breakeven or slightly below. Therefore, it is not also contributing as much as we would like it to be contributing to our business, but when we look down the line towards the second half of this year and next year, we are very optimistic about where the business will be driving. It's also a valid question, thank you for that.

Question:
"What is your internal rate of inflation? Are you able to pass through this rate of customs via price increases?"

In a typical year if you look at it historically, Mavi's cost inflation overall would be around 60% of the headline inflation of Turkey on a per-unit base. This may be exceeded a few percentage points given the current currency exchange levels, as some of the raw materials are denominated in dollars. The good news is we feel we have enough room to pass this impact to pricing, as the competitive environment is getting more favourable with most of the international players typically reflecting euro/U.S. dollar prices on their products. Hence, as you have seen, we did keep out EBITDA margin guidance for 2018 unchanged.

Question:
"Should we assume that current inflation environment would help you to operate above 20% LfL sales growth?"

My answer directly is yes. As part of the volume growth and price growth, this time in a way forced us, willingly or unwillingly because of the pricing that will come through, to maintain a 20-plus percent like-for-like when we look further out into 2019 onwards.

Question:
"You generally target 50bps margin expansion every year. Are you still confident on this target for the coming years?"

I am. You will recall that the 50 bps was a direction of working mantra that I shared with you. What I have been sharing is that when we went to IPO we were more like a 12, 13% EBITDA company and our ambition over the next three or four years would be to take this company to 15, 16, 17% EBITDA margins. I am happy to report back that we have kept to our promises based on sell-through rates, markdown management, inventory management, good pricing and like-for-like growth, and operating cost management. Directionally speaking, as a company we maintain our EBITDA margin growth or total margin growth for the coming three years. Therefore, yes, the short answer is yes, we remain optimistic about margin improvements, even looking out into the next year.

Question:
“Could you share the latest markdown levels and sell-through rates?”

As I’ve shared, I mean if you look at… just to make a point also, we are very happy in terms of our inventory levels and how fresh they are. We closed the first half with, from our perspective, record sell-through rates. The number is around 92%, where we are still depleting it through markdowns in our outlets. This season, Fall/Winter, we are really fresh. And in terms of markdowns, vis-à-vis Spring/Summer ’17, our markdown spend was around 21.7, and right now we have roughly spent 18% in markdowns, so we have also made progress as part of this markdown, so both in terms of sell-through rates, markdowns, we are making benefits. We will continue to be managing these KPIs closely and some of this hopefully we will use against the competition and negative macro environment to defend our brand, and some of it, as the previous question alluded to, it will continue to benefit our bottom line.

Question:
“Any particular reason for the 55% y/y increase in Turkey wholesale revenue, what should we expect for the full year?”

You should always evaluate the wholesale revenue improvements biannually. Please don’t forget that we are running on two seasons from a wholesale perspective predominantly. It is Spring/Summer and Fall/Winter. Wholesale customers are buying for the season in the first quarter and then replenishing throughout the second. There could always be a transition between quarters and to a certain extent, for those of you who might be digging into the numbers deeper, it also holds true for a bit of our international wholesale business too. I just want to add that on.

Question:
“Would you re-evaluate store opening plans going forward to reflect fewer than 25 store openings per annum in Turkey with a shift towards online versus brick and mortar?”

Generally speaking, I just want to make it really clear that if we wanted to open up 25 stores moving forward for the coming years, we can open up 25 stores. The critical point in time right now is as the cost of capital is increasing, we have to be very diligent and we have, as a company, as one would understand, made sure that we are getting into the right rent contracts. Therefore, at this point in time it's too early for me to back off from the 25 number. All I'm doing or all we are doing right now is for the rest of the year, with all the uncertainty, taking the 25 number for this year to 20. For all intents and purposes, in our systems and three-year outlooks we are keeping the 25 number for the following year. Having said that, once we have more clarity at how things are moving forward, I will be really quick to update you in terms of what and how this number might change.

As part of the second piece of the question, which is bricks and mortar versus digital, I would like to reassure each and every one of you that the digitalisation of Mavi is one of our key, top priorities and I look forward to giving you more insights in terms of how we are progressing in this area. Therefore, it's not an either/or question. It's an "and" question and from our perspective we will continue to invest in our digital and e-comm business for the coming period, and hopefully, as you have seen in these numbers, you will see that our e-comm business will continue to grow disproportionately faster than our total classical business.

Question:
"In terms of the breakdown of LFL growth that you've shared for August 1 - September 10 (of c.26%), is it a similar composition to 2Q18 in the sense that transaction growth is ahead of basket growth?"

The answer is yes. What I'm trying to say, yes, in the sense that in terms of volume growth we are maintaining above 10% growth, so the volume growth is around 12- 13%, whereas it wouldn't be wrong to assume within this 26% that there is a bit more higher pricing increase that is taking place. So, yes, we have already taken a bit of a high price increase starting in the early days of this season.

[No further questions]

Cüneyt Yavuz
I would like to thank each and every one for your participation. Both myself, my CFO, Tuba, and our IR director, Duygu, is more than happy to any further questions you might have down the line. In these uncertain times and challenging times we, as Mavi, as I mentioned, remain very confident and look forward to keeping an open channel of discussion with you and answering any questions you might have, and I wish you all the best in your daily endeavours. See you all, bye-bye, thank you.