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Max Stock Ltd.

Second Quarter 2021 Earnings Call

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CORPORATE PARTICIPANTS

Evan Nuemann, *Co-Chief Executive Officer*

Nir Dagan, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Randy Konik, *Jefferies and Company*

Brian Nagel, *Oppenheimer and Co.*

PRESENTATION

Operator

Good morning. Thank you for joining us today to discuss Max Stock's Second Quarter 2021 Results Conference Call.

On the call today are Evan Nuemann, Co-Chief Executive Officer, and Nir Dagan, Chief Financial Officer.

It should be emphasized that during this call, the Management team will present the second quarter 2021 results and other information as presented in the Investor presentation, and that information includes forward-looking information as defined under the securities law 5728-1968. The forward-looking information includes forecast projections, estimates or other information which refer to a future event or matter, the eventuation of which is uncertain and or not within the Company's control. The forward-looking information is based on the current information held by the Company or its current adjustments.

With that, I'll turn the floor over to Evan Nuemann.

Evan Nuemann

Thank you, and thank you everyone for joining us today. Good morning to you all.

Before reviewing the highlights of the second quarter, I want to point out as it says that we posted an updated investor presentation on our Investor Relations site, and that includes the information that we're going to go through over on this call.

For those of you who are less familiar with Max Stock, let me just spend a few minutes explaining our concept.

Over the last 15 years, we have evolved Max Stock into Israel's leading extreme value retailer of everyday essential items, and we now have over 52 stores across the country. The winning formula has always been our ability to carry on implementing a secret source which is to provide the right products at the right price coupled with superior customer service and a highly enjoyable shopping experience.

Our attractive store model, which includes both large and small formats, supports a long-run rate for growth and the opportunity more than double the footprint in Israel over time. We carry an expansive selection of merchandise across six categories. These are housewares, toys and babies, office, school supplies, consumable products, basic apparel and art and crafts. We also have increased our range in categories such as sport and electrical, and this has really accelerated our growth, and you will see later the numbers of our basket size.

We continue to offer our customers their everyday needs. It's a mix of private label products with prices of up to 50% below conventional retailers. We're able to do this thanks to a differentiated sourcing model which is led by a highly experienced buy team, and approximately half of our inventory is now sourced internationally primarily from Asia, with the other half coming from local suppliers.

We also look to excite the customers with the treasure hunt in-store experience, an easy to navigate layout featuring a first down of the store, which is always at the seasonal idle range. For example, now we're in back to school, every store, the first aisle is filled with back-to-school products.

We operate both large and small formats with a large stores carrying a full range of merchandise and are located in highly accessible, mostly destination areas. These stores are roughly 20,000 square feet and are company-owned as well as a partner manager model. Max 20, a smaller former, are mostly franchise stores located in the city centers with an average size of 2,000 square feet.

Max 20 features a curated merchandise assortment with price points of $6 or ILS 20 and below. The Max concept captures the elements from several best-in-class U.S. retailers such as Target, Five Below, Ollie's, Walmart, and Grocery outlet, to name a few.

Beyond store expansions, our plans also include continuing to drive comparable store sales, which you'll see in our results. Current and future strategies on this front include increasing our traffic and basket size by providing a differentiated shopping experience and deeper range of products, enhancing customer experience through exceptional service and digital engagement, providing value and variety to customers through dynamic merchandising, leveraging our first arm of ever-changing products, and capturing the seasonal demand.

As we discussed on other calls, we are also very lucky that in Israel, we have Jewish festivals as well as Muslim and Christian festivals. This creates a lot of seasons in the store and ever ranging change of products. We're also capturing and tracking customer data analytics by enhancing distribution, capabilities to drive increasing inventory and replenishment in the store.

Our Max economics are incredibly compelling with target store-level EBITDA margins in the low double-digit range and cash and cash returns of approximately 75% in year one. Before I move on to review the business and quarter two results you'll see on Slide 6, I want to provide a brief update on the situation in Israel in relation to COVID.

On our earnings call earlier this year, we discussed how in February, the Israeli economy started to reopen and our stores resumed normal operations. More recently, the Delta variant has been leading to a new rate of infections in Israel, and the government has implemented new restrictions. We as a company have dealt with these restrictions in the past, and our staff and our business know how they operate under these conditions.

On Slide 7, we can see our new store growth strategy. We've opened two stores so far this year. A 3,400 square meter company-owned location in Ra'anana and a smaller franchise operating store in Tel Aviv, and currently have 52 stores in total. We are very excited to open three more stores over the remainder of this year, including a 5,500 square meter, that’s 55,000 square feet store, our largest ever, in the third quarter. This is a true level and will be our (inaudible) store. We continue to believe that we can more than double our store count in the medium to long term.

Now turning to review of quarter two, as you can see on Slide 8. We're very pleased with the strong top-line results we delivered, which represents a second-quarter record for the Company and come on top of a very strong growth we experienced in the year-ago period when consumer spending was very high following the lifting of mandatory school closures.

Momentum in our business has been building over the past year, driven by the successful execution of our key merchandising, store expense and customer service initiatives, combined with investments we've made in our people, system, and infrastructure. Our recent results underscore that our expanding product selection and competitive pricing are resonating with broader audience, and importantly, leading to market share gains. Our second-quarter performance built on this positive momentum we saw in our core retail business to start the year and was highlighted by a total revenue increase of 28%, Comparable store sales increased 26% and Adjusted EBITDA increasing 4%, and Adjusted EPS increasing 23%.

Each of these growth roads exclude the impact of the one-time sales of COVID-19 related goods generated in the second quarter of 2020. It must be stated that the one-time sale of COVID-19 related goods were an irregular business transaction for our Company, and this is not part of our everyday business operation. We continue to see tremendous opportunity for growth across our business, and if you look at the investor deck, you'll see our model generated strong second-quarter results, which I've already covered.

I will now turn it over to Nir to go through the numbers in more detail.

Nir Dagan

On Slide 9, for the first half of 2021, our total revenue increased by 36.8% year-over-year, driven by 32% increase in a comparable store sale and four new stores opening. Like the second quarter, the increase in comparable store sales was driven by a larger basket size and increase in-store traffic.

Our gross margin for the first half was 39% compared to 39.4% for the first half of 2020. In terms of profitability, Adjusted EBITDA increased by 35.8% to 73.2 million, and Adjusted EPS increased by 47% to 0.32.

On Slide 10 and 9 with the summary of the second quarter and the first half P&L, most of which me and Evan already covered. Slide 12, you can see the drivers of revenues in the second quarter, as I mentioned, with primarily same-store sales growth, and the new stores along with some other factors as well.

Slide 13, here you see you have the driver for the second quarter improved profitability, strong revenue growth partly offset by lower margins from higher expenses this year related to new stores and an unusual low level in the year-ago period due to cost saving in response to COVID.

Slide 14, you can see the driver of revenue in the first half, which was similar to that of the big quarter, same-store sales growth and new stores opening along with other factors as well. On Slide 15, here you have the drivers of improved profitability in the first half, which are similar to those of the second quarter. Strong revenue growth with minor offset from a slight contraction in operating margin.

On Slide 16, with historical numbers, we continue to be very pleased that all them charts are going up to the right, and we expect this trend to continue well into the future. Turning into the balance sheet, Slide 17, at the end of the second quarter, our cash and cash equivalent totals of ILS 31.2 million compared with ILS 122 million last year. The decrease was driven primarily by the 70 million dividend that we paid.

Slide 18 show that we continue to deliver on our goal of driving both comparable still shared growth and new store expansion.

Now, it's back to Evan.

Evan Nuemann

Just before we discuss a few other things, if we look at Slide 21, we can see that we're exceeding the long-term annual revenue and comparable sales targets we outlined at the time of our IPO. We're on track and even beating the unit growth of three to five stores annually. At the same time, adjusted net income growth is outpaced in our annual target of 18% to 20%, and we're very proud to be able to do as we promised in the IPO that we've increased our EBITDA by 200 basis points.

We are very pleased with the underlying strength of the business as we head into the second half of the year. Our teams are successfully executing our growth strategies, including expanding our geographic footprint with larger store formats to reach new customers. Combined with our financial flexibility, we believe we can continue to capitalize on the opportunities for our business to drive long-term value for our stakeholders.

Two things we would touch on, which I'm sure some of you have questions on. We saw a little bit of a decrease in the growth profit margin. That's due to logistics which everyone is suffering from around the world, the logistics costs. Where we can, we will try buy better, so the more stores we open, the better we can buy, so we're always trying to get that $0.05 off or $0.06 off or $0.1 off. Where we can, we'll try adjust price to make sure that we're in the margin range that we need to be, but most importantly, and this has led to our EBITDA, is that we become better operated. We're controlling our wages. We're controlling our operating costs. I believe we'll really see the fruits of this where the logistic prices go down and operation price—efficiencies stay the same. Then we'll see even more increase, hopefully.

Another good thing is staff, so with all the COVID, there was pay without leave or pay with leave, paid leave. All those government subsidies have now stopped, so we have adequate staff to fill the stores, and there's less of an issue with staff around the country.

To conclude, we are once again extremely pleased with our financial and operational performance in the second quarter. Next time we speak to you will be after the opening of our mega store, which is 5,500 square meters, 55,000 square foot which we'll be very excited to tell you about.

We could not have achieved these results without our amazing team members and daily dedication of them that continue to drive a rapid growth and of course without our customers.

Thank you very much.

Operator

Are you ready to open the line for questions?

Evan Nuemann

Yes.

Operator

Our first questions come from the line of Randy Konik with Jefferies. Please proceed with your questions.

Randy Konik

Thanks a lot. Hey, guys. I guess first question, maybe Evan, in the PowerPoint slides, you gave the COVID update and you talked about; I guess the implementation of green and purple standards. Just for us that are going to be a little less or those are going to be a little less familiar with what the changes are, can you just elaborate a little bit and give us some perspective on how any of the changes that the government is mandating due to the delta variant impact the way your stores operate or not change the way your stores operate going forward.

Evan Nuemann

Hey, Randy. How are you? Okay, so look, to date, yes there's a green and a purple is it, and it's not affecting us as of yet. When we had seriously harsh conditions last year where you couldn't put in more of a certain amount of people into the stores nearly as bad (inaudible) right under this condition (inaudible) have not affected our day-to-day operations. Most people have a green pass and the purple pass.

It's just amount of people you can put in stores which doesn't affect us because our stores are large, and so it hasn't really affected us yet. We're very confident because of our experience we had last year. These restrictions came as a shock, but we learned to adapt with them. We know how to adapt with them. Also, if we have to turn the business to (inaudible) which we did last year, we're ready for that, and we're much more well planned because of last year's situation.

Randy Konik

Super helpful. You mentioned in the remarks, you talked about the gross margin. While the gross margin was down a little bit, it was still very kind of solid, right. When you think about the outlook for gross margin going forward, do you feel that this 38 level over the next two quarters is appropriate? How do you think about where we should be modeling or thinking through gross margin over the next, I don't know, two to four quarters?

Evan Nuemann

Yes. Look, we're in the same battle as everyone else, so we're trying to fight the battle smart. We don't want it to go under this. We definitely don't want it to go under 38, and we're going to fight not to get it under 38.

How are we doing it? Well, we're choosing the range of products we bring in. So, we won't be bringing in knock-down furniture, we won't be bringing in couches, we won't be bringing in any products that you can only fit 100, 200 in a container, and we focus on the products with the furniture (inaudible), which are smaller items and generally have less relevance because of the freight.

That's our game plan. Nir, the CFO, sits with the planners and the buyers weekly to make sure that they're doing all their costing.

Randy Konik

Understood. Just on the inventory levels, I think you brought in some inventory to kind of offset some of the disruption. Can you just give us some perspective on the strategy behind that and where you made those investments just so we kind of get some perspective there?

Evan Nuemann

Yes. The investment was just basically in inventory, stocking up on inventory. Probably six months, four months, probably four months over the stock. I don't call it over the stock. I call it for winter. We identified in October that there will be price rises, and it's not even the price rises that scared us. What scared us that we wouldn't have items for back to school. I can tell you that a few days, we're breaking records of back to school sales, and the only reason we can do that is because we have enough stock, we have enough inventory.

There's a lot of stores, retailers around the world who don't have enough inventory to offer their customers. So, it was a strategic decision not only because of price but also because to make sure that we're in stock. It doesn't cost us a lot of money here to store the goods. We can store them. We don't have to invest in any new Capex or anything. That's all-third-party warehouse in which we can turn on and turn off.

Randy Konik

Super helpful. Thanks, guys.

Evan Nuemann

Thanks, Randy.

Operator

Our next questions come from the line of Brian Nagel with Oppenheimer. Please proceed with your questions.

Brian Nagel

Good morning. Thanks for taking my questions. There's a nice acceleration in the business on a comp basis between Q1 and Q2. Can you speak about the drivers of this strength, whether it was industry tailwinds or consumer dynamics or internal initiatives? Did you have any strength in particular in product categories?

Evan Nuemann

I think what's happening is a lot of consumers that we knew this would happen, a lot of people who didn't know who Max Stock was and what you could buy at Max Stock finally realized what they can buy at Max Stock and how much of a saving it is. I think COVID helped us with that. When there were a lot of closures and let's toy stores were closed or this and Max Stock was open, a lot of customers who normally wouldn't come to Max Stock suddenly came. Once a customer comes in, they realize it doesn't matter how much money a person's got, everyone wants a bargain. No one wants to overpay for things. I think it's just doing our job and making customers more aware. It's a bit of product variety expansion. The buyer is doing a good job.

I think it's a bit of everything. You can't really pinpoint one thing. Also, a lot of people never travelled this year. A lot of people stayed home once again. Although more trouble than last year but a lot of people stayed home so a lot of local and summer items, which was really successful for us.

Brian Nagel

Thank you. That's helpful. Another question I had was about back to school. We're excited to see how a potentially strong back school season could be for retail this year. Can you comment on what this season means for your business? Potentially how buying is looking to date, and how you're preparing for merchandising for the fall, especially considering higher supply chain costs globally.

Evan Nuemann

Look, we're very happy with back to school, how's it going at the moment. We've got two weeks before we go back to school. We're very lucky with our timing because we don't know what's going to happen with back to school. Every week that goes past before they make a decision is great for us, so we're a week away from being where we need to be. I think we're already there.

Here in Israel, I'm not sure. What I think in the States have gone back to school, but here in Israel, first of September is the back to school date, and we're kind of there. We kind of done what we need to do, hit, and beyond our expectations.

Brian Nagel

Thank you. That's helpful. I appreciate it.

Operator

Thank you.

There are no further questions. At this time, I'd like to hand the call back over to Management for any closing comments.

Evan Nuemann

Once again, we would like to express how happy we are with how things are going in the business. We would like to thank all our investors, all our customers, all our staff. We keep waking up every morning just trying to do the best, follow the secret sauce of the business, the right culture, the right product and the right shopping experience. Have a great day.

Operator

Thank you. This does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time. Have a great day.