Transcription for Q1 2023 Financial Results Webcast

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DUYGU INCEOZ
Welcome to Mavi webcast regarding the financial results for the first quarter of 2023. Our CEO, Cuneyt Yavuz, will be presenting the results followed by a Q&A session. We would like to inform you that this presentation is being recorded and we kindly ask you to keep your microphones muted throughout the presentation. Now, I will leave the floor to Cuneyt Yavuz.

CUNEYT YAVUZ
Hello everyone! Welcome to our webcast for the financial results of the first quarter of 2023. I would like to take a few minutes to elaborate on the general trading environment in the quarter. Following a very successful year, 2023 started off with a strong quarter both operationally and financially. Our spring summer collection was well received by the consumers and hence the solid top line growth was driven both by price and volume. Almost all product categories continued to grow in number of pieces for both women and men. Our strong brand strategy, demand creating newness supported by dynamic price planning helped offset part of the significant product cost inflation experienced this quarter. We continued to focus on excelling at dynamic supply chain management, flexible and responsive product planning and efficient inventory management. As a result, we achieved a relatively strong gross margin performance for a seasonally softer first quarter. Through effective cost management, supported by the strong sales performance, we delivered 170 basis points improvement in opex to sales ratio in the first quarter of 2023. With continued operational cash generation, our net cash position increased to 1 billion 896 million TL. In Turkey retail, February was marked by the devastating earthquake that impacted 11 provinces in Turkey. Recall that we had seized operations in 32 points of sale after the disaster. As of today, five stores remain temporarily closed with one being permanently closed. Consumer demand returned to its robust levels after March amid high inflation. The Eid holiday season moved from May last year to April this year, positively impacting the quarter sales. With a right product - right price - high quality strategy we continued to grow sales volumes in jeans, women and men lifestyle categories in Turkey. International sales recorded 12% constant currency growth in Q1 2023 despite an economic slowdown in some of our markets. International sales and margins were pressured this quarter as currency levels remained relatively stable. Online sales growth was mostly driven by mavi.com performance in Turkey and the positive marketplace performance in the international markets.

Lets look at the key highlights for the period, moving on to Slide 6. Our consolidated sales in the first quarter realized at 3 billion 947 million liras growing 109% year on year. Turkey retail sales grew 119% and Turkey online sales grew 82%. Our EBITDA realized 911 million TL, resulting in an EBITDA margin of 23.1%. Our net income growing 71% reached 515 mn TL. In Turkey, we acquired 282K new customers in the first three months of the year. Number of active Kartuş card members in Turkey exceeded 6 million.

Moving on to review our channel performance: In Turkey, the inflationary environment continued to drive consumers to shop and we strive to make sure we have the newness and variety at the right price to respond to this demand and remain consumers' brand of choice. Recall that the Eid holiday moved from the second quarter last year to first quarter this year, further positively impacting Q1 sales. As a result, our sales in Turkey grew 124% in the quarter, with Turkey retail growing 119%. The wholesale growth of 170% is mostly related to low base. We continue to witness some softness in demand internationally, especially in Europe. Nevertheless, total international revenue grew 12% in constant currency and 50% in TL terms in Q1 2023. Retail and direct to consumer online channels were the drivers of growth internationally. With the continued robust performance, 86% of total consolidated revenue was generated in Turkey in the first quarter.

Focusing on Turkey retail business: Growing retail is still at the heart of our business strategy in Turkey, despite the slowdown of store openings in the recent years. We will continue to expand current stores in square meters, grow our product offering while constantly taking new actions to make sure that consumers have a great shopping experience. Having said that, in the first quarter we opened 2 new stores, closed 3 stores to close the period with 328 own-operated stores, 167 thousand sqms of selling space in Turkey with an average store size of 510 sqms.

On slide 11, lets elaborate on the like for like store performance: Traffic growth of 19% in Q1 2023 displays continued strong consumer demand including the positive impact of Eid Holiday moving to April. In the quarter, like for like sales grew 124%, driven by 94% basket size growth and 15.4% transaction growth. Basket size growth was enabled not only by the dynamic pricing strategy but also the newness driven right product mix. As Mavi management we always review the success of our growth figures, especially in these days of high inflation, with actual volume growth in number of pieces sold. 12% volume growth achieved in Q1 2023 is in-line with Mavi's growth targets.

Moving on to slide 12 to review category-based developments in Turkey retail: We continue to trace strong growth across our product categories. Almost all categories also delivered growth in number of pieces as stated earlier. Both denim and non-denim businesses grew 120% in Turkey with denim constituting 45% of total Turkey retail sales in Q1 2023. Denim's weight in sales is higher in the first quarter compared to the 39% in full year 2022 due to seasonality as spring lifestyle products are relatively smaller ticket items and holiday season sales include more denim products. We are constantly following changing consumer preferences and enriching our product range especially in casual lifestyle categories. Knits business constituting of t-shirt, sweatshirt and jersey offerings grew 117% year on year and make up 25% of our retail sales in Turkey. Capitalizing on the same trend, our new category non-denim bottoms grew 141%. Jackets being one of our focus categories in the recent quarters continued its strong momentum and grew 173% in Q1 2023. Accessories grew 105%

and shirts grew 100% this quarter.

In the next section, lets review our online sales performance: Our direct-to-consumer online sales are made up of mavi.com and marketplace sales that are reported under e-commerce channel. In these charts we review the total online sales of Mavi including the sales to the third-party digital platforms to which we wholesale. In the first quarter of 2023, our direct-to-consumer e-commerce sales share in total consolidated revenue is 10%, whereas including the wholesale e-com, total online sales is 11.4% of total consolidated revenue. Online sales in Turkey consists of only direct-to-consumer channels and grew 82% driven by the 115% growth of our own website mavi.com. Marketplace performance varies among platforms. There are some platforms growing aggressively and some that are cutting down on marketing spent hence performing softer. Online sales now constitute 8.3% of total sales in Turkey. International online business grew 56% in the first quarter largely driven by direct-to -consumer channels and constitute 30% of total international sales. With retail being a significant channel for the consumer, especially in a Turkey context, omni-channel capabilities are becoming more important for future growth and in improving the shopping experience for consumers. Mavi will continue to invest in digitalization and CRM projects that support omni channel growth and make sure online business continues to be a positive contributor to margins.

Let’s move on to review our consolidated financial results: On slide 16, we review our gross margin performance: Recall that in 2022, the higher product costs started kicking-in in the second half of the year. Hence in the first quarter of 2023, there was significant product cost inflation due to low base. On the other hand, with the exchange rates remaining relatively stable, we are also witnessing deterioration in international gross margins in the last few quarters. Meeting high consumer demand with newness, variety and the right product/price positioning supported cost mitigation. As a result, the gross margin decline of 670 basis points should be considered a normalization from the extraordinary base, and we view the 49.7% gross margin as a seasonally strong performance given the macroeconomic conditions.

On slide 17 we review our EBITDA and bottom-line performance. The significant opex inflation in the first quarter was again leveraged by the strong top line growth. We continued to deliver improvements in our rent ratios and our central operating expenses. Total opex to sales ratio improved 170 basis points year on year. As a result, our EBITDA excluding the IFRS16 adjustments grew 66% year on year resulting with an EBITDA margin of 19.6%. EBITDA margin including IFRS16 realized 23.1% in the first quarter of 2023. Thanks to our net cash position, the increase in net financial expenses were limited and hence the operational performance was mainly reflected to our bottom line. Our net income increased 71% to 515 mn TL and net income margin realized 13.1% in the quarter.

On slide 18, we investigate our operational cash flow and working capital performance: Operational cash conversion is relatively lower in the first quarter due to working capital requirements. This is in part due to seasonality of the quarter but is also the result of the increasing cost of inventory and the initiatives taken to mitigate product costs pressures such as cash payments, early booking, advance payments for raw materials and so forth. The 147% year over year increase in inventory level at the end of April 2023, is largely driven by 107% product cost inflation yoy. Inventory in number of pieces in Turkey is 27% higher compared to an extraordinary low base of Q1 2022 and in line with business plans and demand expectations. Inventory as always comprises of all fresh, spring summer season products.

Let’s now move on to the next slide: We spent 86 mn TL in capital expenditures in the first three months resulting in a Capex to sales ratio of 2.2%. On the retail side we had few store openings and new store concept transformations taking place. Apart from retail, we have been investing predominantly on IT projects and digital investments. With positive cash generation in the first quarter, our net cash increased to 1 billion 896 mn TL. All of the foreign currency debt you see on our consolidated reports belong to our subsidiaries, all borrowing in their respective local currencies and hence does not pose a currency risk. We continue our approach of holding no foreign exchange position in our balance sheet. On the other hand, average cost of debt is increasing in Turkey, and we foresee higher rates going forward.

We are sharing our official guidance for the year as promised. For the financial year 2023, we are expecting 75% plus minus 5% consolidated sales growth, with net 5 store openings and 7 sqm expansions planned for the year. We expect an EBITDA margin of 18% plus minus 0.5% excluding IFRS16 and 22% plus minus 0.5% including IFRS16. We are foreseeing a decline in our net cash position within the year due to our plans and strategies to use cash in mitigating cost pressures, but we target to stay in the net cash territory. We are planning to spend 3% of sales as capex. I would also like to provide some insight on the current trading environment as of date. We continue to see high demand for our products and a positive pricing environment as of today. Turkey retail sales in May grew 92% on a high base that includes Eid holiday sales. Online sales in Turkey grew 98% in May driven by 141% growth of Mavi.com. With this final note, I am happy to take your questions now.

DUYGU INCEOZ

Ladies and gentlemen, if you wish to ask a question, please click on the raise your hand button, which is a hand icon on your control panel. When I call your name, please open your microphone before you speak. We have a question from Cemal. Cemal, please go ahead.

CEMAL DEMİRTAŞ
Thank you for the presentation, and congratulations for very good results. You always surprise us on the positive side, even in the pandemic times. So congratulations once again. My first question is about the trading updates. We see a little bit, maybe slow down, in the international siDE, from the numbers. Could you just give us some color on that front? That's my first question.

The second question is, recently, Turkish lira is depreciating steeply. What should be the short-term impact on your financials? Related to that, when we look at the Turkish confectionary, or textile industry, we see some shift from Turkey to other regions like Egypt, Morocco. We have been hearing in the media that some ecosystem is moving to other countries because of less competitiveness of Turkish players. That was in the media recently because of the high inflation, and low depreciation, and the margin erosions. How do you see that after recent developments? Do you think this kind of shift will make additional pressure on the profitability of the Turkey operations. If the ecosystem moves to another country, then the producers in Turkey will be less profitable. And it looks like a long-term risk. I would like to understand how is this picture from your side? Any comment on that? Thank you.

CUNEYT YAVUZ
Thank you Cemal, and thanks for the encouraging remarks. It's always nice to hear that, and hopefully, across the year, as we come in with the next quarter results, we'll continue to positively surprise both ourselves and you. In terms of delivering good results.
Starting from the last point you made, in terms of the manufacturing environment, you are very right, and it's also reflected in the comments that I made. Because of the valuation of the Turkish lira, expenses going up in Turkish lira, in terms of labor, energy going up, but at the same time the Turkish lira not depreciating, along the sides of an international currency, whether it's US dollars or Euros. Turkey, from a manufacturing point of view, has been losing its competitiveness. I think it's a point in time situation and I think this will be corrected across the board. Therefore, I would be less worried about that.

Having said that, I know, and I've been doing this business for 15 years, brands and companies do move their manufacturing to make the most out of opportunities they have. Turkey is one country, Egypt is another, maybe Vietnam, Bangladesh, China, and sometimes African countries depending on the product portfolio. So big companies do move around. Having said that, I think the Turkish textile environment is quite sturdy. If I look at our own manufacturing base, which is a hundred plus suppliers that we operate with, they're mostly well positioned, financially solid companies and we do follow up just to make sure everything is fine. They created listings and linings to see if they're also in business. I think as we can see after the election, there has been some impact that has been taking place on the currency and the valuation. Therefore, as the Turkish lira becomes more normalized, I think there will be a more normalized trading environment and Turkey will hopefully remain a more competitive place for manufacturing.

Despite all this, I think whether there is this move in or move out. Just from Mavi's point of view, I think we are well positioned with our suppliers to continue our business and I think the cyclical nature of our business, as you know is more or less six months, outlook is quite firm and there's a lot of contracts that have been signed in. Therefore, if you talk about the next six months, I mean from today till the end of the year covering the fall winter period. I think Mavi, in terms of having already placed the manufacturing products that are being produced, our plans are in place, the suppliers are up and running, either the raw materials or the designs have been submitted, so directionally I don't see any big hiccups coming in and hopefully with some correction it'll be even more competitive for the manufacturers.

You're right, there has been a lot of pressure from that perspective, but for the foreseeable feature, I think there will be some correction and there will be some normalization. That's my take at least for the time being and maybe the following quarter when we get together we can do a reassessment of this point because it's a quite valid point.

I think in terms of the depreciation situation, we talked about the negative potentials on manufacturing of Turkish lira depreciation. Of course the other side is what about cost with Mavi? Or any other manufacturer who's buying in US dollars or raw materials. What is Mavi's stake for the future? As you would recall, and if you've been following us, I'm also sharing this for all those who might be tuning in lately, we always have been across the many, many years have been hedging against our imports and dollar exposures. So if I look at where we have hedged for this year, we are pretty much covered wherever we have US dollar based imports and costs coming in. And I think if I'm not mistaken, I mean don't take me literally, but we have hedged more or less everything around 21- 21.5 TL/ US dollars. So whatever imports we have, we are already more than well off in terms of what is to come and we are more focused on pleasing the consumer, making sure that there is a happy consumer shopping and have the best products and the most competitive price that is on offer. Therefore, unless there is an extraordinary negative downturn on the market, generally speaking, you all by now know that I'm quite bullish about what Mavi can do. I'm quite confident we will continue to gain share. We have a very strong and we enjoy a very strong men's market share with number two position and on women's we are number three position.

So we are quite relatively strong and growing and I think with the product offering, the pricing, the quality, even in such let's say negative circumstances, I think Mavi will continue to flourish and consumers with their very valuable money will choose to spend it with us and they will rightly do so because I think we are offering really good product for a really good price on a very timely and favorable position. Now in terms of the international markets, Turkey has been growing disproportionately fast and we were typically an 80-20 kind of set up, 80% Turkey, 20% international. The international markets also themselves are growing top line, but as I mentioned in my comments, Europe is the one that is sort of flat, it has only grown 1% in quarter one. North America business has grown between, in US dollars, 5% ish, so it's also growing. I would like it to be growing 7-8%, a bit faster. Russia is growing at around 50% year-on-year. So it's doing much better actually. You don't get to see the nitty-gritty, but generally speaking the slowdown in Europe, numbers are being offset by the Russia business. So that's sort of a wash within themselves. And then we have a rest of the world business which is more the franchise business in the CIS countries, Balkans, East of Turkey, Turkey Republics, and Middle East. And that is growing around 27%. So it's small but growing in the right direction. So generally speaking, I would say international businesses is still growing not in double-digit but in a very solid single digit, high single digit numbers and I think this will be the case for the rest of the year. We are also trying to be careful with this part of the business because as you were mentioning through the manufacturing part, the margins here are under pressure because what we were selling at hundred dollars is not making as much money as it used to, but I think this normalization period in the next couple of months it should come back to where it was. So we did an offshoot, there were good times, there were bad times, and also in Turkey last year there were good times and then bad times. I think we are coming, in terms of financials, to a more normalized territory across the next few months. I hope that answers the questions you've raised, but if you have any clarification requests, I'm more than happy to oblige.

CEMAL DEMİRTAŞ

Thank you. Thank you. It's very clear. Thank you.

DUYGU INCEOZ

Do we have any other questions?

CUNEYT YAVUZ

Ah, there is one question coming from Alper.

ALPER ÖZDEMİR

Hello. I'm curious about the OpEx growth. It seems that the ratio of OpEx to sales is very low, actually one of the lowest quarters that I've seen maybe in the last couple of years. So can you give us some details about that? Thank you.

CUNEYT YAVUZ

Okay, so let me give you a flavor of how the operation costs delivered good results. On the one hand, of course, we had very strong top line growth, which is of course as a percentage positively impacting the ratio. But Turkey retail on the other hand, Turkey retail stores OpEx to revenue ratio, further improved in quarter one, about 50 basis points mostly coming from rent and also other spore expenses, which other spore expenses typically in the previous periods included a lot of energy and cleaning related costs, which are normalized to a certain extent. I keep also sharing with you that 1/3rd of our business is on a more rent ratio business, so more of our business as we do better business is improving, rents were down about a hundred bips and also at the same time, employee cost increased 130 bips due to wage increases. In terms of the headquarters, central operating expenses, we were down 40 basis points. So I think from a headquarters perspective in terms of headcount and headcount progression in the headquarters, we were more disciplined and continue to deliver some good measures and savings. So international also, OpEx sales remained relatively stable while the sales increased so net net we were able to deliver pretty good results in OpEx. Again, generally speaking, I've said that from a margin perspective, our company, through our digitalization efforts, big data management, consumer and customer service level analytical tools, we will continue to improve and optimize overheads, rent ratios, and also despite a lot of the challenges, find opportunities to improve the cost of products, gross margins through better markdown optimization. And these are again areas inch by inch, step by step, we are making progress and we continue to make progress. And in this quarter two, again, I see slight improvements, good improvements in this area.

So a lot of the headwind that's coming from inflationary pressure, cost pressure exchange rate pressure, we do our best to utmost offset by good product planning, pricing, buying at the right price and selling at the right price, dynamic pricing as well as internally making sure that the other costs related to rent, overheads are very much under control and we are quite disciplined and actually we work on a more annual basis and we have pretty good insight of what will happen until the end of this year. And we also have a pretty good idea of what will happen next year in terms of where the organization and costs are going. So kudos to my team and their hard work to make sure to keep the expenses under control. Thank you.

ALPER ÖZDEMİR
Thank you very much.

CUNEYT YAVUZ
Okay, it seems like there are no other questions. I would like to thank everybody for their attendance and look forward to meeting you all in good health in the next quarterly update. All my best and have a good summer period. Take care.