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Mister Spex Q3 2023 Results Presentation

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PRESENTATION

00:01 Irina Zhurba (Head of Investor Relations)

Good morning, everyone, and welcome to our Q3 2023 results call. As usual, the presentation will last approximately 30 minutes, and then we'll allow another 10 to 15 minutes for the Q&A. As usual, you can find the presentation online on our Investor Relations website under “Reports and presentations.” The speakers today here with me are Dirk Graber, the founder and co-CEO, and Mirko Caspar, co-CEO of Mister Spex. That said, let me hand over to Dirk to begin today's call. Thank you.

00:28 Dirk Graber (Founder and Co-CEO)

So welcome, everybody, from my side as well. Thank you for participating in this results call again. So let's have a look at what we are going to present today. We basically look at a quarter where we've seen, from the market side, reduced consumer sentiment. I think that's not big news for all of you. We've seen it in many retail sectors and businesses across the industry. But we continue to execute on our Lean 4 Leverage program and have seen very good results on that. We are also, from purely optimizing processes in the lean matter, now also moving more and more into automation. And we will have a deep dive on the automation part as well. So, looking at our revenues in Q3, we grew 2% in net sales, now getting to 6% growth for the nine months of 2023. We also had another quarter of profitable adjusted EBITDA, with €0.2 million in Q3, a significant improvement versus last year's adjusted EBITDA in Q3 2022. So, for the full year, we are now at €0.9 million in adjusted EBITDA for the nine months.

Now, let's have a look at the market. I mentioned it already: it's a situation where we've seen, in the first half-year of 2023, significant improvement in consumer sentiment from a low level to still not a great level, but it was an improvement. In Q3, as we’ve flagged already earlier, we've seen a flat, even slightly declining development of consumer sentiment, according to GfK. We’ve also seen very unseasonal weather patterns. In our industry, that's obviously impacting sunglasses sales. And we'll come to that as well when we look at the category revenues. Looking at Mister Spex comparing to the German optical market, we see that the sunglass unit sales in Q3, or in July and August 2023, according to GFK, were shrinking by -15%. We've been at -12%. And prescription glasses units grew in the same period 3%. We grew 4%. So, although it's a challenging environment, we still slightly outperform the market with Mister Spex.

Now looking into the development of the two major categories by month, as you know, our strategy is to move more and more into the higher-margin categories, meaning prescription glasses and sunglasses. And that is something which we are pursuing, basically, in our daily work at Mister Spex. For us, especially in the sunglass season, which is typically Q2 and Q3, we see some negative correlation between the two categories. So, whenever sunglasses are up significantly, we typically see some lower growth in prescription. Why? Because at Mister Spex, we have a lot of prescription sunglasses, and people typically only buy one product at a time. So, having said that, I would say, looking at prescription glasses, we saw, a certain strength in July, where we saw good weather for sun, and in sunglasses we've seen a very good start into Q3. If we look at August, I don't know if you remember that, but it was the wettest August in Germany for the last 10–12 years. So sunglasses were really down in that month, with a positive impact on prescription glasses growing north of 6%. September was reversed, so we had a very good late summer, so sunglasses picked up significantly, but at a significantly low level. So, typically, high season ends somewhere in August, and that negatively, then, impacted prescription glasses at Mister Spex. And we’ve seen a reverse trend again in October, where we will come to that when we look at the outlook at the end of the presentation. And throughout the quarter, as mentioned, we've seen persistently reducing consumer sentiment in the German core market of Mister Spex.

Now, with our aim to increase gross margin, we’ve continued to reduce our discounts. That was one of the measures we always shared with you over the last quarters, and we continue to do so. Giving the mixed weather patterns, we had a product mix development which has been slightly unfavorable for our overall gross margin development. That is for sure. But we will see on the next slide that we continued also to increase gross margin, especially for prescription glasses, so that's something which we continue to work on.

Now, have a look at Lean 4 Leverage and what we achieved in Q3. We have three pillars, as you remember: concentrate on the core, optimize price mix and product margin, and focus on the operational leverage of the organization. So, looking at our “concentrate on the core” initiatives, one was always focused on the German market. And you will see that in one of the next slides. We continued to grow overproportionately in that market. The second effort is to focus on our existing store network here. Given a high share of sunglasses in our retail business compared to the industry, where we have roughly 30% of revenue share in sunglasses, we have been impacted negatively by the weather. And so our like-for-like in Q3 turned negative. Next to the weather, there was also the high sickness rates that we experienced in our business. And so this takes the overall business to a like-for-like growth for the nine months of 3%. And the second lever we're working on, and very successfully worked on, is increasing the labor productivity. And we went up 18% in the nine-month period for the first nine months of 2023, meaning that the revenue per FTE increased by 18%, which has a significant positive bottom-line impact on our retail business.

So now looking at margin and average order value. So, in that not-so-easy environment given the consumer market, we continued to increase our average order value significantly. Q3 AOV for prescription glasses went up 13% and also allowed us to increase the gross margin in that category by 260 basis points. We also continued to show higher AOVs for sunglasses. Looking at our Lean initiatives for the headquarters but also our operational department, what we achieved is that we significantly increased productivity, not only in retail, as I just mentioned, but also in operations. And by streamlining processes, we're now also moving more and more into process automation. Mirko will give you in a second some insights on which initiatives we are working on at the moment. One is customer service.

09:14 Dr. Mirko Caspar (Co-CEO)

Thanks, Dirk, and welcome, everyone, from my side. Let me give you a quick update on some strategic initiatives that help us to build our brand promise and improve our operational effectiveness and customer experience. And I want to start with an update on eyeD, which is our custom-made frame collection, and at the core of our promise: “A perfect fit for every face.” We've rolled out our custom-made frame collection to half of our stores by now, and to great success. The average custom-made frame SKU sells 2.5 times more than a normal luxury SKU would and has a margin that is 1.5 times higher than a normal luxury SKU would be. And we see really strong customer feedback. If you look at the consumer and customer feedback, what they're telling us is it's really the custom fit and the style that they like a lot; then, the lightness and the flexibility of the material is something that is highly appreciated; and last, but not least, that it is locally produced in Europe, is low waste and on demand is something that is appreciated a lot by consumers. So we see quite an opportunity for Mister Spex also in the future with this approach. The first thing that we decided immediately is that we are going to roll it out to all stores within this year. The second thing is, if you look at the customer base, it's already relatively broad, slightly older customer base, because the slightly older consumers value the custom-made aspects and the exclusivity of the product a little more, and on the other hand, they have also the budget to afford it. But we are already investing in more shapes and more colors and are sure to broaden the addressable market, with that, even more. And while it’s already our most profitable collection, we see significant further potential also in the future through economies of scale, once we roll it out, and also a learning curve that comes with this innovative technology. So really, really strong development there.

And now, going from the customer experience and shifting the focus a little bit more on operations. Let's start with the customer experience. As you probably know and we've said a few times, the core of the custom-made frame collection technology is our own. And we have been using it and talking about that in our online shop basically and mainly for existing customers. And what we have now done is we’ve rolled out that technology in the App Store on iOS, and it's equipped with the same face scan technology that we used for custom-made frames. It's combining it with personal preferences, and then we offer a direct recommendation to our customers in that app, where they can immediately purchase. You're welcome to try it out. There's a QR code in the presentation. And what we already see is reduced returns and an increase in conversions. Now these are early times, but we get good feedback. And this is really picking up.

Now moving over, as I said, to business processes. Based on the lean analysis but also the philosophy that we apply, we see more and more opportunities where AI and robotics can help us improve efficiency significantly. So let's start with the VoiceBot. Customer service is very important in our high-involvement category. So the responsiveness and the quality of the service is really important. And what we've seen is, by introducing VoiceBot, the reachability, the responsiveness, and also the quality advice has actually gone up, with significantly higher efficiency on our site. So we're going to roll that out to more processes from customer service. But as you can see, more than 18,000 users have been in touch with that new technology, and we continue to roll it out with very good success.

And the other thing is, looking at one of the product categories, contact lenses, it's not at the core of our strategy. However, it is still a significant chunk of our revenues. And the two most important factors when selling contact lenses is actually speed, and the other thing is price. It's a commodity product. And what we have done is we have completely automated our fulfillment process for contact lenses, being able to ship faster and pack fulfill cheaper. And we see decreasing cost per order, and more efficient and speedy delivery. So that was quite a big project that we completed in Q3, the last quarter. So that was a glimpse on our strategic projects, and back to Dirk.

14:48 Dirk Graber

All right. So let's look into the financials in a bit more detail. We already mentioned a growth of 2%, bringing us in the nine months now to 6%, which is fully on track with our revenue guidance for the full year. Also the adjusted EBITDA development, continued a quarter of positive adjusted EBITDA with €0.2 million, now €0.9 million for nine months – again, fully on track with our full-year guidance. On the cash side, which is an important element of our soft guidance that we gave you for the full year €105 million to €110 million at year-end is also fully on track with what we are expecting.

So now, looking into the revenue split by category, we already mentioned the drivers. In Q3, revenues of prescription glasses declined by 3%, sunglasses was up 4%, and contact lenses was up 7%. For the nine months, revenue of prescription is now up 8%, sunglasses 13%, and contact lenses down 3%, which, again, is the focus of our strategy as Mirko just explained: moving into the higher-margin categories of prescription, prescription sunglasses, and sunglasses as well. And especially on contact lenses, please keep in mind that in Q3 2023 we significantly focused on margin improvements for contact lenses, and therefore the comparison basis was very low. Hence, the 7% has to be put into a relative comparison there.

Now, our segments that we report. Germany grew 4%, as I mentioned, and with a very strong focus on the omnichannel model in that market. International declined by 2%. Again, here, FX, like in the last quarter, played a significant role. The Swedish and the Norwegian kroner basically lost significant value versus last year. And therefore, on a like-for-like basis, or constant currency basis, it would have been +2% in our international markets.

Looking at the overall drivers for the improvement of profitability, I already mentioned that, in Q3 2023, we had some pressure on gross margin, given the product mix. Nevertheless, our very strong cost discipline helped us to also improve adjusted EBITDA by 150 basis points. What are the drivers for that? It's really the marketing expense, which we continue to optimize and which gave us 70 basis points, and other operating expenses, 140 basis points. And maybe something to mention: on the HR costs, on the one hand, we added 10 new stores on a like-for-like basis quarter over quarter last year. But if you basically take out the IFRS2 charges that we booked into Q3 this year, actually the comparable basis would have been €13.6 million for HR costs, which only then amounts to 23% of revenue. Again, here, we were very focused on cost optimization across the entire business. And for the full year, this brings us to an adjusted EBITDA improvement of 330 basis points, which was one of the main goals for this year, to significantly improve profitability.

Now let's come to the guidance for 2023. We mentioned it already, so we confirm the guidance. One, on net revenue, the aim is to grow mid to high single digit, to have a low single-digit percentage of adjusted EBITDA margin. And also on the cash side, I already mentioned that. Looking at Q4, I would say that October gave us a material improvement in trading versus the second half of Q3, but November is the month that contributes most revenue, and we're just at the beginning of the month. So, therefore, we remain cautious, given the overall consumer sentiment development in our core markets. Nevertheless, as we said, we fully confirm our full-year guidance. So, if you want to meet us, we are attending the following conferences in the next couple of weeks. And also, we will issue our full-year report on March 27th next year.

20:02 Mirko Caspar

So, therefore, I close the presentation and would hand over to the moderator for Q&A.

Q&A

20:12 Operator

Thank you very much. If you would like to ask a question, please press *11 on your telephone keypad and wait for your name to be announced. That's *11 on your telephone keypad.

Our first question today comes from the line of Harrison Woodin-Lygo from Berenberg. Your line is open. Please ask your question.

20:41 Harrison Woodin-Lygo (Berenberg)

Hi, there. Good morning. Congratulations on a good quarter. I've just got a few questions for you, if that's okay. So my first question is, how has sales growth developed so far in Q4? Sentiment has softened, but you have very weak comparators from last year. So are you seeing a reacceleration of sales growth into Q4? And specifically, are you seeing prescription glasses up again? And then my second question is, the AOV was up 10% in Q3. How much of that was pricing versus mix? Are you still seeing consumers trade up to higher-value lenses and continued strong demand in premium frames/brands? Or are you seeing any evidence of downgrading? And then question number three, what consumer feedback has there been on the new eyeD product line? We saw it at the Berenberg conference in Munich. It felt good in hand, but I'm just wondering, how are you measuring sentiment? And what has been the take-up so far on eyeD? And those are my questions. Thank you.

21:50 Mirko Caspar

Okay, so on Q4 sales trends, well, there's two things probably, to answer you. The one is, if we could have included October in Q3, we would have seen a relatively normal development in Q3, with prescription glasses growth year over year, and again, a strong development in that product category. You could always say it's almost been like a pent-up demand in October for us, compensating for what we've lost in September. So we started strong into the Q4, with prescription glasses leading – well, actually, both sunglasses and prescription glasses leading. However, in November, the thing is, we have seen, in terms of consumer sentiment, people seem to be waiting for Black Friday campaigns. Our started yesterday. It's too early to call how consumers will react in a month that is a big month, because it's one of the most important due to Black Friday campaigns. And, frankly, speaking, it's too early to call for the rest. But October was strong.

Then, the AOV, what we've seen is a continuous trend. We had one of the strongest quarters for private label, on the one hand. But we see, on the other hand, again, a strong development in boutique. So what you see is that the AOV is influenced by upselling into higher-value product categories, and you still have the effect of our price increases year over year, because some of the lens prices we introduced in April this year. So there is still a positive year-over-year effect of prices.

Last but not least, eyeD, what we've just seen is that consumers are really happy about the styles, the fit, the haptics of the product. And that's why we decided to actually roll it out faster to all of the stores. Initially, we only had it in mind for our boutique stores, which are roughly half of them, where we have a very strong boutique assortment. But no, consumer sentiment has been strong, and customer satisfaction has been high, return rates have been low… So those are the KPIs that we have been measuring, and that's why we decided to roll it out faster to each and any individual store.

24:53 Operator

Thank you. Our next question comes from the line of Ralf Marinoni from Quirin Privatbank. Your line is open. Please ask your question.

25:03 Ralf Marinoni (Quirin Privatbank)

Thank you. Good morning, everybody. One final question from my side. Why is there so much volatility in the sale of prescription glasses? I mean, if I have bad eyes, I go to the optician. It's a necessity, and not depending on high interest rates and whatever.

25:28 Dirk Graber

Actually, normally we don't see that high volatility. So this is an outlier for us. We've been debating internally, was it the mix of weather and the scheduling of the summer vacation? Actually, usually we don't see the volatility. We can't really explain it, other than what we tried to do. If you balance it out, and you include October, you would see a relatively normal development. And I don't expect that type of volatility to really come back. Otherwise, we see again an external shock.

26:16 Ralf Marinoni

Okay. And the second question is, then, can you provide specific marketing initiatives to stimulate growth in the field of prescription glasses?

26:31 Dirk Graber

Yes. What we'll see, and you'll see more of that in the next year, is we've shifted our budget in marketing from TV. So you haven't seen as much TV activity that we did in the past, and we have shifted it more into online, video, and social channels, also including influencers. Although the influencer profitability has been down and has been degrading over the past years, we have done extensive media mix modeling and revised our media budget. So what you'll see is more online video. You will see more on influencers, Instagram, TikTok. And what you will also see is slightly more local targeting. So if you are in a region where we do not have a store, you might see actually less. And if you are in a region where we have a store, you might be seeing more because, also digitally, we can have local targeting.

27:49 Ralf Marinoni

Okay, thank you. So I'll keep my eyes open. Thank you very much.

27:56 Operator

Thank you. Our next question comes from the line of Cedric Rossi from Bryan Garnier. Your line is open. Please ask your question.

28:06 Cedric Rossi

Thank you. Good morning to everyone. I have three questions. The first one is, so you managed to reduce discounts again in Q3. I was curious to have your view on the pricing environment in the German market. And how do you see this evolving for Q4 and 2024? My second question is regarding eyeD. So it was very interesting to notice that 70% of the customer base is older than 45 years old. Is it also an opportunity for you to increase the share of prescription lenses thanks to this product? And my third question is regarding the store opening. So, no new stores opened in Q3. What are your plans for Q4? And are you also sticking to the 10 new stores plan for next year? Thank you.

28:59 Mirko Caspar

Okay, pricing. I mean, obviously, the consumer markets in Germany are not in good shape. We have seen retail markets overall decreasing year over year. So, if you put it into context, the first thing, like I said, is that consumer sentiment in Germany is not great. We have seen it. It's not great. What we've seen is we have, normally, resilience in the luxury and boutique segment. What we've seen in the overall market is that the likes of LVMH, etc. have not been delivering the growth rates in super luxury that they did in the past. Now, what we see in prescription is that we've been relatively resilient in the boutique segment. It's been growing strongly in Q3. So we see in that affordable luxury segment, I would say, a pretty resilient demand. On the mass market brands, we see there a shift of demand into private label. That's what we see in pricing.

On the eyeD, yes, we do see that that collection attracts consumers who want something special and quality. So we also see, on the lens package side, that they are geared towards the higher-value lens packages, and they attract the prescription glasses buyers. And the third question--

30:39 Dirk Graber

I can do it. So the third question was on the stores, Cedric. So you're right, Q3, no stores – that was in our initial plan. It was [a matter of timing] because of availability of stores. So we expect to open two more stores at the end of the year, so December. One moved into 2024 for building purposes. I think that's one you can expect early 2024. For next year, we're still in the budgeting phase and prioritizing, I would say, our investments. What I can say is I think we are obviously happy with the significantly improved store economics of the stores that we opened in 2023. So I would say the working hypothesis that we have is we will see a similar new number of stores as in 2023 also in 2024.

31:36 Cedric Rossi

Okay, very clear. Thank you.

31:40 Operator

Thank you. Next, we have a question from Harrison Woodin-Lygo from Berenberg. Your line is open. Please ask your question.

31:51 Harrison Woodin-Lygo

Hi, there. No. Apologies, that’s a tech problem on my side. But thank you for answering my previous questions.

32:00 Operator

Thank you. In that case, we have no further questions at this time. Please continue. Okay, that does conclude our conference for today. Thank you all for your participation. You may now disconnect.

32:15 Irina Zhurba

Thank you.