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Transcription for MAVI
March 15th 2019

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Presentation

OperatorLadies and gentlemen, welcome to Mavi's Fourth Quarter 2018 conference call and webcast. Today's speaker is Mr Cüneyt Yavuz (CEO). I will now hand over to your host, Mr Cüneyt Yavuz. Sir, please go ahead.

Cüneyt Yavuz
Hello and welcome to our conference call regarding the financial results for the fiscal year 2018 ending 31st January 2019. At this call I have my finance and IR team with me. Today, I will be taking you through our operational and financial results for the year, and I will share our expectations for 2019. Following the presentation, should you have any further questions, I will be happy to answer them.

I would like to start off by thanking all my team across the markets for delivering solid results in a very challenging year. I am invigorated with our healthy performance and continued growth, a testament to Mavi's strong brand identity, holistic customer engagement, and uncompromising passion to deliver results across the functions with utmost quality. As a combination of all our efforts, Mavi in Turkey exceeded attracting 1 million new customers in 2018. Continued investments in digital channels also played an important role in delivering our sustainable profitable growth targets. I am confident that Mavi's emerging digital business is on a solid path to maintain many years of solid top and bottom line growth.

Now, let's start with slide two on the key highlights for the period. In 2018, our consolidated revenue grew by 32% to TL 2.353 million. EBITDA grew by 46% to TL 367 million, resulting in 15.6% EBITDA margin, a 150-basis-point improvement compared to last year. Due to high financing costs resulting from foreign exchange volatility, especially within the second half of the year, net profit grew slower than planned by 12%, reaching TL 101 million. Excluding the FX cost impact, net profit growth is 44%. During the back end of the year we cautiously slowed down new store opening decisions, given the high uncertainty in the domestic market. Store rollout in 2018 was 13 net new openings in Turkey. As of end January, we have 300 own operated stores in Turkey and 427 monobrand stores globally, including franchises. Mavi Turkey's retail business continued to deliver very strong results with a like-for-like performance of 22.5%. We continue to stand out as a loved brand and a trusted brand, and acquired 1.1 million new customers in 2018. We now have 5.3 million active loyalty cardholders that have shopped with us in the last two years.

Moving onto slide three, we exceeded our revenue growth targets across all sales channels. In 2018, global revenue grew by 32%, reaching TL 2.353 billion, out of which 65% was in retail, 31.6% was in wholesale, and 3.3% was in e-commerce. We are placing great emphasis on building the best-in-class online platforms across the countries we operate in. In 2018, the global e-commerce business, including Mavi.com, and marketplace sales grew by 103%. In 2018, sales into Turkey grew by 32%, with 30% growth in retail, the main driver of our domestic business. Turkey's wholesale channel grew by 35% with strong sales growth in quarter four. This is mainly due to early start of the new season SS19, and with some volume transitions coming from the third quarter. Turkey e-commerce also performed very strongly in quarter four, with strong sales during Black Friday campaigns, bringing 2018 e-commerce growth to 92%. International markets in 2018 grew 33% in Turkish lira terms, including the positive contribution of the currency impact. As you know, we have been closing down retail stores in Europe throughout the year, where we target future growth to be driven mainly by focusing on wholesale and online channels. It is worth noting that Mavi's international e-commerce grew at 118% in the same period. Once again, e-commerce is currently a small, but definitely a very promising channel for our future business growth.

Moving onto slide four, let us focus on Turkey's retail business. Given many uncertainties and increased cost of capital in 2018, we had to revisit much of our investment plans and remain very prudent in new store openings. We completed the year with 13 net new store additions, resulting from 14 new store openings, two transfers from franchise operations, and three closures. As of end of January, we have 300 own operated stores with more than 149,000 square metres selling space in Turkey. New stores and the expansion of 10 stores accounted for more than 10,000 square metres of additional selling space, and the average store size reached 498 square metres. As a result, Turkey retail revenue growth of 30% was mainly driven by like-for-like growth in 2018.

Now, to elaborate further on our like-for-like performance, let's move onto page five. We are happy to note that consumer confidence has remained strong behind the Mavi business in 2018 and we continue our healthy track record of new customer acquisitions and increased spending in Mavi stores. Our like-for-like stores performed a very solid 22.5% growth in 2018. Of this like-for-like growth, 12% was in transaction growth and 9.4% was in basket size growth. We believe this is driven by Mavi's right product offering at the right price, and of course our superior service and quality, which is building increased customer loyalty.

Now, let's take a closer look at our category-based performance and move to slide six. Both our denim and lifestyle category sales remained robust. We had happy Mavi customers across the whole range of products in our portfolio. Our denim category grew by 24%. Across the lifestyle categories, we again delivered very strong results. The Knits category, which consists of t-shirts and sweaters, which constitutes 22% sales, grew by 36% in 2018. Sales growth in Shirts was 35%, Jackets 39%, and Accessories 32%.

Let's move on to review our margin performance on slide seven. As you know, since the IPO, we have been guiding for continuous improvements in margins through better planning and markdown management, better rent to sales ratios, and operational leverage on all cost items, especially fixed costs and overheads, supported by our like-for-like retail performance. In spite of all the challenging externalities, at Mavi, we again continue to deliver margin improvements. We delivered significant improvements in our markdown ratios, coupled with very strong sell-through rates, thanks to the collective hard work of all our teams, from design to sourcing, to planning, to marketing, to sales. We have been sharing with our investors the fact of significant cost of goods increases resulting from currency impact on raw materials and high inflation. Despite the pressure on gross margin due to increased costs in the second half of 2018, we ended the year with 33% growth on gross profits, resulting in 40 basis points margin improvement versus last year. Thanks to many actions we took on many operational cost items, our EBITDA grew by 46% in 2018, resulting in 15.6% EBITDA margin, meaning

150 basis points of improvement. On the other hand, due to the impact of high financial expenses, especially in the second half of the year, mainly due to currency volatility, net income grew by 12% in 2018. Excluding the FX and related hedging losses, net income growth would have been 44%.

Now I would like to move onto page eight to take you through our working capital management. 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 a percentage of sales stands at 5.5%, implying a slight increase compared to last year. This is mainly due to the increase in the unit cost of goods, which is directly reflected on the inventory and trade payables levels. In 2018, we have generated TL 319 million operating cash flow, and our cash conversion stands at 87%.

Let’s now move onto the next slide, slide nine. We spent TL 66.1 million on capital expenditures this year, resulting with a CapEx-to-sales ratio of 2.8%. A few comments on our debt mix. Our net debt level has decreased to TL 109 million as of the end of January 2019, implying a leverage multiple of 0.3 times EBITDA. Looking into the currency composition of our debt, 24% of total consolidated debt belongs to Mavi U.S., Mavi Canada, Mavi Europe, and Mavi Russia, all in local currencies. As of 31st January, only 7% of debt is in foreign currency and is covered by receivables from subsidiaries. Hence, we have no open positions on our balance sheet as of today and we aim to keep zero FX exposures going forward.

Moving onto slide 10, let me share with you our full year expectations for 2019. We are expecting 2019 to be another strong growth year and believe it may hold some great opportunities along with many uncertainties and challenges. We are prepared to remain agile and responsive to consumer trends and macro environments. For the financial year 2019, we are again targeting 25% consolidated sales growth. We expect both Turkey and international businesses to contribute to this growth. In our Turkey retail business we are targeting 18% like-for-like sales growth, along with 15 net new store openings and 10 expansions of store square metres. We guide for an EBITDA margin of 14.5%. Although we believe 2019 is a challenging year, we would like to keep our options open to take advantage of any opportunities that can help us achieve any upside to deliver further growth and profitability over and beyond our stated targets. In this spirit, we retain our strategic base target of staying below one times net debt/EBITDA multiple. We expect our CapEx spending to be around 4% of total sales and close to 20% of this CapEx will be invested behind IT and e-commerce.

On a final note, before moving onto your questions, as customary, I would like to give a brief update on season to date quarter one 2019 performance. We have started offering our Spring/Summer 2019 season collection in February. We are trending close to 18% like-for-like as of March 12 in the first 40 days of the quarter. Especially since the start of March, we are again at an above 20% like-for-like territory, with very positive traffic growth.

With this final note, I am now happy to take any questions that you may have. Thank you.

Question and Answer Session

Operator
Our first question comes from Marco Spinar, Neuberger Berman. Please go ahead.

Marco Spinar
My main question just comes on the EBITDA margin. You're guiding to a drop in the margin after a really good 2018 result and I'm wondering how much of that is on the gross margin front driven maybe by some hedging that you had done and the need to bring prices down, or keep prices down, in a period where maybe some of your competition will be finally able to bring its prices down.

Cüneyt Yavuz
As you know, through the back end of the year, in terms of pricing strategy, this is a question that also pops up from that perspective, we had a phenomenally strong back end of the year where we had already bought into the product, and we ran through the closing of the year. But with the cycle of the business coming into early 2019, where we are placing orders a couple of months into it in the closure of 2018, there is definitely a cost base increase that we are experiencing and, hence, we don’t typically guide for gross margins, but what we are guiding for is an active management of right price for the consumers while managing our OpEx, as we continue to better manage our sell-through rates, markdown rates, and rent ratios. Unfortunately, there is a decline now moving forward or that’s what we project.

You will recall that post the IPO we had been guiding a 100 bps EBITDA margin improvement every two years. We did deliver a phenomenally strong year last year, but it seems like there's going to be a fallback year this year where there's going to be a lot of challenges and transitions, and from there we will take it and see where it goes. From a consumer pricing perspective, we are today wanting to say that vis-à-vis the interim period, the consumer price position vis-à-vis where Mavi stands versus the local competition and international competition, the market is now quite settled in, and as we have with the agility and the manufacturing capability being in Turkey with 80% of our sourcing coming out of Turkey, we will continue to see the opportunities vis-à-vis the markets whether it's from a consumer price or from an off-take perspective vis-à-vis the competitor set, and manage the year on a monthly basis.

As there is a lot of uncertainty, and I have left a lot of room, as you can see, from our debt and CapEx investments, and margins, as much as there are uncertainties, we also believe, looking back historically, these times can offer opportunities and as a team we are trying to maintain a healthy balance of being agile, but at the same time chasing after the right opportunities to maximise gross margin and EBITDA margin through the year. I know a gave a windy answer, but I know many questions that have come through the day, so I also try to, through this question, tackle also the questions that many of you have during the day that you have shared with me. Thank you.

Marco Spinar
Just one follow-up question, on the financial expenses, are any of those non-cash? I mean, I know there was a big increase, the FX would have hurt, there were hedges, and there were probably some… certainly some cash impacts of the hedges, but were any of the financial expenses non-cash?

Cüneyt Yavuz
No, they were not.

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

Gulsen Ayaz
My question is about the sensitivity of your sales through unemployment rate, which hit about 13.5% by December and as of today. I was wondering… I mean, do you have, by judging the history, any sensitivity? Where would you see a downside to your 25% sales growth if unemployment rate increases? Judging by the recent traffic data, do you see any slowdowns in your transaction growth?

Cüneyt Yavuz
Definitely internally there are certain KPIs that we follow with regards to Turkey. Unemployment rate is one of them, consumer confidence index is another one, and we do our utmost care in terms of benchmarking our sales migration or the progress vis-à-vis what has happened. I think we have roughly around 10 years of data that we track vis-à-vis these KPIs. In terms of the current economic difficulties that Turkey specifically is facing and our addressable population, and looking into the current traffic and sentiment, at Mavi we, today, are not calling out what one could say is a defensive mind-set. We remain very bullish or I would say constructively positive about what we can achieve in terms of sales. I think where we see, due to this economic downturn, a bit of the challenges with the working capital cost going up, cost of capital going up, the number of shopping malls being constructed is slowing down, therefore we have to put extra diligence in terms of our expansion and the current new store openings. So our concern vis-à-vis consumer versus growth and expansion, it’s more focus and diligence in terms of where do we invest our money, where do we grow our business. As I mentioned at the back end of my closing remarks, as of now the traffic is on the positive side vis-à-vis last year same period in the month of March, so if that remains to be the case, we are going to be okay through the year in terms of delivering Turkey targets.

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

Ece Mandaci
I have a question. On your CapEx guidance, in 2018 you guided around 4% CapEx to sales ratio and you actually delivered lower than that figure, around 2.8%, and you opened 13 new stores, for 2019 do you expect similar growth actually or not similar growth? Could it be possible to have a lower CapEx to sales during the year, around 3% levels? You also mentioned about your additional investment in IT and e-commerce side, could you please provide more detail regarding your CapEx guidance for 2019?

Cüneyt Yavuz
At this point, within that CapEx, of course you are observing slightly more stores, a handful more stores, in absolute numbers being opened in Turkey, plus more expansion, which is going to in absolute TL perspective increase in the CapEx spending in terms of expansion. There is also global expansion on retail, which is not part of the guidance, which you don't see, where we are investing in the retailization in Russia, for instance, coupled with the IT and e-commerce. From where we stand today, we would like to keep the 4% CapEx, because we also believe in terms of budgeting purposes that through these uncertain times there will be opportunities potentially to continue to expand Mavi stores and/or open up new stores within certain malls that we may not be existing right now. Therefore, we have guided and budgeted for a 4% CapEx. The ratio within that CapEx spending of where we put more money versus last year in terms of IT and e-comm is also increasing, as you can imagine – the top line is growing by 25% and then I increase also the 4%, the ratio of CapEx, you can imagine that there is also a global effort from our side to take the digitalization and e-commerce in Russia, in Germany, in Canada, in U.S., in Turkey into another level, so there is also a lot of constructive efforts, in preparation for the future growth of our company, both locally and globally, that is going on as we speak.

Operator
We have a follow-up question from Marco Spinar from Neuberger Berman. Please go ahead.

Marco Spinar
Can you maybe also elaborate on the closing of the stores in Europe and how to build the brand strategy outside of Turkey, to what extent that has changed at all in the last year or two and what the store closings in Europe suggest about the brand development strategy outside of Turkey? Just what success you're having in building the brand online outside of Turkey in particular.

Cüneyt Yavuz
In terms of Germany, we came at a crossroads looking at the German operation, we had roughly 13-14 stores in Germany, retail stores. Quite a handful of them, actually, were delivering acceptable results but when we looked into the future of where the growth would be coming, especially in this Germany, Austria, Switzerland landscape, we sat down and opted for closure. Actually, because of that, you will see that our international growth is, actually, from an absolute currency perspective, due to Germany top line shrinkage of store closures is being adversely affected. Hopefully this will be offset in the year 2019 as we continue to grow our wholesale, speciality, and digital business.

Now, at this point in time in terms of international growth, we have two different territories with two different strategies behind. One is the European landscape, the other is the North American landscape, and the growth strategies in this area are built on distribution, product expansion, and also digital transformation. Then there are countries – at this point that country is Russia – but there are countries what we call out to be the retail countries and we are now at 14 stores in Russia and hopefully by the end of this year we will reach 23-24 stores, so we do aspire to look into opportunities of opening more stores and continuing our a la Turkey mode in a Russia model.

In terms of the digital marketing and social media and all the good and best practices, I am very happy to say over the last two years and as it is reflected also in our performance, our e-commerce business is on fire with… although it is coming from a small base, but on a very profitable base, growing 100% year-in/year-out, and at least for the next couple of years, I see no reason why this would slowdown, both from a supply chain, infrastructure, warehousing, coupled with consumer franchise building and capitalising on social and digital media, we are building our brand and loyal customers in the social and digital arena, and I am quite confident that this will continue for quite a few more years to come.

In terms of organisational setup over the last two years, and if you look also from a structural perspective/resources perspective and focus perspective, this team (the digital e-comm global team) is also transforming into becoming a global powerhouse in terms of the people capabilities and systems and how it is managed. Therefore, when we talk about international, just to reiterate, we will continue to talk about eventually more and more retail markets that we grow, wholesale and specialty markets that we will continue to grow, along with a global e-comm strategy which will probably come and even exceed and surpass some of our expectations, because at the pace it is going, it seems like we are on track. This year, actually, as we close this year, I feel that we have now reached another level, another platform, another base with which we can spring on.

Marco Spinar
Just to follow-up maybe on that, where is that digital team, do they sit in Istanbul or are they in Europe some place? Two, how do you measure your brand awareness other than the sales data that you're getting in Europe? Are there any KPIs you can share with us in terms of Mavi’s brand positioning in Europe and in North America and what your goals are there?

Cüneyt Yavuz
In terms of organisational structure, the global headquarters and the systems operating are here in Istanbul. In terms of metrics, because reaching out and measuring spend and return of investment, the systems and procedures are all global, whether it is Facebook, Google Analytics, whatever tools we want to use. Having said that, of course, each country has marketing leaders that enable the business run there, when it comes to the local celebrity endorsements and events and campaigns and product and category influence and communication influence, and the relevant celebrations that might be going down. In Russia, you have the Women's Day, or in the U.S. you will have maybe Christmas coming in etc, which may not be relevant in this part of the world.

Therefore, the team, as we continue to grow, our aspiration is to make as Istanbul-driven as possible, which is giving us a lot of leverage in terms of cost and also even working with certain agencies, whether it is advertising agencies, shooting agencies or even pay for performance metrics. We end up getting better rates, vis-à-vis paying something in Frankfurt or out of our New York offices, but we do keep a healthy balance and the need to have the leaders in the relevant markets. Today, there are leaders that run the e-comm business reporting into Turkey, in Canada, in Germany, in the U.S. and in Russia.

In terms of absolute top-of-mind kind of brand-share awareness, other than Turkey, at this point in time, considering the size and position we are in, we are not necessarily, or unfortunately, able to measure where Mavi is, as in Turkey. I can at this point say that as a branded denim, we are globally – as Mavi Jeans – one of the top 10 brands in the world, so we are looking at macro trends at this point in time but as we gain more scale and leverage, definitely this will be an area where we put more resources and more measures coming in.

Operator
We have a question from Berna Kurbay from BGC Partners. Please go ahead.

Berna Kurbay
I have a couple of questions. First on the forward contracts that you had that led to the hedging losses that we saw in the second half of the year. Would it be fair to assume that all these contracts have matured now and you don't have any outstanding contracts at this point? That is my first question.

The second and third questions are about your online initiatives. You said that they are profitable in terms of what you have observed so far. Going into the future, when these operations become an even larger portion of your revenue, is there any reason to expect some dilution in the margins.

My final question is again referring to your online initiatives. Your classification of revenue, we see there is e-comm and there is wholesale, and if I am not mistaken, your wholesale segment revenues also include online form third party websites. Is that still valid or have you classified all your online business into the e-comm category as we see it in the footnotes. Thank you.

Cüneyt Yavuz
In terms of contracts, on the balance sheet, we don't have any contracts. We do have import-related contracts for products that we are going to import. What we try to do is we have to get a rate and then have the category team's work on a given budget rate and focus on sales. We do have certain imports that are going to come in that have already been contracted and the prices have been taken in, and it is already part of the guidance that I am sharing with you.

When it comes to e-comm, our number one priority from day one has been and still is and will continue to be to make sure that e-comm as a channel is a profitable channel, and in theory, if everything one day was e-comm, that we would be as profitable a company as we are today. That is the direction. At this point in time, if we were to take our e-comm business standalone, you would see that it is a net in line or in sync business that we are growing in a very profitable way, therefore, I am not only proud with the speed with which the business is growing, but I am as well proud with the cash and profit this business is delivering and will continue to deliver for us for many years to come.

When it comes to the wholesale digital e-comm part, what we are communicating with you guys and will continue to do so is the e-comm and marketplace together, so any sales that are direct to consumer will be viewed as an e-com business. Anything that is wholesale, whether it is digital or bricks and mortar will remain in wholesale. Within the wholesale business, as of today, are there digital business partners which come in and place orders and place firm orders from us and sell in their own channels. They are not necessarily increasing, but even if so, we treat them as an intermediary to reach customers. For Mavi, whenever you hear e-comm from us, this means Mavi.com and added into it, the marketplace business partners where we are serving the customer directly.

Operator
[No further audio questions]