Company: Step One Clothing Limited
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Start of Transcript

Operator: Thank you for standing by and welcome to the Step One Clothing Limited investor briefing. All participants are in a listen only mode. There will be a presentation followed by a question-and-answer session. If you wish to ask a question, you will need to press the star key followed by the number one key on your telephone keypad. I would now like to hand the conference over to Mr Greg Taylor, CEO. Please go ahead.

Greg Taylor: Thank you, good morning. I'm Greg Taylor, CEO and founder of Step One and joining me is our CFO, Nigel Underwood. This morning the Group announced its financial results for the 2022 financial year. In May we revised our EBITDA guidance to a range of $7 million to $8.5 million. I'm very pleased to report we have beaten the top end of that guidance with an EBITDA of $9 million.

Turning to page 2 please. Today I'm going to cover the following topics which I will discuss in detail of course over the presentation and Nigel will cover off the financials.

Turning to page 3 please. The highlights of the 2022 financial year are as follows. Revenue of $72.2 million, which is 17% above prior year and mid-range of our previous revision to guidance of $71 million to $74 million. Gross margin was 82% and while it is down 0.6% due to cost pressures from inbound logistics and currency movements, we still remain a strong margin business. Average order value was up 0.7% to $75.10, despite the increased frequency of our colour releases in which customers generally order a single pair. And finally, a pro forma EBITDA of $9 million, which was above our previous guidance of $7 million to $8.5 million issued in May, due in part to improving our advertising efficiency in May and June and also a successful mid-year sale.

During the year we've achieved many milestones, notably, breaking down our volumes, we've now hit a milestone I'm incredibly proud of and that is that every eight seconds a pair of Step Ones are sold somewhere around the world. In January we had a very successful launch of our women's line. We also released our thermal and sports range, which will sit as an adjacency to our core product and also expanding into the North American market, which of course I'll cover off in further detail later in the presentation. We are very pleased to see our website visits increase 65% to 16.5 million visits and whilst our conversion rate did drop to 5.2%, this is still well above industry averages.

Turning to page 5 please, I'll start with a milestone of great personal satisfaction. This year we achieved a milestone that over 1.1 million unique customers have now purchased a pair of Step Ones. This is an increase of 52% on the prior year and demonstrates how both the functional purpose and brand awareness of Step One holds strong with consumers. We launched our women's range in January and quickly sold out, followed again by selling out of our second shipment in February. Unfortunately the third shipment didn't arrive until April, at which time sales momentum had reduced. We do however remain very focused on regaining that momentum and run rate seen earlier in the year.

Step One has also amassed over 50,000 five-star reviews across Google, Trust Pilot and Product Review, further highlighting our brand equity, quality of product, customer service and ultimately consumer satisfaction, which in turn drives our high repeat customer rate. As mentioned earlier, we launched our thermal and sports ranges on the back of consumer demand. They will remain ancillary to our core products, but nonetheless contributed to our range expansion and of course revenue.

Late in the financial year we began testing selling on Amazon in all three markets, Australia, the UK and the US. Amazon presents an additional channel to acquire new customers and will help us enhance our brand visibility in the UK and US where Amazon is a more established consumer shopping habit compared to that of Australia presently. We have started selling a limited selection of our core range. We'll of course monitor and adapt to the needs of the Amazon consumer as we grow. We're currently listed as the number one best seller in clothing, shoes and accessories category in Australia. Lastly, our customers continue to engage with major sales events, which also act as a great tool to not only recruit new customers, but also engage existing. Our customers continue to engage with our colour releases, of which we released over 45 during the year and these also remain a great tool in attracting both new and existing customers.

Turning to page 6 please. The chart here illustrates the growth in website visits in each half-year period. There were a total of 16.5 million visits in FY22.

Turning to page 7 please. While our home market here is in Australia, we have a foothold in the UK and remain at the entry phase in the US. The UK we did experience logistical issues at Christmas. These took longer than expected to clear and also regained the trust of our customer base. We've made very solid progress with the introduction of our women's products and also refined logistical procedures.

Our entry into the North American market did not grow as fast as that experienced in the UK. We remain absolutely confident that the product functionality resonates with the US customer, however the cost per acquisition has been highly expected and as such, did not gain the momentum as anticipated. Progression to the scale phase in the US involves investing advertising funds in advance of revenue generation and while there was initial success, we did not get the growth in traction anticipated based on what we saw in the UK and whilst also, as I mentioned, seeing higher than expected customer acquisition costs.

We do plan to pursue growth in the US with an approach that balances both growth and profitability, however growth will take longer than initially predicted. By no means are we abandoning our D2C strategy in the US. we've taken lots of learning so far and we look at Amazon as a way to increase the speed of acquisition of new customers. I remain very confident about our success in this market.

I will hand over to our CFO, Nigel Underwood, to present the financial results.

Nigel Underwood: Thanks Greg and good morning everyone. I'll turn first to page 9. The chart on the left illustrates the revenue by half year reporting period. Revenue for the 2022 financial year was $72.2 million, which was 17% above last year. Within that number, Australia grew 14.6% on the prior year, while the UK was 4.7% on the prior year.

Gross profit margin in the second half reduced to 80.7% as a result of cost pressures. These pressures were predominantly from adverse foreign exchange movements and increases in the cost of inbound logistics, which includes shipping, air freight and ground transportation to and from the ports to the warehouses. These cost pressures were experienced across all markets and resulted in a 15% overall increase in COGS. We did, however, increase our prices in May and again have increased them July in response to these cost pressures.

Turning to page 10, pro forma EBITDA for FY22 was $9 million, split as you can see into $7.4 million in the first half and $1.6 million in the second half. The second half of the financial year is seasonally a more difficult trading period. You can see from the chart on the right that advertising efficiency is lower in the second half. To expand further, this advertising efficiency was lower than we expected in the second half of FY22, especially in the UK and the US. It should also be called out that we recorded a $2.8 million loss in the USA, mostly in the second half of the financial year. We have provided additional information in our reports showing advertising efficiency in each of the markets for your information.

Turning to page 11, customer orders increased 13.5% on the prior year. This changes to 7.5% if you exclude the USA sales. The average order value increased to $75.70, mainly because of the increase in the AOV in Australia. The increase in Australia was, however, offset by a reduction in the AOV in the UK as we moved from a four pack to a three pack and associated changes to the bundle price. These changes were necessary to reflect standard bundling in that market.

The chart on the right shows the proportion of sales made to first-time versus returning or existing customers. You can see that our customers continue to support us after their first purchase, with 60% of all sales to customers who have purchased before. Despite the high proportion of returning customers, we've still recruited 375,000 new customers to the brand, representing an increase of 51% since June 2021. By June 2022, as Greg has already said, over 1.1 million customers have purchased a Step One product.

Turning to page 12, advertising spend is directed at both new and returning customers. There is no way of separating these expenditures by customer type, so we calculate advertising cost to acquire new customer orders as well as the cost to acquire all orders. The real answer falls between these two methods, however we monitor performance against a methodology that assumes all advertising costs after new customer acquisition.

Applying this methodology, the cost to acquire new customers has increased to $93.80 in the last half, or $87.96 if you exclude the USA. This level of expenditure was higher than expected and results form a range of factors affecting advertising effectiveness, predominantly in the UK and the US. We will continue efforts to improve efficiency in customer acquisition, however, given the repeat purchase rate, this level of acquisition can still be accommodated.

Turning to page 13, the pro forma income statement is provided on this page. We've used pro forma values as they remove the noise of costs associated with the IPO and capital raise, as well as other costs that are not expected to reoccur in the future. The adjustments required to reconcile statutory to pro forma profitability are provided on page 30. The income statement shows the revenue by market building to the 17% growth in Group revenue and how this translated to a 16.1% growth in gross profit dollars. Gross profit rate declined predominantly due to FX and logistics costs in the second half, as already said.

Advertising costs increased by $4 million. Advertising as a percentage of revenue is 44.5%, which reduced 1% on the prior year, but remains above levels previously expected. Improving advertising efficiency will remain an area of focus for management. Distribution and fulfillment costs increased as cost inflation is experienced across a range of functions within the logistics industry.

Overhead increased as the size and complexity of the business increased. Key contributes to the overall $2.2 million increase include workforce costs of $1 million as workforce capacity is increased and transaction and merchant fee costs of $0.5 million as we now accept a wider range of payment types. Pro forma EBITDA was $9 million, which is 7.4% below the prior year. It should be noted that the $9 million pro forma EBITDA excludes the loss of $2.8 million from the USA operations.

Turning to page 14, the balance sheet provided shows the movements resulting from the IPO and the capital raise from other movements resulting from business operation. The IPO and capital raise generated $32 million of funds for the company after deducting transaction fees and the settlement of related party lines, et cetera, that existed pre-IPO. $16 million of the IPO funds were used to increase the level of inventory. The inventory holding will, to an extent, protect the Company from future supply chain disruptions. The balance sheet shows that the Company is a capital light business and has a strong cash position and no debt.

Turning to page 15, the cash flow statement shows how receipts increased in line with revenue after adjusting for the movements in contract revenue. Contract revenue is the revenue that is earned in the last couple of days of the year that cannot be recognised until the customer has received the order. This changes when the sale events occur nearer period end and depending on the timeliness of the postal and parcel delivery services. Payment increased with the increase in inventory, as well as to fund increased advertising distribution and other overhead costs. The $8.6 million of cash used in operations is mostly attributed to the growth in inventory. The rest of the larger movements relate to the capital raise. The cash flow again shows that this business is a capital light business.

I'll now hand you back to Greg.

Greg Taylor: Thank you for covering those off, Nigel. Could everyone please turn to page 17? I would like to take the opportunity to reiterate our strategy. You can view the strategy in four pillars. The addressable market for Step One is huge. Assuming most people wear underwear, the introduction of our women's line has doubled our total addressable market. Step One remains a capital light business. We don't manage forests, own factories or have distribution warehouses and haven't invested funds in IT systems. We do own the brand. We specialise in marketing and managing its components to bring the product to market. We manage the interaction with customers and use their feedback to improve the way we do things and the product iterations required.

Step One has commenced selling on Amazon. Amazon is a reference point for product research and purchasing. In the UK this will expand reach to new customers and in the US will not just expand reach, but also assist to build brand credibility and awareness. The last pillar in our strategy is our product range to women, a 50% increase in our addressable market happening out of this and the products available in our women's line such as briefs and other potential adjacencies. We will not lose focus on the core products and core values as we pursue these ancillary revenue lines.

Please turn to page 17. This is our forward-looking strategy and we break this up into four parts: our market size, capital light, partnerships and product adjacencies. Every person needs underwear, so the market is huge and that's just the men. As I mentioned, we have now added our women's range. Capital light, low capital invested, we own the brand and we specialise in manufacturing, warehousing and logistics to ensure high quality products and a class-leading product.

Our partnerships, we are using Amazon to establish brand presence and access a larger customer pool. We will evaluate other online or retail partnerships on their commercial merits and align in the areas including customer service and ESG. And product adjacency, natural adjacencies to men's underwear include expanding the customer target market, including a broader range of our women's product, as I mentioned and expanding the product range within the innerwear category.

Turning to page 18 please, our business model remains the same with four key approaches: design, marketing, a customer-first approach and ESG. To our design, functional product features, we always wanted to create something that wasn't just a comfortable pair of underwear, but solves a functional need for people wearing a product. So we do have our UltraGlyde panels, our 3D elastic pouch and our organically grown and Eco-Cert bamboo.

Marketing, it is strategic and direct. All the content you see is in house and our marketing capabilities are both through social and paid influencer channels continues to grow the brand. We do have a very, very strong customer-first approach, with such things as a 30-day first pair guarantee, free shipping and a 12-month warranty. And we do aim to return all customer enquiries within one hour. And finally, something that is very close to me, is an ESG purchase. So our business model is built on a transparent production process, organically grown bamboo from responsible sources and strict ethical manufacturing across our supply chain to minimise our carbon footprint.

Turning to page 19 please, this is something new to the market which we haven't previously disclosed and this talks about our production cycle from start to finish. And a lot of companies would look at the product on the final slide there, the finished product and talk about the manufacturing or the garment manufacturing et cetera and claim that sector there is ethically certified.

What we've done is gone all the way back through our whole supply chain, back to where the bamboo comes out of the ground and made sure that we have these certifications such as OCS, organic certified content, FSC, OEKO-TEX and those accreditations are carried the whole way through our process, so from fabric manufacturing to knitting, dyeing, to our sub-suppliers and then finally wrapping it up into a compostable bag. The ethical supply chain remains a key focus to Step One and is something we continue to evolve over time.

Turning to page 21 please, so to recap, looking forward we do plan to continue expansion in markets while testing in other markets. This will involve expanding customer reach using third-party platforms such as Amazon and other established retailers and partnering with third-party platforms that will assist in building brand awareness and credibility, especially within the UK and the US. The supply chain is expected to be the subject of continued pressure on costs and manufactured products. Warehouse and distribution costs are similarly expected to remain under pressure from cost inflation within logistics industry sector. Our expansion to the USA, I will reiterate, will manage both growth and profitability.

And Step One is a consumer product and while wearing underwear is a need for most people, sales are still subject to consumer confidence and economic conditions. Due to current economic uncertainty in all jurisdictions, we're not providing guidance at this stage. I thank everyone for your time today and I'll hand back to the operator for Q&A.

Operator: Thank you. If you wish to ask a question, please press star/one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star/two. If you are on a speakerphone, please pick up your handset before you ask your question. We'll pause for a moment while callers join the queue. Once again, if you wish to ask a question, please star then one.

Our first question is from John Burgess with RAAS Group. Please go ahead.

John Burgess: (RAAS Group, Analyst) Thanks guys. Can you comment on your expectations for inventory relative to sales over the next 12 months?

Greg Taylor: Nigel.

Nigel Underwood: Yes, thanks John. Yes, look we're not providing guidance going forward, but we do like having plenty of inventory, it helps us to respond to global supply issues and whilst what we've got to keep in mind with our inventory is that it's not perishable, nor is it seasonal, so we have the luxury of being able to hold a strong level of inventory. So look, won't be materially different to where we're at now, but we're not commenting specifically on it.

John Burgess: (RAAS Group, Analyst) With the addition of women's wear and thermals and obviously the limited releases and new countries, there must be a growing number of SKUs. How are you finding your ability to manage that?

Greg Taylor: I'll cover that, Nigel. That's the beauty of being a capital light business with 3PL as our logistics provider. So as we scale and increase our SKU number, we are able to continue to do that without any additional resource to manage those. So it is, as Nigel pointed out, a product that is not seasonal and is also not perishable, so the theory behind building stock during the period is around, number one, avoiding what happened in the UK at Christmas where we struggled to get stock and also reducing our reliance on air freight moving forward as well. So managing of SKUs is done by the warehouse and as we've outsourced that to 3PL, we've designed this business to scale up very quickly and efficiently.

John Burgess: (RAAS Group, Analyst) Okay, thanks. In terms of like women's thermals, sports, so as a percentage of sales, I don't know if you can comment on, obviously they've only launched in the second half this year, but what they currently are and what you think they could get to over the next three or four years?

Greg Taylor: Look it's a good question. As I mentioned earlier, we did sell out of our first lot within a week or so in January and then we had another shipment arrive in February. So there is certainly demand for the product and you can simply see that by looking at the number of reviews and comments online that we do have that.

Probably where we fell short of, say, on that is that we underestimated the demand of colours and prints that women wanted, so we've been working on growing those and continuing that market. So whilst the thermals and things like the sports range will sit as adjacencies to us, these additional product lines, particularly with the women's and as we expand out that women's range, will continue to add both contribution and profit to the business.

John Burgess: (RAAS Group, Analyst) You're sitting on a lot of cash, I mean have you got any – you don't really need $34 million and you've obviously invested a lot of inventory, but you've still got a lot of net cash, have you got any plans for that cash?

Nigel Underwood: Look initially the proceeds of the IPO went towards the building of inventory. We're not making any changes to the capital management strategy as we speak, but hopefully it's something we'll monitor and going forward we'll make decisions on the capital structure to maximise shareholder value.

John Burgess: (RAAS Group, Analyst) I guess finally just from me, I guess in terms of marketing, let's call it new customer acquisition costs, it was about $93, I know you're mentioned you're not happy necessarily to continue at that level but is there are target in mind to sort of try and bring that back to?

Greg Taylor: Whilst the customer, as Nigel mentioned, we do have over a 60% repeat customer purchase rate, so we do monitor those daily, the costs on a daily basis, so as Nigel said, as they were higher than expected, we still are able to make these work commercially for us, given that high repeat customer rate and particularly as we grow out our women's range and other products, that repeat customer rate and AOV we expect will be increased over time as well.

John Burgess: (RAAS Group, Analyst) Okay, thanks. That's it from me.

Operator: The next question is from Alexander Mees with Morgans. Please go ahead.

Alexander Mees: (Morgans, Analyst) Thank you. Good morning Greg and Nigel and well done on getting this over the line. Just with regard to your comment about expanding into existing markets and testing other markets, I just wonder what you're thinking about the pace of that expansion is, what's involved in testing a new market and when you're talking about working with potentially other established retailers, could that include bricks and mortar please?

Greg Taylor: Yes, good question Alex and look, as we said, this a product that the way we look at this is it's a product that every single person in the world wears every day. So we take the approach of what reason are we giving people to not buy our product. So as we talked about going into different markets and different channels, we're seeing particularly with the presence of Amazon penetration in the UK and US, there certainly is a place for that within our business. We did mention that we are running a very limited range within that Amazon selling period, so we're not listing all of our SKUs on the Amazon site. We have seen some good traction with that, still very early days, as mentioned, however this is just one of many different channels that we can consider.

There are some other channels that we are considering which are a mix of both D2C and potentially never taking off the table, a presence in retailers and things like that, which we will assess the merit of those and also look at them ultimately as a contribution. But we're certainly looking at ways in which we can expand our growth in the UK and as I mentioned, in the US particularly, managing both growth and profitability.

Alexander Mees: (Morgans, Analyst) Thanks Greg, that makes sense. Then just with regard to cost inflation, it's a big topic for everyone at the moment, I'm just wondering what you're seeing in terms of cost inflation out of your factories up in China. Is there anything we should be aware of in terms of bamboo and other raw material, labour costs, et cetera?

Nigel Underwood: Not to date, Alex. So we've got contracts with the factories on their pricing and we're not experiencing pressure on those at the moment. Most of our cost inflation has been from global logistics and obviously because we purchase from China at X rates.

Alexander Mees: (Morgans, Analyst) Got it. And then if I can squeeze a third in, just with regard to the all-important marketing costs, clearly you've been good in terms of your cost control towards the back end of the year and that's why you're above the guidance range, I was just wondering what we should think about in terms of your ratio of marketing costs to revenue going forward from here please.

Nigel Underwood: Always a hard answer when we're not giving guidance, but obviously the level of marketing for FY22 would probably be your starting point, but with the management focus on trying to make that expenditure a little bit more efficient.

Alexander Mees: (Morgans, Analyst) Excellent.

Greg Taylor: Just to add to that, Alex, as you mentioned, the introduction of additional channels really do help assist us with acquisition of new customers at a much lower CAC, which then ultimately we will aim to filter through to our D2C model. So there are lots of different ways we look at this and we're always monitoring how we can reduce that, particularly because we have such a sticky and well-rated product where we do have a 60% repeat customer rate.

Alexander Mees: (Morgans, Analyst) Brilliant, thank you and well done again.

Nigel Underwood: Alex, just one more thing I'd like to add. My team informs me that I may have said that USA was excluded from the result. It's included. So when you're doing your modelling, one of the things you can consider is adding the $2.8 million loss back to the $9 million.

Alexander Mees: (Morgans, Analyst) Great, thank you.

Operator: There are no further questions at this time. I'd now like to hand the call back to Mr Taylor for closing remarks.

Greg Taylor: Thank you everyone for your time. I'm pleased to announce our inaugural annual results. Whilst it wasn't as expected, we did beat our revised guidance with an EBITDA of $9 million. I continue to remain absolutely focused to this business, I'm nearly a 70% shareholder and I continue to remain focused and grow this business into a global empire. So thank you very much for your time today and appreciate it. Thank you.

Operator: This does conclude our conference call for today. Thank you for participating, you may now disconnect.

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