## Q2 2024 Global Fashion Group SA Earnings Call Transcript

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### PRESENTATION

**Christoph Barchewitz - Global Fashion Group SA - CEO, Member of the Management Board**

Good morning, everyone, and welcome to Global Fashion Group's Q2 2024 results presentation. I'm Christoph Barchewitz, CEO of GFG, and I'm joined today by our COO, Gunjan Soni; and our CFO, Helen Hickman. I will start with the highlights and then Gunjan and I will cover our regional results and key developments. Helen will then take us through the group results and outlook. After that, we'll open it up for Q&A.

In Q2, we continued to make important changes to our business as we navigated market demand challenges. The rate of our active customer decline has started to reduce compared to the past few quarters as a result of our customer expansion and engagement efforts. NMV has also decreased at a slower rate, reflecting the continued subdued demand environment.

However, our operational efficiency has had a positive impact. Gross margin expanded primarily due to stronger performance of our retail business, as we reduce the amount of discounting compared to this time last year. This improvement, combined with our ongoing cost discipline, drove a significant uptick in our adjusted EBITDA margin for the quarter. We delivered breakeven normalised free cash flow for Q2, demonstrating our ongoing focus on profitability and cash flow.

Let's now take a closer look at our Q2. In Q2, our net merchandise value decreased by 12% year-on-year on a constant currency basis, primarily due to lower volumes. However, we observed some easing compared to Q1 in both LATAM and ANZ. Our efficient inventory management has resulted in an improved retail margin and drove the year-on-year improvements in gross margin.

We achieved a 45% gross margin, our strongest quarterly gross margin to date. Our adjusted EBITDA margin increased by 6 percentage-points benefiting from the cost and productivity initiatives action in 2022, 2023, as well as new ones implemented this year. We ended Q2 with an active customer base of 8.1 million. We placed 4.4 million orders at an average order frequency 2.3 times.

Next, we have our segment results and business updates. We are committed to the disciplined execution of our strategic priorities and are making good progress across all of them. These priorities include creating a best-in-class customer experience, being the brand partner of choice and operating people and planet positive.

Let's move into each region's performance and key highlights in delivering our strategy. Starting with Latin America. LATMA's Q2 performance has demonstrated positive results amidst volatile trading conditions, including the top line, being impacted by extreme weather events such as heat waves, which reduced demand for fall winter seasonal product.

By delivering on trading costs and cash flow initiatives the team successfully adapted to the changing market. This included efforts to reduce discounting and aged inventory levels, which drove up gross margin to 46%. In H1, LATAM's adjusted EBITDA margin increased by 6.9 percentage-points despite the NMV decline. This improvement was primarily a result of the significant cost actions implemented over the last year.

Next, let's turn to some specific examples of how we have improved operational efficiency and customer engagement in LATAM. We launched Fulfilled By in the future in Brazil at the end of Q2. This offering is a key component of our group strategy and will mirror its success in SEA by enhancing both seller and customer experiences, increasing platform services revenue, and expanding our market share from its 2023 level of 38% of NMV.

Additionally, this offering will increase utilisation at our Brazil fulfilment centre over time and thereby improve efficiency. Our app centric strategy has led to a 52% increase year-over-year in app installation, which we achieved through targeted marketing campaigns and CRM initiatives. App users are our most valuable customers and the app share of total NMV increased by 8 percentage-points to 63% in the first half of '24. These strategic shifts and operational advancements position us strongly for long-term success in LATAM.

I will now hand it over to Gunjan.

**Gunjan Soni - Global Fashion Group SA - COO, Member of the Management Board**

Thank you, Christoph. In Southeast Asia, our business faced a challenging first half of the year as we navigated subdued consumer demand, regulatory change, and other external factors. Specifically, Q2 was impacted by the shift of the Muslim Raya holiday from Q2 last year to Q1 this year and disrupted our typical festive sales timing.

Additionally, an unexpected change in import regulations in Indonesia, our largest market temporarily halted the cross-listing of products from Malaysia into Indonesia impacting sales. Despite this challenging market conditions, we successfully grew gross margin by 4.3 percentage-points, both through higher retail margins as well as continued platform services participation increase.

Let's now look at how we are driving customer loyalty, efficiency with AI innovation and platform services penetration in Southeast Asia. Our premium one year loyalty program, ZALORA VIP has seen significant growth as it continues to be fully integrated across all customer touch points. Customers, both taking the subscription have increased their spend on an average by 2.2 times and their order frequency by 90%.

We have significantly improved efficiency in SEA to the use of generative AI. Our new AI chat bot handles a growing number of customer inquiries without human health, even complex questions in multiple languages. With the success of this chat bot, we are exploring its role to handle more tasks and create a better shopping experience for our customers. Additionally, our newly developed AI pricing system automates product pricing at scale in our multi-country environment, thereby helping improve retail margins as well as inventory efficiency.

Platform services remains a significant driver of SEA's bottom line potential. Operations by ZALORA continued to expand rapidly with items shipped increasing by 70% year-over-year in H1 of 2024. Our single stop solution offering now supports close to 50 brands to distribute their assortment on both ZALORA as well as external platforms. We are excited to build on this momentum and explore ways to further expand the service line.

Let us now turn to the Australian New Zealand business. ANZ faced a significant competitive and discount heavy market last year, resulting in lower gross margin in Q2. Through better inventory management, ANZ has now broadly recovered this margin with a 5.1 percentage-point increase year-over-year. Margin improvements, strong cost discipline and slowing top line decline have together increased ANZ first half adjusted EBITDA margin by 4.2 percentage-points year-over-year to near break-even.

Let us now look at how in ANZ we continue to drive efficiency and position ourselves for future growth. ANZ has successfully migrated its order and warehouse management system to SEA system through a SaaS based service model. Since May of this year, the platform has processed over 0.5 million orders in Australia and New Zealand.

This OWMS transition positions our ANZ business to introduce new services and innovations for customers and brand partners alike, like the single stock solution which also streamlining spend on technology as well as enhancing warehouse efficiency. In parallel ANZ got you looking master brand reset has been very well received as a new look and feel of that iconic. We have relaunched with high impact and high reaching full funnel brand campaigns.

Got you looking goes beyond a typical marketing exercise, it is a long-term value driver as it strengthens our brand identity for our customers. To further promote brand collaboration we hosted our Annual Partner Day attendance by over 100 of our strategic partners. We used this event as an opportunity to promote our marketplace as well as platform service offerings and key drivers of our robust and attractive ecosystem for our partners. These accomplishments position our ANZ business for continued success and long-term value creation.

I will now move on to our platform business progress. As demonstrated through our regional updates, the group transition to a platform business remains a key part of our strategy. We have progressed this transition with our marketplace share increasing to 40% of NMV in the first half of 2024. Our share of items fulfilled by GFG and cross-stocking has also increased to now represent 40% of marketplace shipped items. Platform services have also scaled to 5% of revenue and is now at the lower end of our longer-term growth goal.

I will now conclude our business update with the latest developments on our people and planet positive agenda. I'm happy to report that we are making significant progress across our entire strategy. But today, I will focus on two key areas. First, we have improved our sustainability transparency and reporting. To better align with the evolving industry standards we have revised our sustainable data credentials, library, and updated product tagging across all our regions, assets, including websites and apps.

This increased transparency helps consumers accurately identify products with sustainable attributes that they are looking for. Additionally, we have successfully completed and validated our double materiality assessment. This is a crucial step to ensure CSRD compliance in fiscal year 2024.

Second, we are proud to announce that GFG has been approved to purchase cotton through the better cotton initiative for our own brands. This partnership supports our target of sourcing 100% sustainable cotton by our own brands by 2030. Better cotton, which represented 22% of global cotton production last year offers a more cost effective and sustainable option compared to other cotton materials.

By participating in this initiative we not only contribute to environmental sustainability, but also improve our business efficiency as well as the responsible sourcing practices. We are excited about the progress we have made and look forward to continuing our sustainability journey.

I will now hand it over to Helen to take you through our group results and outlook.

**Helen Hickman - Global Fashion Group SA - CFO**

Thank you, Gunjan. Now let's review our group KPIs. Similar to last quarter, fewer new customers have driven the reduction of our active customer base, which decreased by 16.7% year-over-year. However, improving reactivation and churn rates are beginning to counter this trend. Order frequency saw a smaller decline to last quarter and is now 2.3 times.

In quarter two, our NMV declined 12% year-over-year on a constant currency basis, driven by lower volumes, whilst orders declined by 16.9% in the quarter due to reduced traffic. The rate of this decline has moderated compared to last quarter. We continued to see growth in average order value, which partially offset the impact of reduced volumes on NMV. AOV increased by 5.5% year-over-year, driven by price inflation and a favourable shift and category mix.

Now looking at revenue and margins. In Q2, whilst revenue declined 13% on a constant currency basis, gross margin increased 3.5 percentage-points year-on-year. This increase was driven by retail margin expansion that was achieved by improving the quality of our inventory. We did this by reducing aged stock levels and associated discounts.

Our continued focus on increasing marketplace share, along with our growing platform services also contributed to the year-on-year gross margin improvement. We delivered an even stronger step-up in adjusted EBITDA margin, increasing 6 percentage-points year-over-year as we benefited from our cost initiatives executed in 2023 and in the first half of this year.

Moving on to costs, our commitment to efficiency resulted in a EUR34 million cost reduction year-over-year in H1 ‘24. This is an 11% decrease on a constant currency basis. Our cost reductions were primarily driven by targeted initiatives with lower demand and external factors like inflation and FX contributing to the remainder.

Notably, we reduced our total headcount by over 20% compared to the end of H1 '23, with 60% of the reduction coming from fixed cost functions such as customer services and marketing. Our ongoing cost efficiency efforts will centre on leveraging savings through technology such as our OWMS project and executing cost initiatives, including further optimization of our delivery and returns processes.

We are equally focused on actively pursuing NMV recovery through strategic initiatives that target customer acquisition, retention, and engagement. We maintained our prudent inventory management efforts over this past year and have reduced overall inventory levels by 18% by the end of half one. We targeted inventory older than 180 days and reduced aged stock by EUR13 million year-over-year to represent 21% of gross inventory.

This approach has been critical to improve our cash flow position, as I will outline next. This slide describes our normalised free cash flow, which is our measure of operational cash invested in the business. In Q2, our adjusted EBITDA loss was EUR4 million, and we generated a working capital inflow of EUR23 million by reducing inventory and increasing payables through extended supplier payment terms.

We invested EUR9 million in CapEx, the majority of which relates to capitalised payroll for technology projects. This is slightly elevated versus last year's spend as we complete the OWMS project investment. For the quarter, we generated a normalised free cash inflow of EUR3 million, improving by EUR8 million year-over-year.

For the half, our improved profitability has driven year-on-year improvements similar to those in Q2 with a normalised free cash outflow of EUR58 million. Despite the challenging trading environment, our cash position remains strong, especially after our recent convertible bond repurchases. In Q2, we repurchased EUR12.6 million of our outstanding convertible bond, followed by another EUR110 million repurchased announced a few days ago.

These repurchases were executed at significant discounts, creating strong cash savings. This strengthened our balance sheet and preserved our strong liquidity and financial flexibility. We remain open to considering other opportunities to repurchase our remaining outstanding bonds. As of Q2, we held a pro forma cash balance of EUR317 million and EUR144 million on a pro forma net cash basis.

This net cash position excludes the outstanding convertible bond liability and other smaller loans. The other cash outflow of EUR7 million on the chart on the left resulted from the small convertible bond repurchases in Q2, which was partially offset by a small inflow from increased LATAM receivables factoring. The recently announced buyback will result in a EUR94 million cash outflow and increase our pro forma net cash by EUR16 million from the Q2 closing position. Post settlement, it will be EUR55.7 million of our bond outstanding.

Before we open the floor to questions, I'd like to reconfirm our full year guidance for 2024. As outlined in March, we have made strong progress in the first half of the year with customer trends starting to improve, gross margin progression and incremental cost actions driving further adjusted EBITDA benefits. June and July have been our strongest months this year in terms of year-on-year NMV trends, which supports our confidence in the guidance for our full year NMV year-on-year decline of between 5% and 15% on a constant currency basis.

We continue to expect year-on-year adjusted EBITDA improvements in half two, driven by the momentum we've seen in half one. This puts us well on track to deliver our full year guidance of an adjusted EBITDA loss between EUR25 million and EUR45 million. Combination of these factors sets us up well to drive our ambitions to returning to positive adjusted EBITDA and achieving positive normalised free cash flow.

We will now open the call to your questions. If you'd like to submit a written question, please click on the speech bubble at the bottom of the screen. Thank you.

## QUESTIONS AND ANSWERS

**(Operator)** We'll now take our first audio question from Matthew Abraham from Berenberg.

**Matthew Abraham – Berenberg – Analyst**

Good morning. Thanks for taking my questions. First one is just in reference to outlook commentary, which you ended the prepared remarks with and I just noticed there was a slight difference in the way you're talking about the second half in today's results relative to the first quarter's result. In Q1, you did say that you expected an improvement in demand of which Australia would be the first jurisdiction to show. Are you still expecting that improvement in demand in H2 and at what point in the half are you expecting it?

And then if so, can you please clarify why there hasn't been a change to the full year adjusted EBITDA guidance range, given you've delivered beyond at the low point of that uplift in adjusted EBITDA and you expect the second half to be stronger from a demand perspective? That's the first question. Thank you.

**Christoph Barchewitz - Global Fashion Group SA - CEO, Member of the Management Board**

Thank you, Matt. I'll maybe take the first part on the top-line recovery, and then let Helen comment on the question around the guidance and the adjusted EBITDA specifically. So I think when we started the year and recorded full year and also Q1. I think we've been quite transparent that we expect that a gradual recovery in the demand throughout the year.

I think that has taken a little bit longer than we expected early in the year as we I think also addressed with the Q1 results, but we have seen June as last month in the second quarter and also July as the first month in the third quarter, as you heard from Helen as well actually be the strongest month when you look at year-on-year rates effectively. And so that gives us some positive indication that that expectation still holds. Now the seasonality in our business, as you know, is very weighted towards the Q4. And so I think that's really where I think we are still cautious around our expectations.

So I think we're very comfortable with our top line guidance. And the range that is sitting in with the better end of the range, implying quite marked improvement in the second half. And obviously, the bottom of the range seen more of a continuation. But I think where we are today, we do continue to see the opportunity for an improvement in the second half, probably just not quite as much as we had been expecting early in the year. And as a consequence, we've also adjusted on inventory intake and some of our cost actions.

Helen, do you want to take the second part of the question?

**Helen Hickman - Global Fashion Group SA - CFO**

Thanks, Christoph. I mean, it flows really from where Christoph was speaking with regards top line. So we've made significant step forward in reducing our losses in the first half, which we're really pleased with. And we have continued cost efficiency programs into the second half that, bear in mind, we're starting to annualize our proactive cost efficiency measures that we implemented towards the second half of last year.

So some of the annualization benefit and comes off in the second half. And also the second half is our peak trading, but it's also our area with the most risk and the most caution and so as it stands at the moment, we're confident in the guidance that we set and pleased that we are heading from our first half towards the top end of that.

**Matthew Abraham – Berenberg – Analyst**

That's really helpful. Thank you. And then my next question, just in reference to the cost reductions that you helpfully disclosed that you did say it was a 34 million reduction in cost delivered in H1 relative to the prior comparative period. And I'm just wondering if you could please disaggregate and how much of that cost reduction reflects lower volumes relative to fixed costs that you've taken out of the business? And in reference, the fixed cost that you've taken out of the business, could you please clarify to what extent measures introduced in FY 2024 to date have been the driver of that fixed cost reduction?

**Helen Hickman - Global Fashion Group SA - CFO**

Yeah, Matt, I don't mind sort of talking that through. So the majority of the savings as a result of our proactive initiatives. I think you then as you say have a volume impact. However, it's worth also obviously, realising we've also got inflation as well, which is starting to counter some of that volume piece. So there is sort of steps within each. But if you still want an idea, really around the levels of cost initiatives that we're delivering. The majority of that 34 million comes from proactive cost measures from this year and last year with sort of volume savings then being offset by inflation and other external metrics.

**Matthew Abraham – Berenberg – Analyst**

Okay, that's helpful. And just to clarify, when you say driven by measures this year and last year, does it remain significantly weighted to last year's measures? Or is it a more balanced contribution from this year's measures to last?

**Helen Hickman - Global Fashion Group SA - CFO**

Yeah, definitely a more balanced contribution. So whilst I've sort of mentioned, we get the annualisation of this year we've still got a significant pipeline of activities that have been initiated this year, which we will see flow through into our second half.

**Matthew Abraham – Berenberg – Analyst**

Okay, great. That's very helpful colour. I'll pass it on.

**(Operator)** Thank you. We'll now take our next question from Volker Bosse from Baader Bank.

**Volker Bosse - Baader Bank - Analyst**

Thanks for taking my question it's Volker Bossa at Baader Bank. First of all, congratulations on the substantial improvement which you made. And my first question would be on June/July. You said an improvement trend here could you give us an indication on how is payers are NMV would have seen on a combined basis in June/July, just to see if you are already positive or less negative or how June/July on a combined basis developed please? And would you also confirm my view that we have seen the bottom of this top line decline in H1. So same gradual improvement in the second half means also that and yeah, that we have seen the worst behind us, so to say.

And the second question is difficult question to answer, but nevertheless, I tried to get your idea and your thought in regard to the decline in all regions. How much of the decline is driven by weak consumer sentiment, so weak economic momentum and how much is driven by intensified competition, for example, driven by price aggressive Chinese players, for example?

And the last question -- third question is more on a strategic outlook. I did not get what you said at the end of our outlook statements at when do you expect to return to a positive top line and positive adjusted EBITDA and free cash flow positive on a full-year basis. To get your thoughts on that would be great. Thank you very much.

**Helen Hickman – Global Fashion Group S.A. – CFO**

Volker let me start with your first question with regards to top line improvements that we've seen recently. So if we look at quarter one, we declined our NMV by 16% that reduced than to 12% in quarter two, if we take July and June combined, we're in sort of single digits. So in sort of mid-single digit decline that we've seen through that gradual improvement with July being slightly better than we saw in June.

**Volker Bosse - Baader Bank - Analyst**

Perfect. Thank you very much.

**Christoph Barchewitz - Global Fashion Group SA - CEO, Member of the Management Board**

I can take the other two questions, maybe Volker. So I think as you say, it's a difficult thing to allocate really what is driven by consumer sentiment and what is driven by intensified competition. I think the way we look at it is we’re very focused on how we can serve our customers in this environment. That includes both factors for sure, i.e., price sensitivity, high inflation or having come off a period of very high inflation in many of our markets.

And we do see that our customers respond to very sharp pricing,discounts, campaigns, big sales events much more strongly and are much more cautious around full-price purchases and also the more expense products. So from that perspective, I think we are seeing this impact, but we're more taking an approach of how do we adapt our business through making sure we have the right assortment.

We're bringing on the right brands to the customers to cater to those needs in this evolved environment and working very closely with our brand partners. And I think from that perspective, we feel like the changes are we are driving on the assortment side and how we go to market, our actually making us adapt better to this environment and some of the improvement in trends we would not necessarily in any way attribute to really big change in the environment, but actually us adapting to the environment more strongly.

One example being, we have a much healthier inventory position because we're much more prepared for this type of environment and some of this stock overhang that we had from last year in certain categories in Brands, we've made a lot of progress in clearing that as you can see from the numbers. In terms of returning to positive top line, clearly we don't have that in the guidance for this year.

I think it's too early to talk about next year. Clearly for us, this is an important critical priority, and we're really approaching it from a customer perspective, through all of our customer engagement, churn prevention, reactivation in a very app centric way. And so we don't want to give guidance at this point. But certainly, if we can land the second half in a significantly improved position to where we were in the first.

Then that would obviously give more visibility and more clarity that we can move into positive territory across the group in the course of a not-so-distant future as we are starting into '25 then and I think directly linked to that we feel very good about the H1 adjusted EBITDA improvement. I think if you can maintain the momentum around that it will put us in a very healthy position to then come you know much closer in touching distance towards achieving adjusted EBITDA breakeven not very far out the way we also look at it is turning each of the regional businesses into positive EBITDA as quickly as possible.

And then obviously, there's a bit of group costs that we also need to cover. But I think returning each of the regional businesses to a positive territory is the first step. And that's what we're really focused on.

And then the normalised free cash flow will follow after that. We have a bit of leases and CapEx, as you know, to cover, but we feel like we are making very good progress and being very disciplined on both of those line items. And also, as you see from the H1 numbers, continue to see some benefit from the working capital initiatives and continued focus on shifting both more into the marketplace business as well as managing the inventory that we buy in the most efficient way possible. So hopefully, that gives you a bit of colour and we'll obviously give more clear timelines as we're getting through the peak trading and than starting to '25.

**Volker Bosse - Baader Bank - Analyst**

Thank you very much. Of course. Understood mainly clear. You make your home works, and then we see what will be the outcome. Thank you very much and all the best for the remainder of the year. Thank you.

**(Operator)** We have no further questions in queue currently heading into the webcast questions. Thank you.

**Saori McKinnon – Global Fashion Group S.A. – Head of Investor Relations & Communications**

First question from the webcast is how will you stop the loss of customers or rather how will you reverse the trend and what is the lowest level of marketing spend you should have to stabilise the business?

**Christoph Barchewitz - Global Fashion Group SA - CEO, Member of the Management Board**

Yeah. Thanks for the question. I think I touched on that, so I will keep it brief. I mean, fundamentally on the reversal of the customer loss. We focus on three areas, number one, a very app centric approach to customer acquisition. You will have seen some of that in the presentation and also the engagement. We now have a clear majority. If not much more than that of the business through the app. So that is really the centre of all of our customer engagements.

Secondly, we are very focused on CRM measures to drive next orders, both from existing customers and from new customers. So that we manage churn prevention much earlier and really have a very tailored approach in the lifecycle of a customer and loyalty programs are playing a role in that. I think we've spoken about the Southeast Asian one. Clearly, that's an area of focus in all of our markets.

And then thirdly, we have a big opportunity still in customer reactivation, we now have an over 10 year history in all of our markets. And so from that perspective, there is a real opportunity to re-engage. Some of the customers we've lost and re-educate them and reposition the proposition of the platform for them. Clearly, we've evolved as a business quite substantially over the last couple of years.

So we're focused on all of those. And together, I think that means that we will continue to spend, obviously on marketing, I think we're disciplined around that. It's been a slightly higher level. If you look at it as a percentage of NMV in the first half. But typically our marketing represents around 7% of NMV. And we think that for the time being, we'll be around that number to deliver on the turnaround in the customer dynamic.

**Saori McKinnon – Global Fashion Group S.A. – Head of Investor Relations & Communications**

The next question from the call. Are there plans to make the company better known on the stock market? How is your exchange with the major shareholders?

**Christoph Barchewitz - Global Fashion Group SA - CEO, Member of the Management Board**

Yeah, I think most of our attention is obviously focused on improving the performance of the business and doing that. However, we continue to also engage with all existing shareholders and interesting shareholders our IR team and management were always willing to have conversations and get people up to speed on the business.

And we also have a number of conferences coming up in which we're going to be present to engage with a broader investor community so that is something that we obviously maintain and manage and anyone who has interest or questions, please feel free to reach out to Investor Relations. We're happy to support with answering any questions.

**Saori McKinnon – Global Fashion Group S.A. – Head of Investor Relations & Communications**

That is all the questions today from the webcast. Thank you all for joining. If you have any further questions, please reach out to the Investor Relations team directly.