Transcription for Q3 2019 Financial Results Webcast

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Corporate Participant

Cüneyt Yavuz

Mavi – CEO

Presentation

Operator

Welcome to Mavi Third Quarter 2019 Webcast conference call. I will now hand over to your host, Cüneyt Yavuz, CEO. Sir, please go ahead.

Cüneyt Yavuz

Thank you. Hello everyone, welcome to our conference call regarding the financial results for quarter three and the cumulative nine months of 2019. I will be taking you through our operational and financial results for the period and will provide insights on the current trading environment, and our expectations for the year end. Also, I will address the questions I already received throughout the presentation. Should you have any further questions, as always, I will answer them at the end of the call.

Before going into the key highlights for the period, I would like to do a quick overview of the third quarter in terms of market and consumer trends in Turkey. You will recall that after a challenging first quarter, we delivered a strong second quarter with positive traffic and transaction trends. In our previous call, going into the fall/winter season, we stated that we expected a pickup in transaction growth, coupled with lower basket growth for the second half of the year. We also highlighted that the third quarter last year was an extraordinary quarter in terms of sales growth and operational profitability and would be a challenge to beat.

We are happy to report that on top of the last year's strong third quarter, this year, our Turkey retail business remained robust with around 20% like-for-like growth, delivering positive transaction figures and increasing sales volumes. We continued to gain new customers while also increasing our market share in 2019, showcasing the strength and resilience of Mavi as the jeans brand of Turkey.

Now, let's move onto slide two with our key highlights. Just as a reminder, as we did every quarter this year, throughout this presentation I will be sharing the results without the IFRS 16 impact to provide a more meaningful comparison with the previous year. You may find the full IFRS 16 impacts in the appendix of the presentation.

In the nine months of 2019, our consolidated revenue grew by 21% to TL 2 billion 148 billion. Nominal EBITDA grew by 8% to TL 330 million, resulting in a 15.4% EBITDA margin. Net profit grew 44% in the third quarter resulting in 14% increase year-to-date and reached TL 115 million. We opened 14 stores and closed six stores in the nine months of this year, resulting in eight net additions. As of end October, we have 308 own-operated stores in Turkey and a total of 435 mono- brand stores globally including franchisees. Mavi Turkey retail business delivered like-for-like revenue growth of 20.5% in the nine months of 2019. As a loved and trusted brand, we continue to acquire new customers, an addition of 983 thousand in year-to-date 2019. We are confident to exceed our annual target of 1 million new customers. As of end Q3, we have a total of 5.7 million active loyalty cardholders.

Moving onto slide three. Consolidated nine months global revenue grew by 21% reaching TL 2.148 billion, out of which 65% was in retail, 31% in wholesale, and 4.2% in ecommerce. We continue to see the results of our focus on our online business. We delivered a solid 97% growth in sales generated from mavi.com and marketplace in the nine months of 2019.

Sales in Turkey grew by 22% in the reported period, with a healthy 24% growth in retail; the main driver of our domestic business. We are on the right path with our ecommerce business in Turkey that grew by 95%.

In addition to the calendar shift, the transition of seven franchised stores to retail in the last 12 months, and the wholesale ecommerce business converting into a Marketplace model plays a significant role in Turkey wholesale channel performance, which stood out weak in the third quarter. In an adjusted like-for-like basis, wholesale growth for the current fall/winter season is actually around 21%. You will recall that in the third quarter last year, we delivered a significant revenue growth from international operations, given the very high currency exchange levels. With the currency impact reversing in the third quarter this year, there has been a downside on international sales contribution, resulting in 14% growth in the nine months of 2019. The strategic focus on global ecommerce operations is paying back. Our international ecommerce sales grew by 99% as of nine months of 2019.

Moving onto slide four, let us focus on Turkey retail business. Recall that we guided for net 15 new store opening and 10 expansions for 2019. We are on track to delivering this guidance for square meter expansion. We have opened 14 new stores and closed six stores, totaling net eight additions. Additionally, 10 stores went through expansions as targeted. As of end October, we have 308 own- operated stores totaling 154,000 square meters of selling space in Turkey, with an average store size of 500 square meters. Turkey retail revenue growth of 24% was mainly driven by like-for-like growth and new store openings in the nine months of 2019.

Now, to elaborate further on our like-for-like performance, let's move onto page five. On top of a very strong base, Turkey retail like-for-like stores continued to deliver positive traffic and transaction growth in quarter three 2019. In line with our expectations for the second half of the year, the basket growth has started easing with 17.4% and the number of transactions was up 2.3% resulting in 20.1% like-for-like growth in the third quarter.

All in all, nine months like-for-like revenue growth stands at 20.5%.

It is worth noting that the basket growth of 21% year-on-year in 2019 is in line with the competitive landscape and we continue to maintain our price positioning in the Turkish apparel market as per our strategy.

Going into the last quarter of 2019, we project traffic and transaction growth figures to increase, resulting from both a relatively lower base and the positive developments, such as lower inflation and interest rates that support the consumer sentiment. To this end, I am happy to report that November like-for-like is 23.2% with 9.3% transaction growth and 12.7% basket growth. As we continue to offer the right product at the right price and continue to deliver excellent shopping experience, we remain confident that we will continue to retain our happy shoppers and continue to gain new Mavi customers.

Now, let's take a closer look at our category-based performance and move to slide six. Our denim category continued to achieve positive sales volumes and grew 22% in value in the nine months of 2019. Denim now consists of 45% of our total Turkey retail net sales. The lifestyle category, in total, grew 25%. Knits category, which consists of t-shirts and sweaters, grew by 30%, shirts by 17%, jackets by 32%, and accessories by 16% in the reported period.

On slide seven, we again highlight our online growth performance, as this emerging channel now has a significant share in our total sales. In addition to our direct consumer sales covering mavi.com and marketplace, our customers can also buy Mavi products through third party digital platforms to which we wholesale to. Including the wholesale e-comm, our total online sales grew by 52% and reached TL 160.4 million globally, constituting 7.5% of our total revenue.

As you know, we are placing a disproportionate focus on our ecommerce business in order to grow our presence and to improve customers' online experience. We are continuously adding new features and benefits for our shoppers on our own mavi.com website, while also improving our availability on third-party platforms. Our efforts are being rewarded by our customers. The share of online increased to 3.1% in Turkey sales and 28.1% in international sales as of nine months of 2019.

Let's move on to review our margin performance on slide eight. As you know, we guide for continuous improvement in margins and have been able to deliver beyond our commitments against all the challenging externalities in the previous years. We view 2019 to be a transition/bridge year in which managing externalities while focusing on operational efficiency is our main priority. We hold on to our commitment on becoming a more profitable company for the years ahead.

The pressure on gross margin resulting from significant increases in the cost of goods has started to decline as of quarter three, with only 180 bps contraction compared to the 310 bps in the first half of the year. As a result, our gross margin for the nine months of 2019 stands at 49.8%. We are continuously focusing on improving our OpEx management in order to offset product cost pressures. It has been a harder task in quarter three, given the extraordinary high base of same quarter last year. Nevertheless, overall, in nine months we have managed to gain back 90 basis points of margin by improving our OpEx/ sales ratio.

As a result, our ex-IFRS 16 EBITDA realized at TL 330 million in nine months 2019 with 15.4% EBITDA margin, 170 basis points lower than the same period last year. With the absence of the one-off hedging losses of same quarter last year, our net profit in Q3 improved by 44% to TL 70 million, bringing the nine months net profit to TL 115 million ex-IFRS 16. Including the IFRS 16 adjustment, EBITDA is TL 510 million and net income stands at TL 95 million in nine months 2019.

I would like to move onto page nine to take you through our working capital progress. Given the volatile consumer sentiment, we have further increased our focus on inventory management this year, as a result of our efforts to improve our speed-to-shelf, responsible efficient open-to-buy management and effective supply chain planning, inventory level as a percentage of revenue has improved significantly. Consequently, our working capital as a percentage of revenue declined from 6.9% same time last year to 6% as at the end of Q3 019.

In the nine months of 2019, we have generated TL 262 million of operating cash flow, resulting in a cash conversion of 79%, which is also above same period 2018 levels.

Let’s now move onto the next slide. Opening 14 stores and expanding 10 stores these nine months, we have spent close to TL 74 million on CapEx, resulting with a CapEx/sales ratio of 3.4%. We still plan to open seven more stores by the end of the year and to reach 15 net additions and feel confident to stay within our annual CapEx target or about 4% of revenue.

Following the improvement in cash generation, our net debt level declined by 56% to TL 48 million as of the end of October 2019. This implies a leverage multiple of 0.1 times of last 12 months EBITDA, getting closer to our target of becoming a net cash company.
Looking into the currency composition of our debt, 26% of total consolidated debt belongs to our subsidiaries all borrowing in their respective local currencies. As of end of October, only 8% of debt is in foreign currency and is totally covered with foreign currency assets and receivables from subsidiaries. Therefore, we have no open FX positions on our balance sheet as of today, and we aim to continue to carry zero short foreign exchange exposure going forward.

Moving onto slide 11, I would like to provide a review of our guidance for the closing of the year 2019. Following the nine months results and mainly as a result of the underperformance of our brick and mortar international operations and the consumer weakness at the beginning of the year, we now project that we will deliver a consolidated revenue growth of 21%. On the other hand, despite the macro challenges this year, our driving channel; Turkey retail stood very solid, starting from the beginning of the second quarter, thanks to our increased focused on brand and product investments and the efforts by my talented team. Hence, we are updating our like-for-like growth expectations to 20%.

We are holding onto our initial plans of opening 15 net new stores and 10 expansions. Recall that in the second quarter, we have highlighted the technical mathematical downside risk of EBITDA related to the impact of interest rates on purchases. With the interest rates for the second half of the year realizing lower than our initial projections, we also foresee a slightly lower EBITDA margin at 14%. We are happy to see a major improvement regarding the deleveraging and we project to finalize the year at the current levels of 0.1 times net debt-to-EBITDA, one more step towards becoming a net cash company. We still expect our CapEx spending to be around 4% of total sales.

With these final notes, I would like to wish you all a very happy and healthy new year, and at this time, I am happy to take any further questions you may have.

Thank you.

Question and Answer Session

Operator

[Operator instructions]

The first question comes from Görkem Göker from Yapi Kredi Yatırım. Please go ahead.

Görkem Göker

I have two questions. One is on the revenue front and the other one is on the CapEx front. On the revenue front, could you please reiterate your November developments, I mean, both on the transaction front and the basket size growth. You have been long in charge as CEO and based on your past experience, how do you see the consumer response to this type of crisis, I mean, first a decline then increase on the transaction front.

Secondly, on the CapEx front, you are projecting 15, and how many of them will be transformation from franchise stores and how much CapEx should we be projecting for the last quarter.

Thank you

Cüneyt Yavuz

Thank you for the questions. Let's start off with the November update just to reiterate. November, we finished the month of November in Turkey for the store like-for-like performance standing at 23.2%. Of that 23.2%, the transaction element is around 9.3% and the basket is at 12.7%. This is actually a trend that we have been expecting that will take place, meaning the first half of the year would be more focused on – with all the cost and inflationary pressures of adjusting pricing, which would, as expected, realize in relative slowdown in volume transaction. Over the last couple of months, actually we follow it on a weekly basis, as we are also building the plans for 2020, we see this 20% like-for-like growth composure changing in favor of volume and transaction, and November has been also a testament in that direction.

In terms of consumer sentiment, the good news throughout the year has been in terms of traffic and new customers coming in and the brand investments and the new acquisitions we have been able to deliver has been on the positive end. We believe that today, Mavi stands as a stronger and a bigger market shareholder in the apparel business than the beginning of the year, so that is the good news from our perspective.

Overall, in terms of how we see this playing out, I think at this point in time from where we are, it is important that we continue to build on the base of the new customers. We are reaching, roughly, 6 million active customer base. It will be now on us starting with spring/summer, which is a fresh start, with potential better margin improvements and positive consumer sentiment to continue to grow moving into the next year.

In terms of CapEx, of the 15 net new stores that we will end the year, three of them were converted from the franchise. As you know, the wholesale business or the franchise part of wholesale, as we call it in Turkey, is for us a no-growth channel. Towards infinity, it is a channel where there is more migration towards us taking over some of the stores where and when the time is permitting, and it turns out to be feasible for us. Sometimes this happens because the franchisee wants to leave out, and sometimes it happens as there is a shopping mall coming into a town and it no longer becomes viable for the franchisee to continue to operate its own stores in that location.

In total, for the rest of the year, we will be spending and ending the year where our total CapEx spend will be 4% of our revenue, so you can extrapolate from that, roughly, what our turnover will be with 21% growth, and what that equates to for this quarter.
Thank you very much.

Operator
The next question comes from Gulsen Ayaz from Deniz Invest, the floors is yours. Please go ahead.

Gulsen Ayaz
Can you talk a little bit about your international business, maybe start with the reasons for the weakness, and talk a little bit about the restructuring going on there. Is there any change in strategy? How do you see the markets like Russia, because I think you had some plans in that market at the beginning of the year? Are there any changes there?

Cüneyt Yavuz
Thank you. Our strategy for international is as always, so there has not been any major changes throughout this year in terms of how we review the international markets.

On the one hand, there is a growing trend across the whole international spectrum of digitalization and e-comm taking place, so as a big strategy, whether it is Russia, Germany or Canada or U.S., there is a lot of continued focus and interest from our side to get the website, the customer service, the supply chain up and running, along with a lot of the marketing and online investments and marketing tools so that we have the most efficient cost-to-serve model across the international environment. And hence, therefore, we bundle all of international, as you know, about 17-18% of our business, in one presentation, whereas we take out and focus a lot on e-comm. Again, towards many years to come, we believe the e-comm and digital part of our business in the international area will also be a critical growth driver for the individual markets.

Now, in terms of the activities on specifics, I am happy to report that U.S. and Canada, the whole North America business overall, is a nicely growing and digital transforming business, where we are delivering very good margins and very good top line growth. So we are very happy and pleased with the momentum that we are delivering in North America.

It would be fair to say, to a certain extent, the success in North America is subsidizing within its own P&L the activities and restructuring we are doing in the other two geographies, mainly in Europe and in Russia. In Germany, we are gradually, as you know, closing down the stores. So hopefully by the end of this year and moving into next year, we will come to almost a zero kind of level in terms of retail landscape in the European market.

Simultaneous to this action, we are again investing heavily on the digital transformation in Germany, so our Mavi.eu business; Zalando business, OTTO business, Amazon business etc is picking up, and we are speedily catching up with new accounts and transforming a lot of our business into a marketplace operation in this area.

In Russia, the focus is on a healthy mix of getting digital right and the retail stores right. This year, we have now slowed down and we are observing the best performing and worst performing in terms of stores. I am happy to report that the majority of the stores that we have started are in the green, so they are delivering positive store contributions, and we will sort of take it at a pace. Permitting our total CapEx and balance sheet, we will continue to choose to speed up and slow down the Russia operations. It is more for us a handle-with-care in terms of retail part of the business.

And in terms of digitalization, also in Russia business, I am happy to report that our Mavi website is up and running and over the last one to two months, it is already delivering over and above our expected top line revenue.

As I mentioned at the very beginning and at the onset, overall in the international arena, digital and e-comm will be a key growth driver for us while we continue to maintain our distribution and the wholesale doors that we serve. Hence, not only for this year but I foresee for many quarters to come, we will continue to report the e-comm portion of our business in a separate one-two charts to give you a better feel of how that momentum is going and how we will be driving our business.

I hope that sort of gives you a macro picture of all the little bits of hard work we are doing in individual markets.

Gülşen Ayaz

Thank you, that is very helpful. Can I ask a very small follow-up question on Germany? Should we expect any one-off expense item in the fourth quarter due to this restructuring?

Cüneyt Yavuz

No. I think, if any, if there are any one-offs, they are already factored into our current reporting. So there will be no down-the-line surprise, a big sort of financial impact.

Operator

The next question comes from Cemal Demirtaş from Ata Invest. Please go ahead.

Cemal Demirtaş

Thank you for the presentation. My question is about your November like-for-like growth. You mentioned that it is around 23% and 9% was coming from traffic growth. Could you tell us more about the Black Friday impact? What was your perception about the consumption in your area? And what is the expectation about your outlook? Thank you.

Cüneyt Yavuz

Thank you. It is important to note that this is – well, from my personal experience, I am now speaking as a general comment, last year Black Friday became a very important event in Turkey. This whole week became a very important business operation week last year. Likewise, for this year, we had all the preparations ready to deliver against what we wanted to do.

On this digital or dotcom growth area, whether it is through Trendyol, Morhipo, Hepsiburada or through our mavi.com, we have been well-prepared both from a systems and service point of view. I am happy to report back that both on the retail level and on the digital level, vis-à-vis like-for-like versus last year, which we had also a phenomenally strong promotional week, let's say, a couple of days, (actually we don't do a week, we do two days, and this year again we did only Friday/Saturday once again) we came through very positively.

The good news for this year, I would say, is that vis-à-vis last year, the early part of November for Mavi was stronger, so the footfall and traffic went very strong, and hence, if you have noticed as a consumer, we have been very prudent in terms of doing promotional offers, so we gave a 20% markdown vis-à-vis 25% versus last year, and despite that, we were able to hit and exceed our targets. Net-net it is good.

One thing that is a bit different versus last year in terms of like-for-like is that this year's promotional activity has a spillover effect into December, so some of what was shipped or some of the orders that were taken in terms of digital have been invoiced on the Monday and Tuesday following the weekend, which is from a calendar perspective coming into December, but that was already within our plans and that is also going in line with our expectations. I was just checking the first two, three days of December, which is just an indication, tip of the iceberg, and I am happy to report that even the first two, three days are doing pretty well. Actually, I am really happy that the weather is getting cold and it is raining, so we can sell a lot of the coats and outerwear, which is big ticket items, which is also encouraging.

So far, everything seems to be going as per our plan.

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

Berna Kurbay
Good afternoon. I was wondering if you could provide some soft guidance on 2020 in terms of the like-for-like revenue growth in Turkey. Also, given that cash flow generation has been quite strong and you're almost able to have closed the entire debt, how should we think about dividends next year or whether you're planning to spend more both on the CapEx, both on the brick and mortar side and also on the online side. Thank you.

Cüneyt Yavuz
Thank you, Berna. In terms of dividends, straight on, we project that the 30% net income dividend as per our original charter will be delivered at the end of the year, so that is within our target, so we look forward to paying the dividend.

In terms of with the cash and the business growth plans, whether we are going to invest more and where we're going to put – clearly, of course, we're going to continue next year chasing new locations, expansions, new store openings, and continue to invest behind e-comm, digital transformation, both in Turkey and also in the international markets.

As a macro picture, I have clearly said that if you look at the trend, like a longer version of Mavi and how Mavi has been delivering, we have been around a 20% like-for-like company with about 10-12% of it coming from volume and 7-8% coming from price and price adjustments. Hopefully, with the inflation coming down and moving into… the current trend, as I mentioned, directing in that momentum and, hopefully next year, we will be around a 20-ish like-for-like, this is what we are working on.

But on a very macro level, I would say, the budget process is not done. Actually, we are going to have our board meeting in 10 days' time or so to finally discuss and review what we think might be the right plan for the next year. But it would be fair to say that moving into the first half of the year, there will be potential positive base effects that we want to maintain and keep the momentum in terms of continued consumer gain, market share and making sure that our wardrobe share and distribution and traffic and repeat customer maintains at Mavi with continued marketing and consumer investment as our mantra, but that is all. That is all I can say at this point in time.

Hopefully, it will be a better year than this year is what we are projecting.

Operator
There are no further questions in the conference call. I will now give back the floor to the speakers for the webcast questions.
There are no further questions. Dear speaker, the floor is yours.

Cüneyt Yavuz
Thank you again, thank you everybody for being part of the conversation. I look forward to a good closure of the year and hope to see you next year.

All my best. All our best from Mavi team. Bye-bye.