

Q1 2014 Earnings Call

Company Participants

- Jose Roberto Lettiere, Chief Financial Officer and Investor Relations Director

Presentation

Operator

Good afternoon, ladies and gentlemen. Welcome to Alpargatas first quarter 2014 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 at ri.alpargatas.com.br.

Before proceeding, it is important to mention that any forward-looking statements provided in this conference call depends on focus 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 Roberto Lettiere, CFO and Investor Relations Director; Mr. Jose Salvio Moraes, Investor Relations Manager; and Mariane Weger, Investor Relations Analyst.

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

Jose Roberto Lettiere {BIO 16358413 <GO>}

Good morning and good afternoon to all of you. It's a pleasure to be here and to talk about our first quarter results. You may have the presentation with you. So starting with the page number two, where we highlight the major financial indicators. We for this time, we prepare a comparison with another players in the market primarily in the footwear and apparel business. Just to illustrate, our performance in the scenario, which according to our understanding was very, very challenging. You may know about the slowdown in our economy nowadays.

So you can see that our top line growth was 14% followed by our gross profit growth in 9%, EBITDA growth 13% and our net income growth was 26%. Our understand was that, we had good performance in our domestic market and also primarily in our international markets. We had good performances primarily in our Argentine market which is a consequence of several initiatives we conducted during the last quarter in order to restructure the business and reorganize our go-to-market in our operating operational -- operating and market initiative.

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So starting with the slide number four, the major highlights focused primarily in Brazil starting in Brazil. You can see all the brands, all the major activities we conducted during the quarter. I would like to highlight the strong sales growth in our Havaianas stores, I'm talking about our flagship stores, our own stores and also the franchisees stores with the same-store sales in the order of 30%. So it was a fantastic performance, and here we -- also good sign that our brands, that our products and our innovation process is really functioning accordingly. We also had a record in sales in March, we reached 19.2 million pairs which was really, really very good month. I can add here comment to say that in March we had a great was good, but the start of the year was not that good because we had a proper operation probably in our main manufacturing in Campina Grande in the State of Paraiba where we had some problems with some equipments.

So these reduced our capacity in order to sell more volumes in that specific months. Then we recovered in February partially and in March, we also recovered most of the volumes we lost due to these problems faced in January.

So we are committed in preparation for the goods and apparel for the Havaianas brand. Actually by next two weeks, you have the launch of the brand extensions, the apparel Havaianas in Sao Paulo. And the following day, we will open our first foot store including the apparel in Sao Paulo in the Oscar Freire store and the following day we will open another foot store including the brand extension apparel in the stored located in Iguatemi shopping mall in Sao Paulo also. In the next day, we open our third foot store including brand extension apparel in Buenos Aires and Leblon shopping mall, okay.

Talking about Dupe. Also we had very good quarter for Dupe. Dupe is growing and that's very good best primarily -- mainly in the northeast region in the country. So all in all, we had a very good performance in Brazil with our Sandals business and also, we saw our Havaianas brand. Could be better, yes, could be better, but we had to face some problems technical problems, operational problems in our Campina Grande plant.

Osklen is also doing -- the preparation for the World Cup. We launched our football series collection signed by Oskar Metsavaht and our core brand is our Topper brand to illustrate the teams of the World Cup. Topper is also working very hard in preparation for the World Cup. The point of sales activity. Havaianas We have a very good product for Havaianas. We launched the new collection for apparel and we reached an impressive 114% growth comparing to the same base last year. Mizuno was another very good quarter, I'd highlight the increase in the footwear 8.6% increase, apparel and accessory sales volume also. The new collection is performed very well, the Creation 15, the Prorunner 17, we sponsored several circuits with highlights for the Mizuno Half Marathon and other runs in the country.

Timberland had also a good performances. Timberland volume growth was good 10.8% and our outlet brand of the Meggashop also had a good performance and celebrated its 20th anniversary.

Moving to page number five. I'd like to highlight some points about our production capacity at our Montes Claros new plant. You can see in this slide, the evolution of the

production, the blue columns, the dazzling blue are the extras. We have already produced in April 2.5 million pairs and the grey columns are the estimates.

So as you can see according to this lines, we will reach our capacity by September. We will be running at full capacity at September. So if you analyze 12 months ahead, we will be producing close to 100 million pairs. So the ramp up is being conducted okay. And by September, we should be in a position to reach our full capacity production.

Moving to page number six, we have some highlights for Osklen. You may remember that, we've completed 12 months operation and we are now in a moment closing the evaluation in order to determine the enterprise value for that company. So by end of May, we will conclude this evaluation and we pay, we will complement the payment for the first 30% of the business. And after that, we have an option in our contract to acquire an incremental 30% which is planned to include by June, July this year. So Osklen performed okay. The brand is really continue being top brands in the lifestyle apparel, the collection for the winter season Brazil is already on the windows, in the stores, it's really doing very well according to our plan.

The integration process was conducted in a very, I would say very good way. The teams working together, some in synergies, some together example within Soccer, we also launched the World Cup team using and working together for our top brand. So many other activities are working very well and we are very happy with this project and looking forward to acquire the 30% first and then complement acquiring the another 30% reaching the 60% equity in that business.

Going to page -- moving to page number seven, now talking about Argentina. Argentina performed in a differentiated way, I would say this quarter, because we started collecting the benefits from the restructuring, we started last year in a more deep way. So we can see here on the left side of the chart, so several initiatives were conducted and the business responded accordingly. So sales volume went up by 30%, net revenue 30% and our margins increased and recover the margins we lost maybe last year when the market and the economical, the economical situation of the country where really not favorable.

Our EBITDA was positive in this quarter. So it was really a turn around. And then from now onwards, we would expect this consistent results due to continue in the coming quarters as a result of the initiatives in the restructuring process we implemented in Argentina.

Talking about our Sandals International business in this slide number eight. Was a very good quarter. Our Sandals International business is performing very well. Our growth strategies is in line with our expectation, in our plans.

We conducted several initiatives in Q1 2014 opening new clients, new stores. You can see in Europe, another 38 stores, new stores is been opened, US, three. We started operation in Germany with a new subsidiary and also branch offices will be opened in Austria, Holland, Belgium and Luxembourg.

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Our Sandals International is growing and margins as expected are reaching a new stage as you can see on the right side of this slide. Starting with growth, growth is really performing amazing. Gross profit. We were in a position to increase 12 percentage points in margin -- gross profit margin and another 5.2 percentage points in EBITDA.

You can see here in the slide, talking about volumes, you will see a negative in export. This is retro phasing. In the last quarter 2012, we have some volume is moving from Q4 2012 to Q1 2013. So this is a case of phasing and we are going to recover this negative in the coming -- the coming quarters for export.

So the volumes we saw from Brazil to other countries, okay. So now talking about consolidated performance providing you more details about our financial performance on slide number 10. So the highlights for the net revenue growth is 14%. Argentina and Sandals International playing ahead of the average. So 13.17% [ph] growth respectively.

So volume in Brazil in March as I mentioned the beginning was key to deliver the strong results, also growing in sporting goods. Sporting Goods Argentina and growing in Sandals in Europe and US. 20% volume growth in Sandals International was really very good result. Mix and price also played a very important during the quarter.

We as you can see our high-end products, we call mix, we sold more high-end products in sandals in Brazil than last year. You can see from 37% to 49, so almost half and a half. Basically brought an high end. So this is good because increase our revenues, we increased our ticket and also leveraged our margin.

Sporting goods in Brazil showed increase, more added value products mainly Mizuno and Timberland. The negative side of the quarter in terms of revenues was the peso, the currencies. The peso devaluated against the reals show our strong growth in Argentina where you consolidate in reals.

Okay, we had the opposite dollar and euro. Okay. So it was good for revenues, but the net was negative because of our sales in Argentina was higher. So when we do the calculation to be consolidate to reals, we had a negative impact coming from the business.

Talking about the breakdown of the revenues, the page number 11. You can see on the slide on the left. So 58% of our revenues were generating our sandals business, 37% is sporting goods and 5% in the textiles business.

When you look by region, another vision, another view. You see that more than 30% of our sales are generated internationally which is good, which is another quarter where our sales are maintained at that level. 30% is a bit more, but it's proving also that our internationalization strategy is working well.

And we can say that that we analyze our results. So the results we are consolidating, we are collecting from our international business, it's really proving that our

internationalization strategy is working accordingly.

So moving to slide number 12, analyzing the gross profit, we had a year, we lost 2.1 percentage points in our gross profit. And this is basically has caused by and impacted by the Forex, if we exclude this Forex effect, our margin in Q1 2014 would be 45.9. So the Forex impact in our costs impact the evolution over the gross profit margin. So you can see some analysis in the bottom of the slide, so commodities also reduced a little bit our margin, but the major impact was for -- most significant impact was the Forex.

Okay, so I can also highlight the productivity initiative will be conducted in Argentina, the renewal of some textile machinery, some adjustment labor in Argentina improving our productivity which of course help that they moved fixed cost.

And another side, we still have to carry, we have to carry the fixed cost or the let's say the run cost process in our new plant in Montes Claros. So until September, we will continue to carry more fixed cost as we are not selling the total potential of the plant. By that as of September, we do expect to reach the right level of production and we will start to seeing the dilution of the fixed cost as prepared using that plant.

Talking about EBITDA generation on page number 13, we had a good growth generates primarily in the international business is good. So we have these portfolio management in terms of regions, countries. So it's very good to see that when we have some difficulty, some -- when we have a more volatile or more difficult market like we are experiencing now the Brazil. We have the combination with your international which is not that easy as well, but you can combine the performance between countries and regions and in a consolidated basis, we had a very strong business. So we could grow our EBITDA by 13% and maintaining our EBITDA margin around 16%. This is what allows us to a very strong control in expense as we lost 2 percentage points in gross profit. So we had to control it more efficiently, all the expenses in order to deliver a reasonable and a good EBITDA.

So all in all, we had a good quarter with a good top line. We have a strong pressure in our costs mainly it can be from Forex, inflation and some commodity like rubber increase a little bit. But we compensate, we had some compensation in our expenses control in line with EBITDA, in line with last year margin.

Going to page number 14, talking about net income. Our EBITDA growth, our financial results we have our cash, our average cash generate some financial results which help us. We continue working very hard in tax planning, tax dividend.

So this altogether with also with the combination of the disposal of the -- the sale of our non-operational property, this is regarding a Sporting Goods brand, we had in the Northeast, it's a part of our productivity project in order to optimize assets and we had this plant which in the past was the propose of this slide was to produce the Sporting Goods brand in Brazil.

We closed this plant and put this brand for sale and we concluded this project this quarter selling these plants by BRL35 million with a net impact in our properties in around BRL30

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million. So BRL35 million was the price we sold deducted by tax which is very good tax effective claim we did, so we pay very little tax on that and less value.

So net-net, in our P&L we accounted BRL13 million, okay. So talking about cash generation on page number 15. Another recurring performance in operational cash generation BRL217 million. The company is -- our business model focused on cash generation. We had a very important CapEx expenditure during the quarter, during the year. Last year we were talking about this slide, about the last 12 months. So the company continue investing in strategy, in growth and brand extension, put more capacity to support our growth strategy, building new plants, opening new stores, developing new IT systems. So at the end, we ended the quarter with a cash balance in the order of BRL835 million, after the payment of the shareholders' remuneration, the order of BRL110 million divided into interest on capital and dividends.

Moving to page number 16, talking about the net cash position. This is just an evolution about our net cash position. We are improving our net cash position which is good because it ensures the product and the strategic growth plan. We are very confident that our future investments will be well supported by the cash -- the organic cash we are generating quarter-after-quarter.

Now talking about the shareholder compensation in slide number 17. We can see that this year, we already paid interest on our equity. We paid in April 16, we paid BRL22.9 million and we are going to pay the complement of BRL23.5 million by July the 3rd. So we are using are very effective tax planning to use the equity, the interest on equity in order to pay more as we can, be more effective in terms of tax planning and distributed more payment and the compensation to our shareholders.

So we are keeping roughly the average, so the payout considering net income without -- around 70% or just analyzing or comparing the total distribution against the net income is around 40%.

Continuing the page number 18 about shareholder compensation. This year we continue with the same methodology started two years ago. So we conduct again another types and share bonus.

And all the credit of new shares already occurred by in last April 29. Yes, we have the fraction auction, it happened yesterday. So now the shareholders, all the shareholders they had another 10% increase in their shares. So it's a good, it's a good way to remunerate the shareholder's believe. And for the third year consecutive, we implemented this compensation scheme.

Going to slide number 19, just inflation about our share -- preferred share performance. Here, where we have, I can say that it's good but also can be good, because in a way we are below Ibovespa for first time in the last five years. We have a challenge ahead of us, but also I think that one of the toughest target for us here is to change these trends.

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And but another side, it's an opportunity because the price, our share, our shares are really cheap [ph] compared to other papers in the country. And the company is well restructured, all the strategy, all the business plans, all the restructuring -- restructure as Argentina is the nation. So all the strategic plans are evolution. So we are very confident that our performance is going to continue being differentiated in the consumer behavior - consumer market in Brazil and also when you do compare with combat stores in our segments.

So, it was a good quarter and we believe that we will face a year where we had some uncertainties, ahead the election year, we have the World Cup, but we are as always we are well prepared to face all kinds of uncertainties. We are performing in a differentiated way, because our strong brands, when we face difficult, when the market is not performing well and economical -- economics of the country is not the delivering what it should be the delivering .

When you had a strong brand makes the difference. And we believe that our brands are strong, all of them are performing well and this is going to be our key differentiation in the market. Okay. So, thank you. So now we are here, Salvio, Mariane and I, we are here for talk about answer your questions.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions). This concludes today's question-and-answer session. I would like to invite Mr. Jose Roberto Lettiere to proceed with his closing statements. Please go ahead, sir.

A - Jose Roberto Lettiere {BIO 16358413 <GO>}

Okay. Thank you for your participation in the call. Looking ahead, I can say that repeat, we are working to tribute a global business. So we will continue as behind our brands, our brands are delivering according to our plan. And always have meaning, so we are very confident that we will continue delivering differentiated performance in our segments. Thank you very much and until next call or if you have a another question, so we are always available here and our team, Salvio, Mariane and myself. 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.

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