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Mister Spex Full-Year 2022 Results Presentation

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PRESENTATION

00:03 Operator

Dear ladies and gentlemen, welcome to the full-year 2022 results presentation. At our customer's request, this conference will be recorded. As a reminder, all participants will be in listen-only mode. After the presentation, there will be an opportunity to ask questions. May I now hand over to Irina Zhurba, who will lead you through this conference? Please go ahead.

00:22 Irina Zhurba

Hi. Good morning, everyone, and welcome to our 2022 results. The presentation will last approximately 30 min and then we will allow 20- 30 minutes for the Q&A. The speakers today are Dirk Graber, the founder and co-CEO of Mister Spex, and Mirko Caspar, the co-CEO of Mister Spex. That said, let me hand over to Dirk. Thank you.

00:48 Dirk Graber

Thank you, Irina, for the introduction. A welcome also from my side. As Irina already said, today, Mirko and I will give you the presentation. We are going to start with a review of 2022, especially looking at industry development, market trends, followed by a strategic update on our brand promise, but also our Lean 4 Leverage program. And then we are going to look into the financial update for 2022, followed by the guidance, and then finishing the call, basically, moving to a Q&A session afterwards. But having said that, handing over to Mirko for the first part of the presentation.

01:37 Dr. Mirko Caspar

All right. Thanks, Dirk. Good morning also from my side. We saw a year of consumer confidence so low, it was really unseen. That led to a market that was shrinking by 2%, which is rather rare in the more resilient and defensive market of optical. On the other hand, we continued to gain market share. So far, come rain, come shine, we've been very, very resilient to with our business model, and we did grow 8% last year. So let's have a closer look.

Consumer sentiment, I mentioned it. I mean, we're going back here on the left-hand side to '19, just to show you. Usually, consumer sentiment is actually positive, even if it's on a low level. And then we've seen consumer sentiment degrade and decline over the years, but last year was really an enormous outlier. The deterioration continued and we saw historic record lows in Q4 2022. That did have an impact on the otherwise very resilient optical market. And you saw it: -2.4% in sales in optical in Germany, and actually -6.7% in numbers of prescription glasses sold. Why? Because consumers adopted a wait-and-see behavior. They postponed purchases, and it was not an easy situation.

Now, how do you interpret that in our performance? I've said before we have been very resilient, come rain or come shine. But let's look back at 2019, when the optical industry was performing, I would say, normal. We've seen those 2% to 3% growth rates over decades, really. And you clearly see we have been outperforming in those two-month slides across the year. And those two-month slides are from the GfK, the consumer research agency in Germany. And now, on the right-hand side, you see the market as it developed last year. There was a catch-up in the first two months, but then the market was really going down. And what you'll also see is that after the first four months, when we needed to recalibrate, we have been outperforming the market again in every each individual two-months slice.

So that's basically how the market developed and how we have performed versus the market. And as you have seen, 2022 was heavily impacted by external forces. And we responded with our like-for-like program to carefully and selectively adjust for more profitability—and Dirk will tell you more about that. Nevertheless, our brand promise stands strong, and we continue to be guided by it strategically. So let's look at the brand promise one more time and then double-click on the individual components.

So, basically, we promise the **perfect frame for every face and the perfect lens for every eye**. And we do that with ease, style, and expertise. And that's what sets us apart from the competition. So if we look and double-click on **style**, what do we mean? So we have actually added quite a bit of style in the fashionable segment. We've added 11 new brands in 2022. That gets us to 170 brands overall. For our own brands, we had more than 17 collaborations with celebrities, influencers, designers, etc. And that is what really drives our promise. And we have been talking about our efforts in luxury and independent for quite a while because we do see a wide and big opportunity in the European market, because none of the big retail chains is really focusing on that segment.

And let's now look at some numbers. We grew 38% in the boutiques section last year, and it represents by now 19% of our prescription glasses and sunglasses sales. And if you look a little closer, with 47% growth, and then anyway very strong sunglasses here, you see where the growth came from: primarily from boutique, where we grew 47%. And the sheer boutique assortment is already 25% of that category. And we continue to see strong growth from boutique. The other thing is in prescription, which had a more muted growth path last year. Still, boutique was growing 28% and makes up 15% of the total sales in prescription glasses by now.

So, long story short, we see significant benefits showing up from our boutique strategy. And we are doubling down on it under ‘Others’ with the flagship store that we opened in Cologne. The aim and the objective of this store is to, on one hand, create a fantastic new omnichannel experience and another touch point, but it also helps us to acquire a new brand. And it's a fantastic platform for us to acquire some brands, to shine, and for us to engage with them. And let's have a closer look at that store. We're talking about 400 m^2 in one of the most frequented shopping streets in Europe, Schildergasse in Cologne. We have the second floor, and you see that on the lower right-hand corner. The second floor is completely dedicated to boutique brands. We're talking about 30 luxury and independent brands, with more than 700 SKUs on that floor alone. And then what we see is already more than 30% of the purchases being made in that store are from the boutique section. People are learning it or picking it up. And it's really a fantastic touchpoint to engage with those brands. And we do get a really strong feedback from our suppliers that have already helped us to acquire new brands through that store experience.

Now, let's look at the other part of the triangle, the **expertise**. We see a significant growth opportunity for us in optical expertise. If you look at the market, 70% of the revenue is really made by lenses. And historically we have been coming more from the frames side, and we have been consistently growing the share of lens revenue over the years to now 40%. But we do believe that there is significant opportunity for further growth from that segment. And if you look at our 20 more stores last year, 18% more online eye exams, with the pure online refraction and, and more lens options that we added. We grew the lens part of the business, the lens revenue, by 14%. And the very focal part of the business we grew by 24%. You see that that is leading and driving our growth going forward.

And last but not least, **ease**. Also the flagship store, the way it is designed, delivers – obviously – the lightness of a shopping experience, the ease of a shopping experience. But for us, fundamentally, the data and technology side of things is of very high importance. So, jointly with the Tribe team that we acquired a while ago and our own data team that have been now migrated and merged, we've developed a new recommendation algorithm, a) for existing customers, 38% of existing customers last year. We are at 50% share until end of March. And what we see is a significant decrease in returns, 300 bps lower return rates. What we also see is a significantly higher conversion on the home trials, 100 bps, and it does show and trickle down, really, to the bottom line. On the other hand, b) for new customers, we're using the face scan technology to be able to assess the width, the nose, etc., to be able to recommend. And we are using that technology by now in a couple of stores to also sell 3D-printed frames. We've been talking about that for quite a while. It's been live now in, I believe, three stores as of today, and we are rolling it out further. And we get very, very positive feedback on the customer frames, but also on the recommendation that we are giving based on that technology. Now over to Dirk, who is going to tell you a little more on the Lean 4 Leverage and the impact that it has on our numbers.

11:54 Dirk Graber

Okay, all right. Hopefully you can hear me now. So thank you, Mirko, for the introduction. Maybe before we go into the details of **Lean 4 Leverage**, just zooming out a little bit, why did we do that? And why did we initiate this program? We started the year, I would say, coming out of COVID with a quite good rebound in the industry and some positive hopes for 2023. As all of you know, the Ukraine war starting end of February has led to a significant reduction in consumer confidence, as Mirko already elaborated, and also followed by a quite significant increase in inflation. So, to actively manage our cost base and to focus on the bottom line, we decided, basically, to put this program in place beginning of September.

So, it consists of three pillars. One is to really **concentrate on the core**, so the profitable or the very long-developed business in the German market, and to focus on this omnichannel in this country. So, therefore, we have seen a good like-for-like growth in 2022 for our existing stores. So the 2016 to 2020 cohort grew by 20%. And we will see a little bit more detail later on here as well. We also focused on further flexibilization of our workforce, especially in the stores. Why? We see, obviously, a significant traffic peak on Fridays and Saturdays. And to cater that with more employees, we moved to a significant part time in employees moving from 30% to 40%. And also, to manage costs and risk, we increased the fixed-term contracts up to 20% by the end of the year. A third part in that program is that we focus on new staffing tools and incentivization models. We took that live in Q1 this year, but we obviously did most of the work in ’22 on these programs.

So, the second pillar of our Lean 4 Leverage program is to focus on **price optimization, product mix, and margin**. Here, we've seen already good progress. I will show you some more details on the next slide in terms of improving gross margins for our products. We also optimized marketing spent throughout the year, reducing the marketing spend versus 2021 for the full company by 60 basis points. And we reduced significantly discounts starting September. So there was a small impact already seen in Q3, but a more significant one in Q4, also then leading to better gross margins in the individual product categories. And we also did some strategic pricing actions to drive up our average order values across the categories. As you all know, I would say we have a very attractive price positioning compared to all our competitors. So we decided to, step by step, increase pricing for prescription lenses – Mirko mentioned that – still being the most attractive, I would say, player in Germany when it comes to price, if you compare apples to apples. Nevertheless, price is not the only USP for Mister Spex. And therefore, we've increased the assortment and have a very, very attractive customer value proposition. And therefore, we believe that we can slightly lower the delta towards large competitors in the market in terms of price.

And third bucket is really focusing on **overhead costs** and reducing them, especially in percent of sales. So, as you already know, we reduced our headcount in the headquarters starting September by 8%, on a comparison basis, versus the year before. And so we continue to do so as well.

So now, looking into some of the improvements that we've seen, and especially on the price development and margin management. When you look at prescription glasses on the left-hand side and sunglasses on the right-hand side, this is always on a quarterly basis, comparing the average order value and the gross profit margin for our German business. And what you see is that we've significantly increased the average order value in the second half of the year, followed by a flat first half. Remember, September, we started at 5%. We’ve already seen AOV going up for prescription glasses in the third quarter. And in the fourth quarter, it was even 10% For sunglasses, this impact was even bigger in the fourth quarter, going up by 13% AOV. And that also is reflected, then, in the gross margin, allowing us to compensate some of the cost increases in the lower part of the P&L, to recover them by higher gross margins. And in the first half, we've seen even declining gross margins in a very competitive market environment. But then, with the active decision to go for more attractive unit economics, we've seen, I would say, a transition quarter in Q3 and then significant improvements in Q4.

So, looking ahead a little bit for **Lean 4 Leverage**, what does it mean for 2023? I think we've seen first good results in the last quarter of 2022 in terms of structural development of our P&L, but we are by far not done yet. So there's significantly more potential to grab. And that's what we're doing in 2023. And we also see already further positive results in the first quarter of 2023.

So what does it mean, on the left-hand side, **concentrate on the core**? It's really focusing on the rationalization of our stock portfolio. That means we don't shy away from closing down individual stores if they don't have the potential to become profitable. I mean, we are only talking about a very low single-digit number. But nevertheless, I think that's something where we committed to. On the other hand, we do plan to open new stores as well. And the second, maybe, highlight on the left-hand side is really the focus on store training programs and more experienced opticians that we're hiring at the moment for our retail stores. On the middle column on the **margin optimization**, it's really continue to improve the marketing spent and to further work on the margin by lowering discounts and, step by step, improving price points as well. And on the right-hand side, it's really continued **cost optimization** and corporate overhead. And we also initiated an operational excellence program for our warehousing customer service.

So now, looking at the financials for 2022. Mirko already mentioned a very tough market environment with -2% in the German market. We grew by 8%, which makes us proud that we gained market share again. And looking at our retail stores, we've seen, on a comparison basis, a good recovery from a 2021 COVID-impacted year but also a good development, I would say, from our initiatives by 20% like-for-like growth. Breaking it down into different unit drivers, we've seen that the active customer base grew by 2% last year, although we saw a muted demand in the overall market. We've seen orders going up by 4%. And on a full year basis, average order value is going up 5%.

So, looking into the **categories,** I would say 2022 was clearly the time for sunglasses to shine. So we grew by 19%; it's 28% of sales. And always be reminded that this category also includes prescription sunglasses, which even grew overproportionally to the total category. And the AOV for the full year went up 2%. Prescription glasses, I would say, was impacted by the muted demand, but we still grew by 5%. And we saw a good catch-up effect in Q3, with a strong growth and improving unit economics. It also was supported by 20 new stores and an increasing average order value for the full year by 4%. Contact lenses, we saw a mixed development. First half, good growth rates. Once we decided to move to higher margins and higher impact on bottom line – and this was deliberate, basically, a deliberate decision by management – we saw less revenue in the second half, but higher margin or higher profits from the lower revenue base than compared to the higher revenue base earlier in the year.

Looking at that slide, it really, I think, demonstrates our passion for **omnichannel** and our path going forward. The share of retail or store revenue increased as planned, and also in line with our strategic ambitions, step by step, quarter by quarter. On the right-hand side, I think a few key indicators that we really have a unique business model, and this is valued by customers. So 25% of our online sales have some kind of store touch point. This can be an eye test. This can be returns. It can be, basically, a visit in a store to test a pair of frames, and then you basically order later on from home. Also, 20% of our prescription customers have already used both channels for their orders. And if you look, then, into regions with stores in Germany – which are quite a lot because, end of the year, we already had 60 stores in the German market – you see that 40% are still bought purely online, 30% of customers have bought in retail, but 30% of the orders are already coming from customers that use both channels. And since we have a lot of new customers, you obviously see, always, a migration towards the middle, so towards an omnichannel behavior. And as I said, that's clearly unique, and that speaks for the value proposition of Mister Spex.

Now looking a little bit into **categories,** I think we mentioned most of that already. For the full year, we saw prescription growing by 5%, sunglasses 19%, and contact lenses by 5%. Boutique – Mirko already mentioned it – with our unique assortment and passion for that part of the assortment, sales increased by 38% across the categories, accounting now for 13% of the group sales. And our own brands increased by 4%, accounting for 15%. Both assortment parts are really something that differentiates us and that gives us a very attractive positioning on the consumer side.

Part of the Lean 4 Leverage was focusing on the core. So the **German business** grew 11% last year, and the **International business** grew by 1%. This is something which we managed on purpose like that. We significantly scaled back the marketing spend in our international countries by 300 bps, especially driven in the second half. And that also led to a below-average revenue development, while on the German business, where we see obviously a significantly higher return of investment for marketing because of the high brand awareness that we've already built, we've seen a solid 11% growth in 2022.

Now, let's look a little bit into our **store model**. So stores, in general retail, didn't have an easy time during COVID. In 2021, and also beginning of 2022, a lot of retail companies did struggle in retail. Cohort stores, I would say, returned to a healthy model. And so what we've seen is that, over the time, we see through our store cohorts, 2016 to 2020 – for 2020 is the one that we already opened during COVID – a confirmation of our existing store model. Year 1, just a reminder here, this is on average. Stores are open six months during the first year, because we are opening them throughout the year, so on average six months open. So we see a good step-by-step development also in the outer years, which is giving us a lot of confidence that, in the long run, all our stores will have a very attractive P&L structure. And on the right-hand side, you see that we are still break-even in the first full year of operations, and also increasing the forward EBITDA. So that's always including the rent of the store to a very healthy level over the years. Maybe, here, just a comment: obviously, Year 1 to Year 3 are impacted by COVID, and therefore are, I would say, slightly lower than in our initial store model. But we aim basically to increase the number again, given the current development.

So I think what's very positive is that all our **store cohorts are contributing to like-for-like growth**. As I mentioned before, we saw on a comparable basis a 20% revenue growth. And this is something that we see across all the cohorts. Here, you see also the number of stores in each cohort that we included.

Now let's have a quick look at our **P&L structure.** So we see that, basically, personal expenses, driven by the store expansion, increased in 2022. Gross margin was slightly down, especially due to the product mix effect that we've seen. So that's something, obviously, we're working on with Lean 4 Leverage, and we want to continue to improve our gross margin profile. As I said, personal expenses, driven by store rollouts, marketing slightly reduced, that was part of the Lean 4 Leverage optimization of our marketing spend as well. Operating costs, other operating expenses declined. And adjusted EBITDA for the full year at - 4% is obviously something that we're not happy about, and we're not satisfied about that. And you will see that in our guidance, that we are working on significantly improving this again in 2023.

So how do we want to get there in 2023? So **going from -4% to a low single-digit EBITDA margin** requires a number of efforts. The largest impacts are basically gross margin and marketing optimization, but also revenue growth and overhead cost reduction pay into that improvement. So, on the revenue side, we plan to grow mid to high single-digit. That obviously gives us some operational leverage. And also price increases are part of the revenue growth. When you look at gross margin, we will see the full-year effect of the reduction of discounts and even further ambitions to, also on a like-for-like basis, step by step, reduce discounts and promotions, improve the product mix towards more prescription share, and also continue with gradual price increases. On the marketing side, we will further rationalize our marketing spend. There's also a structural effect that, with more retail revenues and new stores, marketing spend will be reduced because, for our additional retail revenue, we have a very small share of additional marketing spend that comes with that. And on the overhead cost side, as I said, we initiated an operational excellence program that should lead to productivity increases in logistics. Also, we plan to further reduce our administrative expenses, our costs, but also HR overhead cost in 2023.

So, for the **commercial outlook of 2023**, I would say we've seen three years now with a very unpredictable environment on the macroeconomic level. We've seen very dynamic things, like in 2022, with the war coming, inflation and consumer sentiment basically worsening. And that requires a very active management of the business, and we are committed to do that. So, that said, it doesn't mean we want to compromise on our customer value proposition. We actually want to improve that and strengthen that. We also want to use the strength of Mister Spex and the omnichannel model to be there, wherever the customer wants us to be, so be online but also in retail. And so, what does it mean for our strategy in 2023? It means we will focus on continuing to improve store profitability, growing the prescription glasses category, including prescription sunglasses, active cost management, and operational excellence projects. And we want to deliver on our brand promise, which is, “The perfect frame for every face and the perfect lens for every eye.” So, looking at Q1, we see that growth rate margin developments are in line with expectation and coupled with very healthy unit economic development and also gross margins.

So now, what does it mean in terms of **guidance**? It means – I mentioned it already – mid to high single-digit growth numbers when it comes to net sales and growing prescription glasses share. The same applies for the gross margin. And on EBITDA, we plan to go for a low single-digit percentage margin. CapEx is planed flat for 2023, but don't be surprised that, at the end of the first quarter, there will be a high inventory posted also on a like for like basis, because we made use of buying a significant contact lens product before the supplier announced their significant price increases in this category, beginning of the year. And cash balance we planned with EUR 105–110 million in the bank. So, overall, a significant improvement in 2022, but underpinned by a lot of actions we've taken already and also will take during 2023. So, having finished now with the guidance, I would say let's move to Q&A.

Q&A

34:52 Operator

Thank you. If you have a question for our speakers, please dial *11 on your telephone keypad to enter the queue. Once your name has been announced, you can ask your question. If you find your question is answered before it is your turn to speak, you can dial again *11 to cancel your question. Once again, it is *11 to ask a question. Please stand by for the first question. Once again, it is *11 to register for a question.

The first question comes from the line of Laurent Stockli. Please go ahead with your question, Laurent.

36:34 Laurent Stockli

Good morning. I wonder whether you can help us understand a little bit more in terms of the guidance you've given for 2023. For the year-end net cash, you're talking about EUR 105 to 110 million. Is this going to be linear? Or are you going to consume cash in the first half and start generating at the end of the year? And can you help us to understand, with your new plan, by when you start to turn cash positive? I think in the past you said cash positive at some stage in 2024. But do you expect to be cash generative in the whole year in 2024? Thank you.

37:22 Dirk Graber

Thank you, Laurent, for the question. So, in 2023, in terms of cash flow, obviously, we've historically always seen different cash flow profiles during the year between the quarters, driven by working capital. So, we will assume that there will be, I would say, a continuous development of the cash flow profile comparable to last year in terms of relative comparison. So, therefore, there will be, for instance, also a negative cash flow in Q3. That's typically a working capital topic. Nevertheless, we want to, step by step, improve. Regarding 2024, I think, very much in line with what we've said historically, we are planning to break even on free cash flow during 2024. And I would say, on a very ambitious level, that would be also a positive free cash flow for the full year, but that's something which we need to elaborate, basically, at the end of 2023 with the improvements we've made during the year.

38:48 Operator

One moment, please, for the next question. The next question comes from the line of Cédric Rossi from Bryan Garnier & Co. Go ahead.

39:24 Cédric Rossi (Bryan Garnier)

Good morning. Thank you for taking my questions. I have three, actually. The first one is regarding the AOV improvement. So could you just quantify the contribution between price increase and the mix improvement, not only category mix, but also the shifting from high end or own brands? Just trying to assess the gross margin rebound potential for '23 and beyond. So, in other words, even if the category mix remains similar to 2022, would you be able to improve the gross margin anyhow?

My second question is regarding the boutique format. So, a very successful launch. Do you plan to open new flagship stores with the boutique format in '23 within the 10 net store openings you are planning?

And my third question is regarding marketing. So, as you said, the marketing should be optimized and probably decrease as a percentage of sales in ’23. I assume that will be mainly also concerning the international market? Thank you.

40:42 Dirk Graber

Thank you, Cédric, for the questions. So, I would hand the new flagship store and the marketing topic to Mirko to maybe start with, and then I will finish off on the AOV part with the mix effect of that. So, over to you, Mirko.

40:58 Dr. Mirko Caspar

Thanks, Dirk. Hi, Cédric. Yes, on boutique, we haven't decided yet. As of now, there is no clear plan to have another flagship store this year. It’s developing nicely. What you will very likely see is elements of that boutique store being brought into the newly opened stores. Part of that is, for example, customized 3D-printed frames. But it's not unlikely that there is going to be another store, but really, it is how fast the store can turn profitable and how positive we assess the speed with which they can recoup the CapEx. That is really our guiding principle on which we base the rollout of the flagship stores.

When it comes to marketing, the short answer is yes. It is partly a more careful international growth pass, waiting until consumer sentiment picks up. Especially in the Nordics, consumer sentiment has been pretty weak. And we’d rather ride the wave of stronger consumer sentiment when it starts than trying to create it ourselves. Maybe over to you, Dirk, on the AOV.

42:33 Dirk Graber

As I already mentioned, there are a number of factors. And it gets really hard, I would say, to split it up precisely on a percentage level, but I give you just a high level. So the reduction of discounts probably contributes roughly a third to AOV improvement, which is also leading then into improved gross margin. So another third, I'd say, is likely the pricing of prescription lenses. As you know, we increased prices for prescription lenses or different parts of the assortment throughout the last year three times. And we're also working on more strategic pricing actions going forward. So here, Mirko, I think, on one slide, also had the information that the average revenue from prescription lenses grew by 14% versus the category growing only 5%. So here you see basically another driver for higher AOVs, but also higher margins. And the last part is the assortment. As you mentioned, higher boutique share, luxury, independent, obviously helps to increase average order value. That typically doesn't come with a margin improvement, but also not with a margin dilution, since margin for this category is in line with the overall margin. Obviously, it's slightly below the private label margin, for sure. But on the absolute level, it helps. And also, if you look at contribution margin below variable cost and marketing, you'll see, basically, it's aligned with the other segments, since you have same fulfillment cost for a higher basket. I hope that helps to understand it.

44:27 Cédric Rossi

Yes, this is super clear. Thank you, Dirk and Mirko.

44:33 Operator

Once again, if you would like to ask a question, please dial *11 on your telephone keypad.

No further questions. I hand the conference back to you, speakers.

45:04 Dirk Graber

Okay. Thank you, everybody, for participating in this full-year 2022 result call of Mister Spex. If you have any questions following this conference call, please reach out to Irina Zhurba, our Head of Investor Relations, and we will get back to you as soon as possible in answering questions. Thank you, everybody.