Transcription for MAVI GIYIM

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Presentation

Operator
Ladies and gentlemen, welcome to Mavi Nine Months 2018 results conference call and webcast. I will now hand you over to Mr Cüneyt Yavuz, CEO. Sir, the floor is yours.

Cüneyt Yavuz
It is a pleasure to be with all of you. Today, once again, I am with my CFO, Tuba, and IR Head Duygu.

Without losing any time, I will just hit the road running and start the presentation. Welcome to our conference call regarding the financial results for the third quarter and nine months ending of October 31 2018. As you know, we have started the fall/winter 2018 season on the 1st of August and the third quarter results reflect the performance of the first half of our fall/winter 2018 season. I will be taking you through our operational and financial results for the period and will share some insights on the current trends in the operating environment. We will also provide you with an update on our expectations for the financial year 2018. We have already received questions from our analysts and investors and I will try to address them throughout the presentation. Of course, should you have any further questions, as always, I will be happy to answer them at the end of our call.

Let's start with slide two with the key highlights for the period. In the nine months of 2018, our consolidated revenue grew by 32% to TL 1.778 billion. Following a very strong quarter, our nine months EBITDA grew by 46% to TL 304 million, resulting in a 17.1% of EBITDA margin. Net profit also grew by 20% and reached TL 101 million. We held back in store opening decisions in the third quarter given the high uncertainty in the market. Store rollout for the nine months remains at seven openings in Turkey. As of end October, we have 294 own-operated stores in Turkey and 425 mono-brand stores globally including franchises. Mavi Turkey retail business delivered a solid like-for-like revenue growth of 23.5% on top of the strong growth performance of last year. Mavi continues to stand out as a loved brand, consumers continue to choose Mavi to shop. We acquired 905K new customers in the nine months of 2018. We currently have 5.2 million active loyalty cardholders and our happy customers will continue to be our key enabler for continued future growth.

Moving onto slide three, we have seen a strong sales performance in the third quarter of 2008, both in Turkey and in international markets and in every sales channel.

In the first nine months of 2018, our total revenue grew by 32%, reaching TL 1.778 billion out of which 64% was in retail, 33% was in wholesale and 2.6% in ecommerce. Global ecommerce sales grew by 83%, more than double the growth rate of all other channels. In the nine months of 2018, sales in

Turkey grew by 31% with 32% growth in retail, the main driver of our domestic business. Wholesale channel grew by 26% and e-comm sales grew by 65%. International market sales performance picked up in the third quarter and we have also seen the expected positive contribution of the currency impact on our top line. International sales growth for the nine months realised at 36%. In line with Mavi's strategy to drive an important portion of its international expansion via online channels, international ecommerce sales grew 110% in the same period.

Moving onto slide four, let us focus on Turkey retail business. Given the recent financial turmoil and regulatory developments, we remained very prudent in new store openings and have completed the third quarter at the same level we started. In the nine months of 2018, we opened a total of 10 new stores and closed three, resulting in seven net additions. As you know, we had initially guided for 25 net new store openings for 2018, and had revised our guidance in September down to 20 openings. We constantly review all our investments on efficiency basis, and we are planning to complete 2018 with a net of 16 new stores and expansion of 13 stores.

As of the end of October, we have 294 owned-operated stores over 146,500 square metres of selling space in Turkey. New stores and the expansion of nine stores accounted for more than 7,000 square metres of additional selling space. As we continue to open larger stores, average store size reached 498 square metres. As a result, Turkey retail revenue growth of 32% was mainly driven by like-for-like growth in the nine months of 2018.

Now to elaborate further on our like-for-like performance, let's move onto page five. Following a very strong 27+ percent like-for-like performance in quarter three, we are again reporting a very solid like-for-like growth of 23.5% for the nine months of 2018. Of this like-for-like growth, 13.7% is driven by transaction growth and 8.6% 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. It is important to note that consumer confidence has remained strong behind our Mavi business in year-to-date 2018, and we continue to benefit from increases in traffic and conversion rates, coupled with steady growth of new customer acquisitions. We believe this is driven by Mavi's right product offering at the right price, along with our superior service and quality, which is fuelling increased customer loyalty.

Now, let's take a closer look at our category-based performance and move to slide six. We are happy to report that 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 shirts, jackets and dresses grew by 25% in the first nine months of 2018. Across the lifestyle categories, we again delivered very strong results. The knits category, which consists of t-shirts and sweaters constitute 22% of sales and have grown 40% in the nine months of 2018. Sales growth in shirts with 40%, jackets with 43% and accessories with 31% clearly indicate that the appeal and demand for Mavi is on a solid continued growth trajectory.

Let's move onto review our margin performance on slide seven. We have been guiding for improving margins going forward through better planning and markdown management, better rent/sales ratios and operational productivity rising from economies of scale, especially supported by our like-for-like retail performance. As you know, there have been major developments in our trading environment this year that have not been included in our initial planning. Nevertheless, Mavi has been able to deliver the promised margin improvements above its targets. Our gross profit grew by 26%, delivering 170 basis points improvement against same period last year. Our EBITDA grew by 55% in quarter three and 46% in nine months, delivering 17.1% margin with 170 basis points improvement. The currency volatility in the third quarter and the increased financing costs had a negative impact on finance costs and, hence, on net income. Excluding the FX gain/loss, net income in quarter three would have been improved by 54%. In the nine months of 2018, net income grew by 20%.

Now, I would like to move onto page eight to take you through our working capital progress. Today, as a leading retailer, we are even more focused on efficient working capital management, improving speed-to-shelf and on achieving successful sell-through rates. We continue to see the results of our multifunctional planning efforts as we improve our open-to-buy supply and allocation planning and inventory management. Our working capital as of nine months stands at 6.9% of last 12-month sales. The slight increase in working capital requirement is mainly driven by the increase in inventory levels, which is a result of more expensive cost of goods in fall/winter season and the currency impact from international inventory. We have generated TL 229.6 of operating cash flow, resulting in a cash conversion level of 75%.

Moving onto slide nine, we spent TL 43 million on capital expenditure in nine months of 2018, most of which was related to new store openings and store expansions. CapEx to sales ratio is now at 2.4%, as we prioritised the quality of new openings and expansion of existing stores, we foresee below 4% CapEx to sales ratio for the full year, lower from the previously guided 5%.

A few comments on our debt mix. With strong cash generation, our net debt level has reduced to TL 93 million as of end of October 2018, despite the currency impact. Our leverage multiple is now 0.3 times last 12 months EBITDA.

In terms of the currency composition of our debt, majority of our hard currency credit on our consolidated balance sheet, which is 23% of our total debt, is related to Mavi U.S., Mavi Canada and Mavi Russia and are covered by their own sales in their local currencies, resulting in zero currency risk. All of the FX-denominated debt of Turkey is now fully hedged and tied to forward contracts. 56% of total of our debt is already in Turkish liras. Deleveraging and staying unexposed to currency fluctuations will continue to be one of our top priorities moving forward.

On slide seven, I would like to elaborate a few minutes on our rent management in Turkey retail stores. As you know, in accordance with the recent Turkish Government decree, all of our rent contracts have been translated into Turkish lira as of October 2018. This is a positive development for us, removing volatility and uncertainty of a major cost item. We continue to manage rental costs with a focus on target rent/sales ratio, which as you can see from the chart, has improved in quarter three despite the high exchange rate volatility.

Moving onto slide 10, I am happy to give you some good news regarding our full year expectations. Given the outperformance of the business in the nine months and including the impact of the macroeconomic developments on our business, we have revised our full year expectations. As you know, last quarter we gave a guidance update and increased our top line expectation to 30% versus the original 25%. We are keeping our 30% top line growth guidance. We have a better like-for-like growth projection, which was already revised to 20% versus the original expectation of 16%. We now believe it will be above 20%. Traffic and conversion is very healthy and still trending strong as of month to date November. We believe Mavi is well positioned to continue to win in this challenging environment.

Given the very strong results in nine months, we are revisiting our EBITDA margin target to 15% from the previously stated “above 14%”. We had revised our CapEx plans down at the end of second quarter to 20 openings of the planned 25 stores and the expansion of 15 stores in 2018, considering the cost of capital and on-going rent negotiations. We now project that we will complete the year with 16 net new store openings and 13 store expansions in total. In accordance with the store rollout plan, we foresee our CapEx spending to stay below 4% of consolidated sales. I find it important to reiterate that as Mavi we are not experiencing any slowdown in demand or weakness in the trading environment as of today. The like-for-like growth in Turkey retail operations in month to date November is still trading at above 20%.

Thank you for listening and I am now more than happy to take any questions that you may have.

Question and Answer Session

Operator
[Operator instructions]

Our first question comes from Gorkem Goker from Yapi Kredi. Please go ahead.

Gorkem Goker
My question is regarding your physical expansion plans. You revised this down to 16, but it still suggests nine net openings for the last quarter, I mean, nine openings in a quarter is relatively a high number when compared to earlier quarters. Should we expect any adverse impact on your margins on the last quarter? Also, we see some discounts or campaigns on your shops nowadays more frequently than before. Should we expect a contraction on your gross margin in the last quarter? Thank you.

Cüneyt Yavuz
One good news I just want to reiterate is typically we would have also in quarter three, potentially have opened more stores, but as I mentioned, we held back a little bit and we were also in the midst of negotiating a lot of rent contracts. I am happy to see that we are back on track, the contracts are behind us and I believe, actually, the fact that we will be able to open up nine stores is a good indication that we are back on track to keep our growth and physical expansion going as best as possible under the given economic conditions.

From a margin perspective when I look at how we operate. As you know, we as a company are constantly committing to limiting and bringing down our markdown ratios and make sure that we have higher sell-through rates with better planning. If I look at how we are tracking year-to-date, both from a markdown and sell-through performance, we are really on a solid track, so I would be less worried from that perspective.

From a margin perspective, I will be more proactive, because many others might have a similar question on their minds in terms of where margins might be going. I mentioned this to a couple of our investors who have been coming and visiting us in this time, I just want to reiterate it and take the opportunity once again in this call that our number one priority is being very close to our customers, and making sure that they are keeping the traffic and shopping with us. Hence, my number one priority not only for this quarter four but potentially for the next two, three quarters is going to be being very close to the customer, understanding their income and shopping habits and making sure mavi

that as Mavi we remain very cognisant of their shopping needs and follow that. Therefore, we will be under pressure of margins, especially also with the increase of cost of goods, but as a company we are working really hard through better planning, better pricing, better markdown management, strong marketing communication, faster turns and more turns and efficient inventory management to negate or offset some of that margin stress that we might have and maintain a good healthy EBITDA margin.

Thank Gorkem for the question and the opportunity for me to clarify some of the points.

Operator
Our next question comes from Berna Kurbay from BGC Partners. Please go ahead.

Berna Kurbay
I have three questions. The first one is about foreign currency losses in the income statement. It was labelled as the change in the fair value of forward contracts. I was wondering what the maturity of these contracts are and would it be fair to assume that until the maturity, if Turkish lira continues to appreciate, are we going to continue to see some mark-to-market losses.

My second question is on the competition. When Turkish lira was depreciating, Mavi's price points seemed to have been appreciated by the Turkish consumer. Now, that Turkish lira has started appreciating, how should we think about the competitive situation going forward? Perhaps this is more of a question for the spring/summer season.

Finally, on the margins, you have already touched upon that, but looking out to 2019, would it be fair to say that you have already over delivered on the margin increase front so far in the last two years, and you would be less aggressive on the margin side, but more aggressive on the revenue side. Is that a good way to look at it?

Cüneyt Yavuz
First and foremost, I'll take the last question and start at the very end. We are tracking and will have reached a level of 15%. And you are right on positioning and pointing out that we have been tracking a little faster than what we projected we would do. Next year, We will be in a better position in quarter four to give you a better guidance, but standing where I am standing today looking into next year, maintaining this 15% EBITDA and staying around those kinds of numbers would be a reasonable assumption going forward.

Now, going back to the other point you mentioned, we have decided not to take any more currency risk when the market became too volatile in September and tied all of our open positions for the rest of the year 2018 to forward contracts. We entered into forward contracts to hedge our foreign currency denominated payments, both financial debt and trade payables in September at a substantially higher rate than the prevailing rates and, hence, we booked mark-to-market losses in quarter three 2018. The forward level was at 6.78 USD/TRY and 7.93 EUR/TRY and we will have another TL 8 million potential forward or fx loss loss in quarter four results. In terms of maturity, our maturity is covered until the end of January.

Now, the other point that you brought about in terms of competitive sales and price points, you are right to point out that some of the international brands have been more euro or dollar-denominated and faster to increase their prices, and they were also fast to do markdowns. Whereas Mavi has been more a steady goer. So, again, it goes back to what I was answering previously, we will be very close in monitoring the competition. I don't see any threats due to price volatility, on the contrary, the fact that we are going at it at a sound and one-step-at-a-time pace, we will continue to win in this marketplace.

For next year, although the rates might have come down, it would be fair to say that the exchange rate a year ago in January was around 3.6-3.7, now it Is probably going to settle at around 5-5+, still we will see the international brands doing 30-40% price increases and hence that should give us enough room to manoeuvre and be able to position ourselves.

I would say we have lost a quarter of disruption, hopefully that is behind us. Now, it is a time to, in a way, ameliorate things and recover some of the uncertainties and keep the business moving down the track. Thank you.

Operator
Our next question comes from Gulsen Ayaz from Deniz Investment. Please go ahead.

Gulsen Ayaz
I have got one question. In six months results, if I am not mistaken, you had 6.9 active loyalty card members, whereas in this quarter, as a percentage you have a number around 5.2 million. How should we interpret this? Is this a result of trading down i.e. you were gaining new customers but losing some of your existing or is there a different explanation?

Cüneyt Yavuz
Thank you for bringing this up, because it is a slight change of how we're reporting. The 6.9 million you see is the gross total sum of customers that are enrolled in the programme. In this presentation, we have decided and added as footnote to page two, but I will reiterate it, it gives us an opportunity to clarify.

Of that gross sum, there is always net active customers who are shopping with us. From here on, starting with this presentation onwards, we have decided to take the inactive or those who are slow to come back and shop with us, out of the system and give a more realistic outlook of who is shopping with us and, hence, we have adapted the number of 5.2. We have internally, just to clarify, have always looked at it that way. The gross and the active, so it is not a change from our internal reporting, but it is also bringing in more transparency in terms of what is happening in terms of our customers to the investment community, but thank you very much for bringing this one up.

Operator
Our next question comes from Ece Mandaci from Tacirler Investment. Please go ahead.

Ece Mandaci
I have got two questions. One is on the like-for-like growth. Could you please provide some insight on your like-for-like growth for the fourth quarter in 2019? And given these price increases in the market and you also made as well, is there slower growth, are you observing on the transaction side for the fourth quarter especially? Also, how should we see for next year in 2019, especially for the first half?

Secondly, when I look at your international store numbers, I see that some store closures are continuing, but one less store in Russia. Is there a strategy change in your Russia business? Do you still continue with your strategy of opening 30 stores in the coming two, three years? Could you please provide some information regarding that? Thank you very much.

Cüneyt Yavuz
Just to reiterate, in quarter four and as part of our guidance, I hope I was clear that we believe that we will continue to maintain a 20+ percent like-for-like, and if you look at month to date November, which is the first month of quarter four, I am happy to report back and as I stated in the presentation, that we don't see any slowdown in terms of footfall, new customer acquisition etc. Right now, of course in terms of that 20% more of it around 12% is coming from basket size and around 7-8% is

coming from transaction and volume.

I would assume, and if I were in your shoes, the outlook for the next year would not be any lower than these kinds of numbers for quarter one and two of next year, therefore, we are looking into and planning for a continued solid like-for-like performance for the coming next couple of quarters.

In terms of stores and store closures, yes, just to remind you all, in Germany we are closing down our retail operations and reinvesting those funds behind our dotcom and digital efforts, and they are picking up very solidly and I will be able to present more and more information as we move down the quarters, to give you a better feel both from our P&L balance sheet of what is happening in Europe, and also top line growth.

We have closed down one store in Russia, that is also true, but our Russia plans are very solid and actually just after this meeting, we are going to have a Russia meeting. I know that we are very much looking into Russia and how we are expanding and we will come back and open up a lot more stores and I will give you more guidance as we go down the road. Please, when you factor in what we are planning for Russia growth, factor in further retail expansion in Russia, as the stores themselves are performing in positive like-for-like performance and the contribution is in the right setup, so we are, as of today, very much pleased with what is happening in the Russia market. Thank you.

Ece Mandaci
In the Russia business, you mentioned before that you were at EBITDA breakeven right, in the third quarter, is it the same as well?

Cüneyt Yavuz
It would be fair to say that EBITDA is breakeven. It will be because of the CapEx requirements and the investment requirements, the EBITDA margin for the foreseeable future until we come through our threshold of around 30 stores plus, we will remain on an investment mode. We are, right now, at around 14 stores and down the line, probably within this next 12-16 months, 18 months, we will add on another 10 stores and once we crossover the threshold, by the end of 2019, early 2020, we are looking forward to reporting positive EBITDA terrain in the Russian market.

Operator
[Operator instructions]
[No further questions]

Cüneyt Yavuz

We have checked all the questions that have been forwarded both vocally and written. I believe the presentation and what I have provided covers for all the questions that have been posed. Should there be anything that you feel or listeners feel that we missed out, please refer to IR. Duygu will be more than happy to get into the details of what you might be interested in.

I would like to thank each and every one of you who have attended this meeting and we look to come back and provide you with, again, happy, good news at the end of the year and with a better outlook even for 2019. I would also like to take this opportunity to wish you all a happy new year and a healthy prosperous new year. All my best and thank you.