# Q3 2023 GFG Earnings Call Transcript

*9 November 2023 / 8:00AM GMT*

## CORPORATE PARTICIPANTS

Christoph Barchewitz – Global Fashion Group S.A. – CEO & Member of Management Board
Helen Hickman – Global Fashion Group S.A. – CFO
Saori McKinnon – Global Fashion Group S.A. – Investor Relations & Strategy Manager

## CONFERENCE CALL PARTICIPANTS

Matthew Abraham – Berenberg – Analyst

## PRESENTATION

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

Good morning, everyone, and welcome to Global Fashion Group's Q3 2023 results. I'm Helen Hickman, CFO of GFG. I'm here with our CEO, Christoph Barchewitz, who will join us for Q&A. Today, I'll provide a short summary of our third quarter results and recently updated guidance for full year 2023. After that, we'll open it up for Q&A.

I'll begin with an update on our cost actions. We continued to manage our inventory prudently. At the end of Q3, we reduced our inventory 27% on a constant currency basis compared to a year ago, and have made strong progress on our aged inventory levels, reducing by €12 million since this time last year, now representing 21% of our gross inventory.

Amidst rising customer acquisition costs, we've maintained our disciplined approach and reduced our marketing spend on an absolute basis. In this competitive environment, we're making strategic adjustments to our marketing investments, recognizing the importance of both attracting new customers and fostering stronger relationships with existing ones. To maintain this balance going forward, we are reallocating a portion of our marketing spend from pay performance campaigns to initiatives that develop deeper connections with our customers, in particular on our app.

Lastly, on overhead and capital investments, we continue to take action that will deliver a return to operating cost deleverage as demand recovers. Our Q3 total headcount and tech and admin costs both reduced close to 20% year-over-year. Despite the competing effects of inflation and lower volumes to our bottom line, our completed cost saving actions, and those still underway, will position us for a strong 2024.

Before delving into the numbers, I'd like to update you on our geographic footprint. In early September, we made the decision to close our operations in Argentina. It was challenging to operate there due to multiple factors, including consistently high inflation, restrictive import controls, and the exodus of international brands and vendors. As the business is now classified as a discontinued operation, all of our group results in this presentation, including prior-year comparisons, exclude it.

Dafiti Argentina was relatively small in the Group context, accounting for about 4% of NMV and 3% of revenue in half one this year.

Now moving on to Q3 performance. Cost-of-living pressures escalated across our markets in half one, and we consequently saw further step-downs in consumer spend throughout quarter three. Consumer sentiment remains low, particularly in ANZ, as a result of these periods of high inflation and interest rates. While regional inflation appears to have peaked and interest rates are projected to moderate, our demand is still lagging as disposable income is impacted in the near-term. As a result, our top line figures came in weaker than expected.

In October, we revised our full year guidance to reflect this further slowdown and exclude the Argentinian business. In Q3, we delivered NMV of €284 million, a 19% decline year over year. Our gross margin improved 1.3 percentage points to 42%, supported by increasing Marketplace participation and additional Platform Services revenue. This shows the benefits of having multiple flexible offerings as the growth in these two areas more than offset the pressure on our retail business. Our adjusted EBITDA margin declined 3.6 percentage points due to fixed cost deleverage from lower volumes.

Now let's take a look at our key metrics. Half-one trends continued into Q3 with a decrease in our active customer base of 19%, driven by lower new customer acquisition. Customer declines over the past year have been a result of both our decision to reduce marketing spend and weaker demand, which is particularly challenging for fashion due to its discretionary nature. Order frequency declined marginally at an average of 2.4 times.

NMV was €284 million in the quarter, with the Group's Marketplace share reaching 39% of NMV, gaining eight percentage points from last year, reflecting our continued shift towards a platform business and disciplined inventory investments. Our customers are shopping more cautiously, leading to lower conversion rates and therefore, fewer orders. Our orders were down 26% this quarter. Average order value increased by 9% due to multiple factors, including elevated inflation, lower items per order and mix effects. This partially offsets the direct impact of fewer orders on NMV.

I'll now move on to our financial metrics. Revenue was down 25%, reflecting the reduced demand environment. Our improved gross margin of 42% was offset by fixed cost deleverage, resulting in an adjusted EBITDA margin of negative 9.7%.

Now, turning to our regional performance. All of our regions are now following similar performance trends, with top line figures down and margins benefiting from higher Marketplace share and Platform Services growth. In LATAM, we have seen similar declines each quarter across the year. However, we've been delivering on our investment plan and taking further decisive decisions and actions to streamline the business.

For example, we combined our specialist platform, Kanui for sportswear and Tricae for kids into the main Dafiti platform. Whilst this action has led to a small expected NMV loss, it simplifies our commercial marketing and technology efforts in Brazil to be solely focused on the Dafiti platform.

To execute on LATAM's next phase of its journey, we have appointed a new CEO, Leandro Medeiros, who will join us in a few weeks' time. With 25 years of leadership experience and deep commercial expertise, we're excited to have Leandro execute our investment plan with a fresh focus.

In SEA, gross margin has had the largest step-up of the regions, improving 2.3 percentage points to 40.8%. This improvement was driven by strong expansion of its Marketplace and Platform Services, particularly in operations with large accounts such as H&M and Birkenstock.

In ANZ, the top line decline has accelerated along with worsening consumer sentiment. Despite this external backdrop, ANZ has managed to hold retail margins flat and reduced its aged inventory significantly. This puts the region in a much stronger position going into next year to be well-placed for when economic pressures ease.

Now, let's move to our cash flow for the quarter. The breakdown of our normalized free cash flow is on the left. This is the measure of operational cash invested in the business, excluding funding interest and other non-operating items like exceptional items and one-off tax payments.

In Q3, our adjusted EBITDA loss was €18 million. We had an inflow of €1 million from working capital, which was over €20 million favorable to last year, as a result of disciplined working capital management. We spent €8 million on CapEx, which was 37% less than last year. The majority of this was on technology projects, mainly capitalized payroll.

Other cash flows include operating tax payments and interest on working capital facilities and factoring balances. This resulted in a normalized free cash outflow of €34 million, a €20 million improvement on Q3 last year.

Despite the challenging trading environment, our cash position remains strong, especially after our recent convertible bond repurchases. In August, we successfully repurchased €102 million of our outstanding €280 million convertible bonds at a significant discount. This saved us about €27 million of future principal repayment, reduced our debt load, and ensures we maintain strong liquidity and flexibility going forward. We continue to look for further opportunities to further reduce our outstanding convertible bond liability, whilst balancing our cash needs.

We closed the quarter with €350 million of pro forma cash and €158 million of pro forma net cash. The net position removes the convertible bond liability of which there's now €178 million following our repurchase and other smaller loans.

Finally, the other cash outflow of €8 million on the right hand side mainly includes the reduction of factoring in LATAM as we manage our interest rate expense against higher rates.

I'll now conclude today's presentation by looking at our guidance. Following the decision to close our operations in Argentina and continued pressure on demand as evident in our Q3 results, we announced revised guidance in October. To recap, we now expect a 16% to 18% decrease in NMV year-on-year on a constant currency basis, which equates to around €1.2 billion to €1.3 billion. Revenue is expected to be around €0.8 billion with an adjusted EBITDA margin of negative 9% to negative 7% for the year. CapEx is expected to be about €30 million.

As we look at Q4, our peak trading quarter, we remain cautious amidst weaker customer spend and ongoing market uncertainties. Our upcoming key selling events will provide valuable insight into customer engagement and market dynamics. Despite these challenges, we remain confident in our long-term prospects and are focused on the areas we can control.

We continue to manage our inventory prudently, positioning us for a strong start into 2024. We remain committed to executing our platform strategy and delivering our cost action plans to achieve our path to profitability. We will share an update on our expectations for 2024 at our Q4 and full year results in March.

We'll 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)** The first question comes from Matthew Abraham from Berenberg.

**Matthew Abraham – Berenberg – Analyst**

Good morning, all. Thank you for taking my questions. I might just start with FY24. So that previously provided guidance for breakeven EBITDA in that period, can you just touch on what you think needs to be done to get there and the achievability of that target given the revision of guidance in late October. Thank you.

**Christoph Barchewitz – Global Fashion Group S.A. – CEO**

Sure, Matthew. It's Christoph here, I'll take that to give Helen a breather. I think one thing to be clear, obviously, we give guidance in the formal sense of German Capital Markets rule on an annual basis. And so I would not consider '24 or beyond as guidance per se.

Directionally, you're absolutely correct. We have set out an ambition to get to that level. And as we talked about with the half-one results, we did that with the assumption of being at a similar scale to the business that we had back in '22. So last financial year, clearly with the top line trends being weaker than we had expected coming into this year and also at the middle of the year, this was more challenging to see that recovery to that level of NMV. And therefore, certainly, the goal is more stretched.

We have an ambition of returning the business to positive EBITDA as quickly as we can and I think the action that Helen talked about on the cost side very much goes into that direction. We want to see how November and December trading, which is so critical from a seasonal perspective, goes for us in terms of the customer engagement and also where we end the year from an inventory position to then feel more comfortable about setting targets for '24.

But I would say the overall direction remains and the focus on taking out enough cost of the business to return to adjusted EBITDA, even in a low-growth environment remains, but certainly it's become more challenging to achieve that in '24. And we'll update on our expectations with the full year results on the back of having the peak trading numbers which are literally just ahead of us with 11.11 campaigns actually ongoing in a number of our countries.

**Matthew Abraham – Berenberg – Analyst**

Okay, great. That's really helpful. Yeah. And just on the cost measures as a follow-up. Can you just provide a bit of color as to what part of the cost base you still say that being an ability to remove cost from, and then can you also just talk to the extent to which ongoing cost measures can continue to reduce the operating leverage in the business, so that this weakened demand backdrop doesn't continue to see margin cold weather?

**Christoph Barchewitz – Global Fashion Group S.A. – CEO**

Yeah, I mean, certainly we are looking at costs at every level. And I think we have taken a quite decisive action on this through the course of this year. So this is certainly focused on being very disciplined on the marketing side, which we have been, which hasn't had an impact on our customer base if you've seen the numbers very clearly. But we still feel strongly that we should not loosen our criteria around payback and these types of things despite the customer decline.

We are attacking the fulfillment cost very strongly. And we have done that to some degree with customer policies around minimum order values and things like that. But then obviously also trying to look at renegotiating supplier contracts reducing capacity by giving back space in the fulfillment centers, we have reducing working hours in fulfillment centers, I mean many initiatives around the fulfillment costs to bring that down. There's obviously a big component in the fulfillment cost that is variable. Even there, we are obviously looking at ways of driving efficiency and then we've really gone after the fixed fulfillment cost base.

And then on the admin and tech side, this is also something where we've looked at everything on the tech side, in particular also, on vendors, what software tools we're using, and how we are making that as efficient as possible. And some of these things are ongoing and take a bit of time to implement. And on the admin side, we have taken out costs literally in every area across the group.

So we are going to see an annualization effect of the actions we've taken in the course of this year, but we're not stopping at that. And we're continuing to look at additional opportunities across every part.

And last piece here, since from a managerial perspective, we are very focused on cash. As you know, we've also taken down the CapEx guidance for the year and really constraining, especially the tech spending on that side as well as doing only a minimal level of maintenance CapEx on the PP&E. So I wouldn't exclude any particular aspect from looking at the cost base here and continue to do that into next year given the demand environment that we have seen over the last couple of months.

**Matthew Abraham – Berenberg – Analyst**

Okay. Thank you. I'll pass it on. Cheers.

**(Operator)** It appears there are no further questions from the phone. I'd now like to hand over to the webcast questions. Please go ahead.

**Saori McKinnon – Global Fashion Group S.A. – Investor Relations & Strategy Manager**

First, there are several questions related to the share price and actions we can take to address it, specifically, one about why there are no director dealing purchases of GFG shares. I will hand it over to management to share their views overall on these several topics.

**Christoph Barchewitz – Global Fashion Group S.A. – CEO**

Yeah, I'll take that. Thank you. So we're clearly very frustrated with our share price. No surprise there, and we share that frustration, I think, with many of our shareholders. We think it doesn't reflect the actions that we're taking and the underlying fundamental value and assets that we have as a business when we think about the size of our customer base, the quality of our assortment, and the depth of our brand relationships, a very well-invested infrastructure, and brands that has huge reach in our geographies.

So I think there's a lot that is not being captured there. We are focused on managing our operational and financial performance, as you've heard from Helen. And we believe that as soon as we can report stronger results there, which we are all working hard on achieving, we will hopefully also see a strengthening in the share price.

I think we have also executed shareholder beneficial transactions like the buyback of part of our convertible at a significant discount, which I think demonstrates that we're not only looking at operational measures, but we're also looking at other measures of managing liabilities and protecting and creating shareholder value.

In terms of the directors' dealings, obviously, that's always an individual decision. I think what is true is that all of our management team, not just on the management board, so the Directors, but also the broader executive team are significant shareholders and are being compensated to a meaningful part of their overall compensation with equity. And so I think we're all heavily incentivized to drive an improvement in the share price over the medium term.

**Saori McKinnon – Global Fashion Group S.A. – Investor Relations & Strategy Manager**

The next question is from Volker from Baader Bank. How is the competition evolving? How much impact have Chinese competitors impacted your top-line performance?

**Christoph Barchewitz – Global Fashion Group S.A. – CEO**

Yeah, I'll take a stab at that. I think generally, it is a very competitive environment and the overall market is chasing more limited spending power from consumers and a much more hesitant consumer in our discretionary category. We are seeing the offline and omnichannel players, so department stores, benefiting from continued return to physical retail and also the integration of their online and offline channels working much better than that was the case a couple of years ago. So this is in particular relevant in ANZ.

We continue to see the general merchandise online players do well or at least, we always have one or two leading players in each of the markets that are doing quite well although they have not, I would say in general, increased their focus in our category. And we're also seeing that for many of the bigger brands we work with who are sometimes trying out these platforms, they are not always yielding the expected results because they have huge reach, but the customer doesn't necessarily perceive them as a place to buy branded trend fashion product. Rather, they're buying their general merchandise goods, as you would expect.

We are seeing a stronger presence of the brand.coms in our markets with many brands having built stronger propositions. And we see that more as a partnership than as competition, given that we are providing plenty of services to these brands, in particular in Southeast Asia. And clearly, we are looking to be a more important service provider to these brands also in the other geographies.

Then cross border, you mentioned, I think the Asian competitors, we are seeing those with a strong presence in many markets, especially where they are benefiting from a unlevel playing field, i.e., a playing field favoring them because of taxation, be it VAT or import duties or postal rates. So this is a significant competition but it is at a much lower price point, which certainly in the current environment is very attractive to the customer. So we continue to see that.

We also see increasing regulatory activity around that. One example that I think made quite a bit of headlines is TikTok being effectively banned in Indonesia from selling on their social media app. So the Indonesian regulator decided that social media apps cannot be e-commerce apps at the same time. So either it's a social media business or an e-commerce business.

So I think you'll see more of these types of regulatory events happening in different markets for different reasons, but generally with the direction of leveling the playing field for all e-commerce players. And we certainly welcome fair and level playing field competition.

So it's an area to continue to watch. We are focused on our differentiation as a house of brands with the best global and local brands, and I think we are in a good position to defend that, because most of the cross-border players are obviously offering unbranded, very low price point products, mainly, directly from Chinese factories.

**Saori McKinnon – Global Fashion Group S.A. – Investor Relations & Strategy Manager**

The next question is from Michael Neises – is management confident that the remaining net cash will be sufficient to run the business and to reach cash positive free cash flow despite past bond repurchases and any potential further repurchases?

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

Thanks. I'll take that. So yes, we're confident we can fully repay the bond. We've got a very strong balance sheet. We've closed the quarter with €350 million of pro forma cash and our net cash position is €158 million. We have a plan that we're driving towards, free cash flow breakeven in the future. So we don't foresee any funding gap, but obviously, we're actively managing and monitoring our position. Thank you.

**Saori McKinnon – Global Fashion Group S.A. – Investor Relations & Strategy Manager**

There are no further questions on the webcast. So thank you all for joining today. If you have any further questions, please do reach out to the Investor Relations team directly.