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Transcription for MAVI GIYIM
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Corporate Participants

Cüneyt Yavuz
Mavi – CEO

Tuba Yilmaz
Mavi – CFO

Conference Call Participants

Asli Tuncay	**Goldman Sachs**
Aydi Dipender	
Ayse Budulay	**HSBC**
Berna Kurbay	**BGC**
Bertug Tuzun	**Ak Investment**
Bulent Yurdagul	**HSBC**
Firat Erel	**Carrhae Capital**
Gorkem Goker	**Yapi Kredi Yatirim**
Ilya Ogorodnikov	**Bank of America**
Jasper Wright	**Hermes**
Kayahan Demirak	**Is investment**
Lutfu Gazioglu	**Ata Asset Management**
Mohsin Memon	**Schroders**
Mr. Hariharan	**Goldman Sachs**
Neerav Agarwal	**HSBC**
Ozgur Ucur	**QNB finans invest**
Paul Steegers	**Bank of America Merrill Lynch**
Sergej Shkolnikov	**Fiera capital**
Vik Sinari	**Not given**
Vikram Raghavan	**Moon capital**
Vladimir Babich	**Merrill Lynch**

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Presentation

Operator
Ladies and gentlemen, welcome to Mavi Q1 2018 webcast. I now hand over to Mr Cüneyt Yavuz, CEO. Sir, please go ahead.

Cüneyt Yavuz
Thank you. Hi everyone, welcome to our financial results webcast conference call for the first quarter of 2018, which reflects the performance of our business from February 1st to April 30th of 2018, the first half of spring summer 2018 season. I will be taking you through our operational and financial results for the quarter, share our current expectations, and then I will be happy to take any questions you may have.
Let me start with slide two and take you through the key highlights.

In the first quarter of 2018, our consolidated revenue grew by 25% to TL 536 million. At the same time, our EBITDA grew by 30% to TL 72 million, resulting in a healthy 13.5 EBITDA margin, delivering a 50 basis points improvement compared to the same quarter last year. Coupled with strong top line and EBITDA growth, our net profit also grew by 43% and reached TL 25 million. Store rollouts continued as per our plans and we opened, net, three new stores in Turkey, and one in Russia to reach a total of 315 own-operated stores. As of end April 2018, Mavi has reached a total of 426 stores globally, including our mono-brand franchise stores. Mavi Turkey retail business, again, delivered a very solid like-for-like revenue growth of 20.8% on top of the strong gross performance of last year. Our loyalty card Kartuş holders reached 6.7 million customers.

Moving onto slide three, there was strong revenue growth in line with our guidance, both in Turkey and international and in every sales channel. 82% of consolidated revenue was driven from Turkey. Global revenue grew by 25%, reaching TL 536 million, out of which 60% was retail, 38% was wholesale and 2% was in e-comm. As you know, first quarter is not indicative in terms of the channel mix, as more of the wholesale sales takes place in the first half of the season. Global e-comm sales grew by 55%, higher than all other channels. In the first quarter of 2018, sales in Turkey grew by 26% with 30% growth in retail, the main driver of our domestic business. Wholesale channel grew by 18% and e-comm sales grew by 42%. International growth was 20% including a very strong gross performance of 76% in Mavi.com sales.

Moving onto slide four, let us focus on Turkey retail business. As you know, we have guided for 25 net new store openings for 2018. In the first quarter of the year, we opened five stores and closed two stores parallel to our budgeted projections, resulting in three net additions. As of end April, we have 290 own-operated stores over 142K square metres of selling space in Turkey. New stores and the expansion of five stores accounted for more than 3K square metres of additional selling space. As we continue to open larger stores, average store size has reached now 490 square metres on average. As a result of selling space growth and our strong like-for-like growth, Turkey retail revenues grew by 30% to reach TL 306 million.

Now, to elaborate further on our like-for-like performance, let's move onto page five. We have delivered a very strong like-for-like growth of 20.8% in quarter one 2018. Of this like-for-like growth, 13.2% is driven by transaction growth and 6.6% by basket size growth. Mavi, today, is even a stronger leader in the apparel industry thanks to its healthy brand position and top of mind awareness. We are happy to note that consumer confidence has remained strong behind our Mavi business in quarter one, and we continue to benefit from increases in traffic, new customer acquisition and conversion rates. We believe this is driven by Mavi's right product offering at the right price, and of course, our superior service and product 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 equally strong, and we have happy customers shopping across the whole range of products in our portfolio. Our denim category, including denim jeans, shirts, and dresses have grown at 21% in the first quarter of 2018. Across the lifestyle category, we again delivered very strong results. Knits category, which consists of t-shirts and sweaters constitutes 19% of sales, and has grown by 40% in quarter one 2018. Sales growth in shorts with 40%, jackets with 70% and accessories with 23% sales increase clearly indicate that the appeal and demand for Mavi is on a solid continued growth trajectory. Not only are we growing by country and by channel, but we are also growing consistently across all product categories, both in denim and lifestyle products.

Let's move on to review our margin performance on slide seven. As you know, 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 growth performance. We completed a rewarding year in the year 2017 in delivering the abovementioned productivity increases, which reflected in both top and bottom line margin improvements. On top of our previous year's strong performance, in this quarter of 2018 we continued to deliver margin expansions at every level of our P&L. Our gross profit grew by 28%, delivering 130 basis points improvement against same quarter last year. Our EBITDA grew by 30% and net income grew by 43% in the quarter. Our EBITDA margin improved 50 basis points in line with our target to reach 13.5%.

Now, I would like to move onto page eight to take you through our working capital management progress. We are clearly seeing the results of our multi-functional planning efforts. We continue to improve our open to buy supply planning, become more efficient in inventory management, and increase our sell-through performance. Despite the first quarter requiring higher working capital seasonally, we have improved our receivable days and continued our efforts to optimise our inventory levels, and hence realised significant improvement in our working capital. Our working capital as of the first quarter stands at 5.8% of last 12-month sales, considerably better than the 10.4% for the same period of last year. As a result, our operating cash flow turned positive this quarter, and our cash conversion increased to 54%.

Let's now move onto the next slide, slide nine. We spent 16.8 million TL on capital expenditure this quarter, most of which was related to new store openings and store expansions. CapEx to sales ratio is now at 3.1% and we continue to guide for below 5% CapEx to sales ratio. A few comments on our debt mix, with strong cash generation, our debt level has declined to TL 109 million as of end April 2018, and our leverage multiple stands at 0.4 times last 12 months EBITDA. As a principle, we will work towards maintaining our debt ratio below 1.

In terms of the currency composition of our debt, majority of our hard currency credit on our consolidated balance sheet is related to Mavi U.S., Mavi Canada, Mavi Europe and Mavi Russia, and are covered by their own sales in their local currencies, resulting in almost zero currency risk. Only 28% of our total debt is exposed to currency risk and is subjected to foreign exchange gain/loss, which is mostly consisting of Exim credits for export financing that have very favourable interest rates. 47% of our debt is in Turkish liras.

Moving onto slide 10, we would like to remind you of our guidance for 2018. As you know, we are going through some uncertain times, which requires maximum level of attention, monitoring and hard work from our management. I am happy to say that, as Mavi, we have not experienced any slowdown in demand or weakness in trading environment as of today, including the sales performance of May. Hence, we are holding onto our initial guidance for 2018, in which we target 25% consolidated sales growth, 16-plus percent like-for-like sales growth in Turkey for retail operations, along with 25 net new store openings. We continue to target an above 14% EBITDA margin, striving to deliver another 50 basis points improvement compared to 2017.

This wraps up the presentation I have for you. I am here standing with my CFO, Tuba, and our Investor Relations Director, Duygu. Should you have any questions, I will be more than happy to take them. Thank you.

Question and Answer Session

Operator
[Operator instructions]

Our first question comes from Ilya Ogorodnikov, Bank of America. Sir, please go ahead.

Ilya Ogorodnikov
Good afternoon everyone, congratulations on strong numbers. I have a question on your rental costs. I recall you had a number of initiatives to optimise your domestic rental cost base. Can you give us any updates on your progress here and how should we think about this cost item in the second and third quarter, given the recent TRY weakness. Thank you.

Cüneyt Yavuz
As you know, we have very strong like-for-like performance that is keeping us afloat, but as you also have mentioned, the currency has weakened, especially in the last month it has really taken a dive, although it has stabilised a bit. From our point of view, although almost two-thirds of our rent contracts are in hard currency, a good 50-60% of that number is either pegged or with reverse caps, so we are not as much exposed directly with what might be happening from a currency perspective. The other 40% is on a continuous negotiation basis, whether it is me or my retail development team, working hard on a daily basis, monthly basis negotiating to make sure that we cap the currencies at a reasonable rate.

This year, when we started the year, we have taken as a budget, the dollar at 3.95 and the euro at 4.60, I am quite confident that me and my team will do their utmost to make sure that from a rent exposure perspective that we are able to fix the rates at these current rates. So far we are more successful than as we would have expected, as we remain as one of the key players in the Turkish retail environment.

Moving forward, should the exchange rate go left and right in other direction, I still maintain that although there might be an uphill battle, that we will continue with our strong position and relationship with the shopping malls and the street locations, that the exposure here will remain quite minimal vis-à-vis what might be on a contractual basis.

Operator
Our next question comes from Gorkem Görker, Yapi Kredi Yatırım. Please go ahead.

Gorkem Görker
My question is regarding your cash conversion performance, it is much better than I initially expected. Could we take such levels or improvement in the next quarters and is there any room for further improvement or any one-off issue in this performance. My second question is, as far as I remember correctly, you opened net 10 stores and seven renovations last year this time (this quarter), this is a bit slower this year, but the decline in CapEx is not that high. On a unit basis, I see an increase on your CapEx side. Is there a risk on that front and should we see an acceleration in the next quarter or third quarter in terms of new openings. Thank you very much.

Cüneyt Yavuz
Thank you. First of all in terms of cash conversion, I am happy to say through our better inventory management, open to buy management, making sure that our inventory remains very fresh, also in terms of margin improvement, you see a lot of positive margin improvement coming through. As Mavi team, we are having phenomenally strong initial sell-through rates where customer demand is very high, which is also enabling us to use up less of our markdown support, which also is fuelling our margin improvement. But net-net, if you look at the picture, we do maintain that our cash conversion will remain strong and that our working capital requirements will remain around 5% of our total sales. The picture, I think, for the rest of the year – if you were to model it – I would take it as these levels moving forward.

In terms of store openings, I had similar questions also last year when we started by presenting quarter three, quarter four, so in terms of timing. Unfortunately, these 25 stores that we open are not going six, six, six, all uniform, but in terms of our guidance that we are confident that we will open up to 25 stores remains strong. Actually, we have opened up, in this quarter, five stores, but we did end up closing stores, so the net number did come down and we did also expand five stores to bigger square metres, so net-net I think in terms of the rhythm, it's slightly slower than what we would expect, but also if I look at May openings, for instance, we are back on track and there are strong numbers coming through in May, therefore at this point in time, in terms of guidance, in terms of whether we will be able to expand and open new stores, I remain positive.

There is also one point – I mean, we will be also very smart, I will just reiterate that, we are not growing for the sake of growing. Especially in these uncertain times it becomes very important that we put a lot of effort behind our great products, open-to-buy management, keep the traffic growing, so a lot of strong like-for-like growth like we are witnessing right now, which is at 20% plus, which can also potentially should there be a risk in downside, like one, two stores downside, we will more than compensate for potentially any lack of openings, which at this point in time I don't foresee. Should there be some turbulence down the road, as you know quarter two is going to become quite an interesting quarter, as we did not budget for an election, which happened along the way, so we'll see how that goes. But as of now we are in the month of May, which is the second quarter first month, life seems to be holding up, the traffic is strong, conversion rates are good, product appeal is strong, so we remain very positive in terms of output for the whole year.

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Gorkem Goker
A follow-up for the CapEx issue, should we see a similar level of CapEx as we saw last year? I mean, last year I see 73 million CapEx, so this year considering that you are foreseeing a similar level of store openings, could we take it as a benchmark for this year as well or is there any particular issue for this year?

Cüneyt Yavuz
I mean, yes, I think using less than 5% as a guidance, 4-5%, would be the right thing to do. Looking at 25 new store openings and potentially 20-25 expansions, I think we will do quite a similar sum of money to be spent behind CapEx, plus we are investing, as I have been also mentioning in our prior calls. We are investing as much as we can behind technology and digital transformation, so there is also money that we will be putting behind, but net-net, our CapEx spend should not exceed 5% of our sales.

Operator
Our next question comes from Eddie Dipender. Please go ahead.

Eddie Dipender
I just wanted to ask in terms of your performance in the month of May when the currency took a bit of a dive, was there any deterioration in any of the performance metrics or did you continue to perform in the same way that you performed in Q1?

Cüneyt Yavuz
In terms of May how we are progressing, of course we are in a business where we have bought the products, priced the products, and moving forward accordingly. The good news I can reiterate is in terms of main metrics we of course benefit from – you will see potentially slightly more benefit in terms of margin improvement from international. Our euro and dollar based businesses in U.S., Canada, Germany of course is going to take a benefit out of this. And there will be slight negatives coming through the Turkey margin or pricing, but these have all been factored in. Net-net I am quite positive. The good news is sell-through rates are very high, inventory is very fresh, and also we are using less markdown than we have planned for, which should more than compensate for the downside or the tests that might be coming through. As a theme, you can be rest assured that we are working very hard to remain agile, to be on top of our cost structure, to make sure that our inventory management, our cost expenses, our overhead costs etc, are stringently managed. At this point in time, as of May, life from our standpoint is pretty good.

Operator
Our next question comes from Asli Tuncer, Goldman Sachs. Please go ahead.

Asli Tuncay
A couple of questions, the first one is I just wanted to confirm the rates that you use in your budget assumptions, so you said 3.95 for the dollar and for the euro you shared 4.6. Did I get that right?

Cüneyt Yavuz
3.95 for U.S. dollar, 4.60 for euro.

Asli Tuncer
Okay and just to confirm, you said that these would be the levels that you're looking to fix the rates on your rent contracts and so far you've been successful in doing this.

Cüneyt Yavuz
Yes, I mean, when we started the year, these are the cost basis, import base etc, rent basis rates that we have used. All our efforts are built around making sure that we maintain, whether it's the cost part or from a product mix pricing perspective that we are taking the right measures to maintain or to minimise any potential exposure that might come because of higher exchange rates.

Asli Tuncer
My second question is obviously you had strong like-for-like growth in this first quarter and there were other questions around how you see the current trading environment, you commented that it's still quite strong, you're seeing traffic remaining strong. Was there anything in April that was different than the two first months in the first quarter that you've noted that could be relevant for the coming months? The reason why I'm asking this is in the overall consumer environment in certain sectors we did see some weakness in April, so it's quite surprising that you're not actually… I mean, we don't see this in your overall for the quarter like-for-like figure. Is there anything that you can share that's something that's different that you've noticed in April or something that you're seeing a continuation into May or anything that you would expect?

Cüneyt Yavuz
The quarter one average, as you know, was 20.8. April was actually significantly above that, so we had a very strong April. If anything, from February to March, March to April our business and like-for-like performance has been on a growth trajectory rather than on a sliding trajectory, therefore, we are very much encouraged with also May numbers coming through that our business and the consumer sentiment in terms of coming and shopping, and spending their money behind Mavi remains very strong. So I don't know what are the other indicators of the other retailer, consumer data that you are tracking, but from Mavi's perspective, April was a brilliant month.

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Operator
Our next question comes from Kayahan Demirak, İş investment. Please go ahead.

Kayahan Demirak
I have two questions. The first one, your general and administrative expenses went up by 26% year-over-year. Is there any particular one-off inflating this number and what should we expect for the remainder of the year-over-year figures for the year-end? The second question is you recently announced that you will buy back some shares at your Canadian operation, which you have already full control and you fully consolidate, what's the reason behind this decision?

Cüneyt Yavuz
Can you repeat the question on Canada once again? Sorry for that.

Kayahan Demirak
You have bought some additional shares at your Canadian operation, which you have full control over and you fully consolidate. What was the logic behind this?

Cüneyt Yavuz
From an SG&A and general admin costs, I mean, over and above the 26% increase that you're mentioning, there is no exception. For the rest of the year in terms of… as a portion of total sales, our G&A should remain quite consistent through the year. In terms of the Canadian acquisition, as was explained in the IOC ahead of the IPO, there was a managing partner there and we had committed to buying their shares to have full ownership, and that's the plan that we executed for the Canadian operations, and now it's 100% ours. One of the benefits coming through the Canadian acquisition hopefully might be down the line as we may apply to Turquality Government support. This way we can have higher support coming through in the future there. But more importantly it was part of the original IPO roadmap, that's something we had committed to and we executed it when we found the time and the opportunity.

[No further questions]

Cüneyt Yavuz
If you want, I can read one question that has been posted and try and answer that. There was a question in relation to commenting on the impact of inflation on cost base and how we have been thinking about pricing policy and potential trade-off with volume growth. Overall, the inflation in Turkey is around 11-12% and typically our cost inflation on the product side is about 60-70% of that, so it's 7-8%, and typically we average one third of

our like-for-like growth coming from pricing and product mix adjustments, so we are able to offset the inflationary environment from a product price perspective through that. I'm happy to say in this quarter and also in these coming quarters, from a price mix perspective, we are taking the prices and we are able to take the prices that we targeted. As I was mentioning, the sell-through rates and the consumer confidence remains strong, so we look forward to that.

For quarter two, it will be a similar approach. We are carefully analysing the marketplace and the competition, both the local players as well as also the import-driven brands. As you know, 80% of our sourcing is coming from Turkey. Having said that, there are lots of importers, whether it's Inditex, H&M, Mango, and they are euro/dollar based companies, so we have to also analyse them, and we will have time until mid-July, end of July to decide and see where the market is landing to decide on a final pricing strategy. We think as a company we have both from a product planning perspective and also pricing perspective a lot of agility and flexibility to make sure that we are managing our balance sheet to deliver both top line growth as well as bottom line margin improvements, so that would be our position.

In terms of volume growth, both from a lifestyle category and denim category, all categories are rewarded by strong consumer demand and we remain very optimistic about whether it's the externalities going bad or remaining similar market trading environment that the customers' choice of buying and shopping will remain with Mavi, as we are offering superior products, a very good shopping experience, and service quality. Therefore, our guidance for the year as of today remains similar to what I have stated at the back end of 2017.

[No further questions]

Cüneyt Yavuz
Thank you very much. Thank you for joining our conference. As the whole Mavi team, my CFO Tuba and our IR Director Duygu, we are very much committed to answering any further questions you might have along the way and we are doing out utmost effort to make sure that we keep all the channels of communication in terms of how our business is tracking on a regular basis, and I hope to see you all very soon in a couple of months when we are coming back with very good results for the second quarter, and I wish you all the best. Thanks a lot.