Allbirds, Inc. (NASDAQ: BIRD)
Management Commentary
Q2 2022 Earnings Call
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Good afternoon, everyone and thank you for joining us. With me on the call today are Joey Zwillinger and Tim Brown, Allbirds's co-founders and Co-CEOs, and Mike Bufano, Allbirds's Chief Financial Officer.

Before we start, I'd like to remind you that we will make certain statements today that are forward-looking within the meaning of the federal securities laws, including statements about our financial outlook, 2022 and medium-term guidance targets, impact and duration of external headwinds, our simplification initiatives, and other matters referenced in our earnings release issued today.

These forward-looking statements involve a number of risks and uncertainties that could cause actual results to differ materially. Please also note that these forward-looking statements reflect our opinions only as of the date of this call, and we undertake no obligation to revise any statements to reflect changes that occur after this call. Please refer to our SEC filings, including our Quarterly Report on Form 10-Q for the quarter ended March 31, 2022 for a more detailed description of the risk factors that may affect our results.

Also, during this call, we will discuss non-GAAP financial measures that adjust our GAAP results to eliminate the impact of certain items. These non-GAAP items should be used in addition to and not as a substitute for any GAAP results. You will find additional information regarding these non-GAAP financial measures, and a reconciliation of these non-GAAP measures to their most directly comparable GAAP measures to the extent reasonably available, in today's earnings release.

Now, I'll turn the call over to Joey to begin the formal remarks.

Joey Zwillinger

Co-Founder and Co-CEO

Good afternoon everyone. Thanks for joining the call today. And a warm welcome to Katina – we're thrilled that you've joined the Flock.

I am pleased that we delivered solid financial results during the second quarter, in line with our top line guidance and ahead of our EBITDA guidance. Net revenue grew 15% year over year or 18% excluding FX headwinds and was driven by the strength of our US business, which grew a solid 21% year over year. Our adjusted EBITDA loss was $9.2M. Importantly, Allbirds surpassed $1B in lifetime net revenue this quarter, which is an incredible achievement for a brand founded in 2016.

In what continues to be a tough macroeconomic backdrop, we are proud of our growth compared to the category and believe we continue to take share as our products and value proposition continue to resonate. As for product, Q2 also saw the highly successful launch of our first high performance running shoe, the Flyer. We have made incredible strides in our foray into the performance footwear category with the Dasher, Trail, and Flyer franchises together now comprising 24% of total sales.

We believe that now, perhaps more than ever given the record heat waves occurring around the globe, our relentless focus and authentic leadership in the sustainable footwear category truly sets us apart and will allow us to win with consumers for years to come.

Stepping back, I'd like to make a few comments about how we currently see the external environment and how that is informing our view of the second half. Since our May earnings call, persistently high inflation has started to take its toll on consumers. Across our industry, elevated inventory and promotional levels have begun to impact digital and retail traffic trends. Our customer tends to have higher than average income, and hence, there was a lag on the impact of inflation, but this trend became notable in the US beginning in the back half of June. One of the greatest advantages of our business model is that our sophisticated data platform, and our direct relationship with our customer allows for rapid visibility into changes in demand signals. As a result, we are likely seeing this slowdown before others in our industry, and therefore have been able to pivot sooner.

In our international markets, FX headwinds have intensified since May. In China, while COVID restrictions have eased, they are persisting and translating to lower consumer spending there. And sentiment in Europe continues to be negatively impacted by ripple effects from the Ukraine crisis.

As it pertains to our 2022 guidance targets, we are taking a conservative view of demand in the second half, and proactively managing our business with the assumption that these headwinds will continue throughout the remainder of 2022. We anticipate that the most significant impact of this change since our last call will come from the US.

In response to this backdrop and current business trends, we have taken a series of actions to set ourselves up to continue delivering strong topline growth while keeping us on our path towards our profitability targets. These actions are intended to have positive impacts across gross and adjusted EBITDA margins, and to tighten inventory to more efficiently generate cash. I'll expand on these to give additional color.

First, we are investing in various elements of our supply chain to reduce both cost of goods and our carbon footprint. This includes forming new relationships in our manufacturing base, upgrading to more automated distribution centers, and moving to a dedicated returns processing provider in the US.

Second, we are streamlining our organizational structure and reducing SG&A. In addition to slowing the pace of new hires, which we began doing early in Q2, we made the difficult, but prudent decision to reduce global corporate headcount by approximately 8%. These reductions, in part, free us up to shift resources to continue to invest in areas that are critical for long-term demand growth, including product, sourcing and brand marketing.

Overall, we believe these Simplification Initiatives will optimize our cost structure, enabling us to drive substantial adjusted EBITDA improvement next year. In addition, because of the high quality nature of our inventory, we feel comfortable taking a leaner approach to our inventory management by tightening the open to buy over the next few quarters, increasing turns, and focusing on improved free cash flow generation.

Now I'd like to move on to provide updates on our three growth pillars. These pillars remain unchanged and are where we will focus efforts in this dynamic market. As a reminder, these pillars are:

- Expanding and energizing our product portfolio,
- Growing our store fleet, and
- Scaling our international business.

Within product we will further enhance our emphasis on footwear products and innovation to expand our offering across lifestyle and performance footwear. The highlight from the second quarter was our successful Tree Flyer launch, and its unique midsole technology, SwiftFoam™. Tim will talk through what's on deck in the second half of the year, why we're excited about our recent materials innovations, and how these enable a robust long term pipeline.

Moving to our second growth pillar – stores – we remain pleased with the performance of our US store fleet. Our stores are not only the best expression of the Allbirds brand, but are a fantastic customer acquisition tool, while delivering strong 4-wall economics. Moreover, as we grow our store footprint we continue to expand our base of valuable omni channel customers who spend around 1.5 times more than single channel repeat customers and comprise approximately 15% of our repeat customer base. During the quarter, our US store sales increased nearly 120% year-over-year.

We opened 7 stores in Q2, bringing us to a total of 46 as of June 30. To highlight a few…in the US, we opened in Fashion Island in Newport Beach in early June, which is our first store in Orange County, and 7th in Southern California, and it has exceeded our expectations. As we build stores in a region such as Southern California, we see meaningful gains in awareness drive strong store economics across the region, while substantially lifting overall commerce across channels. We also launched our first ever store in Canada in Vancouver and opened a second in Toronto a few days ago. And finally, I'd be remiss if I did not mention our Shanghai-based China team for their incredible execution while in lockdown, managing to launch our 5th store in the city of Hangzhou, which demonstrated our ability to generate high sales productivity in a low-capex build-out format.

Moving onto our third growth pillar – scaling our international business – based on our early investments in Europe and Asia, we continue to view the opportunity in our international business as at least as large as the one in the US. We remain steadfast in our conviction that our international expansion will prove to be an early mover advantage, allowing us to define what a sustainable footwear and apparel brand can be for consumers globally. Given the current macro uncertainty, and our actions to streamline workflows, we are focusing our resources more heavily in five regions: China, Japan, the UK, Germany, and Canada. We are proud of the inroads we are making in China and continue to see it as a key engine for future growth with attractive margins. Japan is experiencing significant consumer spending and FX headwinds, yet our underlying growth is strong; this is encouraging, as Japan is an important region to generate global style credibility, in addition to its large sales and profit opportunity. In the UK, we continue to gain traction with growing brand awareness, particularly within the 25 to 34 age group. During Q2, we acquired more new ecommerce customers in London than in any other market outside of NYC. In Germany we have had early success with our partnership with Zalando and are seeing traffic recover in our Berlin store.

In addition to our three core growth pillars, we are continuing to expand select third party distribution as a profitable marketing vehicle for our direct channel, with incremental top and bottom line growth over the medium term, albeit with modest impact in 2022. We believe that thoughtful and disciplined expansion into third party distribution can be a critical lever to help us expand awareness of the Allbirds brand while also building greater credibility in the performance category.

While it's still early days for our third party distribution strategy, we have established initial partnerships with marquee retailers, including Nordstrom, Zalando, Public Lands and Scheels, all of which are off to a strong start. Prospective partners view our brand as an exciting new growth lever for their businesses, and also a way to express their own commitment to environmental values, helping them meet this growing demand from their shoppers.

When we evaluate future partners, we focus most importantly on the consumer that shops there, and look for both credibility with those consumers, and reach to a new group who we haven’t met through our direct channels. This includes accessing geographies that we don’t expect to reach with our brick and mortar stores; a good example of that is our partnership with Scheels, which is a premium regional chain in locations where we do not expect to build stores for many years, if ever. We then focus on partners that present our brand in a compelling and prominent manner, such as our recent activation in the high visibility Center Stage at Nordstrom’s flagship store in New York. And finally, we show preference to retailers who are committed to improving their environmental impact.

Looking ahead, in the coming weeks we will be launching an exciting new partnership with Selfridges in London - a key shopping destination for global trendsetters which should help drive significant brand heat, and we will continue to update you as we get closer to launch dates with other marquee partners.

In closing, I am incredibly proud that we've grown Allbirds into a beloved brand. Consumer-focused innovation is the lifeblood of great consumer companies, and we believe that our innovative, sustainable approach to footwear and apparel is what truly sets us apart. I believe that one of the most important characteristics of an innovative company is the ability to quickly determine what is working and what misses the mark and having the agility and prudence to pivot accordingly.

Today's announcement of our simplification initiatives shows our team's ability to proactively manage this dynamic demand environment and position us for continued success, even amidst a difficult landscape. Importantly, and despite the increasingly challenged consumer backdrop, we have several proof points that I and other members of our Executive Leadership team track that show that our fundamental model is working. As a consumer-obsessed company, we look to maintain a best in class NPS, which we have continued to deliver; we also focus on our repeat purchase rate - which is strong at over 40% - that lets us know that our customers love our products. Similarly we also track customer LTV, which continues to grow as we provide new product that our consumers love and offer them additional occasions to buy in our stores and more recently in our third party partners' stores. These metrics demonstrate a best-in-class customer experience with a modern distribution model, all inside an enormous and growing addressable market where we still have low double-digit awareness - collectively, this gives us great confidence in our future potential. I firmly believe that the strength of our operating model will continue to propel us towards our medium term financial and sustainability targets, and we continue to win with consumers that we believe are increasingly aligned with the core tenets of the Allbirds brand.

With that, I'll turn it over to Tim.

Tim Brown
Co-Founder and Co-CEO

Thanks Joey and good afternoon, everyone. I'm excited to update you today on the steps we are taking to reinforce our brand positioning of *Super Natural Comfort*. We are proud of how quickly we were able to become a leading source for sustainable footwear and establish Allbirds as a standard bearer for the industry. Our relentless focus on innovation has been key to our success. 2022 is no exception and, as we shared in prior calls, is shaping up to be the strongest year in our history for new product launches.

The successful launch of Tree Flyer in Q2 represented our third performance shoe for running. The Flyer is lightweight, bouncy and super comfortable, bringing a powerful combination of performance, style and natural material innovation to our consumers who wanted an expanded offering to complement our Dasher and Trail Runner franchises. We know that if you're going to make a running shoe, it has to be extraordinary and so we spent more than 2.5 years researching, designing, testing and iterating to create a running shoe that is a key building block of our performance journey.

Made with revolutionary SwiftFoam™ technology, the Flyer represents a big moment for Allbirds and another groundbreaking step forward for our values, our purpose and our journey to meet consumer demand for natural material innovation in the category. SwiftFoam™ is a first of its kind bio-Pebax© midsole technology using plant-based castor bean oils enabling an estimated 20% reduction in carbon footprint versus petroleum-based synthetic alternatives. We believe that Tree Flyer's bouncy airy SwiftFoam™ midsoles are among the most responsive, lightest weight and most energy-efficient-to-produce midsoles on the market. Big kudos to our teams for bringing the Flyer to life on yet another new Allbirds materials platform that delivers both unique consumer benefits alongside significant advancement towards our sustainability objectives.

Cracking this code and meeting an expanded running use case opens up a substantial opportunity for us to build an enduring competitive moat in the performance category and the response from both consumers and media alike has been overwhelmingly positive. In fact 43% of Flyer sales in the first 30 days post-launch were to new customers - which we believe is a strong proof point that our performance offering is not only resonating with our existing audience but bringing new customers into the Allbirds brand.

We also delivered some exciting brand heat moments in the quarter with the launch of our Allbirds x Rosie Assoulin Sugar Sliders and limited edition Pink Flyers, which were a top selling style in the quarter thanks to a cheeky ad we launched with actress Lindsay Lohan. And just this past month, due to overwhelmingly popular demand, we re-launched our children's Smallbirds shoes with updated styles as a permanent collection, with an extended offering to cover Toddler and Youth sizing.

Turning now to apparel, we are sharpening our focus and refining our offering going forward. I think it's important to take a moment to ground everyone in the origins of our apparel strategy. First and foremost, we know our Allbirds customers have a desire for apparel and we also know that having apparel increases average order value and lifetime value. When we decided to connect our successful footwear franchises to apparel offerings, we leveraged unique natural materials to deliver next-to-skin comfort - a consistent hallmark of the Allbirds brand. This is reflected in the success of some of our core apparel offerings, including our socks, underwear, our classic t-shirts, and sweats which continue to perform well as expansions of our material platforms and articulations of *Super Natural Comfort.*

As we look back on our apparel journey, there are a couple of key learnings we're bringing forward to our next generation of product.

1. First, we went too deep on leggings, an incredibly competitive category.
2. Second, we were overly focused on narrow end use cases and have come to understand our customers want items that provide versatility across occasions that our material innovation supports.
3. Finally, given the strong sell-through data, we know that our customer values and prefers classic, seasonless items such as tees that complement our footwear offering.

Going forward, we will focus on a simplified lineup of apparel that showcases the versatility of our natural materials. Our Gen 1 assortment was less than half evergreen product. With our Gen 2 collections, a vast majority of the assortment will be evergreen product, which requires less seasonal merchandising and simplifies our buying process. We'll be leaning into classic everyday styles that emphasize functionality and versatility and we will sunset our leggings offering. Similar to our successful footwear strategy, we will continue to focus on the key materials platforms that can be leveraged across multiple products.

On a separate note, I am excited to share that we are launching a new design and product hub in Portland, Oregon. This office will serve as the creative headquarters for the majority of our design, and product development teams, enabling us to centralize resources, operate with greater agility and access world class talent in the greater Portland area. Moving forward, we remain committed to investing in our product and innovation teams which play a critical role in the continued success of Allbirds.

Later this year, we will be introducing our plant leather platform with the rollout of a new lifestyle franchise which will represent a new and more contemporary style moment for Allbirds. This is just a teaser of what's to come. We'll have more to discuss on our Q3 earnings call, but needless to say, we're excited to be bringing yet another groundbreaking Allbirds franchise to market.

In 2023, we have more on deck in both our lifestyle and performance categories.
As we matrix our materials across silhouettes, we have a big opportunity to create families of products – and associated pricing tiers across different lifestyle and performance occasions. We believe this investment in innovation and materials platforms continues to be our most powerful and durable competitive moat.

Now, over to Mike to discuss the financials.

Mike Bufano
Chief Executive Officer

Thanks, Tim and hello everyone. We are pleased that we delivered on our net revenue guidance target and beat our adjusted EBITDA guidance target in the quarter.

Our ability to deliver these results in this incredibly dynamic operating environment shows us that the underlying competitive moats Tim just mentioned are indeed durable. The Simplification Initiatives announced today will allow us to continue to invest in the customer while we navigate the external headwinds and work towards achieving our medium-term targets.

Going deeper into our Q2 results, Net Revenue grew by 15% vs last year, 18% excluding the impact of FX rates. Our two-year growth rate accelerated to 55% vs Q2 2020. The growth in Q2 was equally balanced between Orders and AOV, with AOV driven by a combination of price increases and increased units per order, due in great part to core apparel offerings. The price increase we implemented in March has broadly played out in line with our expectations with the increase in price more than offsetting any short-term elasticity. This speaks to the strength of our brand and the quality of our product offering.

Net Revenue growth by region was consistent with our expectations with International flat and the US growing 21%. Our International business was again pressured by external headwinds. In the US, the primary driver of growth was the Retail channel, which continues to perform well.

Given the US consumer dynamics Joey outlined earlier, I would like to provide some color on our recent monthly trends. From May to June, we saw a sequential slowdown in total company net revenue growth from the mid-20s to the mid-teens. This was driven by our US business, which began to slow starting in the back half of June. As of today, these trends have not yet abated. Our read on the data is that this slowdown corresponds to a broader slowdown in US discretionary goods spending, specifically in footwear. In other words, we do not believe we are alone in experiencing these dynamics in our US business.

Looking at adjusted Gross Profit, Q2 increased by 4% to $40 million, with adjusted gross margin at 51.0%, down 519 basis points to Q2 of last year. The main drivers are an estimated 400 bps of YoY COVID-related cost headwinds, as well as a lower mix of sales in our margin accretive International business. These factors were partially offset by mix shift to physical retail and higher margin products, as well as the price increase.

Wrapping up Q2, adjusted EBITDA was negative $9.2 million, ahead of our guidance target range due to tight management of corporate SG&A.

I'd like to now provide more detail about our Simplification Initiatives, starting with why we're proactively taking these actions now. It starts with our belief that we have a beloved brand, great products, durable competitive moats, and a powerful business model. We believed that at the time of our IPO and we believe it with even greater conviction today. In light of how the operating environment has changed over the last quarter and continues to evolve, the reality is that to be good financial stewards, we have to take quick and decisive steps to ensure that we can drive the business towards our medium term targets. As we said last quarter, we remain steadfast in our belief that there are several paths by which Allbirds can achieve those targets.

Said simply, the destination has not changed but the route we need to take over the next several quarters to reach that destination has.

Joey discussed the strategic rationale for the Simplification Initiatives. I would like to discuss how they will positively impact our cost structure going forward.

Starting with the supply chain initiatives, the transition to automated DCs and a dedicated returns processor will provide greater cost predictability in the second half of 2022 and should begin to positively impact adjusted Gross Margin as soon as 2023. The more rapid scaling of our manufacturing network should begin to meaningfully reduce product costs by late 2023. Taken together, we believe these initiatives can keep us on track to achieve our medium-term target of 60%+ Gross Margin in our direct business and make up some of the ground we lost to the COVID-related headwinds in 2021 and 2022.

Moving to the SG&A initiatives, the steps we've taken to simplify our operating structure and reduce office space are expected to generate annualized Corporate SG&A savings of $13M - $15M and will allow us to continue to invest in marketing spend, as well as add talent across product, brand and sourcing. The 2022 impact of these actions is approximately $4 - $5M and is factored into our updated 2022 guidance.

There are non-recurring costs associated with these Simplification Initiatives. We expect most of these to be incurred in 2022 but will keep investors updated on our progress. Let me walk you through our current estimates of those expenses:

- One, we are liquidating end of life inventory, primarily first generation apparel. We expect the non-recurring net expense related to this liquidation to be $(12) - $(14)M. The bulk of that expense already came through as a non-cash charge of $(11.6)M in Q2.
- Two, in Q3 & Q4, there will be $(3) - $(5)M of non-recurring SG&A expenses associated with employee-related expenses, reducing office space, and other projects. We estimate there will also be another $(3) - $(5)M associated with the transition to automated DCs and the dedicated returns processor.
- Summing that up, we expect the total non-recurring net costs associated with the Simplification Initiatives to be $(18) - $(24)M.

I'd like to close this section by again emphasizing that we are taking these steps to optimize our cost structure and set us up for significant adjusted EBITDA improvement in 2023.

Taking a look at the balance sheet, we ended Q2 with $122M of Inventory, which was up 3% from the end of Q1. While shipping times have improved somewhat, in-transit continues to account for about 1/3 of our total inventory.

Adding more color here, included in that $122M is about $10M of end of life product that we plan to liquidate as part of the Simplification Initiatives. Looking at the $112M remaining, this is good inventory, primarily core, evergreen footwear. In this dynamic demand environment, we will buy tighter on core footwear for the next few quarters, enabling us to make calculated buys on new footwear styles. This tighter buying approach, when coupled with our selective promotional strategy, is expected to lead to lower inventory levels and improved turns.

We ended Q2 with $207M of cash. To be clear, the majority of the non-recurring expenses outlined earlier are non-cash and will not have a material impact on our cash needs. With mid-teens revenue growth this year, slower SG&A spending, improved inventory turns, and tighter buying, we expect free cash flow to improve and do not anticipate having any incremental cash needs in the foreseeable future, as we have ample cash to fund our growth initiatives.

I'd now like to share some thoughts on our guidance targets. Until we have more certainty around the length and severity of the external headwinds, which now include the slowdown in US consumer spending, we will continue to take a cautious approach with our 2022 guidance targets. There are three elements driving our outlook:

- First, we now estimate a $(20)M - $(25)M full year impact on International Net Revenue from external headwinds. Worsening FX rates are driving the entire increase from our prior estimate of $(15)M - $(20)M.
- Second, we anticipate that US consumer discretionary spending trends will worsen in the back half of the year.
- And, third, in a demand environment like this, we know it's critical to stay nimble and meet consumers where they are. We will continue to be thoughtful about our selective promotional strategy, but we do believe the competitive environment will require an increased level of promotional activity, especially in Q4. We know that for Allbirds,

promotions introduce the brand to new consumers, drive demand, and efficiently move inventory. We are beginning to implement an expanded promotional calendar to include a more typical customer-centric cadence around holidays, as well as markdowns on end of season or “last call” products. To be clear, we will still be selective with promotions and for the full year, anticipate full-price yield in our direct channels of approximately 85% - 90%, which we believe is in line with, or higher than, other premium brands.

One housekeeping note: Our guidance targets exclude any non-recurring revenue and costs associated with the Simplification Initiatives.

Our updated 2022 Adjusted Net Revenue guidance target is $305 to $315 million, up 10% to 14% vs 2021, including an estimated YoY FX impact of 275 to 350 bps. We continue to target opening 16-17 new stores in 2022.

Our updated 2022 Adjusted Gross Profit guidance target is $150 to $157.5 million. At the midpoint of our Revenue and Gross Profit targets, this represents an Adjusted Gross Margin target of 49.6%. The changes from our prior target are business segment mix and a modestly increased level of promotional activity.

Our updated 2022 Adjusted EBITDA guidance target is negative $42.5 to $37.5 million. The change from our prior target reflects the flow through of lower Revenue and Gross Margin, partially offset by Corporate SG&A savings from the Simplification Initiatives.

Looking briefly at Q3, our Adjusted Net Revenue guidance target is $65 million to $70 million, up 4% to 12% versus Q3 2021, including an estimated YoY FX impact of 225-300 bps. Our Q3 adjusted EBITDA guidance target is negative $17.5 to $15.5 million.

Let me add a few more thoughts to help you model the second half.

- First, in the second half, total adjusted net revenue growth is targeted to be in the mid- to high-single digits. We expect the US and International to grow at similar rates for the balance of the year.
- Second, for the full year, we are now targeting International to grow low- to mid-single digits and the US business to grow mid-teens. We expect the second half slowdown in the US to impact Digital and Retail equally.
- Third, on an absolute basis, we expect adjusted Gross Margin to moderate sequentially in Q3 and then strengthen sequentially in Q4.

Let me close by acknowledging that this is a meaningful change to our 2022 guidance targets compared to what we were expecting at the start of the year. The reality is that the world and the operating environment have also changed meaningfully in the past six months. We believe that the external headwinds our industry is currently facing will pass and do not change our long-term story. We are a sustainability leader in an attractive market with a massive whitespace opportunity to grow our brand awareness from low-double digits.

During this consumer downturn, we are investing in building brand momentum through product innovation, marketing, retail stores, and marquee third party partnerships. We are confident that these investments in the customer, coupled with the Simplification Initiatives, will allow us to navigate this environment, position us well when the headwinds pass, and help us continue to make progress towards our medium-term targets. Again, the destination has not changed but the route we need to take over the next several quarters to reach that destination has.

Thank you for hanging with us for longer than usual prepared remarks. Let's open the call up for questions.