

Q2 2016 Earnings Call

Company Participants

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

Other Participants

- Guilherme Assis, Analyst
- Robert E. Ford, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. Welcome to the Hypermarches Second Quarter of 2016 Results Conference Call. Today with us, we have Mr. Claudio Bergamo, CEO; and Mr. Martim Mattos, CFO.

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 Hypermarches remarks, there will be a question-and-answer session for investors and analysts when further instructions will be given.

We would like to inform that questions can only be asked by telephone. So if you are connected through the webcast, you should email your questions directly to the IR team at ir@hypermarches.com.br. Today's live webcast may be accessed through the company's Investor Relations website at www.hypermarches.com.br/ir.

We also 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 over 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. Good morning, everybody. In the second quarter of 2016, Hypermarches reported good results that reflects the company's continuous effort on implementing improvement opportunities and to roll out its strategy of organic profitable growth.

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The company net revenues increased 11.4% compared to the second Q 2015, reaching BRL 807 million in the quarter, in line with the growth of the sell-off demand for our products which was 10.9%, according to IMS Health data.

Net income increased 59.1% compared to second Q 2015, reaching BRL 176 million in the quarter. This growth was related to a mix of the improvement of our operating results as well as the reduction of our net financial expenses. Which was triggered after the change of the company's capital structure with the sale of our cosmetics business to Coty.

Continue operations EBITDA reached BRL 305 million in the quarter, with a margin of 37.8% and a 26% growth related to second Q 2015. In the year, continuous operations EBITDA amounted BRL 615 million, positioned the company on track to reach this guidance of BRL 1.1 billion for the calendar year of 2016.

The company also posted free cash flow of BRL 233 million in the quarter, ending the quarter with a positive net cash position of BRL 252 million after hedged FX. We highlight that this cash position does not includes the second installment which is to be received after the approval of regulator of the sale of our Condom Business to Reckitt in the order of BRL 600 million.

In the quarter, Hypermarchus completed the completed the reorganization of its pharmaceutical business into three business units, Prescription Products, Consumer Health, and Branded Generics and Generics. We highlight that in the Prescription Products, one of the key focuses has been the launching of new products and increasing the effectiveness of our team that promotes our brand Mantecorp to the medical community.

In the Consumer Health, the company combined launches of line extensions with stronger communication and with promotions and point of sale actions. In the second Q 2016, the company launched for example Tamarine Fibras in the diet market. In total, more than 15 pharmaceutical brands were advertised directly to on TV, radio and other media in the quarter.

In Branded Generics and Generics segment, the company is offering a broader supply of (05:29) with new launches in the quarter with the national distribution scale.

We stress that also very important that our Diapers Business also posted very good operating momentum now. Our net revenue grows 19% in the quarter compared to second Q 2015. Also very important that the company was able to grow that with an improvement in this profitability and margins and with maintaining our market shares stable. The business now has been managed with a completely independent management team segregated from the pharma businesses. The process of analyzing the strategic option it's a continually moving and in a fast pace at this point.

Also, we would like to highlight that given that our comfortable situation in terms of the cash position, the company announced an additional distribution of dividends for the

calendar of 2016 of BRL 158 million which amounted BRL 0.25 per share which with the previous dividend, we totaled BRL 0.50 per share in the year.

In addition, the company has an open share buyback program, which might be executed over the coming months.

I'd like to pass over to Martim to discuss more in detail the financial numbers.

Martim Prado Mattos {BIO 16015889 <GO>}

Good afternoon. We begin on page two of the presentation in order to quickly discuss some of the highlights of the second quarter results. Our growth in the quarter was 11.4%. The totality of it came from price increases with almost flat volume increase. The most impressive performance came from Prescription Products, not only in the quarter but also in the first half of this year by the way. Gross margin was 75.8%, 60 bps lower than the same quarter of last year. The price increase caused a 2.7 percentage points growth on the margin. However, the depreciation of the dollar over input costs reduced the gross margin by 2.3 percentage points. Moreover, there were other cost increases that impacted the margin negatively by 1.9 percentage points. But, on the other hand, we had a better mix which increased the margin by 1 percentage points.

Operating expenses were reduced by 5.3 percentage points in the combination of less aggressive marketing expenses compared to last year. Operating leverage on commercial expenses, reduction of G&A compared to last year, and an expense reimbursement in other operating expenses. Therefore, the EBITDA in the quarter has margin of 37.8% amounting to BRL 305 million or BRL 278.3 million if we disregard the expense reimbursement booked in other operational expense.

Financial expenses were BRL 51 million, still under the influence of BRL 14 million of debt prepayment expenses and BRL 30 million from hedges related to the purchase of raw materials for the year of 2016. Thus, continuing operations net income was BRL 176 million, a 90% growth compared to last year.

In discontinued operations, net income was BRL 300,000 and the impact of some final expenses related to the beauty business. Therefore, net income amounted to BRL 176.4 million in the quarter. As we can see on the next page, gross debt ended the quarter at BRL 1.9 billion and the cash positions is at robust BRL 1.9 billion in addition to non-realized hedge result of BRL 334 million. Net cash after hedges therefore was BRL 252 million even after a payment of BRL 158 million as difference in the quarter, as we can see on page three, given the good operating cash flow and free cash flow generation in the quarter. Continuing on this trend, we have also announced the distribution of additional BRL 0.25 per share as dividends should be paid down on August 15.

Thanks everyone for your attention and interest. And we may now proceed to the Q&A session.

Q&A

Operator

Thank you. The first question comes from Robert Ford with Bank of America Merrill Lynch. Please go ahead.

Q - Robert E. Ford {BIO 1499021 <GO>}

Hey, Thank you and good morning, everybody, and congratulations on the quarter. My first question was with prevailing FX rates mix market pricing. What is the implication of a real-U.S. dollar FX rate at 330 to gross margins and your business plan in the second half of the year, please?

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

Hi, Rob, Martim. It certainly helps on the gross margin front. Approximately 30% of our cost currently is exposed to currency fluctuations. Our inventory still holds an average of BRL 3.50 per dollar of all the imported raw materials that we have there.

So any purchase that are executed going forward of raw materials below that BRL 3.50 will represent, from the current level of margin, will represent then an increase on the gross profit that we post. So obviously we don't know what will happen with the FX, but certainly, at this level, it helps us improving our margin.

Important to also notice that when we initially viewed our budget for the year of 2016, we have an estimate of, if I'm not mistaken, BRL 3.8 per dollar on average for the year of 2016. But with this new FX, that certainly helps us on the budget as well, and that's why one of the implications of that, as we discussed on the Portuguese call, is that in terms of the other expenses, operating expenses of the company, there's a little bit more room for us to achieve the same guidance for the year of around BRL 1.1 billion on continued operations.

Q - Robert E. Ford {BIO 1499021 <GO>}

Okay. That's very helpful.

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

(14:01) Rob, I want to just add to what Martim is saying that for the diapers business, that's specifically situation is - will be even more helpful because, in diapers it's a 70% of the cog, (14:29) is a dollar related. So given that we went through the process of making all the price increases last year, that's one of the reasons also that we had the back gross margin level of the last quarters in this business.

And if that strength continues and we continue having a more real appreciate as we have now, we tend to see it as a good important lever for continuous good performance for this business.

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Q - Robert E. Ford {BIO 1499021 <GO>}

It's good to know and congratulations. And then in Note 21 of the ITR, you have a section that's entitled Cessão de Créditos por Fornecedores, and it sounds like you're buying back in some of the factored payables from some of your suppliers. I just wanted to make sure that that's what this is.

And then how big was this in the quarter and how big can it be? And I was curious as to where this is being booked?

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

(15:43) a little bit, if we understood your question correctly. But the breakdown we do on the financial report is of how much of how much we paid, how much we owe to our suppliers were anticipated by them on financial transaction. There is a program that we have in place that entitles some of our suppliers to anticipate their receivables from us bringing up certain interest.

So for a lot of them, it's good for them to working capital management on their sites and we use it as a tool to better negotiate terms with our suppliers. But it means that breakdown shows how much was anticipated by them and not by us.

Q - Robert E. Ford {BIO 1499021 <GO>}

Okay. And is this something that you recognize in the gross margin line or is that a financial income element?

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

No, it's immaterial.

Q - Robert E. Ford {BIO 1499021 <GO>}

Okay. And then on the Portuguese call, you touched on some of your uses of cash but not really buybacks. And I think you have a buyback plan in place. It's relatively small. But can you touch on what's driving your philosophy in terms of uses of cash and your position on buybacks, please?

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

Well, the - as we said in the Portuguese, the company is in a situation which is cash-rich situation from the standpoint that is operationally is generating a good operating cash flow as well as we have the expectations of the proceeds from the diapers based it on the Condoms Business expected to be something around BRL 600 million. Additionally, to some point in time, some proceeds also from the diaper business.

So, if you add all these three, that leaves us in a cash range situation. And at this point, the board and the controlling group is not (18:30) not to make any acquisitions for the time being, so the structures will be to give it back to shareholders.

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A part of this cash is excess cash in the mixed form of dividends and share buybacks. The dividends – there will be a consistent policy of distributing dividends. And for the year, we've distributed BRL 0.50 per share, and the objective is to continue increasing this amount at a certain level that we don't know how for the mid to long run.

In terms of share buybacks also is part of our policy if we see good opportunities and as well to face our stock option problem and at least we will move in the open – in the existing open program which is BRL 5 million but we don't have a timing for that. It's just a policy. And then as we move, we'll see how that will turn out.

Q - Robert E. Ford {BIO 1499021 <GO>}

Okay. That's very helpful. Thank you very much.

Operator

The next question comes from Guilherme Assis with Brasil Plural. Please go ahead.

Q - Guilherme Assis {BIO 16143141 <GO>}

Hi, good afternoon, everyone. Thanks for taking my follow-up question on this call. I think it's a lot from the Portuguese call and I know that you mentioned that the focus of the company now will be organic growth. I'd like to see with a good cash position under the prospective of getting more cash with the closing of (20:45), and the potential sale of the diapers business. Would the company consider like more acquisitions to complement its portfolio in the pharma segment like anything that you think that might be happening in the market in Brazil that could make change to you guys despite you having the focus on organic growth? Is there anything that you could think of that could make, seem to make sense? That's one question.

And another question which is if I'm not mistaken your EBITDA guidance for the year is BRL 1.4 billion, right? I'd like to know is there any upside or any upside risks given that now you have the six months EBITDA for the period? Is there any upside to BRL 1.1 billion in the official guidance that you have? That's the question, thank you.

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

Okay, Guilherme. Thank you for the questions. Well, in terms of M&A, as I already said in the – both in the Portuguese call and I just explained to Bob, at this point, the objective, the focus of the company is to distribute this excess cash back to shareholders in the form of dividends or share buyback, a mix of both.

We don't have in our target now any M&A activities. We believed that the best investment that we can make now is in our own platform. I think we – as explained in the Portuguese, the company is going through a very important reorganization process by training the three different business units in the Prescription Products, in the Consumer Health, and in the Generics and Branded Generics.

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And that process will be sustained by an investment that we have been making to upgrade our innovation capabilities, and we believe that initiatives gave us tremendous amount of opportunities moving forward in terms of even accelerating our organic growth in the mid to long run if we do our job properly.

We have the platform to do it. We have the opportunities (23:31) that. And that's - for now, that's what the board and the controlling group believes is the best investment and returns for our investment at this point to leverage in and own our existing platforms. So M&A is not part of our (23:11) strategy at this point.

Talking about the guidance of BRL 1.1 billion, at this point, we don't have any change on that guidance for the time. And then if we see any further space, as I said in the Portuguese, we have some plans to accelerate some of our marketing investments in the second half. And as we move, if our profitability give us this space so we don't have any change for the guidance for the time being.

Q - Guilherme Assis {BIO 16143141 <GO>}

Okay. Thank you.

Operator

Showing no further questions, this concludes our question-and-answer session. I would like to turn the conference back over to Mr. Claudio Bergamo for any closing remarks.

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

Again, thank you very much all for participating. Thanking you for all the support you're having for Hypermarcas. From our side, we continue working very hard to continue delivering superior results for our shareholders. And please, if you have any further questions please contact our IR area that will be more than willing to answer you and to give you further insights. Thank you very much and have a nice day.

Operator

The conference has no concluded. Thank you for attending today's presentation. You may now disconnect.

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