Allbirds Q4 2023 Earnings Call
Tuesday, March 12, 2024
Management Commentary

Christine Greany, Blueshirt Group

Good afternoon, everyone and thank you for joining us. With me on the call today are Joey Zwillinger, CEO, Joe Vernachio, COO, and Annie Mitchell, CFO.

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, including cash flow and adjusted EBITDA expectations, 2024 guidance targets, impact and duration of external headwinds, strategic transformation plan and related planned efforts, go-to-market strategy, planned transitions to a distributor model in certain international markets, anticipated distributor model arrangements, expected profitability, cost savings targets, gross margin estimates, product plan timelines and expectations, third party partnership strategy, marketing strategy, 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 September 30, 2023, 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, CEO, Allbirds

Thanks, Christine, and welcome everyone. We concluded 2023 with Q4 results at the higher end of our expectations, marking the fourth consecutive quarter of meeting or exceeding our guidance, with strong execution towards reshaping the business under our strategic transformation plan.

This being my last earnings call at the helm of Allbirds, it is a big moment for me both professionally and personally. I'm incredibly proud of what Tim and I helped create over the past 9 years. I'm also incredibly pleased with the renewed foundation we've established through our transformation work over the past year – not least of which being the incredible management team we have recruited to lead this next chapter of revitalization and growth.

Zooming out for a moment, I want to remind everyone about our higher-level opportunity. Allbirds makes shoes that are timeless and versatile in style, and innovative in the nature-derived materials we use. The blend of our unique approach to design and materials creates a highly differentiated offering – one that our consumer feels immediately when they slip on our shoes. The consumer we target – a group we call the Changemakers – represents approximately 20 million people in the US when applying the sharpest definition; and when we include closely adjacent demographic groups, this group grows to approximately 68 million people. Only about 5% of that 68 million target have purchased our products since our inception. And, with a per capita average of 8 pairs of shoes per year, the untapped potential of this group constitutes a tremendous market opportunity for Allbirds in the US alone. Judged by consumer reviews and NPS, we know that people who try our products *love them* – the challenge we are tackling now is to raise awareness of the brand, and compel this group *to buy* through delivery of great product and storytelling.

I will get back to product and marketing in a moment, as this is the most essential aspect of our transformation to revitalize momentum behind the brand this year. However, before we could bring our refreshed product line to market – as we expect to begin in earnest later this year – and invest behind those introductions with breakthrough marketing, we had to clean up our business.

In just one year's time, we have fundamentally changed and strengthened our underlying operating model, touching all critical aspects of the business, including our store portfolio, international marketplace, manufacturing efficiency, and cost structure. *And* we closed out 2023 with our inventory in a clean and healthy position in terms of both composition and absolute volume of finished goods, across all channels.

This new foundation enables us to drive durable profit as we grow in the years ahead. I'll give you a quick review of what our Flock delivered in the first year of our transformation:

- First and foremost, we cleaned up inventory, clearing through underperforming, legacy products and reducing our inventory levels by 51% year over year. As a result, we entered 2024 with a healthy mix of core franchise goods, and the ability to lean into the fresh product innovation coming later this year.
- Relatedly, we significantly improved our rate of full year operating cash use and ended the year in a strong cash position, providing us with the financial flexibility to continue executing our strategic transformation plan, and to now invest in profitable growth.
- The third area of success is cost discipline. We delivered cost of goods and SG&A savings compared to our run rate at the end of 2022, keeping us on track to achieve the 2025 cost reduction targets we previously communicated.
- Fourth, we secured pathways for four of our international regions to transition to a more profitable go-to-market strategy via distributors. Canada and South Korea transitioned in Q3, while Japan and Australia/New Zealand are expected to transition later this year.
- The final aspect of improving the operating model is related to our work to balance and optimize the US marketplace. Related to that, we have signed, or anticipate signing agreements to close 10-15 underperforming stores in the US, all of which are expected to close during calendar 2024.

While the groundwork for profitable growth is now laid, there *will be* a short-term revenue impact in 2024 as a result of these transformative activities. Between store closures, and the shift to a more capital efficient go-to-market strategy in international regions, our guidance for the year contemplates between $32-$37 million of revenue impact in 2024. Annie will walk through the implications of these actions in detail. The important takeaway is that we're doing what's right for the business, and this part of our journey is in service of driving long-term profitable growth well into the future.

Stores remain a highly effective way to meet new customers and drive omni-channel purchasing. *And*, omni purchasing is the most profitable consumer journey we can generate, with their lifetime values far surpassing single channel repeat customers. As we focus on renewing brand momentum and driving sustained growth in the US, we are leaning into our most efficient stores in key cities where we want to win. The wholesale channel also represents an important vehicle for Allbirds, one that can help us build awareness for the brand while further balancing the marketplace. We have always envisioned wholesale as a large portion of our long-term channel mix, and continue to see that in the future, offering a major growth vector for us which we expect to drive solid contribution margin and increased awareness, all coinciding with our objective to introduce consumers to a refreshed product line around our icons.

For our international regions, I want to recognize that this is one of the more complex aspects of our transformation plan, and to that end, Annie will provide a detailed walk-through on the economics of these transitions and the related P&L impact. We have secured partnerships in four key regions, with additional regions in process. This was a significant task, and one that the team effected quickly, while prioritizing a premium brand presentation to consumers in these regions.

The distributor model carries multiple benefits, including improved profitability, inventory efficiency, reduced complexity in our US headquarters and improved working capital. In the early stages of the transition, there is a short term headwind to growth, but the benefit is higher quality revenue with greater flow-through to the bottom line. Going forward, we expect to generate approximately 20% contribution margins in the transitioned and new international regions through this model.

With the capability built to effectively serve distributors in international markets, we are now pursuing opportunities to enter new regions, including Southeast Asia, the Gulf Coast Countries, and to localize in key regional marketplaces across continental Europe. We expect to share news on these growth opportunities in the near future. In the UK, we expect to maintain our direct distribution model, as we see a big opportunity to win in London, which we view as a strategically important market for other regions, and where we have made significant inroads. We will also add wholesale in the UK to drive new growth.

With the heavy lifting of last year complete, and a clean inventory backdrop, our teams have amplified their focus on driving long-term, profitable growth.

The most critical aspect, and final step in our transformation is to revive brand momentum, and reignite top line growth. The path to do so is through delivery of a relentless flow of compelling product, coupled with resonant stories aimed at Changemakers. With our approach to innovation – leveraging a franchise offense with embellishments and distortions to our icons – we intend to drive newness while maintaining high SKU productivity. Given we started this transformation in the beginning of 2023, and have typical lead times of 15-18 months from concept-to-consumer, we are on track to begin delivering this refreshed product line in late Q2 of this year. Our first test of this strategy was with the release of the Wool Runner 2 this past November, which was our most successful launch in over a year. And, while just an initial test with relatively minor aesthetic adjustments, the success of this product has given us a clear indication of how we can differentiate from others in our category, and deliver products that our consumer will come back for time and time again. You'll see our first major innovation of 2024 around an icon in April when we plan to launch the Tree Runner Go. We will follow that with additional innovations specifically designed to address our opportunity with women Changemakers in Q3.

In conjunction with the new life injected into the product line, you should also expect investments into brand marketing later this year aimed at growing awareness. The focus of these investments will be to introduce new consumers to the brand, and drive full price sales as they progress through the funnel, with mid- and longer-term impact extending into 2025. Our aided awareness is estimated to be just 15% in the US, illustrating the big opportunity to showcase our beloved products to new consumers.

In support of this effort, we have significantly elevated the horsepower on the creative side of our business. In December, we appointed Kelly Olmstead as our Chief Marketing Officer, as well as Adrian Nyman as Chief Design Officer. Both of these individuals bring incredible track records and decades of experience in footwear and apparel. Adrian helped deliver an enhanced creative vision through his work as an advisor last Fall, and since joining as our Chief Design Officer, has accelerated our work towards a cohesive approach to our franchise offense. Kelly is refining the messaging to match the elevated product offering, and bolstering efforts with a digital-first influencer program to build awareness and relevancy. With this superb design and marketing leadership in place ahead of our upcoming product cycle, we're eager to create the renewed consumer excitement and margin expansion that we anticipate on the horizon from these leaders.

Annie has been successful in driving the operating and financial discipline we have demonstrated through her role as our CFO since joining early last year. And, finally, I'll speak about Joe Vernachio, who – as COO – played an integral role in the success of the first year of our transformation efforts. Along with some other longer-term team members, we have assembled the best executive team in the history of the company.

With a world-class team in place, I am proud to hand over the reins to Joe to be our next Chief Executive Officer. Joe and I have developed a strong partnership over the past three years, as I steadily increased the scope of his responsibility. Not only is he an exceptional retail operator, but I learned that Joe's appetite and ability to drive positive outcomes has increased with each expansion to his role. He is a product executive at heart, but a human-centered leader who pragmatically focuses on driving outcomes for the company and its shareholders. I am thrilled to welcome Joe as our next CEO, and as a member of our Board of Directors, where I will sit alongside him and continue to support him in rebuilding momentum behind the Allbirds brand.

Joe, congratulations! I'll now pass it over to you to share a bit about your background and your initial priorities.

Joe Vernachio, COO, Allbirds

Thank you, Joey. I'm excited and honored to be stepping into this role and look forward to getting to know our analysts and investors in the upcoming quarters. This transition marks a high point in my career, which began in 1987 at Patagonia. It was during those early years that I developed a passion for creating exceptional products. I honed my skills in product development, operations, and merchandising over decades working with several iconic brands such as Nike, Calvin Klein, and The North Face and orchestrated the turnaround at Mountain Hardwear.

I joined Allbirds nearly three years ago, attracted by its potential to become a lasting, iconic brand – led by its lifestyle positioning, commitment to sustainability, and inherent consumer value.

Since June of 2021, I've had the pleasure of working side by side with Joey. Initially, I was tasked with establishing operational excellence across various functions, including distribution, inventory, and manufacturing while leading our global commercial activities in digital, stores, and wholesale. As a key player in our operational transformation, I have been able to apply my turnaround experience to our inventory reduction, international transitions, and retail optimization.

Most recently, I took charge of our product engine, where I installed Adrian as our Chief Design Officer. Together, we are building a world class design team. As the year progresses, we look forward to sharing more about our vision for the 2025 product line.

As I step into the CEO role, I'm pleased that we have structured the business to deliver profitable growth in the years ahead.

Consistent with the key pillars under our strategic transformation plan, in the near term, I will be prioritizing these four areas:

- Number one is product, ensuring we have a steady flow of compelling product that resonates with the consumer is paramount to my strategy. We believe a combination of focusing on our iconic footwear and incorporating seasonal collections is a recipe for delivering more of what our customers love most about Allbirds.
- Number two is brand messaging that delivers a clear, connected narrative at both the brand and product level that results in increased consumer awareness.
- Third is developing a robust US marketplace. This includes growing full-priced sales in our digital channel, optimizing our owned retail performance, and steadily growing our wholesale channel with key partners such as REI, Nordstrom, and Dick's Sporting Goods. We believe there is tremendous growth opportunity in the wholesale channel for our brand.
- Fourth is expanding our international business, primarily through distributors. Partnering with these in-region experts can help us extend our reach and drive greater brand awareness in both existing and new geographies over time.

As you can tell, my priorities are about driving growth. We have significantly improved our business model and reduced our cost structure over the past year – and now it's time to regain momentum with our customer and position the brand to return to growth in 2025. As we turn to this next chapter, we are fortunate to have incredible people across the organization who are passionate about the brand, dedicated to our purpose, and committed to winning.

Now, I'll pass the call to Annie to discuss the financials and our outlook for 2024.

Annie Mitchell, CFO, Allbirds

Thanks Joe, and good afternoon everyone. We're pleased to report our fourth consecutive quarter of both operational and financial progress. Our Q4 results came in at the high end of our guided range on the top line and ahead of our expectations on the adjusted EBITDA line. We also delivered significant progress across inventory and cash, with inventory reduced by half versus a year ago and operating cash use down both sequentially and year-over-year.

Fourth quarter revenue of $72 million declined 14.5%, reflective of our actions to continue clearing through non-core product, and reduced marketing investments.

Gross margin came in at 38.0% compared to 43.1% a year ago. This was in line with our expectations and was inclusive of our planned promotional activity, which allowed us to end the year in a healthy inventory position. The impact of promotions more than offset cost of goods savings resulting from lower outbound freight.

Looking at expenses, SG&A dollars, excluding stock-based compensation and depreciation & amortization, came in better than we expected on both a sequential and year over year basis. This reflects lower personnel expense, as well as ongoing cost discipline. In 2024, we expect SG&A dollars to be down year-over-year, as we realize the full year impact from previous workforce reductions, and capture partial year savings related to 2024 store closures and international transitions.

Turning now to Q4 marketing expense, we were up sequentially from Q3 in dollars, which was in line with our plans to increase spend in support of the holiday selling season, as well as our Wool Runner 2 launch. Looking at 2024, we expect marketing spend to be down, largely associated with our international transitions, with planned incremental investments in the US in the back half.

Moving to the balance sheet and cash flow, we delivered another solid quarter of progress on inventory and cash and ended the year in strong financial condition.

Year-end inventories totaled $58 million. That's down 51% versus a year ago and reflects the cleanup of non-core colors and styles which allowed us to enter 2024 with healthy levels and composition.

Our progress on reducing inventories, coupled with strict control over expenses, enabled us to narrow our Q4 operating cash use to $4.7 million vs. $8.4 million a year ago. On a full year basis, operating cash use was $30 million - down significantly from $91 million in 2022. We closed the year with $130 million of cash and cash equivalents and no outstanding borrowings under our $50 million revolver, providing us with the runway and financial flexibility to execute our strategic transformation plan. After a year in which we converted a significant amount of inventory into cash, we anticipate that operating cash use will naturally increase in 2024 compared to 2023.

We're proud of our strong execution in 2023. We did the hard work, achieved our goals and put us on the path to rightsizing our cost structure. Importantly, we're tracking to the COGS and SG&A savings targets we laid out a year ago. As a reminder, our 2025 targets include $20-$25 million of cost of goods savings on a volume-neutral basis to 2022, and $15-$20 million of SG&A savings on an annualized basis, as compared to our run rate at the end of 2022.

As you heard earlier in the call, we're taking actions this year designed to position the business to return to top line growth in 2025 and set us up to deliver profitability in future years. Now I'll walk you through the financial impact of two key initiatives.

First, we're optimizing our US store portfolio through the exit of certain underperforming leases. We are focused on four-wall EBITDA profitability and anticipate that a leaner portfolio will enable us to improve fleet profitability, working capital and inventory. Following a rigorous fleet review, we are planning to close 10-15 stores in 2024, representing up to one-third of the portfolio. In conjunction with the closures, we expect to incur one-time cash charges to settle these leases, largely in the first half of the year.

Turning now to our international go-to-market strategy. One of our objectives today is to educate our analysts and investors on the modeling implications and related P&L impact resulting from our transitions to a distributor model in the majority of our international markets.

Conceptually, the best way to think about each line item is as follows:

- Starting with net sales. From a high level perspective, we are replacing direct sales to the consumer with sales to the distributors at a lower price – similar to a wholesale model.
- Following a large, initial inventory buy as part of an asset purchase agreement, volumes remain low for the first quarter or so and then begin building in the next quarter. While the distributors will buy from us each quarter, we anticipate volume purchases in Q2 and Q4 will be proportionately higher due to seasonality.
- The margin and profit profile is also similar to a wholesale model in that gross margin is lower than our direct business, and SG&A and marketing expense is minimal.
- We anticipate that gross margin will be approximately 15-20 percentage points below total company margin, and in-region SG&A and marketing costs will reduce to a nominal amount.
- Taken together, this represents in-region savings of approximately $14 million on an annualized basis. Additionally, our in-region capex will be de minimus.
- For added context, we will leverage global creative investments at the corporate level and maintain limited operational costs within our headquarters which will be included in total company SG&A.
- From a bottom line perspective, despite lower gross margins, with minimal overhead in these regions, they are expected to be immediately profitable and carry an average contribution margin of approximately 20%.
- Additionally, from a working capital perspective, the new model is expected to unlock inventory efficiencies and drive improvement in working capital.

To further assist with your understanding of our international transitions and progress against our strategic transformation, at the conclusion of this call we will be posting supplemental materials to our investor relations website under quarterly results.

The financial guidance we're providing today reflects a full year of operations under the new distributor model for two regions - Canada and South Korea - and approximately half-year contributions for other regions transitioning or expected to transition later this year. To assist with your modeling efforts, during this first year of transition, we are also providing a revenue outlook for each of the US and the international geographies.

For the full year in 2024, revenue is expected to be in the range of $190-$210 million. This reflects a headwind of $32-$37 million related to our strategic actions to close US stores and transition our international markets to a more profitable distributor model.

Stepping back and looking at the underlying business excluding these two near-term headwinds, we believe the inventory clean-up in 2023 will enable us to return to more full price selling in 2024. We believe this is the right approach for the brand, but we recognize there may be a natural lag for the consumer after responding to our promotional messages and offers last year. To that end, the low end of our revenue guidance reflects trends down in the mid-teens. The *high* end of our guide reflects sales down mid-singles, which assumes a modest improvement in consumer response to our new products and storytelling in the second half of the year.

Taking a look at revenue by geographical market…

- Full year US revenue is expected to be $150-$165 million and includes approximately $7-$9 million of impact resulting from our anticipated US store closures.
- Full year International revenue is expected to be $40-$45 million and includes approximately $25-$28 million of impact resulting from our anticipated transitions to a distributor model in international markets.

Gross margin is expected to be in the range of 42%-45% and reflects a few key factors:

- Reduced promotional intensity compared to 2023;
- Lower inbound and outbound freight; and
- Initial savings from our factory shift to Vietnam and material innovations.
- These benefits are expected to be partially offset by lower gross profit from international regions that have transitioned or are planned to transition to a distributor model in 2024

Full year adjusted EBITDA loss is expected to be in the range of $78-$63 million.

Turning to Q1 guidance…

First quarter revenue is expected to be in the range of $37-$42 million. That includes US revenue guidance of $28-$31 million and international revenue guidance of $9-$11 million. Adjusted EBITDA loss is expected to be in the range of $27-$23 million. As a reminder, during the first quarter we will be operating with two of our international regions already transitioned to the distributor model - Canada and South Korea.

For added perspective as you think about building your full year models, we expect top line trends to remain fairly consistent for the first three quarters of the year, with seasonally-driven improvement in Q4. There are a number of factors driving the anticipated trendline, including:

- The transition of at least four international regions
- Store closures
- Tough comparisons to promotional activity in 2023, and
- Consumer response to new product introductions, as well as marketing investments we intend to make in the second half of the year.

Looking further ahead, achieving adjusted EBITDA profitability and positive cash flow on a full year basis remains our north star, but the timing to get there may take longer than anticipated. We believe the actions we're taking this year will position the business to return to top line growth in 2025 and feel confident that our transformation work is enabling us to build the operating model needed to drive profitable growth in future years.

We appreciate your time this afternoon and look forward to reporting to you on our progress throughout 2024. Now I'll ask the operator to open the call to questions.

**** Q&A****

Joe Vernachio

Thank you everyone for joining us today. I am incredibly energized by the opportunity ahead of us at Allbirds and I am personally looking forward to getting to know our analysts and investors in the coming months.