

Q1 2022 Earnings Call

Company Participants

- Gabriel Silva Lobo Leite, Chief Financial and Investor Relations Officer
- Roberto Luiz Jatahy Goncalves, Chief Executive Officer

Other Participants

- Joseph Giordano, Analyst
- Unidentified Participant

Presentation

Operator

(Starts Abruptly) This meeting is being recorded.

Roberto Luiz Jatahy Goncalves {BIO 22408649 <GO>}

(Technical Difficulty) opening with a bit more of an aggressive approach to really favor omnichannel approach and the American market will then have some openings that are really strategic to be able to focus on the omnichannel approach and really position ourselves as a brand and only supplier in the American market.

So, digital and then brand already represent over 55% of sales and the stores is about 5% or 6%. And we are still missing a bit more investments in physical retail. We have a long path for growth in physical retail. We know that (inaudible). So moving on to the next slide. About FARM Brazil, it's been growing ever since 2017, a really high rate and this quarter transitioning to deliver BRL242 million in growth.

Once again, it's been growing at high rates in the same period of last year, 38% and delivering (inaudible) that's very robust of 18%. So, this is an operation with the low price points. We understand that we have a big opportunity for an increase in our geographic footprint in this operation. So, we have the capacity to open up about 50 more POSs.

We're already starting to play at this moment. Another important point is that this operation is a wholesale channel. It's been growing exponentially and we've actually stopped our sales whether searching moment, because you want to guarantee this is going to grow and just give an example. And the last showroom, FARM grew more than 50% and then we decided to stop our sales to be able to guarantee this good relationship in FARM is very relevant in wholesales and a significant rupture could harm all of this work that has been done with a relationship of confidence that started years ago.

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So, moving on to the next slide. Here, we are talking about NV, operation delivered BRL79 million in gross revenue, growth of 36%. NV is an operation that will be distributed to commercial market in very intelligent and surgical manner (inaudible) in the main capitals with sales per square meter, it's really high. And so, far we've been able to already open up three (inaudible) and the 13 points have a difference of sales per square meter. Now that we really observe the whole other model and at this moment, we don't think about entering the wholesale market. We will continue to have intelligent growth generating perceptions, scarcity and wholesale, which is almost like a whole new second business for NV we will lead to this next year.

Next slide please. Animale continues to be strong with its recovery. It's a brand that want to revitalization and ever since the last quarter, it already had very strong growth. We have already been starting to reap the fruits of this, work that was really well done by Isabelle. The operation delivered BRL150 million in revenue, 51% growth if compared to the same period last year, with 49% potential show compared to the last year.

And just as far Animale had excellent results in the sales of showrooms in April and we're really happy with this ending process of the revitalization of the brand as we enter the phase where we really capture what we've been reaping in the last year.

And now as we talk about the smaller brands, we have this consideration. And after the pandemic, we are really under assisted. We have very few relevant players in this market (inaudible) still very small, but with growth of 140% versus the first quarter of 2021 with very few store openings and this growth is very much a push (inaudible) which indicates clearly that we have a possibility to accelerate new store opening for physical stores in operation and so we consider that this acceleration and increase of our physical stores really increases the awareness of the brand in the national scenario and obviously we would capture that in wholesale. So, we understand that FOXTON could become a very important relevant asset in our portfolio at Group pro-forma in the next years. Next slide please.

As we talk about FABLE, it is one more operation we have that is operating in the market and it's a very under-substitute market, very difficult children's wear and ever since the pandemic period and here we are not even talking about recurring growth, high rate after the pandemic period. FABLE has been a brand that's really grown a lot during the pandemic, and it's been growing at high rates BRL21 million in revenue and in same-store sales up 41%. Our objective is to bring in a bit of a basic wear for Hering improving the product mix for FABLE and it's also an under-assisted market and we understand that the spend could also become a very relevant asset within the group.

Moving onto the next side. For (inaudible), we also had this issue. The integration during the pandemic period and spend rate, I'm trying to get the calendar for the construction of these collections rights and 22% growth upon the first quarter of 2021 venture sales of 15%.

Next slide please. Finally, CRIS BARROS, 8% growth. These have been very harmed by the launch of their collections to operation that works with a lot of imported input for a lot of

delays, ever since the second semester last year and we've been adjusting this probably in the second semester onwards on recovery growth at high rates.

And finally, before I pass on the word to Gabriel, we continue to be very optimistic in the long term in the company. It's a very challenging moment because on one side, we have no signs of a reduction in revenue in the showroom and even in the month of April and May, much to the contrary, we're continuing to grow at rates that are very high and on the other hand, we've seen an increase in the interest rate that's really intending to kind of how consumption and we don't know what the impact is present yet on our operations.

What we have here in the history of 32 years of brands that are extremely resilient, brands that go through crisis and leave this crisis in a very strengthened position gaining market share. So, in the short term if we look at this, there may be a point for attention when it comes to the crisis that being announced so as to have results, but in our history, we've seen that the fundamentals of our business are very robust. And we've been prepared to face this very positive moment with no setback and consumption also prepared to adjust to a more challenging macroeconomic scenario.

So, as always occurred due to a 32-year history, so after this more difficult period, we've not market share gains and the company has been growing in this way, process now we've been really stepping through this 50%, 60% growth, which is really an exit from the crisis. And once again Grupo SOMA is gaining market share and really taking advantage of the structure and diversification. So, now I am going to pass on the word to Gabriel as we enter the financial part of our presentation.

Gabriel Silva Lobo Leite {BIO 22198565 <GO>}

Thank you, Roberto. Well, as we get into some financial details about the company, we're going to open up first talking about the portfolio, ex-Hering, so excluding Hering in fact in the financial numbers to initial highlight once again, we had a quarter of strong growth and delivery of results are very significant that really confirms this good moment that the company's experiencing. We reached in the first quarter a gross revenue of BRL671 million which represents to the growth of BRL60.3 upon the revenue of the first quarter of 2021.

And also, same-store sales was BRL31.4 in the same period, and the same-store sales is really levered by strong growth in physical retail and it's been delivering levels that are higher than the prepared time of period. So, it's important to mention all of the brands in our portfolio with no exception, have been grown against (inaudible) strength of our portfolio and also the gain in the market share, which is something that we have been mentioning in the last quarters in a very consistent manner.

So on the next slide, we ended the quarter once again with important growth in our gross profit, which reached BRL390.7 million growing to 71% and gross margin reached 67.3% in the first quarter, representing an increase of 2.7 percentage points versus the same period last year.

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So, it's pertinent to mention this market share gain is coming and it's now we have an increase of the share in the wholesale channel with them a lower gross margin upon the total amount of the group. So, the wholesale goes from 26.7% and it reaches 29% of the total revenue. So the gain in share, which would tend to take our gross margins downwards, but even with these market share gains, which is not a market share gains that is substantial and substantial gross margin gains, as well as compared to 2021. So, these results prove our capacity for value generation with the delivery of important collection term, that are really leveraging these returns, which contributes to an increase of sales at full prices in the company.

Moving on to the next slide. As we get into the Hering block, Hering as Roberto mentioned had the best first quarter in history when it comes to gross revenue. We delivered in the first quarter BRL503.7 million which represents a growth compared to the first quarter of 2021 of 51%. This result was within levered by higher levels of services, something we've been talking about a lot, then it focused on its capacity to deliver products that are sold in the showroom, which reduces rupture at the end. And this contributes to positive performance in all of our channels growth if compared to 2019 was also robust delivering 15% variation versus the first quarter of 2019, which is a period without pandemic effect.

So moving on to the next slide. An important highlight here with the sale of same-store sales, which is no doubt the main indicators that we're going to monitor in the next quarter because they will pass on the cost of the sales and will determine our capacity for this growth in the long term. So, this will allow Hering as a whole as a system to once again going a virtuous cycle with supply of healthy levels in our inventory and more profitability in the overall network from chain to the seller evolve 60.2% and what's most important 23.2% if we compare against 2019 which damaged, it's clearly that the franchisees have been capable of generating production with even greater speed they want to receiving, which is a great sign when we look at the next selection in the future, we'll give this pace in the delivery which is a big focus we were mentioning.

So, the trend is that the seller would keep it heated and as you've seen, so we delivered 58.9%, 30.8% compared to 2019. We (inaudible) mentioned that in 2019, we continued the cookie brand operations, now we closed a group of Hering Kids stores which contributes for the same-store sales growth to be even greater.

And moving on to the next slide. In the first quarter, we reached BRL171.8 million and a gross margin of 0.7 percentage point which is higher than the first quarter of 2021, so we gain margins even in this challenging scenario. First, it's important to mention actually that as we've already mentioned throughout the last quarters, the industrial network, Hering does not have the capacity to keep up with this growth.

So, we've been expanding our outsourcing and the purchase of finished products with the focus of really valuing the levels of delivery and lower rupture in selling. This effect is a real game changer when we consider Hering in the future on this relationship in one of the setting. What this network up, wholesalers and franchisees up ahead to having these channels fully supplied with inventories that are healthy, is really essential that the overall Hering system can recover its profitability and get back to growing at a sustainable level.

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Naturally, we will be focusing on nominal gross margin delivery to the detriment of a percentage gross margin and this decision is very positive when we think about the mid-to long-term relationship with these partners, but over time, the trend is that we'll start noticing a gradual recovery in those gross margin from a percentage perspective, which tends to evolve as we recover the internal capacity levels and the products that are industrialized internally, so we can reach the full recovery of these normalized levels.

So, it's important to highlight also one point, which is we've been delivering this margin strategy in line with our plan. There is nothing out of control. We've actually been up earning above budget foreseen originally by Hering.

So, moving on here to the last block. I wanted to talk about our consolidated earnings in the company. We're going to look at all the pro-forma numbers bringing in Hering numbers in 2021, so they could be comparable. And then the graphs consolidated revenue, we ended the quarter with approximately BRL1.2 billion with the gross revenue 56.2% higher than the revenue in the first quarter of 2021 pro-forma losing, influenced by all the factors you mentioned the growth of the wholesalers and physical channel also growing a lot.

Moving on to the next slide, we delivered a gross profit consolidated of BRL562.6 million gross up 66.2% compared to the same period pro-forma and a combined expansion of the gross margin of 2.3 percentage points in the same comparison.

Moving on to the last slide, as we talked about the bottom line of the company, we ended the quarter with adjusted EBITDA of BRL104.3 million, a growth of 256% versus the first quarter. Turning to new one on the EBITDA margin of 10.2%, which represents a variation of 5.6 percentage points versus the previous quarter. And so, I think it's important to highlight an important point here on the EBITDA. From this quarter on, we'll start incorporating the provision for bonus and profit-sharing and we used to book the expenses of the profit sharing and the actual provision in December, but compared to the previous year, we will have a bit of a distortion. And if you were to look at comparable basis, we would have an EBITDA that's higher than BRL110 million in the quarter.

And going on to the last slide of the presentation, we had an adjusted net income of BRL53.6 million against the first quarter of 2021 on a combined net margin of 5.3%, which represented a gain of 3.6 percentage point compared to the last year. I think now close our presentation from the financial perspective. And now we'll begin the Q&A session.

Questions And Answers

Operator

I will start off with the Q&A going over the present questions sent. The first question comes from Ruben Couto from Santander. And Ruben actually has the first question, which says, he would like you to talk about vision on the performance of sales at FARM level in this quarter, it's going well as expected and what we can expect for the rest of the year? There is a lot of things going on in the US. There is a vision of our entrance in

Europe, and if we expect to reach something close to BRL100 million in revenue this year, if that's feasible in this macroeconomic scenario that seems to worsen?

A - Gabriel Silva Lobo Leite {BIO 22198565 <GO>}

Well, on our side what we've noticed is that in the American market, FARM is still a market of great variability. We have no slowdown imagined at this moment. In Nordstrom, we've also entered in with all of our footwear as well. Nordstrom is really going to work on strong distribution with new product line. We also have increased the different occasions for years, everyone knows that the FARM collections and the American and European markets are dedicated collection.

So, we're starting off with the expansion of our product mix to those other year situations, and I think we still have very robust growth to be working on in the American market and probably will be delivering our budget for this year in line with what we communicated in our Investor Day of that.

Operator

Perfect. Well, the next question from Daniela of XP, is if you could talk about the performance of sales in the beginning of the second quarter among brands, especially for Mother's Day and how FARM Global's engines in Europe has been taking place?

A - Gabriel Silva Lobo Leite {BIO 22198565 <GO>}

Starting on the second question, FARM global in Europe has an e-commerce play for quite a while. It's been growing. First movement there with physical stores and contract with the European market and physical store was basic that store was 250 square meter beautiful (inaudible) the expectations are very positive and in the European scenario as well as in the US, the issue of the impact of a macroeconomic perspective in Europe and the US is that we have a lot of difficulties to understand what will happen really.

So, I think all of the economists don't know what's going to happen from a prognosis perspective. On our side, it's even more difficult to understand this, but we are very much prepared as you mentioned in the beginning of the call to face any scenario that we're really keeping our eyes open to correct any of these points.

Operator

Well. Another question also from Daniela about Hering, does it make sense to think about some of the positive impact with the integration of SOMA in the second quarter, but with more strength from the entrance of the summer collection in the second quarter merger while as you mentioned in the call.

A - Gabriel Silva Lobo Leite {BIO 22198565 <GO>}

There's a lot of work being done to improve the operational efficiency, the quick wins and we are actually discussing the Investor Day, we'll continue to see the Hering sellout to be very privileged to the detriment of any other indicator. This is one of the main indicators

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for this year, we probably will have a second semester, which of course depends on the macroeconomic scenarios, but if everything continues as expected and Hering already worked on their showroom, but we were even in the second semester, we will continue to move along in this direction with the growth of Hering at sellout.

The margin, when it comes to pressure in costs, we've been transferring as mentioned and also the industrialization issue with the margins related to the de-industrialization that we have been working on that's going to be corrected over time, and we believe that at the end of the year will be at more adequate levels of margins, but until May at this moment, this entire budget for revenue and margins are in line with what is expected as budgeted in the beginning of the year.

Operator

Our next question from Joseph at JP Morgan.

Q - Joseph Giordano {BIO 17751061 <GO>}

How are we looking at the trends in May, Cris sales, because as we look at retail really accelerating?

A - Gabriel Silva Lobo Leite {BIO 22198565 <GO>}

Well, May is better than the May of 2021. April is even better than from 2021 and so on. Once again we had a Mother's Day that was very strong. April was a very strong month as well. Mothers did well and so, we have no indication for slowdown in the market up until now.

Q - Joseph Giordano {BIO 17751061 <GO>}

Perfect.

Operator

Next question, how this has been the result in the Hering franchisee channel, is there any relevant difference and stores that are more modernized or stores that are more in an old formats do.

A - Gabriel Silva Lobo Leite {BIO 22198565 <GO>}

The updated stores are still very small amount, we're showing very timid process with store refurbishing and renovation work. We would not like to present the Hering in the physical retail with the collection. Now, we consider not the best collection yet, so investing on this now in our opinion while we have some POS trends that have been refurbished or renovated already show such as (inaudible) with more than 6% growth after refurbishing with a reduced make going on to a new store perception.

And we were talking about a normal store Hering. Some of the Hering megastores are also very big successes. They deliver with each megastore that is opened. Stores react

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above the cost of occupation. So, it's a play that's really intelligent, but still in some way, the movements are timid, but all of these have been presenting relevant results that make us very excited with the strategy of what we had seen for potential in Hering in the future.

Operator

The next question is from (inaudible) from Maria Clara.

Q - Unidentified Participant

So, just your question. The first question is about the page sales as you mentioned in the last quarter was a quarter with important date which is Mother's Day, Valentine's Day or could expect something that's similar to what we've seen in the last quarter and how it noticed the perception of same-store sales for SOMA inherent.

A - Gabriel Silva Lobo Leite {BIO 22198565 <GO>}

While as presented when we talk about Valentine's Day in Brazil which is called Dia dos Namorados. We really don't think or look at the showroom, which is an indication of the future. Now that I mentioned that your question, April in the information with the sale of our products in the wholesalers, we expect to have a Valentine's Day in line with what had happened in Mother's Day without any type of change or shift.

Now once again, the big challenge or difficulty we have is to understand, if the interest increased -- if the interest control is going to be important enough to affect the gains in market share of the brands at a low more resilient in retail, but in the short term, we don't see any signs, any red light, or yellow light for operations for same-store sales, basically the rationale is the same.

A - Roberto Luiz Jatahy Goncalves {BIO 22408649 <GO>}

Just to add on. I think it's important to mention that the pace for growth is pretty much kept to same. So, in the second quarter we see maintenance of the levels of growth that we delivered in the first and fourth quarter. There is no sign as already mentioned of a negative impact or a slowdown in our sales. So, the idea is really to have the full maintenance of this so far and the sales and that wholesale showroom are kind of signaling the same trend. So, we consider that the macro situation is quite complex, but from the micro perspective, the company has very solid fundamentals.

Q - Unidentified Participant

And the second question Roberto also from Maria Clara is related to profitability. So she thinks like some investors are very concerned with margins at Hering and we understand that up until now your budget. So, how can we look at this evolution in the next quarters when it comes to the evolution of the gross margin the Hering has.

A - Roberto Luiz Jatahy Goncalves {BIO 22408649 <GO>}

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Well also as mentioned a bit, I think this is an important point that we should highlight the issue with the Hering's gross margin is in no way connected to the transfer costs as input for Hering. All of these impact clearly damage a process of de-industrialization at Hering and from my perspective, we could even mention this transfer but at the moment where the consumers have maybe lost a bit of the perception of value after a controlled inflation cycle, maybe have a loss of control, but I think there is a better way.

Everyone is kind of losing a bit of this notion of how much each of these pointers work, so I think we have no difficulties with challenging this occasional inefficiencies on to Hering. Now, we would have a gross margin that's really in line with 2019, but we're not going to consider just the short term. We're going to think about the long term.

We have no difficulty in transferring this chart and consumer for any kind of costs related to a lack of efficiency and it's not structural. We're very confident that we'll be able to solve this and recover these margins of the chart. Once again, we are not thinking of Hering for the next quarter. We're thinking of Hering in the mid- to long-term. So, within the next 12 or 24 months, will probably already noticed the operational efficiencies that Hering has really remodeled and a lot more advanced and probably the brands are already converging with the year of 2019 and obviously you have the second initiative as well, which is going through the stores, communication, strategy, style and products that we have and actually started working on it. We have all of the creative area and Hering already working, but we are still tracking more creative professionals to transform Hering into a contemporary brand up today and has high desirability rates.

Operator

Perfect, thank you. I think we ended here and I would like to thank you all for your questions and participation. I'll pass on the word to Roberto so that we can end the call.

A - Roberto Luiz Jatahy Goncalves {BIO 22408649 <GO>}

Ending in the call here, I just want to thank you all once again. Any additional questions, we'll be available to answer through our IR department and clarify issues, additional doubts you may have. Thank you very much.

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