

## Q3 2015 Earnings Call

### Company Participants

- Jose Salvio Moraes, IR Manager

### Other Participants

- Howard Siegelbaum, Analyst

### Presentation

#### Operator

Good morning and good afternoon, ladies and gentlemen. Welcome to Alpargatas Third Quarter 2015 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 [ri.alpargatas.com.br](http://ri.alpargatas.com.br).

Before proceeding, it is important to mention that any forward-looking statements 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 Salvio Moraes, Investor Relations Manager, Mariane Weger and (inaudible) Investor Relations.

I would now like to turn the conference over to Mr. Jose Salvio Moraes. Please go ahead, sir.

#### Jose Salvio Moraes {BIO 20049415 <GO>}

Good morning and good afternoon to all the listeners of this conference call. We are going to start to present the third quarter results of Alpargatas. The presentation you have an access through our website. Following the presentation, we start by the slide number two, where we highlight the main achievement of our brands or businesses in the quarter.

Starting by Havaianas in Brazil, we have a good increase in sales volume. In sandals we grew 55% versus the second quarter and 1% versus the third quarter last year. It's important to mention here that in the third quarter of '14 we had a good quarter compared to the third quarter of '13. One year ago, our volume grew approximately 16%

compared to the third quarter of '13 in Brazil. Therefore, the growth that we had now despite is only 1% versus third quarter last year. It is very representative, because the base to compare was very strong one year ago.

Comparing with the second quarter the 55% increase in the volume is mainly due to the start of the Spring-Summer season that happens in the third quarter in Brazil. The new collection of sandals that we launched in the end of June started to be sold in July. So it helped to increase the volume from the second to third quarter as well.

Brand expansion, we have been investing and growing in this product line of Havaianas. Now here we are talking about espadrilles, closed footwear, apparel and different kind of accessories with the brand Havaianas. We grew 27% versus the second quarter '15 and 75% versus one year ago. So was a very important final to us that all the extensions we have been doing under the Havaianas name has been very successful, very well accepted by consumers in Brazil. And this is a very important strategic point for the Havaianas brand to extend it to other products. As you can see in the -- in below we are mentioning that the strategic partnership that we made with Safilo which is an Italian eyewear maker. This will be very important for launching the Havaianas sunglasses starting in the second half of 2016.

Another important factor in the quarter in Havaianas Brazil was the opening of eight franchises in the full format, which means that they are bigger stores compared to the compact format. They have approximately 120, 150 square meters of sales. And in the full store which sell sandals, espadrilles, apparel and accessories compared to the compact that we only sell sandals. And these eight new franchisees were opened in Sao Paulo and Rio.

Havaianas International, we continue to grow in all regions that we sell Havaianas. Comparing with the third quarter '14, in the USA we grew almost 25% sales volume, in EMEA which comprises Europe, Middle East and Northern Africa, our volume grew 36%. And Havaianas exports worldwide not including USA and EMEA grew 20%. So it's a sign to us that more and more Havaianas name has been becoming much more familiar to consumers worldwide and especially in US and Europe where we have a strong presence and it's very important to know the brands to have a good awareness for the future growth of the brand.

Osklen, our lifestyle apparel brand volume grew almost 9% and net revenue, almost 4% compared to third quarter '14. The main reasons behind these growth were we launched the Spring-Summer collection of apparel earlier this year. Most of the products went to the stores in the beginning of July, middle of July. And that helped sales because attracted more consumers to the stores, once they saw a new collection being sold.

And also the winter sale that happened almost in the same time helped to improve the traffic of people in the stores and consequently volume and revenue.

Moving to slide number three, in Mizuno, the main achievement of Mizuno in the quarter was the launching of the 2015/16 footwear collection. One of the best that we have

launched in recent years and this is a setback we had from our major clients, which are in the case of Mizuno, the main retailers of athletic footwear and apparel in Brazil.

This is very important, this new collection is very important to help the margin recovery process of Mizuno because this new collection we increased 40% the average price of the new footwear and also helping (inaudible) higher prices is helping the margin recovery. And together with the beginning of the domestic production of Mizuno in Brazil, these two factors in the coming quarters will be very important for Mizuno recover its profitability.

In Argentina, the trend in the third quarter was the same that we saw in the first and second quarter of this year. I mean that we had growth of net revenue and margins in all businesses comparing with the third quarter one year ago. As you can see, net revenue grew both in pesos and reais. The growth in reais in net revenue, gross profit and EBITDA is much higher than in pesos. This is because the FX impact that the pesos evaluated against 40% approximately against the real in this quarter.

So net revenue in pesos grew almost 19% and almost 67 in reais. Gross profit 29 in pesos, 81 in reais and EBITDA 14% in pesos and 60% in reais. So that the Company is performing very well there. Topper continue to be a leading brand in the sports market, sports footwear and apparel market with approximately 17%, 18% market share depending on the time that we measure. So that has been very important, this market share to sustain the growth of the Topper brand in Argentina.

In retail, retail completed Havaianas stores, Timberland, Meggashop and Osklen in Brazil. We had a good third quarter compared to one year ago considering the macroeconomic scenario that we are having now in Brazil and the construction that we have been seeing in consumption. Therefore Havaianas, the franchises store in Brazil that, we're talking about approximately 400 franchises stores. This group of stores had on a same-store basis a growth of 19% in revenue and this was a result of the increase in the Soul Collections, which is the closed footwear of Havaianas, and of course, the higher average price of sandals.

Timberland had a decrease of 4%. This is mainly due to the lower volume, 4% decrease on a same-store basis compared with one year ago. It is not a significant drop, again always looking at the consumption scenario that we are having now.

Meggashop grew 23% and this was due to increase in volume, 13% and in price 10%. Osklen decreased almost 11% and like Timberland, we faced a drop in the name of -- in the number of sales transactions like in Osklen, like in Timberland. Therefore having a decrease of 11%. Good to mention that Osklen and Timberland are brands that have higher average tickets, because they sell more premium products therefore been more affected by the shorter pockets that consumers in Brazil have to expand.

Moving to slide number four, here we have the main performance indicators for the Company in the third quarter. As you can see on the table, we had growth in all main indicators. Our net revenue reached R\$1.1 billion in the quarter, representing a growth of

FINAL

almost 27% compared with one year ago. Gross margin of almost 41% grew 3.1 percentage points. Our EBITDA grew almost 42%, reaching R\$149 million. Our margin went up 1.4 percentage points, reaching 13%. Our net income 42%, R\$79 million, with a net margin of 6.9%, an increase of almost one percentage point compared with one year ago. We generated R\$141 million of cash in the quarter compared with R\$80 million one year ago.

With this balance sheet, we could say that Alpargatas is one of the Brazilian companies that had the best, one of the best performances in the third quarter comparing with the other balance sheet that we saw that was released recently, not only for the consumer goods sector and retailing, but in different other sectors.

On slide number five, we start to give an overview of the results by the businesses because, just remembering on number four, we consolidated the number for all operations and businesses. And on slide number five, on we break it down by business.

On numbers, slide number six, we have an overview of our net revenue. What happened to our net revenue by business and country. Starting by Brazil, in Brazil, we are talking about business, we have sandals, sporting goods and Osklen. This group of businesses grew revenue in 10% we reached almost R\$703 million compared to almost R\$740 million [ph] one year ago. Therefore, having a 10% increase in our net revenue in our operation or businesses in Brazil. And the main reasons that we grew 10% are in Sandals Brazil was an increase in volume and average prices respectively.

In Havaianas sandal, the volume grew 1% as I already said and the price 17%. In Havaianas brand extension, as I said, the volume grew 75% and the price is 18%. So the combination of more volume and higher price helped to increase the Sandals Brazil revenue and consequently Brazil's revenue.

Sporting goods, the point of sporting goods was the decrease in the volume of sports footwear that was 25% compared with one year ago. However, we had an increase in the average prices that helped to offset in a certain way the decreasing volume, meaning that in the sports footwear, the average price increase was 8%, in apparel and accessories, sports apparel and accessories the price increase was almost 22%.

Finally, in Osklen, we have I mentioned almost 9% higher volume. However, the average price of Osklen items sold dropped almost 9%. And this is mainly because I mentioned that we had better traffic in our stores not only for the Spring-Summer collection, but for the winter sale. So the winter sale was responsible for dropping the average price of footwear and apparel in Osklen stores.

In Argentina, the growth in reais and pesos was very significant 67% in reais and 19% in pesos the Argentine revenue. And the main reasons are price increase, FX that helped go up the revenue. Price increases in Argentina in pesos of footwear were 27%, and in textile 31% per square meter of textile sold.

The FX also helped as I said, the peso appreciated almost 40% compared -- versus the real. Footwear sales volume was 3.5% lower in Argentina and this is mainly because the import of some kind of athletic footwear did not happen in the third quarter, because the license to import was in a certain way blocked in Argentina cost customs.

So the footwear we expected to enter the country in the third quarter. We'll probably enter the market only in the fourth quarter, meaning that they will help probably in the fourth quarter to increase the volume compared with one year ago.

Sandals International volume and FX were the two main factors that helped grow the revenue 71% in reais, 31% in euro, and 10% in dollar. So in USA, we had a growth of 25% sales volume, 36 in EMEA, and 20 in exports I mentioned earlier. And the FX effect was very important. The dollar appreciated 56% versus the real always third quarter versus third quarter one year ago and the euro appreciated 31%.

Slide number seven. We disclosed our gross profit and margin in Brazil, Argentina, and Sandals. We had a growth in Brazil of 17% in our gross profit, meaning 2.5 percentage points more in our gross margin in Brazil. And the reasons are consolidation with Osklen, because one year ago in third quarter '14, we didn't have Osklen in our P&L and balance sheet. So Osklen helped the consolidation of the gross profit.

Havaianas grew its share of domestic market revenue. The more Havaianas as a business grow in the net revenue of Brazil, more profitability we have, because Havaianas, sandals mainly is the main product or let's say business in terms of margin in all the business portfolio we have.

What not contributed to increase more our margin in Brazil was the drop in Mizuno's margin and this Mizuno lost margin this quarter versus one year ago, because we are having now higher import costs due to the FX. That's why, as I mentioned a very important strategic step for Mizuno is to bring back to Brazil the production of all Mizuno's footwear, a process that it is starting now and will last until the end of next year. So we expect that by the end of 2016, we will have almost 100% of Mizuno's being made in Brazil in order to eliminate any kind of impact of the FX. We have a plant in the northeast of Brazil that is prepared to make Mizuno. So we dominate the technology. So there is no let's say major constraint in order to make Mizuno in Brazil.

Argentina, the growth in gross profit was 81% in reais, 2.3% more in margin, and of course, the appreciation of the peso helped, but also we had -- we improved our production costs in Argentina, because we had a greater efficiency of direct labor. Direct labor in Argentina is the main component of a cost of the footwear representing 45% of the cost of the footwear. So any improvement we have in direct labor efficiency is very important to increase the margins in Argentina.

In Sandals International, the growth of 92% in the gross profit and 7.4 percentage points in margin was due to higher gross margin, was due to the FX, I am sorry and the increased average price of exports. Exports not USA and Europe, exports to the rest of the world. I

had approximately a 3% price increase in dollar, representing approximately 57% in reais because of the devaluation.

Slide number eight, we have our breakdown of our EBITDA by country. In Brazil, our EBITDA grew 1.4%, and decreased one percentage point in the margin. The margin was 13%, which is considering the current scenario a good margin. But this drop of one percentage points in our Brazil EBITDA margin was mainly to the lower EBITDA, we had in Osklen, and the lower EBITDA we had in Mizuno. Because in Sandals the margins were up and helped to push up the margin. However again, Osklen and Mizuno's together compensated the increased margins in sandals.

In Argentina, the growth of the EBITDA was 60.2% and the margins decreased 0.6 percentage point. And the lower margin was mainly due to the higher OpEx in Argentina invested and spent approximately R\$10 million more in the quarter in operating expenses mainly related to Topper marketing, sponsorships, those kind of expenditures. EBITDA of course in Argentina grew due to the FX effect.

In Sandals International was a very important shift that we had in our EBITDA. One year ago, we had a R\$5 million negative EBITDA and now we had R\$22.3 million positive, so with a shift of almost R\$27 million in the EBITDA of Sandals International, representing almost 21 percentage points more of margin. Here we have of course a higher gross profit and the FX effects helping to grow EBITDA and its respective margin.

On slide number nine, we have a disclosure of our net income. This is a consolidated net income for the third quarter of this year comparing with one year ago. The main contribution to grow the net income quarter versus quarter was the EBITDA, the variation was almost R\$44 million. Income tax we had a more income tax, this is because we had more profit. In financial result, we had an R\$8.1 million less of financial result, and this is because we're having a decreasing financial revenue due to a lower amount of cash invested. Although the interest rates are higher this quarter versus one year ago, but the volume of cash invested was lower comparing with one year ago. The R\$1.9 million variation, negative variation that we call others come mainly from the equity interest in Tavex, there was our investment in the textile company in Spain. This equity interest existed only in the third quarter one year ago and the amortization, the fair value of stocks acquired from Osklen. These two factors in the fourth quarter, they will not exist anymore.

On slide number 10, we have our cash net debt position, a comparison with the last four quarters. As you can see, we had a cash net of debt of approximately R\$50 million negative in September '15, compared with R\$140.1 million September '14. The drop in the cash position, in the net cash position was mainly because we paid almost R\$280 million or more than that in one year of dividends and interest on an equity to our shareholders. We paid Osklen in this period -- between these two periods. So were two important disbursement of cash that we had, that's why we had a drop in our cash net debt position.

On slide number 11, you have for the fiscal year of 2015, we already paid R\$281 million as dividends and interest on equity. The last two payments to complement the R\$281 million

will happen now in December, on December 16 and December 18 to complete the shareholder remuneration for the fiscal year of 2015.

I would say that as a consequence of this good performance Alpargatas had again always considering the photograph we have now of the Brazilian consumption is reflecting in the price of our shares. Up to yesterday our share, preferred share, which is the one that is more traded went up 36% compared with a drop of 8% in the Ibovespa index.

Okay, this is the resume of our performance in the third quarter. We are now open for Q&A section.

## Questions And Answers

### Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) The first question comes from Howard Siegelbaum, Chambers Street Capital.

#### Q - Howard Siegelbaum {BIO 17609560 <GO>}

Hey guys, congrats on a great quarter. In the same-store sales in Brazil Havaianas, how much of that was volume? And then secondly, in terms of your sunglasses and I know that is, you just signed the deal. Do you think that's going to be a meaningful impact of the business? And what type of volumes are you hoping to get out of that when you launch it in 2016?

#### A - Jose Salvio Moraes {BIO 20049415 <GO>}

Well, hi, Howard, this is Jose speaking. So regarding the same-store sales performance was price, mainly price. We didn't have any growth in volume. And the price in sandals, because we had a growth in the stores only in the brand extension products. But price was more responsible for the increase in same-store sales of our franchises stores in Brazil.

And regarding the sunglasses, we cannot say now, how much we're going to sell, because it will be a different and new product for Havaianas. So the acceptance by consumers worldwide is a little bit hard for us to predict at the moment. So will be -- the second half of next year will be a start of this extension. Of course, we know that which products we should extend, because we had a study that we made two, three years ago, indicating all the different products that Havaianas could extend its name. And one is sunglasses. But to precisely say how much we will represent in terms of volume or even in revenue, it's a bit difficult for us to predict now.

#### Q - Howard Siegelbaum {BIO 17609560 <GO>}

Got it, great. And in terms of your brands that you sold, so what is left on a pro forma basis. And in Argentina, why did you sell 20% of the business, not a 100% or not 0% and

what's the long-term, is there a long-term view on what you plan to do with that business in Argentina?

**A - Jose Salvio Moraes** {BIO 20049415 <GO>}

The sale of 20% was, I would say, because that was the stake that the acquirer wanted to buy at the moment. So I cannot say what -- why he just wanted to buy 20%, but I could imagine that is because he wanted first to know the country and the brand there in order to give a step forward of acquiring more than 20%. They have the right to, if we decided to sell the other 80% of the Topper business in Argentina, they have the rights to be the first one to buy. They don't have an option, they have the rights. So will be a partnership us and them for, I would say, in the coming years. And then let's wait and see what they find out about the business there. And if they wanted to progress in this stake.

**Q - Howard Siegelbaum** {BIO 17609560 <GO>}

Okay, great. Thanks a lot.

**A - Jose Salvio Moraes** {BIO 20049415 <GO>}

All right. See you, talk to you tomorrow. Bye-bye.

**Operator**

(Operator Instructions) This concludes today's question-and-answer session. I would like to invite Mr. Jose Salvio Moraes to proceed with his closing statements. Please go ahead, sir.

**A - Jose Salvio Moraes** {BIO 20049415 <GO>}

Okay, thank you very much the participation of all of you, people from the US and Europe. And it has been, I would say, that October was a good month, the first month of the first quarter -- the fourth quarter was a good month, the first month of the first quarter -- the fourth quarter was a good one in terms of sales for, especially for Havaianas in Brazil. So the trend that we saw in the third quarter continued at least in October. So we are very optimistic about this quarter, because we have strong brands, Havaianas as you know, is a loved one in Brazil. So everything is indicating that now that we have all the capacity to supply better to market, we expect to have a good sales for the fourth quarter especially in the Christmas time.

Mizuno as I said, we're starting to make, I think, we are making already four models of Mizuno now in Brazil or starting to make it. This again will be a very important strategic step for recovering the margins of Mizuno. Of course sales of athletic footwear has been a little bit more difficult than one year -- than the year ago. But again, Mizuno is a very strong and very important brand in the running performance segment. We are here at disposable of all of you, so any questions you may have, just get in touch with us. Okay, thank you very much.

**Operator**



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

*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.*

FINAL

Bloomberg Transcript