# Q2 2014 Earnings Call

## Company Participants

- Claudio Bergamo dos Santos, Chief Executive Officer & Director
- Martim Prado Mattos, Chief Financial Officer

## Other Participants

- Irma Sgarz, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good afternoon. Welcome to Hypermarcas' Second Quarter of 2014 Results Conference Call. Today with us we have Mr. Claudio Bergamo, CEO; Mr. Martim Mattos, CFO; and Mr. Breno Oliveira, IRO and treasurer.

We would like to inform you that this event is being recorded and all participants will be in a listen-only mode during the Company's presentation. After Hypermarcas' remarks, there will be a question-and-answer session for investors and analysts when further instructions will be given.

We would like to inform you that questions can only be asked by telephone, so if you are connected through the webcast, you should e-mail your questions directly to the IR team at ri@hypermarcas.com.br. Today's live webcast may be accessed through the Company's Investor Relations website at www.hypermarcas.com.br/ir.

We would like to inform that statements during this conference may constitute forward-looking statements. Such statements are subject to known and unknown risks and uncertainties that could cause the Company's actual results to differ materially from those set forward in the forward-looking statements.

Now, I'll turn the floor to Mr. Claudio Bergamo, who will begin the presentation. Mr. Bergamo, you may begin your conference.

### Claudio Bergamo dos Santos {BIO 16015846 <GO>}

Thank you very much, all. Thank you for participating in the conference call. In the second quarter of 2014, Hypermarcas advanced on its strategy of sustainable, profitable organic growth with debt reduction, which has been above teens since the beginning of 2011.

The Company achieved satisfactory financial economic performance in the quarter, posting record adjusted EBITDA of R$288 million with 25.4% margin on net revenues; net income of R$122 million, more than twelve times compared to the same period of last year; and free cash flow of R$159 million.

These results allowed once again the Company to reduce its debt of R$98 million in the quarter, leading to the lowest leverage ratio of the last three years. In terms of sales, the Company posted net revenue of R$1.133 billion with 6% growth compared to the same period of last year. These results were possible due to several initiatives starting in 2011 in our Operations, Marketing/Innovation, Sales and Finance branches.

Our target is to strength the Company's condition, to develop superior competitive advantage position to become the best and the largest company of branded consumer health and personal care products in Brazil.

On the Operations front, the Company advanced in the restructuring of its operating platform. We advanced in the immigration of the drug production from Rio de Janeiro to Anápolis, strengthening the manufacturing lines of liquids, semisolids, injectables, dermocosmetics and ophthalmic products. We completed the transfer of a new diaper lines to Goiás, shutting down the Guarulhos plant in São Paulo as well.

In addition, since April, our Consumer division distribution is taking place from the new distribution center in Goiânia. On the Marketing front, the Company will continue to support its brand, keeping the high levels of market investments, which are necessary to maintain and gain market share in key markets and to grow our brand. We invested in more than 20 campaigns for OTC products such as for Benegrip, Fluviral, (4:51-4:55), new flavored Jontex condoms and new Bozzano Men's Care line.

On the Innovation front, the quarter was marked by a fast pace of product launches. In summer, we successfully consolidated the launches of Addera D3 vitamin D pills, Predsim 40 milligram, Rinosoro Jet and the dermocosmetic Ivy C. The division also launched a new drug in the generic and in the branded generic segments, including relevant products such as valsartan, alendronate sodium, azithromycin and sertraline chloride.

In the quarter, the Consumer division reached its highest level of innovation index, which measured the portion of sales coming from items launched over the past two years of 70% in the quarter.

On the Sales and Distribution front, the Company has continued to improve the distribution of its brands, increasing steps taken to points of sale, implementing category management in key segments.

In the quarter, we completed the pilot of the HyperTrade program, our online system that will allow real-time monitoring of stuck-out levels in the points of sales of our products and also will track our investments in shelf space displays, stock promotion and improve the control of our team's execution, our brand positioning, monitoring competitive moves, among other benefits.

This monitor will allow a stall-by-stall tracking of our brand's performance in its continued improvement of our execution in the point of sale, optimizing our trade marketing investment. On the Economic and Operational front, the Company continues to focus on growth with profitability and free cash flow generation, which will be used to reduce debt, increase net income and earnings per share in a sustainable and consistent way.

In Hypermarcas, we believe that we have done much, but there is still much to do and accomplish still. Our management will not lack commitment, motivation and determination to keep delivering superior results levels.

I will pass over to Martim, who will talk about the numbers in more details.

## Martim Prado Mattos {BIO 16015889 <GO>}

Good afternoon, everyone. Before we start the Q&A session, I would like to go through the highlights of our second quarter results. Starting on page 3, we see that net revenue growth was 6%, composed of 12.1% growth to Consumer, affected by close to R$20 million in orders that were not filled due to lack of inventory; and 7.4% in Pharma, of which when calculated disregarding third-party products, presented a growth of 12%.

On the next page of the presentation, gross margin was virtually stable compared to Q2 2013, with 90 bps increase in Pharma because of a more profitable mix and a 230 bps drop in Consumer, which is explained by an almost 1 percentage point decrease as a function of a less profitable mix, and the remaining by average price increase below the expansion of the cost of goods sold.

SG&A before marketing, mostly composed of wage expenses and other expenses of a more fixed nature, had a 1 percentage point drop to 22% of net revenue, giving a good disciplined in other loan wage-related expenses in the quarter. Marketing expenses are still targeting around 20% of net revenue, showing especially in the first half of the year our intention of increasing the investment behind our brand, either in the media, in the point of sales or medical visits.

These factors resulted, as we can see on page 5, with an increase of adjusted EBITDA of 11.5%, with 130 bps gained to R$288 million or 25.4% of net debt.

Net income in the quarter was R$102 million with steep increase compared to last year as a function of both the improvement of operating results and the FX losses we had in Q2 2013, when a portion of our debt was still exposed to the loan. This exposure has been eliminated since the last quarter of 2013.

Switching over to the next page, cash flow from operations was R$185 million, with R$45 million increase compared to 2013 in a quarter with less inventory accumulation, differences from what happened back in Q2 2013. Free cash flow, measured as cash flow from operations less cash from investment activity and before interest expenses, increased to R$159 million, in pace with the expansion of cash flow from operations, also influenced by smaller net acquisition of (11:04) in the quarter. As a consequence of this free cash flow, combined to financial expenses without any FX variation, our net debt was reduced by R$98 million to R$2,738 million or 2.6 times LTM adjusted EBITDA.

Such leverage, as we can see on page 7, indicates the second consecutive quarter of reduction and keep us on track of consistent debt reduction, in line with our corporate strategy.

Thanks, everyone, for paying attention. And we are now open to the Q&A session.

# Q&A

## Operator

Thank you. The floor is now open for questions from investors and analysts. The first question comes from Alencar Costa [Filho] of Goldman Sachs. Please go ahead.

## Q - Irma Sgarz {BIO 15190838 <GO>}

Yes. Hi, good morning, it's – or good afternoon, now. It's actually Irma Sgarz from Goldman Sachs. Just wondering after a question that you answered right at the end of the Portuguese call, regarding the guidance and I think you made a comment there. You were reiterating the marketing spend to be targeted at 20% of net sales for this year, and you maintained or reiterated that. And in terms of the guidance you made a comment that this – if there was a deviation from the guidance it would be related to potentially marketing spend. So I just wanted to understand how you think or how should we think about marketing spend with regards to your guidance. Since marketing spend, I mean, that's obviously something that is at your discretion but do you see more space for marketing spend to rise above the 20% or do you think it's more likely if any surprise to the guidance to come from marketing spend, potentially falling below the 20%? And just basically at your discretion you're deciding that maybe at 19% or 19.5%, it ends up being enough for this year. Just understand kind of where the deviation, where we should think about the deviation more likely to be for the marketing spend and as a result of that the EBITDA guidance, thanks.

## A - Martim Prado Mattos {BIO 16015889 <GO>}

Hi, Irma. This is Martim. What we are forecasting for the remaining of the year and with that also the consolidated results for full year 2014 is, as we mentioned on the Portuguese call, is marketing expense is pretty close to 20%, right, with some variations around that 20%, but nothing significant, so it should be pretty close to 20%. And with that according also to our projections in our budget that we renew every quarter, it should be enough for us to get to the guidance for the year of R$1.1 billion. But to say exactly what type of standard deviation we would have around the 20%, we think there is no need to comment, given that it shouldn't be much.

## Q - Irma Sgarz {BIO 15190838 <GO>}

And just to understand my question was whether it would more likely be towards the upside or to the downside of 20%, but from what I understand in any case would be very marginal anyways so it could be to both directions, but in any case very marginal, correct?

## A - Martim Prado Mattos {BIO 16015889 <GO>}

Exactly. It will be to either direction, but marginal.

## Operator

Thank you. The Q&A session is now closed. At this time, I would like to turn the conference back over to Mr. Claudio Bergamo for his closing remarks.

## A - Claudio Bergamo dos Santos {BIO 16015846 <GO>}

Thank you very much, all, for participating. And again, our management will not lack any commitment, motivation and determination to keep delivering superior results. We know we have done much, but still there is lots to do and lots to conquer. Thank you very much and have a nice day for all.

## Operator

The conference has concluded. You may now disconnect your lines.