



**Transcript**

# **Mister Spex Q3 2022 Conference Call**

37 min

10 November 2022



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# PRESENTATION

## 00:02 Operator

Dear Ladies and gentlemen, welcome to the Mister Spex Q3 2022 conference call. At our customer's request, this conference will be recorded. As a reminder, all participants will be in a listen-only mode. After the presentation, there will be an opportunity to ask questions via the telephone lines. If any participant has difficulties hearing the conference, please press \* followed by 0 on your telephone for operator assistance. May I now hand you over to Dirk Graber, founder and co-CEO of Mister Spex, who will lead you through this conference? Please go ahead.

## 00:35 Dirk Graber

Dear all, thank you for participating in this Q3 2022 results calls of Mister Spex. I will do this call jointly together with my colleague, Mirko Caspar, who will also start with the first part of the presentation and lead you through an executive summary but also strategic updates on our "Lean 4 Leverage" program. And I will run you through the Q3 numbers, and also followed by a Q&A. So over to Mirko.

## 01:06 Mirko Caspar

Right. Thank you, Dirk, and welcome, everyone, to the Q3 results.

So, what do we have? We have a strong set of results in a very challenging environment as Consumer is more and more coming under pressure. So, if you look at the numbers, what we told you is Q2 we observed to some extent in Q3, and that is the postponed prescription glasses purchasing that came back to us in Q3. A 16% growth in prescription glasses and a strong growth in sunglasses, 36% growth, led to an overall growth of 18% in the third quarter.

So, very good results in a challenging environment there. The other thing I want to want to highlight is, we told you last quarter that we announced our Lean 4 Leverage program. And the first impacts of the program can already be seen, especially the one from the measures that are more market-facing and can have an immediate effect. And we'll get to that in a second. And the third thing I want to highlight is the high accessible liquidity of €144 million. That is not only a great cushion, strategically, but also, through our active liquidity management, is a measure to actually reap positive results on interest rates.

So, very positive results in the quarter. However, headwinds are getting stronger. We already see a more challenging environment in Q4, and one has to probably say, an even more challenging environment in Q4, with inflation reaching record highs and consumer confidence reaching record lows, which is putting pressure on consumer buying intent. On the positive side – and we see that in a number of things throughout the presentation – the combination of the data-driven recommendations that we offer, the differentiated premium and boutique assortments, and the full-hearted omni channel approach is clearly the most resilient and future-proof model in the industry. And you will see the benefits from those strategic success factors really come to life also in 2023.

So let's look at our Lean 4 Leverage program. And we told you in August, we have adopted a proactive approach reflected in careful adjustments to drive profitability and growth. And the efficiency program is fully on track. And it's starting to bear fruits. And I remind you, the three pillars are to concentrate on the core, to optimize price mix and product margins for greater gross profit, and thirdly, to increase our operational leverage through structural measures. And let's look at them one by one.



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Concentrate on the core. What do we mean? The first thing is concentrate on the countries where we have the strongest brand equity that we can use as leverage and concentrate on the territories where we can play out our strengths. And the other thing is that we want to focus on the core capabilities, so we can reap the benefits already. So let's look at the area and the country initiatives. The first thing is that you will notice if you also look into the numbers is that we shifted marketing significantly into the DACH region. And you see eight percentage points less marketing spend in international and you see a significant absolute marketing spend in Germany and also the DACH region as a total. That leads to significantly higher growth in the region than in international, but with a better profitability profile in total.

So, the other thing I want to highlight is the productivity increases in retail. If you have lower demand, and also shift in demand within a quarter, it's very important to balance the staffing according to the demand curves and then develop new tooling. And as the tooling is learning, we are significantly better able to staff to demand. The other thing is that, if you have a low-demand season, minimum staffing levels are actually becoming critical to manage. I mean, we need to have one optician in the store; we need to have one on the floor. So you have six days a week, so that's already probably three people that you need. Long story short, what we've done is we've clustered local areas where we have predefined staffing mechanisms to be able to decrease minimum staffing levels on individual store level. And the benefit of the shift is focus into the high-profitability countries, on the one hand side, and the other is the ability to shift resources in retail significantly more productively... are the most important levers on the left-hand side.

The other thing is the core capability that we've significantly focused on was the data-driven customer experience. Now, leveraging this vast consumer data that we have – and mind you, we have the largest pool of digital consumers in Europe – we were able to match with the product technology and roll out a new recommendation algorithm. We rolled that out to roughly a little over 25% of existing customers to test it. And what we saw is the following. The first thing is that conversion rate went up 20%. So, people were able to find glasses that, obviously, looked like they would fit better. But the question is, did they actually fit better? And that is when we look at the home trial. When people then start ordering [inaudible] to their home, it's very important for us that they find one that really perfectly fits. And there, we also see a significant improvement in the home trial follow-up orders. So, long story short, we really saw that improvement through core metrics, through our new technology, which is a significant step forward.

All right. Let's look at the second pillar of our Lean 4 Leverage. And that is basically improving the margin side of the business. And that is composed of a) higher marketing spend, effectively, b) our focus on the most value-creating assortments and segments in our offering, and c) I would call it simply smart pricing.

So, let's look at the first one. We not only shifted marketing into territories where we saw a better return on investment. Within those territories, we also made – I would call it – significant shifts in channel mix to reduce the cost per visit by 7%, and in total, reduce the marketing spend in the quarter by 230 bps.

The second thing is the focus on the most valuable segments in the assortment. And there's the one thing we invested significantly in our own brand assortment, with 200 new SKUs in the quarter, but I want to highlight specially the boutique assortment. What we saw is a 61% growth in the segment in Q3. And that is where we really show the continued effort that we've been talking about for years now, really, to say, "This is where we can be differentiated. This is where we can really offer a special assortment in a way to purchase that is completely unique and new."

And the third thing is the smart pricing, where the first one is, when demand drops you're inclined to just counterbalance that with discounts. And obviously, we also did. But where we went significantly further is in targeting those in Q3. And that means, bluntly speaking, not putting 20% off on the webpage, but rather supporting parts of these stores locally, having different consumer segments that we target through our CRM newsletters to bring down the discount rate, which we did. And the other thing is that is very promising is that we continually increased prices. You see that in the AOV profiles that go up in all three product categories. And mind you, the continuous increase in prices in AOVs came with an 18% growth.

Okay. Let's look at the last column of our Lean 4 Leverage program, which are the structural changes. They have all been implemented. And you will see the benefits of those measures coming in Q4, but they will help us significantly to reduce



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cash burn in 2023 in the total yield and it's a major step on our path to free cash flow breakeven that we are pursuing with much more vividness, I would call it. And so, we're very well on our way in our Learn 4 Leverage program. And I will now hand over to Dirk to run you through the numbers.

### 10:46 Dirk Graber

Thank you, Mirko, for your view on the strategic initiatives. And now let's get into the numbers.

So, as you've seen, net revenue grew to €58 million versus €49 million in Q3 last year. And so, that's a very robust development on the revenue side. And it's also supported in terms of our retail stores by a 5% increase in number of visitors quarter over quarter, so it shows a good recovery in the retail space during Q3. Gross profit is up 110 basis points versus Q3 last year, to 47.1. So, here we see more favorable product mix that is also driven by an increasing share of our boutique segment.

We confirm the guidance for 2022, and we see that, in this very difficult market environment, we continue to win market share.

So now, let's look a little bit more into the details. Revenue overall grew by 18%. We already know that, but it's driven by all categories, so all categories are growing. Overproportionally contributing are our sunglasses, which also includes prescription sunglasses at Mister Spex. And what is important for our business is that the prescription glass business accelerated again. It came from 2% growth in Q2 and now is up to 16% in Q3. If we look, basically, into the sunglass category, as I said, it includes prescription sunglasses, where we saw a 40% increase in growth, so even overproportionate growth within the sunglass category. We also added four new stores in Q3 to end the quarter with 64 stores. If we look at the nine months figures, it's now an 11% growth overall on top line, where we see, because of the higher growth in Q3 now, an increasing growth rate for prescription. But overall, the yield, basically, is very strong in sunglasses, as we already talked about.

So now, segment reporting. Mirko already spoke about Lean 4 Leverage. And we mentioned that we will focus, or we already did focus, our marketing spend more on the DACH region. And that's also reflected in our segments. We see a very strong performance in Germany, with 22% growth, and that is coming basically from online but also from our retail stores. We see that the prescription share in our German core business is now over 40% in Q3, and growing 17%. And what we see is that the like-for-like panel of our retail stores, which includes all stores from 2016 to 2020, is growing by 13% like for like. So it's a very solid underlying fundamental here as well. International, we reduced marketing spend, and therefore growth is at 9% in Q3.

So let me also use the opportunity to illustrate a little bit more the operational leverage we talked about also in Q2. When you look by segment, we see Germany provides a gross margin of 49%, versus the national of 44%. The German higher gross margin is also driven by a higher share of prescription. We see then a variable cost of 23% in the German business. I may remind you or explain what variable cost includes. It includes, in the online segment, all the procurements costs, the warehouse costs from our service payment especially. And for our retail stores, we also include our HR staff because we consider them, at least in the midterm, always variable, because we adjust to the demand levels. And therefore, also the variable cost in the German business today, because of the higher number of stores, is higher than international. So, if you then look into marketing, 10%, that is also reflected in our Lean 4 Leverage strategy and focused to the German business. Because you see, we are more efficient in terms of marketing in the German business, because the brand is already there at 70% brand awareness, including over 60 stores. And therefore, we see a higher contribution margin for overheads in our German business. And that's why we focus on that. That's a quite healthy margin, but we want to continue to increase this also in the future.



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So, international, as I said already, gross profit is slightly lower because of the product mix. But since the majority of the business is fully online, variable costs are slightly lower than that, but higher marketing cost. And therefore, contribution is at 13% and is also step by step improving over time.

So now, if we turn to the group level, we see that we increased our profit margin by 110% basis points. You see that personnel cost goes up by 240. And at the same time, the marketing spend goes up 230 basis points. Why is personnel costs going up? Because we opened 20 retail stores versus Q3 2021. And at the same time, because of the higher number of retail stores, we also have been able to optimize the marketing spent, not only because we spent significantly less for our retail stores, but also because we optimized and shifted to the segment Germany, where we see a higher marketing efficiency. And other operating expenses are down by 4.7%. In Q3 2021, there was still a number of IPO-related fees in the other operating expenses. Therefore, we are now at 16.9% of total sales, getting to an EBITDA of -3.2% and an adjusted EBITDA of -1% in Q3, and a very similar look for the nine months figures there.

And now, let's go to our guidance. We confirm, as I already mentioned, our guidance, with 7% to 12% revenue growth in 2022 for the full year, and an adjusted EBITDA margin of -6% to -3%.

Now, before we go to Q&A, let me point out again that I think these Q3 results really show that we have a very strong position in the market, especially when you look at our omni channel business model that really offers customers a number of ways to get in touch with us, but also to purchase at Mister Spex. And I think that has been the winning model over the last years, where we've seen different, I would say, external effects in the market. And we continue to outgrow the market and gain market share even in these difficult times. At the same time, we realized we need to manage our costs more carefully and focus the business. Therefore, we initiated our Lean 4 Leverage program and we see the first encouraging results. But we also know that we need to take further steps and we are doing so in the next months.

So therefore, we are very confident in our strategy. It's right on spot what we think is right in this situation, but also for us as a company and to create value for our shareholders, not only in the short term, but really in the long term. So having said that, let's move to Q&A. And over with you.



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## Q&A

### 20:03 Operator

Thank you. We will now begin our question-and-answer session. If you have a question for our speakers, please dial 01 on your telephone keypad now to enter the queue. Once your name has been announced, you can ask a question. If you find your question is answered before it is your turn to speak, you can dial 02 to cancel your question. If you're using speaker equipment today, please lift the handset before making your selection. One moment, please, for the first question.

The first question comes from Graham Renwick at Berenberg.

### 20:38 Graham Renwick (Berenberg)

Hello. Good morning, everyone. Thanks for taking my questions. I have three. Just firstly on current trading, obviously some great momentum in Q3. I just wondered how sales growth has developed through October and November so far, and also sort of comparing sunglasses versus optical. I know that some of your peers, Hillman and [inaudible] both called out weaker optical trends into Q4. So, just wondering what you're seeing there.

And second question, just given your focus on the profitability and rising cash burn, how should we think about sales growth over the next few years? Is it a case that we should no longer necessarily expect 20%+ growth in the next few years? Maybe it could be more 10% growth, and actually, the emphasis is more on getting the business to sustainable profitability before you start to accelerate again. Just trying to think about how we should think about the next few years.

And lastly, you've talked about the Lean 4 Leverage plan. That's going to significantly reduce your cash burn in 23. When do you aim to get to free cash flow breakeven? Thank you.

### 21:59 Dirk Graber

Sure. Thank you, Graham. So, on current trading, I think we also see, I would say, a very challenging market environment continuing. Especially when you look at GFK data, -10% in July and August, I assume that's going to continue also for the rest of the year for the German optical market. Therefore, I would say we are also cautious in terms of outlook for the rest of the year. We, I think, see all these trends. And therefore, it's, I would say, in this volatile environment, also hard to basically predict full year trading numbers. And therefore, it's quite a wide range so far. And we will need to observe the next weeks and months and also do very diligent work on them. Again, also in Q4, for our business model, Black Friday and all sales campaigns around it play a quite significant role. And it's just ahead of us. So it's too early to comment on trading for Q4. But yes, I think, the overall market sentiment, we're also exposed to that.

Maybe on sales growth for next years, I think, as we also pointed out in the Q2 presentation, we see that the market environment overall, and especially consumer sentiment, is still sort of deteriorating, at least if we look at the GFK numbers. And therefore, at the moment, we are focusing more on profitability and free cash flow, so may sacrifice, basically, growth for that. Because at the moment it is, in our experience, not very efficient from a profitability and cash flow perspective to try to outspend the market at the moment on the marketing side, if consumers are not buying anyway. So therefore, we, at least for 2023, have a more cautious outlook. And in terms of growth, I also said that we are pushing for more growth if we see that the consumer sentiment and the overall market is turning to a significantly better oval shape. And at the same time, we are using the time to basically get all processes and cost structures in place to be more efficient.

And that also leads, basically, to the last question you asked, Graham, on free cash flow or breakeven. I think I mentioned in the last call that our initial moment was 2026. And we want to get this or see that moment significantly earlier. We are



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at the moment in final budget discussions for 2023 first, and I think we do expect a significant reduction in negative free cash flow next year, and to continue that also in the outer years, too. I would say, in an ambitious case, we will get to free cash flow positivity during 2024.

### **26:03 Graham Renwick**

Okay, thank you. That's great. And just on the free cash flow being potentially positive by 2024, is that before leases or post leases?

### **26:15 Dirk Graber**

That should include leases.

### **26:18 Graham Renwick**

Okay, fantastic. Thanks a lot.

### **26:22 Operator**

The next questions come from Cedric Rossi at Bryan Garnier.

### **26:30 Cedric Rossi (Bryan Garnier)**

Good morning, everyone. I have two questions. The first one is just a follow-up on Graham's questions regarding the current trading. So I assume that you cannot really give us any color on the current trading, but how do you see the gross margin evolving in Q4, considering that last year you had a challenging you had actually-- you're going to have a challenging comparison between glasses and contact lenses this year? So I assume that prescription should probably grow a bit faster than the two other categories. So in other words, a favorable category in Q4.

My second question is regarding the current pricing [strategy?]. So, Mirko, you mentioned some price increases this year. Are you satisfied with the current price strategy, or do you plan any additional price increases next year, considering that Hillman is trying to maintain stable prices?

And my second question is regarding the AOV. So, we see a good increase in Q3. Could you give the breakdown between prescription and sunglasses, and also the contribution of your boutique share? Do you think that it was a main driver of the gross interest rate? Thank you.

### **27:54 Dirk Graber**

Thank you, Cedric. So I might first comment on the pricing strategy and the price increases we talked about this year, but also potential further actions in 2023. And then I might comment on gross margin, but also do the AOV.



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### **28:17 Mirko Caspar**

We are happy with the progress so far. Dirk is going to give you the numbers on the AOV in a second, but we will continue to push carefully. So that's what we're working on, to push AOV and gross margin a little further. If you compare that to the overall pricing level in the market, the combined offer of framed and lens packages that we have in the market currently is significantly better than that of the major competition. So we do believe that the saving for the consumer, we do believe we can reduce that a little bit. We still have a fantastically attractive offer and the preferred offer in the market. So we think that we can squeeze it a bit more. And we'll continue to do so in Q4. Hopefully, that will be resulting in a better gross margin in those categories. We see that, actually, in the end of Q3. We go out of Q3 with stronger gross margins across all three product categories and we entered in Q3 partly as a result of the Lean 4 Leverage. So yes, we continue.

### **29:43 Dirk Graber**

And now let's look at the AOVs. So, the overall AOV – I think that's in the document on the website – increased by 2%. But I think more importantly is this split in the categories. And so, prescription glasses continued to increase in AOV by 2%, to around €150. And sunglasses also increased 1% to around €100. That's always net; obviously consumers need to pay VAT on top of that. And also, I think, in multifocal share, we see basically a steady constant increase in our numbers over the years. Obviously, that's one driver, is that the further retail expansion and the higher share of multifocal, but the overall increase in share, even in the online segments, step by step, it's a gradual process.

And then the first question, coming back to the gross margins in Q4. So, Mirko already explained you we are working in our Lean 4 Leverage program with likely increased prices, but also reduced discounts. That leads to higher gross margins. But we need to balance that, I would say, wisely, to not kill growth too much. So it's a balance that we need to manage. And I would say, as of now, we see slightly increased gross margins in Q4 versus last year.

### **31:48 Cedric Rossi**

Okay, very good. Many thanks.

### **31:53 Operator**

Again, as a reminder, if you have a question for our speakers, please press 01 to enter the queue now.

The next question is coming from Alexander Thiel at Jefferies.

### **32:05 Alexander Thiel (Jefferies)**

Hi. Good morning, Dirk and Mirko. A couple of points left from my side. The first one is on your omni channel business model. Could you shed some light on how much revenue is contributed from the online side versus brick and mortar stores and the difference you see in the growth rates there? Thank you.





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### **32:23 Dirk Graber**

So, what we shared in the presentation was that our retail stores on a like-for-like basis increased 13% in like-for-like growth in Q3. And so the retail share overall is slightly increasing versus last year, but we don't disclose the split in more detail yet.

### **32:59 Alexander Thiel**

Okay. My second one is on your profitability guidance for full year '22. You're currently at the low end of your guidance after the first nine months. How should we think about your mindset going into Q4, as the market is already giving you kind of a free pass to increase marketing spending? And also, on the positive effects that we have seen in Q3, are there any changes expected for Q4 on the adjusted EBITDA side?

### **33:28 Dirk Graber**

So, as we explained, we continue our strategy and also execute further on the Lean 4 Leverage program. And I also explained that we need to balance, basically, very diligently the increase in profitability versus the growth path that we are on. So, so far, I would say we see an environment which is not very easy. And in terms of the guidance itself, at the moment, I would say that on the EBITDA side we're probably in the middle of the range for the full year.

### **34:21 Alexander Thiel**

Okay, perfect. And my last one would be on current trading. Usually Q4 is the highest share of prescription contribution in the sales mix. Is this something that you already see now in Q4 in the first couple of weeks? Thank you.

### **34:40 Mirko Caspar**

It's actually very hard to say. I mean, what we saw in October is what other players in the market have already communicated. October was muted in terms of demand, but we do see a slight shift in the first days of November. And that might mean that people have been holding off in October, knowing that, in November, Black Friday is going to come at one point in time, which would be sensible to do so if you go into a hard winter. So, actually, starting slow, picking up in November. It's almost impossible to say if we see a significant change in the next eight weeks. Roughly, we go into another challenging quarter that is not fundamentally different in the difficulties that we have seen. It may be a little bit more difficult, but long story short, it's really hard to tell.

### **35:40 Alexander Thiel**

Understood. Thank you.

### **35:44 Operator**

There are no further questions waiting at the moment. For closing remarks, I hand back to Dirk Graber.



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### **35:51 Dirk Graber**

So thank you, everybody, to take the time to attend this call. And thank you also for the questions. I'm happy to stay in contact. If you have any further questions, please reach out to Irina (Head of Investor Relations), who is there in case of questions. And talk to you during the next presentation. Thank you.

### **36:17 Operator**

Ladies and gentlemen, thank you for your attendance. This call has been concluded. You may disconnect.