

Q3 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

Other Participants

- Olivia B. Petronilho, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the audio conference call that will review Alpargatas Third 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's 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, these 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. Berto Funari, CEO; and Mr. Julian Garrido, CFO and IRO. I would like now to turn the conference over to Berto Funari. Please go ahead, sir.

Roberto Funari {BIO 17031506 <GO>}

Hello, everybody. It's a pleasure to present the results for the Third Quarter. We'll present the operational results and highlights. And then I'll hand over to Julian to present the

financial results. And then I will close, giving you updates of our transformation project for Alpa.

So let's start with the performance update. I'm on Slide #3. So the consolidated results for the Third Quarter shows our revenues topping BRL 1 billion with a recurring EBITDA of BRL 156 million. Our net revenue grew 11%. Our recurring EBITDA grew 36% as margin expansion of 270 basis points. This is driven by the top line growth across all brand market units. And also Argentina performance and also operational leverage with our gross profit growing 19%, which drove the 36% growth 3x the revenue growth in the quarter. The recurring net income was positive BRL 60 million with the turnaround compared to the losses of BRL 6 million in Third Quarter in '18.

When we exclude Topper and Textile Argentina from the results, our underlying revenues increases by 11%, topping BRL 900 million and our EBITDA BRL 132 million. Gross profit was a growth of 15%, ahead of revenue growth. So gross margin expansion of 180 basis points. And our recurring EBITDA grew 22%, 2x the net revenue growth with the margin expansion of 140 basis points, also showing positive operational leverage.

Our performance in Brazil across Havaianas, Osklen, Mizuno has showed positive volume growth of 4% and revenue growth of 11%. So supported by positive price mix, also double-digit growth across our business. And international growing volume by 14%, driven by Havaianas, who grew -- which grew above 14% and revenue growth of 10%, driven by the geography mix, supported by the growth in Latin America and Asia Pacific.

Our performance in Brazil is driven by sellouts. Our market share in Brazil continues to be very healthy. We have -- grew market share by 3.4percentage points across all regions. And our same-store sales based on our direct-to-consumer stores, both offline and online, has shown double-digit growth in Havaianas, 10%; and in Osklen, 13%.

So I hand over now to Julian to talk about our financial performance.

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

Thanks, Berto. Thanks, everyone. Good afternoon. Good morning, wherever you are.

So on Page 8, next slide, I'm going to drill down a little bit on the KPIs of net revenue, the recurring EBITDA and the recurring net income. As we have plot before, 11% on the net revenue, recurring 36% and the recurring net income going from negative to a positive situation.

If you please change to -- flip to the other page, Page 9. This is the view on the region. So splitting the net revenue by region and the evolution there. We see that it basically didn't change much, slightly increased on the Topper and Textile because we were a little bit higher than the double digits. Again, everybody was double digits across-the-board here. In fact, going to the middle of the page, when I see this by business, again, slightly -- basically a flat year, slightly increased on the Sandals. And in Brazil, per se, I expect that by business, basically no change.

Now let's go to Page #10 on the evolution. As we mentioned before, on Q3, 36%. If you see on the left side here, in the International market from a negative 5.4% to the positive 8.2%. Argentina growing also pretty well and Brazil growing also there. If I go to the next board there on the year-to-date, we see strong 25% double digit, where International part is 33%, in line with our development growth of International part. If I go to the left-hand side, when we see those in percentage points, you see not only on the quarter but also the year-to-date, a positive accretion there. And mainly coming from the International part, with the highlight with Argentina as well as on the operational side there.

Now if I flip to the next page, Page 11, we see there the BRL 155 million that we talked about and the recurring EBITDA with 36%. What we did here, just like we did in the last quarter, is to grow what to guide through margin on recur, no comparable data. So that we can surely get to the core of it.

So you see in the bottom there, EBITDA for the Q3 of BRL 150.3 million. And you see the explanation of what's in and out. So in the case of Brazil, it was in 2019, Q3, the IFRS 16, which we didn't have last year. So it's not comparable; and some restructuring. When I go to Argentina, the BRL 6.2 million is basically hyperinflation and some restructuring.

If I do the same exercise for the Q3 there to try to get the logic, bingo, we see what drove, really, the result for last year's Q3, which was the successful lawsuit on the exclusion of the ICMS from the (COFINS) basis there, some restructuring there. So this is a big driver. That's what made the whole thing change there. In the case of Argentina, we have some restructuring to hyperinflation.

And on the nine months, the story is basically the same. On the nine months of '18, you see there a positive Argentina, BRL 50.7 million, basically because the last year, we sold assets of the headquarters of Argentina, nonrecurring item.

You should go to Page 12 now. Doing the same exercise on the net income growth for the recurring or nonrecurring before I go to Q3, the same drivers that we talked about on the EBITDA and the right side of Q3 as well. The only inclusion here is on the tax shield from interest of capital, the JCP in Portuguese, that we had last year and we don't have this year. So it's not comparable. But basically, they are the same drivers there.

If you please go to the next page, Page 13, where you see the evolution of the net financial position. Growth for us BRL 27.9 million to BRL 123 million. So an addition of BRL 95 million, meaning basically BRL 285 million coming from the operational cash. You see the EBITDA in items that don't relate to cash. The working capital delta there with the growth that we are having. And basically, this IFRS is because it's the upward position before. We had it simply above the EBITDA. And now it's below. So I decided to show this. But basically, the rent payments, no change whatsoever. In CapEx, there we have been, since last year, investing in further growth here. The financial results on the right side is basically driven by Argentina. No big comments. I think everybody has seen what's going on since last year, taxes and the exchange rates.

So having said that, I'll pass back to Berto for the final message.

Roberto Funari {BIO 17031506 <GO>}

So to give you the highlights of the quarter, I think the key word is that in our transformation to increase the focus of our progresses in -- on our brands, on our consumers, we have done a key major step in the Third Quarter. We have moved our office together with the new organization to -- so originally, our previous office was on 14 floors, now we move into 3 floors. And in line with that, to have also launched at our new culture. We've been very much focused on owner's mindset inspired by people. And also, we have put the whole company into G Suite, which is in line with our focus to view the global lifestyle brands or connect the company globally through G Suite, driving better collaboration and also higher productivity. This was done successfully. We have also launched a couple of important programs in the Third Quarter.

Next slide, Slide #16. We have launched our Havaianas Friendly initiative, which aims at changing the dress code norms in companies, in business, making open air footwear accessible in all type of occasions and Havaianas leading that. This has been -- had an extremely positive response. Top companies has already adhered to the program. And we have a pipeline of companies once we start this program. And it's a business-to-business, business-to-employee initiative, which will also drive sales and brand image.

So in conclusion, a strong quarter, where revenues grew double digits, gross margin growing faster than revenue with gross margin expansion and EBITDA growing 3x the revenue growth driven by higher productivity, efficiencies on a very health operational leverage.

With that, I would like to open for questions and answers.

Questions And Answers

Operator

(Operator Instructions)

Our first question comes from Olivia Petronilho of JPMorgan.

Q - Olivia B. Petronilho {BIO 19090195 <GO>}

I have 2 questions. First one is regarding the American operations. So we continue to see some deceleration there. But I understand there's a shift in terms of geographies as well as price positioning. So just trying to understand, when do you guys think that we should start to see growth again? And of course, that's a little bit healthier channel mix versus what we had in the past. And the second question is regarding Brazil EBITDA margin. So we saw a lot of things in terms of gross margin. But I think SG&A is still a little bit pressured. I understand that this is maybe regarding the organizational changes that are going on. So when do you guys believe that we should see maybe semesterly dilution, maybe some more efficient -- more efficiency gains in this line?

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A - Roberto Funari {BIO 17031506 <GO>}

Thank you, Olivia. So North America, we are on the process of restructuring and returning this business to growth. Most of the decline that we see year-to-date is driven by 2 fundamental factors in the channel shift, where we are focusing on higher growth -- higher margin channels, where we can also -- we'll have a better brand experience. So we are shifting from regionally-specializing stores, which are also being pressurized by online sales. We are pushing to online digital sales and fashion, key accounts oriented. So that's the first key shift. The second important driver in U.S., historically, we used to rely on off-line -- on full stock, off-price sales. This has been reduced to a very low level, which also improves our gross margins and profitability. So what we see in U.S. is we are fixing the P&L for us having a very healthy P&L. We have changed the leadership team with a stronger American-centric team with trade of experience into these markets. And now we're starting to turn around in the top line sales with a much stronger channel focus where the growth is. Then we are also looking at how to strength the brand positioning.

The second question's regarding the SG&A in Brazil. SG&A in Brazil has been stable. So in reality, all these investments and new structure has been accretive to the P&L. And we have been able to keep investments in the brand in our go-to-market healthy. The most important part is the productivity leverage, where we see in Brazil an additional margin expansion -- or SJ margin gains -- sorry, SG&A margin gain of 270 basis points versus -- as a percentage of net revenue.

Operator

(Operator Instructions)

This concludes today's question-and-answer session. I'd like to turn the conference over to Berto for his closing statements.

A - Roberto Funari {BIO 17031506 <GO>}

Thank you, everybody. We are on track with our transformation of Alpa. A lot of progress on the key areas to drive the company to become more focused on brands and consumers. And at the same time, delivering strong results on a consistent basis. So I'd like to ask you to have a fantastic week and a great day. Thank you very much. Bye-bye.

Operator

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

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