

Q4 2015 Earnings Call

Company Participants

- Jose Roberto Lettiere, Chief Financial Officer

Presentation

Operator

Good morning and good afternoon, ladies and gentlemen. Welcome to Alpargatas fourth quarter and full-year 2014 results conference call. Thank you for standing by. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions to participate will be given at that time. (Operator Instructions) To follow this conference call, please access its presentation at Alpargatas Investor Relations website at ri.alpargatas.com.br.

Before proceeding, it's important to mention that any forward-looking statement provided in this conference call depends on domestic and international macroeconomic scenario, the footwear markets in Brazil and abroad and other operating factors that could affect the future results of Alpargatas.

The participants of this conference call are Mr. Jose Roberto Lettiere, CFO and Investor Relations Director; Mr. Jose Salvio Moraes, Investor Relations Manager; and Mariane Weger, Investor Relations Analyst. I would now like to turn the conference over to Mr. Jose Roberto Lettiere. Please go ahead, sir.

Jose Roberto Lettiere {BIO 16358413 <GO>}

Good morning or good afternoon to all of you. We are here again to talk about Alpargatas results. And we will start talking about our domestic operations. If you go to slide number two where we have the highlights of 2014, it was a good year for our service business. We gained 2 percentage points in market share reaching 218 million pairs of sandals and products of brand expansion in the country, which represent plus 3.7%. 252 million in Brazil, plus international market, totaling an increase of 3.5% growth.

We also had the debut of our apparel segment launching Havaianas apparel which is performing well above also our best estimate. We increased the number of Havaianas stores totaling 389 units by the end of 2014. And stores are located in the main Brazilian cities. The same-store sales growth of 16% in 2014 represented a good improvement in our retail strategy for Havaianas.

The Incorporation of Companhia Brasileira de Sandalias, our Dupe brand which will drive decreased costs and more efficient administration with the integration of systems and

processes. CBS we're managing as an independent standalone company and now it's part of Alpargatas SA and totally and fully integrated.

Another important point here was the construction of the Distribution Center of Havaianas and Mizuno in Campina Grande, Paraiba state. We started the construction of this distribution center last year and it's going to be concluded by the second half of this year. It's a very important distribution center, which also will reduce costs and improve our efficiency. The ramp up of Montes Claros plant in the final phase. We are expecting to finalize and to put the plant in full operation in the coming months. Costs already are being reduced since the start-up. The production is well established and the productivity and the volumes are increasing month after month.

Another element, another project is the choose of Hong Kong and we chose the Hong Kong to be our new office of Alpargatas in Asia. We started outsourcing initiatives plus Havaianas operation which is going to be fundamental and critical for our internationalization strategy.

Continuing on the page number three, we have more highlights for 2014. Another important conclusion was the conclusion of acquisition of Osklen and beginning of consolidation with Alpargatas results in the fourth quarter. We acquired 60% of the Osklen business, taking the control of the business and the fourth quarter already was consolidated with Osklen numbers. We also had the renewal of Mizuno license for 13 years, plus another 13 years. I think that we already talked about this special contract and it was also concluded during 2014.

The progress in the turnaround project of Topper and Rainha with an improvement in the brands' performance, we rationalized the portfolio, we entered into new (inaudible) distribution channels and also we made some change in our marketing communication for both brands which is already providing better performance for both brands.

We are also focusing on productivity, we launched by end of last year the Value Improvement Program which focused on reduced costs gains in manufacturing productivity as of 2015. We generated more than 40 ideas, projects and we are going to implement all of these initiatives during the year.

Another important highlight for 2014 was the divestment in Tavex, end of equity income in the fourth quarter and non-cash result of divestment BRL6.2 million in the fourth quarter and a cash result of BRL15.6 million which we are going to receive during this year.

Now moving to page number four, we are going to talk about the highlights for Argentina, Alpargatas Argentina. We had a very good year for Alpargatas Argentina after our restructuring realized early in the year. Increase of 10.2% in sales volume due to Topper's strong connection with the Argentinean consumer, good performance of the exclusive Topper retail, increase in sales to key accounts.

Growth of 45.8% in net sales in pesos in local currency and 6.7% in reais as a result of higher sales volume. The brand really increased Topper brand increased and recovered

market share. We had some price adjustment above Argentinean inflation which helped us in growing our margin.

Generated greater profitability. EBITDA grew by 265.9% in pesos and 188% in reais. We decreased our production costs. We really rationalized our manufacturing, reduced head counts and general costs in the plants. Greater productivity of SG&A also helped to boost our performance, our profitability in Argentina.

Improvement in liquidity also was very important. The company started generating operational cash flow totaling ARS154.7 million. We ended the year with a positive cash net of debt of ARS90 million. And we are performing accordingly since July last year, delivering a positive cash flow generation in the last eight months.

Now moving to page number five. Now I'm going to talk about the key highlights for Sandals International. The starting of the increase in our sales volume, 3.8 percentage, more marketing events and advertising campaigns resulted in a growth of 3 percentage points in Havaianas awareness in Europe and USA. Expansion of Havaianas exclusive retail with a total of 102 stores in operations at the end of the year. USA, seven stores and four new openings in the year. Europe, 19 stores, plus three in the year. International distributors, 76 stores plus four in the year.

Our direct operations in five new countries. We started operating directly in Germany, Austria, Holland, Belgium and Luxemburg. This of course will provide a better sales level to our customers and also provide a better understanding and -- for our consumers about our Havaianas brand.

Increase in net sales. We had a very good growth in euros 22.2% and (Technical Difficulty) 61.3% growth in reais due to a strong increase in net sales. So all in all it was a very good year for our international operations, combined with, I would say, a reasonable performance in Brazil due to the issues we will talk in more detail in the coming -- in the next slides.

So talking about consolidated figures, financial performance, starting with slide number seven, net revenues. We increased our sales volume in Brazil Sandals and highlights for Sandals Brazil international and also sports footwear in Argentina. We have higher average sales price. We increased our price close to the inflation rate we experienced in Brazil, in US and ahead of inflation in Argentina.

The forex played a very important paper [ph] in the year. When we talk about Argentinean peso, the forex reduced our consolidated figures, so reducing our net sales and on the opposite side, we had a translation gain from the dollar and euro.

On the graph on your left, you can see that we grew 9.9% in the fourth quarter and 8.3% for the full year. Excluding the forex impact we grew around 14% both the quarter and the full year. You can also note that we consolidated Osklen in the fourth quarter which also helped to boost our net sales in the fourth quarter.

Moving to slide number eight, more detail about our net revenue. On the left graph, you can see the breakdown by business. We maintained more or less the performance or the participation of our Sandals business around 54%. With the entrance of Osklen, our sporting groups were reduced from 41% to 35%. So Osklen in the fourth quarter represented 7% of our net revenue consolidated.

For the full year, no major change. Our international business continued representing 74% [ph] of our total business, Argentina 17% and our international sandals business representing 7%. It is also important to mention that in the full year consolidation Osklen represented only its participation for the fourth quarter. So for the full year we consolidate on one quarter, last quarter for -- in 2014.

Moving to page number nine, we are now talking about profitability starting with the first quarter gross EBITDA grew 12.4. Moving with profitability, increase in profitability for the third quarter which was 11.6% to 14.4%, mainly driven by the consolidation of Osklen which is bringing a high profitability for Alpargatas consolidated figures. We also mentioned the price adjustment above inflation in our productivity especially in Argentina where we conducted a very strong restructuring process early in the year.

The share increase in sandals improved the margins. On the other side, we had lower average price of sporting goods sales mix in Brazil impacting net revenues in our domestic business. And again forex on cost of imported finished products and rubber in Brazil as well as in cotton in Argentina deteriorated our margin. You may remember that we have a hedge policy. The hedge policy continue being very successful.

Despite the control we experienced in last year performed by the Central Bank where they maintain or they control the exchange rate around the range of 20 to 25, after the election process the Central Bank left the forex flow following the market strength. And then our methodology, our hedge methodology has started recovering participation and results. So we ended the fourth quarter generating a positive result stemming from our hedge operations in the order of BRL9 million.

Going to page number 10, I continue to talk about EBITDA. In this slide you see a huge improvement in terms of EBITDA generation coming from our international business. So basically we double the participation, moving from 16% to 35% which is proving that our internationalization strategy is bringing the results as we planned five, six years ago.

Moving to page number 11, we have the bridge for our net income from the fourth quarter. We also grew the net income 16.8%. Highlight for EBITDA generation and also for the Tavex divestment, compensating some costs relating to restructuring Brazil and Argentina, so ending the year with a net margin of 8%.

Moving to slide number 12, cash flow. We started the year with BRL814 million. We generated operational cash flow meeting the EBITDA generation BRL470.5 billion. We did invest in working capital. A highlight for cash conversion cycle. Our average cash conversion cycle in 2014 was 58 days. So we performed a four days reduction compared to 2013. So mainly with our accounts receivables we could maintain the same level despite

the deterioration we experienced in the market, mainly in Brazil in the second semester but we could maintain our accounts receivable days, our DSO, days sales outstanding and also due to the strong inventories control we recognized during the year and maximizing our working capital investment.

CapEx major project were Montes Claros plant around BRL40 million. Expansion and volume growth we spent around 20 million and also the opening of new stores in Brazil and outside Brazil we spent around BRL200 million. Those three projects were the main ones. We also spent CapEx in our infrastructure, in IT and finish [ph] technology in projects due to reduced cost. So all the CapEx we invested in 2014 they will provide return on capital investment which will drive our company for better returns in the coming years.

Then on the financial side, the major lines were the amortization of debt, highlights for Argentina. Out of the BRL103 million BRL96 million were to restructure the Argentina business. The payment of Osklen, 251.7 and also we had other cash outlays 57.5 which highlights for the ramp up of Montes Claros. We also did some buyback shares. So we ended the year with close to BRLO.5 billion in our cash.

So, demonstrate that Alpargas continue generating cash. We did invest in important projects. And our capital structure by the end of the year were more balanced. Our capital structure, you can see on the next slide, on page number 13, you see our cash net of debt. You see that we ended the year with, I would say, breakeven in terms of net debt which represents a better capital structure as we invest our cash in very important projects.

For the future, we are going to continue generating operational cash flow and of course directing these cash through the strategic projects and also to pay back our shareholders which I'm going to talk in the next slide, slide number 14. So with BRL231.4 million with total shareholder compensation for the year, paid during 2014 as interest on equity was BRL84.3 million and payment as dividend which is going to be -- we are going to pay in April 28, BRL147.1 million, increasing our payout ratio. So this is going to be a new trend from now onwards. So we are going to continue investing in our strategic projects and also increasing our payout rate to our shareholders.

Moving to page number 15, this slide shows the performance of ALPA4 in 2015. Remember that we had a bad year in 2014. Our shares dropped dramatically, now it's recovering. You can see the green and the blue lines, also the ALPA3 and ALPA4 going ahead of Ibovespa and ahead of our peers. So our expectation is to continue recovering market cap and continue improving our results in a very complex year we are going to face for 2015.

So this is basically what I would like to share with you, so thank you. And now we are here - - Salvio, Mariane and myself here to answer your questions you may have. Thank you.

Questions And Answers

Operator

Ladies and gentlemen we will now begin the question-and-answer session. (Operator Instructions) This concludes today's question-and-answer session. I'd like to invite Mr. Jose Roberto Lettiere to proceed with his closing statements. Please go ahead, sir.

A - Jose Roberto Lettiere {BIO 16358413 <GO>}

I'd just like to mention that Alpargatas will continue investing strongly in our key strategic projects. Our sandals business will be a key to our growth strategy. We will start more focusing in Asia region by this year and the second semester. Our retail business is growing, and we have very good perspectives for our apparel business in Havaianas, we just launched last year.

In the domestic markets, as you know, we will face a very difficult year in Brazil, but other brands in our company are well prepared to succeed in this environment. And I am very confident that all of the management are very confident that Alpargatas will have a differentiated performance in this economic environment.

Just to end, our Argentina business is performing very well. We already started analyzing and discussing 2015 figures. So January and February we are continuing to generating good results. The economic environment in Argentina will also be very complex, but our operation in our brands are very strong to deal with this situation. So we expected to see our company growing in revenues and mostly in profitability and cash generation. Cash generation will be key in this economic situation. So cash generation is keenly focused. So very strong focus on expense control, productivity in order to sustain our profitability health. Thank you very much and see you next time.

Operator

This concludes Alpargatas audio conference for today. Thank you very much for your participation. Have a good day and thank you for using Chorus Call.

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