

Q2 2015 Earnings Call

Company Participants

- Jose Salvio Moraes, Investor Relations

Other Participants

- Unidentified Participant

Presentation

Operator

Good morning and good afternoon, ladies and gentlemen. Welcome to Alpargatas' Second 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.

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 (Technical Difficulty) 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 afternoon to some. Thank you for participating in the Alpargatas' second quarter results conference. In the next ten minutes, I'm going to make a short presentation about the main results that we had in the second quarter and then we'll open for questions-and-answers. Starting by the slide number two, it's important to mention that in the second quarter the internationalization, I mean, the international operations of Alpargatas helped significant growth of our net revenue and EBITDA especially when Brazil was facing this very tough economic environment.

As you can see, our net revenue and our EBITDA most of them or almost 100% of our consolidated net revenue and consolidated EBITDA came from the international operations. In the case of the net revenue that we grew 14% on a consolidated basis, when we look at excluding any impacts from the FX coming from pesos in Argentina or Euro or Dollar came from Argentina and International Sandals Businesses.

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We generated approximately R\$46.5 million in these two regions and in Brazil, we only grew R\$40 million, so the main part came again from the international operations in the net revenue. When you look at the EBITDA, it's the same, of the 29.4 million growth that we had in our consolidated EBITDA in the second quarter, 28.6 million was generated by the international operations.

So it's important to mention this because Alpargatas in the last ten years has been investing very heavily in expanding its operations outside Brazil. In Argentina where we have the Topper brand which is the main and the leading brand in the country and Havaianas that we sell now-a-days in more than 100 countries worldwide and then becoming more and more very well known flip-flop brand.

So this is a very important achievement that we had this quarter, because it really ensures that the business strategy we have been again performing in the last ten years is being paid off.

When we move to slide number 3, we are showing here a summary of the main performance indicators starting by the net revenue, we grew it 14% versus the second quarter of last year on a consolidated basis.

We reached almost R\$1 billion of net revenue. Gross margin, we grew 0.7 percentage points reaching 41.3%, the EBITDA grew 40.1% and the margin 1.9 percentage point was a very good performance as an EBITDA considering again the scenario in Brazil.

Net income, we grew almost 102%, two percentage points more in net margin and cash generation, which is one strong point of Alpargatas and strong competitive point of Alpargatas, we generated almost R\$130 million in this quarter.

Moving to slide number four, we always like to show that the acquisition of Osklen has been a very important in all senses, not only for adding a very important brand in the luxury and lifestyle segment, but also Osklen is helping and will help more heavily in the future when we consolidate their numbers with ours.

Creating a two quarter '14 proforma which means adding the numbers of Osklen in our 2Q14 numbers, we still have significant growth for this year in our main indicators.

As you can see on slide number four, adding Osklen, last year we grew net revenue in 7.9%, gross profit in 5.2%, EBITDA 27.4% and the margin 1.6 percentage points. And the same happens when we look at the first half of this year in creating the same performance of the first half last year, so that the growth in all indicators are very significant.

So again it was a very good acquisition, not only with a good brand, but also when we consolidate add value in the company.

Moving to slide number five, in the next three slides, five, six and seven, we're going to summarize what happened in the net revenue, gross profit and EBITDA of the Company, separating by business and country. Starting on slide number five, net revenue, in Brazil, we have three main business; Sandals, Sporting Goods and Osklen.

We had a decrease of 1.2% in our net revenue that reached R\$550.9 million and the main reason is that we had -- this decrease was the following. In Sandals in Brazil, one important factor was the increase in the average price of 7.1% that helped to increase the revenue.

And also, the growth in Havaianas brand extension products, which have higher tickets, 66.2% in the volumes held in our Sandals revenue in Brazil. However, the lower Sandal volume of 15.6% was the main factor that dropped the Sandals revenue in Brazil. So we had few factors contributing positively and one factor, which was the lower Sandals volume contributing negatively.

When we look at the Sporting Goods in Brazil, again, the increase in the average price of 9.4% was very helpful for the revenue of this business. However, like in Sandals, the lower sports footwear sales volume 11.1% mainly coming from Mizuno was responsible for drop in the revenue of Sporting Goods in Brazil.

And finally Osklen, we had a lower net revenue of 3% Osklen results in the second quarter, mainly the tough economic scenario we have in Brazil that is lowering consumption because Osklen is a high-ticket brands that suffers more when consumers are not spending too much money. Then altogether, good factors and not so good factors contributing in different ways resulted again in a 1% -- more or less 1% drop in our net revenue in Brazil.

In the other way, on behalf of this, Argentina International Sandals business as I mentioned earlier, contributed very well for increasing our net revenue. Argentina grew the revenue in pesos and in reais, in pesos was 30.3% growth in the revenue in the quarter, that translating to reais was 61.5% growth. And this is mainly because the peso appreciated against real 24% and also because we increased the prices in pesos in Argentina on an average of 38%, which is higher than the current inflation of the country.

When we look at Sandals -- International Sandals business, we also had growth in reais and euros, in reais, we grew 22.4% and in euros 21.7%. In dollar, we decreased 20.5% mainly because the drop we had in our export sales. As you can see, our export sales dropped almost 31% in volume compared to the Q2 last year and this is mainly because countries like Angola, Cuba and the Philippines, which are the top three countries in exports. We had some problems with these countries, some of them restricting imports and some of them restricting the renaissance [ph] of money to other country. I would say that Angola, we have normalized the situation now in July, so the exports to this country began again this month.

When you look at the performance of Havaianas in Europe and USA, we had a good one. We grew almost 16% of our volumes in these two regions and of course the appreciation

of the Dollar versus real and the Euro versus real helped to increase the net revenue besides the good volumes that we had in US and Europe.

Moving to slide number six, the same analysis we do for the gross profit, in Brazil, we had a drop of 2.3% in our gross profit, representing a 0.4 percentage points drop in our margin, and I would tell you that what really -- was the main factor for this decrease was the decrease in Mizuno profitability, which is an important brand that we have and the Mizuno profitability decreased mainly because we had to give discounts on the best collection of Mizuno that didn't perform very well in Brazil and also we had a higher import costs coming from the exchange rate.

So, in one side of Mizuno, we had a pressure in the price -- going down the crisis and the other side, we have a pressure going up, coming from the higher import costs.

So this effect affected on the Mizuno's profitability. And as a consequence, impacting our gross margin. What helped the gross margin was we could say there were two main factors, one was the consolidation of Osklen, which I mentioned earlier was very important not only in numbers but for adding a good brand to our portfolio and an increase of Sandals in our revenues from 54% to 55% and Sandals have a better margin compared to the other business.

Argentina and International Sandals business we had likely [ph] net revenue, a very good performance in gross profit. We grew in Argentina our gross profit in almost 85%, meaning 3.5 percentage points more in our gross margin. And basically we have two factors that benefit the Argentina's gross profits that were increasing in the revenues, as I mentioned due to higher prices and the fall of the average cost of cotton 22% in pesos and 29% in dollars.

Just to mention that Argentina is not only footwear, approximately 30% of our revenue in Argentina comes from the textile business. We manufacture them in Argentina and then we use cotton for this, that's like cotton is there an important raw material.

International Sandals business, we grew our gross profit in 26.6%, representing 2.3 percentage points more in margin. The good factors that helped to increase gross profit there was the growth in revenues higher than the costs. We have two basic costs when we look at the USA and Europe operations. One is the transfer price, the payout for buying our Sandals paid Brazil and the Warehousing is another important cost there. So these two costs were lower than the growth we've had in our revenue, meaning more margins and more profitability.

Another factor benefiting is the increase of Havaianas exclusive retail in those regions, this is a more profitable channel. We are opening more and more stores in Europe and US in order to create more awareness for Havaianas and up only to sell them exclusively in the multi-brand channels. One factor that contributed negatively for the International Sandal business profit was the increase in import tax. Starting January this year Europe, the import tax for flip-flops increased from almost 12% to 17% and US from 0% to 15%. Anyway

even with this higher import tax, we were able to gain more gross profitability with the commercial strategy and increasing the volumes mainly in US and Europe.

The (inaudible) analysis for the EBITDA, in Brazil, our EBITDA grew 7%, meaning 0.2 percentage points more in margin and the two positive factors contributing for the EBITDA growth were the increase in gross profit excluding an impact from commodity and FX and SG&A savings in Brazil.

We really tied up our bells this quarter and we saved money especially in communication of the brand in the -- exactly I would say amount of not affecting the older brands image that we have, but saving in communication represents good money considering that we reinvest on an annual basis more or less 10% of our net revenue in communication.

The impact of the FX in the cost of imported footwear, I mentioned earlier that Mizuno is important and because of the higher depreciation of the real, the cost of Mizuno that they pay in dollars when we import went up. The cost of rubber that in the past was terrible to us is being very well behaved this year as you can see, when we compare the average cost of rubber this quarter with Q2 of last year in dollars decreased 24%, the average cost.

But the FX impact finally made the cost of rubber to increase almost 1% in reais. It is a much better situation that we have now compared to one year ago or even two or three years ago, but we have been controlling as much as we can in this important raw materials that we use mainly for (inaudible).

Looking at Argentina, we grew 113% our EBITDA there more 3.3 percentage points in margin and this came from the growth that we had in gross profit and the appreciation of the peso versus real as I mentioned earlier. International Sandals reflect a more or less the same situation as Argentina, we grew 25% of our EBITDA there, 0.6 percentage points more.

We have higher gross profit in this business. We spend a little more in SG&A differently from Brazil, mainly through related to the Havaianas new stores that I mentioned that we are opening in order to create more awareness and leverage volume in US and Europe.

We had this quarter more seven stores in US, compared to one year ago, and three new stores in Europe compared to one year ago.

I'm talking about leasing costs of operating a store, personnel, all these are SG&A revenues. What helped the EBITDA of the International Sandals business was the appreciation of the dollar and the Euro versus the real. Moving to slide number 8, we could say that all the benefits and the negative points but altogether, the company on a consolidated basis had a good performance that is reflected in the growth of our net income as you can see on slide number 8 that was almost 102% we moved from a net income of R\$22.8 million in 2Q14 to R\$46 million in 2Q15.

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We had two points that we wanted to highlight in the bridge of growth of our net income which are the financial results that were lower mainly because we had less financial revenue due to a lower volume of cash invested, as we'll see in the next slide we have invested our cash in CapEx in acquiring Osklen and paying our shareholders and then the volume invested is lower therefore resulting in a less financial revenue.

And other factors that were contributed positively, is that this year, we don't have any more, the equity [ph] interesting targets [ph] was our investment in a fixed tire company. In Spain we ended with this investment in the last quarter of last year and we still have the amortization of the fair value of stocks acquired from Osklen, which is about to end in the third quarter.

On slide number nine we have the evolution of our cash flow. We've generated in one year from June last year to June this year R\$431 million of cash, which is again one very strong competitive point of Alpargatas and as I mentioned, you can see that the money that we spend in CapEx paying Osklen and paying our shareholders were the three main disbursement of cash we have, that explains the change from 670 million that we had one year ago to 428 million this year.

But, again it's important to mention that we on an operating view, we have generated R\$431 million in cash moving from R\$670.5 million to R\$1.1 billion of cost on an operating concept. This generation was very important to support the acquisition of Osklen, the payment to shareholders and to invest in CapEx.

Slide number 10, we have as a consequence of our cash, we had to deal a cash net of debt situation as of June this year negative in 77.4 million, which is considered a very low leverage for a company like Alpargatas.

In slide number 11, to give more details about the payment to shareholders that I mentioned that was one important disbursement of cash. We paid this year 2015, up to decisions [ph] payment and decisions to pay, taking up to August this year, R\$251 million in interest on own equity plus dividend.

We announced in this week, the Board of Directors approved the payment of R\$30.5 million in interest on the equity that will happen in '16 of September and R\$166 million of dividend that will be paid in October 10 and December 6, in this year. This extra dividend that we are paying this year is because we have accumulated in our profits reserve of the past, such amount of money that we decided to distribute and through to our shareholders at the moment.

On slide number 12, we show you the performance of our share -- the preferred shares, which are the ones that we had more liquidity in the past five years, we had 88% in 2010, 15% in 2011, 34% in '12, 8% in 2013, in '14 we suffered with a drop of 46% was -- just to remember was the first -- last year was the first year that really tough to show kind of weakness in consumption and I think that's not only for Alpargatas, but most of the Brazilian consumption company suffered and year-to-date we are -- to-date meaning yesterday, we are growing 8% versus Ibovespa which is dropping 1%. This is the summary

of our results, first of all, I thank you for listening and we are now open for questions-and-answers.

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 Salvio Moraes to proceed with his closing statements. Please go ahead, sir.

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

Well, just one second I think there is one question. Can we open the question session again, please?

Operator

Sure. The first question comes from Kumar Pandit (inaudible)

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

Hi, Kumar.

Q - Unidentified Participant

Hi there. Hi, how are you?

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

Fine, thanks.

Q - Unidentified Participant

Great. Well, I just thought I'll ask a question, given that there wasn't any being asked, but my thoughts were basically, I wanted to hear what you are thinking about second half of the year in Brazil with retail demand contracting et cetera? And how do you envisage sort of operating in that current environment, please? Thank you.

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

Okay. Very well. That was -- one comment that I could pass to all of you is about without giving a precise number, but I could say both of (inaudible) that in July, our consolidated net revenue grew high double digits compared to July of last year. This growth came heavily from Havaianas in Brazil, the flip-flops sales in Brazil which in July was very good in volume. This is mainly because we presented the new collection of flip-flops, the summer collections of flip-flops for our clients in June. So the orders in July were very strong, it was a very well accepted collection in the view of our clients. So that's the figure for July. We believe that for the rest of the year, Havaianas tends to perform better in Brazil than

performed in the first quarter. This is because the collections not only a flip-flops, but the other products, the brand extensions are performing very well.

And also in, when you look at Mizuno, which was one point that affected our results. The new collection of Mizuno, all Mizuno collection is now in the market, being sold in the market since July. So we have a very few number in our stocks of that collection. And the first comments that we had from our clients are about this new collection of Mizuno was very good, while we change and correct all the problems we had with the other collection. With this new product, we are increasing prices of Mizuno, so we are working in resulting one part of Mizuno's problems by increasing prices.

And when we look at in a medium-term for Mizuno profitability in order to recuperate it will be on the cost side that we are starting now a process to nationalize the production of Mizuno, not the full collection, but at least we intend to in the coming three years to make in Brazil, approximately 50% of the Mizuno stores in Brazil.

So by making in Brazil, we understand that we will offset the impact of the FX in Muzino profitability. So we expect again for this year, the Mizuno new collection, Havaianas new collection, together with the strength that these two brands have in its specific sector will have a better second half compared to our first half in Brazil. International operations, the exchange rate, we have continued to contribute positively.

Argentina, everything indicates that the trend of growth in more profitability in pesos will continue and translate into reais better. Havaianas International sales will drop in Europe and US because of the seasonality. However, we are making now some changes in our exports team in order to in the second half leverage the exports compared to the first half, plus not having the problems in countries like Angola and Philippines as we had in the first half.

Q - Unidentified Participant

Great. Thank you. Just one small question, just regarding to a line in the press release was that you delayed the invoicing of 1.7 million pairs of Sandals. Could you just explain the reason for that please?

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

Because we gave -- let say, collective vacation in the plant of (inaudible) which is the older plant in June. When we were in April, beginning of May, we had to take a decision in order to lower a little bit of inventories of flip-flop, because the consumption -- one fact is consumption of flip-flops in Brazil is suffering in a certain way, the lack of consumption -- due to the situation of the country. This is one fact. So when we were in April and May, in order to lower the inventories, we took a decision of 15 days of vacation of most of our employees of our flip-flop plant in the Northeast. Then we did it, right?

So at the same time in the end of May beginning of June, we presented the new collection, the (inaudible) and was tremendous respect and so we had a lot of orders

from our clients for the new collections that we couldn't produce and sell in June because people were on vacation.

Q - Unidentified Participant

Okay. Got it.

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

Right. So therefore, I couldn't meet all my demand in June, so I had postponed it for July.

Q - Unidentified Participant

Right, so that's an extra 1.7 million pairs of sandal that you'll book in third quarter?

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

Yes. That's right.

Q - Unidentified Participant

Okay. Thank you very much.

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

I would like to mention -- one point to you Kumar which is very important that I would like to highlight is that our agreements or strategic alliance with Disney was concluded and we have --

Q - Unidentified Participant

Yeah, I saw that.

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

Yeah, okay, so that was announced [ph] that there was, owing to you, and then we successfully concluded, this will be very important for the image on the awareness of Havaianas brand worldwide definitely. Because few -- I would say that very few brands, well-known brands, International brands have access to Disney now a days. So it's a very -- we are very proud of having these opportunities. And with this sale, we have stores of Havaianas in 22 park of Disney around the world. We represent more volume, but better than this, we have increased awareness of the brand that will help grow sales worldwide.

Q - Unidentified Participant

Thanks so much, Jose.

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

All right. Thank you.

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Operator

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>}

Well, first of all, thank you for participating in the call. So as I explained to Kumar, we expect this second half better than first half of this year. We have some very important elements that gives us the assurance (inaudible we have the brands with a very long on in Brazil, very strong -- we are having a good commercial policy, innovation and a good communication. So despite of Brazil's economic downturn, we expect we need to have a good second half of this year.

Well, I'm here in Brazil with all the IR team available for any other question you may have, so we can communicate through emails and if some of you come to Brazil, please let us know in order to have a one-on-one meeting here. Thank you very much.

Operator

That does concludes Alpargas' 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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