Transcription for Q2 2023 Financial Results Webcast

September 20TH, 2023

DUYGU İNCEÖZ:
Ladies and Gentlemen, welcome to Mavi webcast regarding the financial results for the second 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.

CÜNEYT YAVUZ:
Hello everyone! Welcome to our webcast for the financial results of the first quarter of 2023. I hope everyone had a great summer and all is fine.

As a leading global denim and lifestyle brand, we have once again delivered a successful performance in this past second quarter thanks to our brand positioning, dynamic product and price planning, high quality offerings and our strategy of continuously bringing newness to our customers. We achieved a strong gross margin by managing the rising product costs with the right pricing, effective planning and sourcing strategies. Thanks to the increasing consumer demand for Mavi and our product variety, which enables us to respond quickly to this level of demand, we captured strong growth in all categories and continued to increase our market share in both men's and women's.

Through effective cost management, supported by the strong sales performance, we delivered 150 basis points improvement in "opex to sales" ratio in the second quarter of 2023 despite the minimum wage hike impact included in July figures. We continued to generate cash from operations and our net cash position increased to 1 billion 913 million TL.

International sales recorded only 3% constant currency growth in Q2 2023 mainly due to slower trading in our developed markets. International margins were also pressured this quarter with macro-economic challenges. Online sales growth was mostly driven by mavi.com performance in Turkey and direct to consumer channels in international markets.

Before going into the details, I have a few notes on brand investments and developments about the Spring Summer 2023 season. Driven by our 'All Blue. All Better. For All' approach, we are working passionately to fulfill our commitment to 'making the most sustainable jeans'. This season, we added the Natural Dye and Mavi Archive-Upcycle collections to our eco-friendly offering, which combines great design with the latest technology, unique ideas and innovation. We continue at full steam to enrich our omni-channel applications to create the happiest Mavi customers and offer the best shopping experience both in the stores and online.

The strong trust we elicit from our customer is our biggest driver. According to FutureBright's 'Trust Survey' conducted in the first half of the year, Mavi was named Turkey's most trusted brands among nearly 150 brands from 16 industries. Reputation, quality, financial soundness, responsibility and affinity were highlighted as Mavi's strengths in terms of trust with consumers. We have long been a favorite lovebrand in Turkey, and now, we are thrilled to crown our powerful position in the market by ranking among the most trusted brands.

After this proud note, lets look at the key highlights for the first half of 2023, moving on to Slide 5: Our consolidated sales reached 8 billion 415 million liras in H1 2023 growing 104% year on year. Turkey retail sales grew 114% and Turkey online sales grew 95%, Our EBITDA realized 1 billion 887 million TL, resulting in an EBITDA margin of 22.4%. Our net income grew 62% and reached 1 billion 139 mn TL. In Turkey, ahead of our targets, we acquired 718K new customers in the first half of the year. Number of active Kartuş card members in Turkey is now 6.4 million.

Moving on to review our channel performance:
As of first half of 2023, total revenue consists of 67% retail, 23% wholesale and 10% e-commerce sales. With the continued robust performance, 87% of total consolidated revenue was generated in Turkey. The inflationary environment in Turkey continued to drive demand and as Mavi we 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, implying a strong base. Nevertheless, our sales in Turkey grew 115% in the second quarter, with retail growing 110% and online growing 109% - catching up with retail. The strong wholesale growth is mostly related to low base and the relatively irregular nature of shipments. In the first six months covering our spring summer 2023 season, sales in Turkey grew 119%. We continue to witness softness in demand internationally, especially in developed markets. Total international revenue in constant currency grew 3% in the second quarter and 8% in the first half of the year. Retail and direct to consumer online channels were the better performers.
Let's look into our Turkey retail business in more detail: In Turkey growing in retail continues to be at the heart of our business strategy, 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 half of 2023, we opened 4 and closed 4 stores and we are now operating 329 own-operated stores across 169 thousand sqms of selling space in Turkey with an average store size of 513 sqms. Most of the new sqm planned for 2023 will take place in the second half of the year.

On slide 10, lets elaborate on the like for like store performance: Traffic growth of 16% in H1 2023 displays continued strong consumer demand. Like for like sales grew 116% in the first half of the year driven by 81% basket size growth and 19% 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. We are happy to report that 18.5% volume growth was achieved in H1 2023, in-line with management's sustainable growth targets.

Moving on to slide 11 to review category-based developments in Turkey retail: We continue to trace strong growth across our product categories. All product categories also delivered growth in number of pieces as stated earlier. Both denim and non-denim businesses grew above 110% in Turkey with denim constituting 42% of total Turkey retail sales as of H1 2023. 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 107% year on year and make up 28% of our retail sales in Turkey. Capitalizing on the same trend, our new category non-denim bottoms grew 135%, now constituting 8% of sales in this Spring summer season. Jackets being one of our focus categories in the recent quarters continued its strong momentum and grew 166% in H1 2023. Accessories grew 97% and shirts grew 108% this season.

Going forward to review our online sales performance on page 13: 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 half 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 10.7% of total consolidated revenue. Online sales in Turkey consists of only direct-to-consumer channels and grew 95% driven by the strong 131% 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 8.0% of total sales in Turkey. International online business grew 35% in the first half, negatively impacted by the macro driven demand weakness in some markets. Direct to consumer channels perform relatively better, growing 49%. Online makes up 29% 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. Our omni-channel projects are launched successfully, and we witness the initiatives driving incremental sales. 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: We review our gross margin performance on slide 15: Recall that in 2022, the higher product costs started kicking-in in the second half of the year. Hence in the first half of 2023, there was significant product cost inflation due to a low base. On the other hand, with the current fx levels, we are witnessing deterioration in international gross margins in the last few quarters. In Turkey, strong demand was captured with variety, newness and right product/price positioning which resulted in high sell through rates with low mark-down spending. All in all, we view the 52.1% gross margin in the second quarter as a success and the 390 basis points decline as a normalization from the extraordinary base.

Moving on to slide 16 to review our EBITDA and bottom-line performance. It should be noted that, Turkey opex figures include the impact of the latest minimum wage hike that was effective as of July. Nevertheless, the significant opex inflation in the first half of the year was once again leveraged by the strong top line growth and effective cost management. We continued to deliver improvements in our rent ratios in Turkey retail business. On the other hand, there is a notable deterioration of opex ratio in the international markets due to soft sales growth. Despite the challenging macro environment, our total opex to sales ratio improved 160 basis points year on year in the first half. As a result, our EBITDA excluding the IFRS16 adjustments grew 73% year on year resulting with an EBITDA margin of 18.9%. EBITDA margin including IFRS16 realized 22.4% in the first half of 2023. Thanks to our net cash position, the increase in net financial expenses is limited and the operational performance is mostly mainly reflected to our bottom line. Our net income in the second quarter realized 624 mn TL bringing the net income for six months to 1 billion 139 mn TL with a net income margin of 13.5%.

On slide 17, we look into our operational cash flow and working capital performance: Operational cash conversion is 49%, due to increasing working capital requirements which is 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 135% year over year increase in inventory level at the end of July 2023, is largely driven by 88% product cost inflation yoy. Inventory in number of pieces in Turkey is only 24% higher compared to same time last year and in line with sales growth and demand expectations. Inventory comprises of all fresh, seasonal products.

Moving on to the next slide: (slide 18) We spent 186 mn TL in capital expenditures in the first half of the year 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, digital investments, and R&D. Although we have been using our cash in working capital to mitigate product cost increases and optimize gross margins, with continued cash generation from operations, our net cash position continued to increase and reached 1 billion

913 mn TL as of the end of quarter two. As always, 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. With the availability of funding being very restricted lately, in order to be prudent, we issued two more corporate bonds this month, a 500 mn TL bond with a maturity of one year and another 500 mn TL bond with a maturity of two years to qualified domestic investors. We will have paid back most of our bank loans by the end of this year.

(On Slide 19) Confident that we will sustain this performance until the end of the year, we are revising our 2023 guidance upwards from the previously announced 75% to 80%+ growth. We are now planning 8 net store openings and sqm expansions in 7 stores which will all come through in second half of the year. We increase our EBITDA margin excluding IFRS16 expectation by 100 basis points to 19% plus minus 0.5% and EBITDA margin including IFRS16 expectation by 50 basis points to 22.5% plus minus 0.5%. We target to stay in the net cash territory and planning to spend 3% of sales as capex, leaving these two items unchanged. As always, I would like to provide some insight on the current trading environment as of date. Fall Winter 2023 season started in August and as of September we are in the back-to-school season, which as you know is an important shopping period for retail. I am happy to report that our back-to-school sales is performing pretty strong. Turkey retail sales increased 81% in August and 91% in the first 14 days of September. Online sales in Turkey grew 120% in August and 154% in the first 14 days of September. 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 the hand icon on your control panel. When I call your name, please open your microphone before you speak. If you prefer to type your questions, you may use the chat screen or email me directly. We can take any questions you have right now. Mustafa from AK Yatirim has a question from the chat screen.

MUSTAFA KÜÇÜKMERAL:
Congratulations on the results. I'd like to ask about the overall competitive environment in Turkey. How is the market share of organized market evolving compared to traditional markets and the market share of domestic players evolving versus international players? And secondly, I'd like to ask the demand outlook in international operations in Q3. Is there any recovery signs? Thank you.

CUNEYT YAVUZ:
Okay. Thank you, Mustafa. If you, by means of asking organized market versus traditional, you mean, if the open bazaars versus the branded environment, given the economic environment, I would say the balance remains still in the favor of the organized trade. I think, especially in our ready-to-wear industry, Turkish market is extremely competitive. The shopping experience itself is very pleasant and Turkish brands are, I think, holding up and doing a great job under the current conditions. And also, looking into the future, I don't necessarily see this trend changing one way or another to the, let's say, to the disadvantage of the organized trade. So I'm quite confident that this will remain the situation for many years to come. In terms of our business outlook for international operations, I think the first half of the year was more challenging and we have just started the second half of the year. The numbers and sentiments are coming in much stronger, both on wholesale and retail, as well as online sales, our off shipments and off takes are pairing better.
I think this is sort of a pendulum, I mean, it's good to have some of our business in international markets and then some major part of our business in Turkey. It gives us an opportunity to, you know, balance, manage the balance sheet in a proper way. But generally speaking, especially when it comes to a mid to long-term perspective, we are very bullish on what we can do more when it comes to North America business, which includes the US and Canada. Slowly but surely, I think we will be delivering better and better results in the territory. Europe is generally speaking more converting into e-comm and wholesale part of the business is more stable. That would be a fair assessment of the situation when it comes to Europe. And then we have some export markets that Turkey team is managing, which is more the Balkans, Middle East, ex-Russia, CIS countries. And in that area, we're also growing in double-digit dollar terms. And that part of the business, although it's small, I believe will continue to grow over the many years to come.

DUYGU INCEOZ:
Erkan Edincik has another question.

ERKAN EDINCIK:
Could you please give us developments in Russia, how is the business environment there? Is there any decision for this operation like exit or continue to do business as usual or expanding operations there?

CUNEYT YAVUZ:
Thank you, Erkan, for bringing this up. I purposefully, in a way, skipped Russia when talking about international operations, because in our prior discussions, I had mentioned that as Mavi, our position on Russia is to maintain what we have. So we are sort of in a holding position when it comes to Russia. So we're not opening new stores, we're not either closing stores. We have about 17 retail shops in Russia. Overall, the business is doing very well. It's a net cash positive driving and growing

business. Having said that, some of the Turkish brands and local competitors we have, and even some international brands, have been taking a look at Russia as an opportunistic market and trying to grow their business. Our approach is more defensive.

Therefore, we are more on a holding position when it comes to Russia. We are making the best of what we have there, which is doing very well, but we are not taking the earnings we make to reinvest back into Russia. So we are more in a watch and see position, depending on how the current conflict evolves. We see ourselves more on a, let's say, Western camp approach. So we are a little bit of an arm's length relationship when it comes to the Russia business. Thank you.

So at this point, I guess there are no more questions coming in. Okay, hold on. Okay, Alper has a question.

ALPER OZDAMAR:
Thank you for the presentation. Net working capital as a percentage of sales has been increasing in the last two quarters. How do you see net working capital evolving for the rest of the year?

CUNEYT YAVUZ:
In my presentation, I alluded that, you know, I guess you are right for pointing this out. Our net working capital percentage has gone up for the simple reason that we are using the positive cash we are generating as a means, as a tool to defend our gross margin in terms of our sourcing strategies, booking capacity, booking raw materials, and at times, making timely cash payments to get really competitive pricing, good quality products versus the competitors. So we want to leverage the strong balance sheet we have in terms of managing our business down the right. So what you see right now at this level, probably looking at our cash conversion rates and our growth momentum, this sort of ratios that we are at currently will be maintained for a few more quarters unless the economic environment changes in another direction, meaning inflation starts coming down. But it's not going to happen anytime soon, would be a fair comment to say. Umur has a question.

DUYGU INCEOZ:
Umur Acikalin has a question. He says:

UMUR ACIKALIN:
In the case of a lower Turkish lira devaluation and higher interest rates in the next 12 months, how would you perceive local demand in 2024 compared to 2023?

CUNEYT YAVUZ:
I think what is most critical here, and maybe we don't 100% have the answer for, is over the last 18 months, let's say, more or less, the government strategy has been to make sure that the income levels of especially the greater part of the population, whether it's the minimum wage levels or the government employees or the retirees to be paid and to stay as competitive as possible. This morning, I was also listening to the news, economic news, where the ministry responsible for the economics was saying that also for the retirees who've fallen back, that there will be more poor. So this is a question of whether the government will be supporting the greater masses, numbers of consumers to be able to go up and shop, which also fuels the economic dynamism, I think, in Turkey. But I guess what's on everybody's mind is where do we sort of go through a mini correction or a slowdown in the economy? This for me is very difficult to say. So from Mavi's perspective, what we are trying to achieve is we want to make sure that our reach, as I mentioned, typically in a year, we gain one million new customers or in a half a year, we typically gain half a million new customers. But as I mentioned in my presentation, this year, we gained 700,000 new customers. So we are 40 percent more accessible, let's say, or more aggressive reach in terms of what we're offering to the consumer.

So our position is to act local, to understand the dynamics of purchasing power and the needs of the consumer and be very aware of the consumer's shopping habits and needs. So regardless of slowdowns or speed ups, etc., my position is Mavi will continue to gain market share and sell more products further down the road. In terms of a devaluation and risk, just to reiterate, you will all recall that we are pretty good in terms of hedging ourselves. And when I look at our current numbers for fall winter, which is this season, and also spring summer, which is the coming season for 2024, we are in a very well position versus the current exchange rates. Although we don't have much of an exchange rate exposure, mostly 80 percent of what we produce is in Turkey and Turkish lira denominated, although impacted by dollars. The 20 percent we import is coming from outside countries. But even so, I think from a fluctuation in inflation and cost management perspective, regardless of ups and downs, I think Mavi will remain to be accessible to consumers. Therefore, for consumers who need to shop and buy clothing and enjoy new clothing and enjoy the new season, we will continue to be fresh and exciting for the consumers.

DUYGU INCEOZ:
Erkan has a follow up question. He's saying:

ERKAN EDINCIK:
According to the news flow, textile sector is having difficulties, especially for fason subcontractors. Is it an advantage for Mavi or not?

CUNEYT YAVUZ:

This is an overall challenge for everybody, but it is an advantage for Mavi to a certain extent in the sense that to twofold, on the one hand of the 130 plus suppliers we work with, they are all top notch. So as you know, we have very strong sustainable targets, ESG targets, social compliance targets, environmental targets. So the manufacturers that we operate with are of quality operators. Therefore, already within our cost structure, their quality is embedded. And therefore, this so-called, quote-on quote, fason or third-party outsides, you know, what they call washing, packaging, ironing or third-party supports is becoming a challenge because for them, cash flow and cash has become scarce. And therefore, this industry where there is a lot of delayed payments, postponed payments, they have been struggling. That is true. But if you look at Mavi's ecosystem, they're sturdy.
Even in cases where there is some opportunity financially, again, going back to what I mentioned, we are using our net cash position to this end. So we are supporting our ecosystem selectively, of course, with the sourcing team and finance team assessing the suppliers and manufacturers and giving them the necessary cash outlays and giving them the opportunity to keep their business afloat. So I think overall, we are in a pretty good position. But generally speaking, the industry, I mean, the point there is right, you're right, both fason because of cash and also generally the industry because of increasing costs in real terms, in dollar terms, because of minimum wages, etc., is having a harder time when it comes to also exports. But this means, put it in another way, that there is more capacity that Mavi can utilize on. So this gives us a greater advantage of greater bargaining power and also a greater leeway to continue to manufacture in Turkey and get the products onto the shelves.

DUYGU INCEOZ:

Murat Ignebekcili from HSBC has a follow up question to Umur. Would a stronger Turkish lira mean multinational peers will be more competitive?

CUNEYT YAVUZ:

I mean, this, of course, this is a pendulum movement overall. I think Mavi, where we are positioned and how we are running our business, we are in an OK situation, whether it goes this way or that way. So we are covering, because from a pricing perspective, let's say the global price competitors, which are H&M, Zara and the likes, or the local price competitors, which are Koton, LC Waikiki, DeFacto etc., they get impacted, as you mentioned, with a high TL or a low TL. But Mavi is sort of holding a position where we can grab customers from both ends. And also, as you are aware, we're increasing our category shares. I mean, I mentioned new categories that we're entering into. We are also growing our square meter slowly, but surely. So there is more space to offer new and more products, which also the consumer is more willing to buy, which are all helping us edge away, take away new customers, you know, invite new categories into new customers' wardrobes on both ends of the spectrum. But generally speaking, a stronger TL would make for the industry, not for Mavi, for the industry, more competitive for Zara's, H&M's vis-a-vis the local players. That's true.

DUYGU INCEOZ:

Another one. Last two years, macro decisions led to demand to pull forward. Do you think tighter rates, particularly on credit cards, lower installment terms, could mean consumer spending could be pressured next three, six months?

CUNEYT YAVUZ:

I think the overall to slow down and tackle with inflation, we are expecting as an overall economy for the consumer spending to cool off a little bit. That’s true. But overall, I mean, if you look at my experience with Mavi, which is more or less more than 15, almost 15 years, OK, minus two months, 14 years and 10 months, ups and downs, we have always, year on year in good times or bad times, however you define it, we have been a growing company. So our mantra of we will continue to grow for the next couple of years has not changed. So our position as management, who’s leading the Mavi team, Mavi business, is that we are ready for the challenges that might be coming this way or that way to continue to grow our business. But, you know, as you’re alluding to, everybody is expecting a sort of a slowdown for the coming year in the economy, a certain cool off to come in. How it will happen, when it will happen, we don’t know. So we keep, you know, keep the momentum going and be prepared for the future challenges.

ERKAN EDINCIK:

As a consumer I find your pricing very well I believe there is some room to increase further

CÜNEYT YAVUZ:

Thank you. You know, on your comment, as a consumer, I find your pricing very well. I believe there is some room to increase further. Actually, this comment, let me put it this way, in my career with Mavi, this is a comment we want to hear. So we always want to have a room to grow. And I think this is exactly what we are after. Meaning, we are a little behind in terms of price taking prices. We do catch up, but we give that breathing space to consumers and consumers are cognizant and aware of what we are doing. And therefore, we are being rewarded by increased traffic and more consumers coming and shopping with us. We could, in theory, price up another 10-15 percent and probably not lose a lot more sales. On the contrary, gain more sales. But what we want to do is we want to make sure that, you know, more and more consumers are introduced into Mavi and can get into the habit of Mavi because we are not far off from many of the consumers in Turkey and their willingness to shop. So we want to be an accessible brand. And also we take it as a challenge. I mean, we use our balance sheet, our sourcing capabilities, innovation to be even more competitive when it comes to pricing, because that’s our businesses. It is a bit of a cutthroat business. It is, quote-on quote, a me too business. Everybody is selling a pair of jeans. Everybody’s trying to sell a pair of T-shirts or a pair of sweatshirts. And we have to make sure both from a price quality and the newness and the variety and the offering that we have to be a much better company.

And that's how the world is. There is no time to rest, so we will continue to work and work really hard. And hopefully more and more of our consumers will join you in saying we believe the pricing and the quality and the product we get at Mavi is great. And that is one of our actually targets that we want to hear from consumers.

ERKAN EDINCIK:
How many mavi card holder?

CÜNEYT YAVUZ:
In total, we have, I mean, the question came about Kartus, which is our loyalty card holders, CRM card holders. In total, there are a gross 8.8 million card holders, and of those, 6.4 million are active consumers. A point I can add is that about 75 to 80 percent of everyday sales goes through card holders, which, you know, in many of our pre-prior meetings I mentioned, this gives us an extreme leverage in terms of understanding the consumer behavior, which then translates into all the planning, pricing, campaign, communication, product type that we can offer to the different segments and needs of consumers. So we are truly a consumer-centric brand, and we, I think, differentiate ourselves by miles versus any other competition in the Turkish market or international markets with our Kartus card program and our awareness and knowledge about who are consumers, how they behave, what they are asking from us, which then translates into the actions, decisions, strategies that we are developing day in, day out.

ERKAN EDINCIK:
Are you planning to this card business into financial tool, like çarşı made it in the past?

CÜNEYT YAVUZ:
No, I mean, it's a question we often get, are you planning to this card business into financial tools like Carsi made it in the past? No, we are not. The frequency with which consumers are shopping at this point, at least, are not at that level. But even so, we prefer to keep Kartus as a propriety tool for us, where a lot of the AI, digital transformation, product marketing, product planning, markdown management, pricing strategy, future growth strategy, categories that we're going to enter. So there is a lot of homework as we speak, even today, that my team is working to figure out how we are going to win. That also is one of the key reasons why I am confident, whether it's good times or challenging times, that as Mavi, we will find a way if consumers out there shopping, we will be the brand of choice and give them the right product and the right pricing and the right quality for many years to come.

I guess that’s all for now, unless anything, any other questions pops up. As always, I wish you all the best and I look forward to catching up with all of you in quarter three with, again, great results, good news and a growing Mavi business. And in the meantime, I do hope the same for all of you, whatever you’re doing, that everything is going your way and you stay healthy and happy and look forward to meeting and seeing all of you in a couple of months. All my best and take care. Bye-bye.

DUYGU INCEOZ:
Thank you. Bye-bye.