

Q2 2019 Earnings Call

Company Participants

- Julian Garrido Del Val Neto, Chief Financial & IR Officer and Member of Management Board
- Roberto Funari, CEO & Member of Executive Board

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the audio conference call that will review Alpargatas Second Quarter 2019 Results. (Operator Instructions) As a reminder, this conference is being recorded and webcasted at ri.alpargatas.com.br.

This conference call includes forward-looking statements or statements about events or circumstances which have not occurred. Alpargatas has based these forward-looking statements largely on its current expectations and projections about future events and financial trends affecting the business and its future financial performance. These forward-looking statements are subject to risks, uncertainties and assumptions, including, among other things, general economic, political and business conditions in Brazil and in other markets where the company is present. The words believes, may, will, estimates, continues, anticipates, intends, expects and similar words are intended to identify forward-looking statements. Alpargatas undertakes no obligations to update publicly or revise any forward-looking statements because of new information, future events or other factors. In light of these risks and uncertainties, the forward-looking events and circumstances discussed on this conference call might not occur. The company's actual results could differ substantially from those anticipated in the forward-looking statements. Participants on today's conference call are Mr. Beto Funari, CEO; and Mr. Julian Garrido, CFO and IRO.

I would like now to turn the conference over to Beto Funari. Please go ahead, sir.

Roberto Funari {BIO 17031506 <GO>}

Good morning. Good afternoon. Welcome to our conference call for the Second Quarter 2019 results. I'm here with Julian Garrido, our CFO. I'm going to cover the performance, the operational results and the highlights. And Julian will follow with the financial results. And I want to, in my closing remarks, to share with you where we are in our transformation of the company in the powerhouse of lifestyle brands.

So our consolidated results for the Second Quarter 2019 showed an increase in revenues of 12% to BRL 993 million and an expansion in our EBITDA margin and a growth of 39%. Our recurring net income grew by 278% driven by our operational performance, market

expansion and also due to the base of last year where we had a deflationary impact in our Argentina business.

Our operational performance highlights with South Argentina, Topper and Textile, showed growth in net revenue of 15%, increasing our net revenue to BRL 843 million, an expansion of our gross profit of 0.4 basis -- 40 basis points, plus 16% and a growth in our recurring EBITDA of 34%, a market expansion of 180 basis points, taking our EBITDA to BRL 112 million.

Our results are driven by quality of our net revenue growth, both in terms of volume growth, price mix and also amplified by the impact of our productivity and efficiency gains.

In terms of our geographical performance. In the Second Quarter, Brazil grew volume by 5% and revenues by 17%. And our international business grew volume by 15% and net revenue by 14% on a reais base. The growth in Brazil was driven by our growth in our B2C and expansion distribution in our indirect channels. And the net revenue performance was driven by volume and also by a positive price mix with the introduction of new collections for both Havaianas Brazil and also Osklen, also have seen an improvement in performance from our Mizuno brand.

In our international business, mostly Havaianas Global, we see continuous growth in our volumes. And our revenues were impacted by the mix of regions with highlight of performance in our Asia Pacific and Latin America business, with steady performance both U.S. and also Europe, Middle East and Africa.

Our strategic focus is on our front line, is in our brands and consumers. So a very critical metric for us is our sellout metric that demonstrates the product of their underlying performance. So our sellout metric is on a same-store basis of our direct-to-consumer business in Brazil.

I also would like to share with you our share performance in Brazil, our volume share performance of Havaianas in Brazil. So our share performance in Brazil was positively gated 50 basis points in market share with Havaianas, driven by our outperformance in direct-to-consumer in key accounts and also distribution expansion in our indirect business.

Our same-store sales performance has been positive. In Havaianas, plus 17%; and in Osklen, plus 21%, demonstrating the power of our new collections. But also our shift of focus on our e-commerce and omni-channel platforms.

In terms of business highlights, we had a very strong performance in our digital market in Brazil. Our Instagram followers grew by 49%. The -- our YouTube video performance reached a record high of 12 million viewers per video. It is outstanding for Brazilian media landscape. We have also launched important innovations in digital in United States, with an interactive boardwalk of virtual reality at the beginning of the season in the U.S. We have also relaunched our e-commerce direct-to-consumer flagship store in Europe successfully with improvements in highlighting our collabs but also in digitalizing our content. We have

also launched in China, our direct operations and our direct-to-consumer, the launch of our Tmall flagship store last month. And in India, the launch of our direct-to-consumer store in Myntra, a key passion-driven platform in India.

In terms of driving desirability from a brand, that's very important element of our marketing strategy, I want to highlight the partnership of Netflix and the launch of -- in sync with Stranger Things series launch, our Havaianas Stranger Things, a success in our store. Also in Europe, we collabed with Happy Socks and also the joint business partnership with Pull&Bear in Europe. Also, we launched a special edition in collaboration with Yves Saint-Laurent. And also we amplified our partnership with Tarsila do Amaral, which in Brazil had a record high success to exhibition in the SÃ£o Paulo art museum this -- last quarter.

In terms of best sellers, we had 5 best sellers for this quarter. The launch -- successful launch of Havaianas Slide in Europe; globally, the launch of Havaianas You Saint Tropez; and the light -- the launch of Havaianas Slim Hit; followed by the Slim Glitter, which we have both launched, Saint Tropez and the Glitter range, which have been success globally; and also our growth in the men platform with the launch of Havaianas Urban Family.

Osklen will continue to grow and expand our omni-channel offer. We had a 104% growth in the Second Quarter, 148% growth in the first half 2019. The Zodiac launch, which supported our Valentine's Day in Brazil was amplified with omni-channel and grew especially in our top 5 stores in SÃ£o Paulo. We also got an incredible recognition by the Green Carpet Challenge, where we got a sustainability recognition for Osklen. And also we continue to amplify the partnership with Tarsila do Amaral. We have done a successful prelaunch online of our Hybrid range back in February. And in May, we launched successfully these range in our stores.

In Mizuno, we have launched beginning of the year our online platform. This is growing extremely healthy in the Second Quarter. We highlighted the launch of Sky 3, our premium running platform but also apparel, where we start to drive lifestyle with the Mizuno brand online and offline.

So I'll hand over now to Julian to share our financial results.

Julian Garrido Del Val Neto {BIO 20748017 <GO>}

Thanks, Berto. Good morning, afternoon, depending on where you are, everyone. So let's go back to the first slide that presented, then go a little bit deeper into the details here.

So on Page 13. So if you go to the left side here on the net revenue, double-digit growth, 12%. The message here is, well, the focus, as Berto said, customer-centricity, the sell-out management and being more digital.

So the highlights here as we see it by regions here. So in Brazil, Havaianas is the main driver there, not only as we saw the volume going up. But also the pricing mix.

FINAL

On the international side, 3 highlights here. The APAC, meaning Philippines and Australia. And the main, it's most of the shallow highlight here on the wholesale, where we grew more versus last year. And in LATAM, Colombia is the biggest driver there. So this is on the top line now.

If I go to the recurring EBITDA here at 39% there, there are 3 main drivers behind this. Now the first one I'll just mention is a top line effect. The second one is the productivity gain that we had at a factory in purchasing level as well. We have the VIP project, which is a project we have for a value-added productivity here, has been doing well. We had a clawback plan here versus test. So that helped it out basically. Part of the headwinds that we had on the increase of the rubber price versus last year. And as I had mentioned before, the volume coming out from Argentina. So productivity gain is a second driver. We also had productivity gain at the SG&A level, not only because of the, of course, more fixed cost absorption due to the volume there. But also the fee-based budgeting that we implemented. So those are the 3 main drivers that drove this 39% and 260 basis points.

Now we'd like to move to the recurring net income. They're all the same drivers. I'll just add one highlight here. Last year in this quarter, in Argentina, we had a huge FX impact that we didn't see this coming up this year.

Now going to the next page, Page 14, we're going to look at the net revenue here for regional and business perspectives. On the left side here, you see that the comparison versus Q2 last year in this, we see Brazil being higher on the share of the pie there. And we see the opposite coming up from the Argentina for the reasons that I mentioned before, the highlight I would also make here by region. You may know, we are talking about net revenue. And you see 28% flat here on the international side. When we go to the EBITDA, we see the contribution of the international being higher. I'm going to get there in a second.

Now go to the right side there on -- in the middle. So you see business on a consolidated perspective. Because of the Argentina Topper on the sporting goods, you see this shifting more sandals than actually sporting goods.

Last but not least, on the right side, with the Brazil by business. What we want to highlight here is that Osklen grew a little bit more than actually the sporting goods. That doesn't mean that sporting good did not grew -- did not gain share. But Osklen grew even higher than.

Going to the next page, Page 15. Now a little bit deeper on the EBITDA per sale. The left side there, you see the 39% that we mentioned. You see there the contribution coming from the international side that I highlighted. On the bars still on the left side here. But more towards the middle, as I compare the first half, you see the growth, 20%. I want to highlight Brazil growing at 14% and international growing a little bit higher.

On the right side here, it's clear that the Brazilian 9.5%, of course, this is Brazil, including Osklen and Mizuno as well. But the international more than the double there on the margin %.

On the highlights on the Argentina, again, as I said, despite of the drop of the volume, there was a price increase in productivity gain. And we have been working there to mitigate the effect coming from the environment.

Going to the next page, Page 16. Now what we want to do to here is to bridge between recurring and the reported EBITDA. The idea here is to have comparable basis. So we set it up there. In order to do there, I'll focus on the first column on the Q2 '19, then I'll jump to the second column. So we had a couple of things here, not comparable, nonrecurring. In the Brazil, to highlight, is this success of the outcome of the lawsuits of the PIS business, one of the excise taxes that we have. That's something that we don't have it. That's why we call it nonrecurring. So that's a good guide. And as a bad guide, we have the impairment we did this quarter related to the investment that I had in Brazil related to Argentina, we had on the goodwill, sorry.

Then, when I go down to the BRL 21.2 million, it's basically 2 things: the hyperinflation adjustment, the IAS 29 that we didn't have last year and we have this year and some of the recurring restructuring.

If I do the same exercise -- same mindset exercise on Q2 2018, we had a one-time success fee on contingencies. We are now booking the success fee even though we are showing that we would have success in some of the contingencies we had. So we've decided to do this last year. Since it was a one-timer, we consider that a noncomparable, nonrecurring. And in the case of Argentina, it's basically restructuring that we started to do last year and we're still having this year.

Only light -- the only highlight that I'm going to do on the first half here or semester is on 2018, where we sold our property there, headquarters of Argentina. And of course, this is not something you do every day. It's not comparable. So having said that, that's why we have the 39% on the quarter and the 20% on the semester in the first half.

Now with the same mindset, if you turn the page to the 17, I did the same exercise for the net income. They basically are the same drivers. The only highlights I want to do here, which we didn't have in EBITDA because this relates to the income tax. Last year, we declared the interest on capital that brings a tax benefit. And this year, we didn't have it. So they are not comparable basis. And this, again, relates to the interest on capital that we have, not something that we have necessarily every year. And again, you see there on the first half of 2018, the BRL 28.2 million (sic) (BRL 28.8 million) again, is the Argentina headquarters that we sold, real estate.

Last but not least is the bridge that we did to show the variance of the net financial position. We go for a BRL 39.9 million to BRL 177 million. So that is BRL 137 million variance. If I exclude the payments to the shareholders, the interest on capital that I mentioned before, we generated closely to BRL 200 million here. And it's all coming from operations. You see the EBITDA being the driver. As I mentioned before, we had the tax that we were -- we had success on the courts. But we still did not use that.

On the right side here, the highlight is on the financial results here, the BRL 68 million negative, of which, BRL 52 million come from Argentina. But I didn't write it. But we also have the effect of IFRS 16 of BRL 10 million negative there as well.

So long story short, we are generating cash from operations. And that's the important message here.

I will hand it over now to Roberto for the final message.

Roberto Funari {BIO 17031506 <GO>}

So Alpargas is the largest lifestyle brand company in Brazil with Havaianas, Osklen and Mizuno. And our additional strategy is to become a global powerhouse of lifestyle brands. So we announced last week the launch of the new Alpa in order to take a performance lead and accelerate our high-growth cycle.

To understand where we are now on this transformation of the new Alpa, we have been driving our strategic bets but also our efficiency productivity programs, the VIP100%. We target this -- of that improvement probably now on costs and our geo-base target in our SG&A.

We're (having) also successfully introduced in the organization a new management system that makes us more analytics-driven but also much more agile with fast decision-making both in terms of capturing these opportunities but also correcting course where we are performing.

In parallel, since the beginning of the year, we have been strengthening our leadership team with a profile of global minds and global-experienced high track record leaders. So we are now very proud to take this organization to a new level. We announced the last week a new organization, a new culture that will allow for this performance and growth leap with 3 main principles. The first one is a higher focus on proximity with our consumers, with the front line on business. The second principle is a higher focus on our strategic bets, especially in geographical one and also the creation of 3 areas of access to support that strategic focus.

And in doing that, we have also to the opportunities to promote and value the people from within with a couple of external adds. So there are 2 major changes announced. The first one was the creation of 6 brand market units. So we are moving now from 3 business units, Havaianas, Mizuno. And Osklen, to 6 brand market units. And I will describe in the next slide what does it mean. Secondly, we are announcing 3 new global areas of excellence: global marketing, global technology and global supply chain.

So the new Alpa has the following new areas. First, we're going to have 5 brand market units for Havaianas Brazil led by Fabio, which is the current Head of Brazil.

FINAL

Bloomberg Transcript

FINAL

Europe, Middle East and Africa, we are adding India. And will be led by Guillaume. Here, the rationale is where the second largest business outside of Brazil. The largest is outside of Brazil. The second largest is Havaianas after Brazil. With place of track record and experience in launching and growing the brand in new markets, now taking over the responsibility over India led by Guillaume, who is the Head of Europe, Middle East and Africa.

Asia Pacific, where the big brand is China, led by Robert, which are in the current incumbent. We are creating a new business market unit, North America and Caribbean, where the big bread is U.S. led by Jacob Uhland. Jacob comes from 22 years experience with VF Corporation, 20 years of North Face. And the last two years has been be a Senior Director on digital channels for all brands of VF Corporation. Jacob has not only deep and proven experience in the U.S. market but also has held leadership positions for Latin America and also the launch of North Face in China.

For Havaianas Latin America, you continue to be led by Tomas, where we have a pilot test in Colombia, which is now performing strongly. And we believe this could be a platform to roll out across Latin America. We are consolidating Osklen with Mizuno, under the leadership of Leandro, the current CEO of Osklen. And with that, we're going to capture not only synergies. But also we're going to capture opportunity expression in the footwear area.

In terms of new areas of excellence, we are establishing our global marketing area led by Fefa Fernanda Romano. And that arrow have 2 pillars: one is global marketing Havaianas. And the second pillar will be marketing and -- digital marketing and digital channel services for all brands. We are also elevating the technology area to report that actually to myself led by Jorge Ramalho. Ramalho has 30 years' experience globally in financial industry and the last 35 years with ItaÃ° Unibanco.

And we are also creating and strengthening our global supply chain area under the leadership of Marcelo Turri focusing on sales and operating planning, transport logistics and also procurement.

These global supply chain have more weight over our global business and also the operations in Brazil.

So all these areas will be reporting to myself and supported by our new management system, is going to have a higher agility, higher empowerment of our brand market units, combined as proximity with focus.

We're also strengthening our Board. We are proposing subject to approval now a general extraordinary assembly that will have authority of August a new Independent Board member. Her name is Stacey Brown. Stacey has been a backbone for the last 20 years in the Apple retail units. She's the current Head of Retail Merchandising and Accessories worldwide. She has held previously positions in Apple retail in the U.K., Holland, Australia, Japan and Southeast Asia. And prior to Apple, she has had 10 years' experience with GAP Inc., which also includes Banana Republic. So we are welcoming Stacey subject to the

approval in our ESM. And Stacey will also be leading our Strategic Committee and will be member of the People Committee.

So with that, we feel we are in a very strong position to continue to build a global powerhouse of lifestyle brands. And I'll open now for questions and answers.

Questions And Answers

Operator

(Operator Instructions) This concludes the question-and-answer session. Now I would like to turn the conference over to Berto for his closing statements.

A - Roberto Funari {BIO 17031506 <GO>}

So thanks for the participation. We will be moving home as of next week. We current -- we are currently sitting in a 14-story floors building. We are moving to a new complex over only 3 floors with a more -- it's marked office approach in the key area here in São Paulo. And I would like to invite you guys to come to our Investor Day Meeting the end of November here in Brazil in our new office and welcome you in the new Alpa.

With that, thank you. Have a great day and a great week. Bye-bye.

Operator

That does conclude Alpargatas audio conference for today. Thank you very much for your participation. Have a good day.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.