Q1 2015 Earnings Call

Company Participants

- Jose Salvio Moraes, Investor Relations Manager

Presentation

Operator

Good morning and good afternoon, ladies and gentlemen. Welcome to Alpargatas First 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 statement 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; and Mariane Weger, Investor Relations Analyst.

I would now like to turn the conference over to Mr. Jose Salvio Moraes.

Jose Salvio Moraes {BIO 20049415 <GO>}

Good morning everybody and good afternoon depending where you are. This is Jose Salvio speaking, the Investor Relations Manager of Alpargatas. I don't have here with me the CFO, because you know one month ago Jose Lettiere, was the former CFO, who left Alpargatas for another opportunity here in Sao Paulo. He is now the CFO of Natura.

The new CFO was announced to the market yesterday in material fact that we release. This person is Mr. Fabio Souza, who was a former Director of Strategy of Alpargatas. He is now leading the finance area, as well as, the Investor Relations area. Fabio has been working with us in the last -- I would say eight years as a Strategic Planning Director and he is going to join the finance team probably in the coming week. So in the next conference call in August he will be with us.

Starting our presentation by the page number two of the PowerPoint. Here we are highlighting the first quarter main indicators, finance indicators. We had in the first quarter consolidated results that we are aligned with our 2015 operational plan, our plan for this year project for the full year higher revenue and profit margins and strong cash generation and in the first quarter we already had it.

As you can see, our net revenue grew 8.7% quarter-over-quarter, gross profit almost 15% with a gross margin 2.4 percentage points higher, EBITDA margin almost EBITDA as a value grew almost 16%, 1.1 percentage points more in EBITDA margin. Our recurring net income grew 17% and the net margin 0.8 percentage points.

Our cash generation was very strong in this quarter, we reached BRL77.5 million with a growth of almost 150%. When we mention recurring net income for the first quarter of '14, we are saying that at that time, at that quarter we had a non-recurrence in our income, coming from the sale of a non-operating factory that we had in Natal, State of Rio Grande do Norte. This factory was a former footwear plant that were out of operation, that production we transferred to the plant we have now in the Paraiba State.

And then as a non-operation Rio state, we sold it last one year ago. And then we had a positive result of almost BRL32 million that benefitted the net income one year ago.

Moving to slide number three, it's important to mention that even when we add the Osklen numbers to Alpargatas in the fourth quarter of '14, we still have indicators that grow. As you can see in this table, net revenue grew 3.8%; gross profit almost 6%, gross margin 0.8 percentage points, EBITDA growth almost 15 and EBITDA margin 1.7 percentage points. We are adding through the first quarter of '14 therefore, creating a pro forma because in the first quarter of '15 is worth to mention that in this quarter all the numbers of Osklen is already consolidated with Alpargatas.

Moving to slide number four, here we have Alpargatas net revenue, we have breaking down by domestic businesses, Argentina and international sandals. We have the net revenue for the periods, the changes and the explanations for the variations. So, starting by the domestic businesses which compresses sandals in Brazil, sporting goods in Brazil and Osklen businesses, we had a revenue of almost BRL561 million this quarter compared to 569.4 million one year ago. So, which means that our net revenue for Brazil decreased 1.5% quarter-to-quarter.

However, this decline in revenues didn't happen in the three business as you can see sandals in Brazil, we had a growth in revenue of 3.8% and the main reasons are, we had an average price increase in sandals in this quarter, just to remember that we gave a price increase in June last year of almost 3% and in January this year our prices went up 6.5% on average.

Therefore together, the two price increases amounted more or less 9% and this is the main reason for having a higher revenue for sandals in Brazil compared to the first quarter, '14. We also had in the sandals business in Brazil a growth in sales volume of Havaianas brand extension products and in apparel closed footwear, accessories everything up related to sandals. This was an important growth of 73% in volume and it helped in increase the revenue for this business in Brazil. Just to remember that when we talk about brand extension of Havaianas, we are talking about products that have higher prices compared to sandals.

Looking at sporting goods in Brazil. The change, the net revenue of this specific business decreased 28.4% and the main reason behind this decrease was the lower sales volume of sports footwear that the sales volume decrease was almost 24% as you can see there. So, sports footwear we have just to remember four main brands Mizuno and Timberland, the two licenses and also high-end Topper.

Mizuno was the, the brand that suffered more in this quarter in terms of sales mainly because Mizuno in Brazil is a higher ticket sports footwear, we're talking about product that range from, let's say BRL500 up to BRL1,100. So assuming and considering that the contraction we are having in consumption in Brazil, those products with higher tickets, they suffer more compared to products with lower-ticket.

High-end Topper did performed well because they are sports footwear with a lower ticket targeting more the middle class that despite being suffered too with the contraction. The economy that, again we are talking about a product that ranges from BRL80 to up BRL120 much cheaper therefore compared to Mizuno.

Finally, in Brazil, Osklen grew 4.1% its revenue and mainly because we had the highest sales volume of the lifestyle apparel and footwear, 6% sales volume growth quarter versus quarter. When we look at Argentina the operations, their continued to perform in this quarter, a better performance. We had revenue there of BRL197.5 million compared to 142.5 million one year ago. The growth was 38.6% in reais, 28.2% in pesos, meaning in pesos are most with the inflation rates there. And the main reasons behind this growth came from footwear price increase, plus better sales mix, together we had a 29% impact in the revenue and also the FX, the peso appreciated against the real in 5.4%, helping grow sales in reais when we translate from pesos to reais.

Finally, net revenue international sandal businesses we had a revenue there in this group of operations, let's say BRL190 million compared to BRL162 one year ago and in all currencies we had a growth in reais was 18.2%, in the invoicing in the USA we had almost 24% sales growth, in Europe almost 10%, in Havaianas exports almost 4%. Havaianas exports is in dollar currency.

The main reason is the higher sales volume of Havaianas, we grew 9.4% compared to first quarter last year and also the FX helped like in Argentina, because the dollar appreciated 21% versus the real in this quarter compared to one year ago.

Moving to slide number five, here the net revenue breakdown is important to mention that 41% of our revenue was generated by the international operations, meaning Argentina in terms of international. As you can see in the first graph, in the first quarter of this year 58% of our revenue came from sandals, 32% in sporting goods, 6% textiles in Argentina and 4% in Osklen. When we breakdown by region, as I said 59% of our revenue was generated in Brazil, in reais and 41% in Argentina in sandals, International in a mix of peso, euro and dollar currency.

Moving to slide number six, we have a gross profit explanation. We have -- in this quarter we have the lowest price in rubber since January 2013, this is a very good news because as you know rubber is a very important raw material for our businesses and the main reasons behind the job in the rubber cost came from the -- the drop in the oil price. And also we are seeing in the market nowadays a surplus of rubber because the production of cars in Brazil has dropped dramatically affecting the sales of tires. As you know, we use the same rubber to make Havaianas that the tire companies used to make tires.

In Brazil, the gross profit grew 6.2%. We had almost 243 million gross profit compared to 229 million one year ago. The gross margin grew 3.1 percentage points and reached 43.3% and the reasons behind this gross margin growth was, as I said the average cost of rubber dropped 5.4% in reais compared to the first quarter of last year. Also the participation of Havaianas, our sandal business in the revenue grew from 60% to 63% in Brazil.

So, as you know, Havaianas, sandals and also brand extension product, they have a higher margins compared to the other businesses we have. So because Havaianas business grew its stake in our domestic revenue, it helped to grow the gross profit and the gross margin. Also we have consolidated Osklen in this quarter that helped our gross margin and negatively we had the impact of the exchange rate on profit for its footwear mainly Mizuno and an increase in general manufacturing expenses, which represents approximately 20% of our cost, main income means some inflation in all items energy that is accounted in this specific group of expenses.

However, the final result of positive factors and negative factors affecting our gross margin was a positive result, again, resulting in a growth of 3.1 percentage points in our gross margin in Brazil. In Argentina the trend was the same, we have almost 60% growth in our gross profit was almost BRL56 million this year compared to BRL35 million one year ago.

The gross margin grew 3.7 percentage points in that country reaching 28.2% in this quarter and main reasons are we had a growth in revenue as we mentioned earlier.

Argentina is having a greater manufacturing efficiency because we have replaced, for example; all the textile machine there and this equipment are much more state of the art and are much more efficient and cost effective.

We also compared to one year ago, we have less labor, direct labor in our plants and are better skewed and trained labor. So altogether it's helping the efficiency in our Argentine plant. We also had a 2% decrease in the average cost of cotton in pesos, we use cotton for our textile business in Argentina and a decrease in this raw materials is important to benefit the margin in the country.

When we look at the international sandal businesses, the trend is the same. So we had a growth of 19% in our gross profit, we reached BRL125 million this quarter versus 105 one year ago. Our gross margin grew 0.5 percentage points reaching 65.6%. The growth in revenue helps, as I mentioned earlier, we also have an increase in sales to more profitable channels, mainly in the US because our -- the number of stores we have in this quarter operating in US is higher than one year ago. I think we have more five stores in this quarter in US compared to one year ago. So increasing sales through this channel help to increase the profitability.

What impacted negatively the gross margin in international sandal businesses was an increase in import tax in Europe from 12% to 17% starting January this year. It's an important tax -- import tax on sandals.

Going to slide number seven, here we have an analysis of the EBITDA, just in March this year our consolidated EBITDA margin reached 21.5% was the highest since September 2010. In the three main countries or regions and businesses we had a growth in our EBITDA as you can see, starting by Brazil, EBITDA reached almost BRL33 [ph] million this quarter, a growth of 2.1%.

Growth in EBITDA margin reached almost 13%, meaning a 0.4 percentage points higher. We had a growth in Brazil's gross profit, we have a decrease in selling expenses and also but negatively, we have an increase in G&A, only G&A not selling due to the consolidation of Osklen. We are, when we put Osklen together in the first quarter of this year, we have the higher G&A compared to one year ago.

If we exclude Osklen, we would have -- and the SG&A grew in more productivity compared to one year ago. When we look at Argentina had an EBITDA of BRL24 million this quarter, a growth of almost 85%. The EBITDA margin reached 12.1% growing three percentage points versus one year ago. The main reasons is, it's like in Brazil, is a growth in gross profit.

What impacted negatively was an increase in operating expenses above local inflation, you know, the Topper is the leading brand of sports brand in Argentina and is very active in -- is sponsoring football teams, it's sponsoring tennis players and also Topper communicates more this year, the brand in order to elaborate sales than one year ago.

When you look international sandal businesses, we had a growth in EBITDA of 17% -- 17.1% reaching BRL64.4 million. In margin, margin was let's say almost stable, around 30%, 34%, despite we had a growth in gross profit, what is more affecting the margins is that I have more operating expenses this quarter compared to one year ago coming from communication and more Havaianas stores in operation in US, in Europe.

So this is -- mainly when you talk about stores they are very important item in the SG&A. As you know not all the stores perform with a good revenue result in the moment we open the doors. So, we have to take the maturity time and wait for the maturity time for the stores to begin to generate more money in order to offset the SG&A behind it.

On slide number eight, we have a breakdown by region of our consolidated EBITDA. So, 55% of our consolidated EBITDA came from our international businesses, including Argentina and sandals international. This is very important because not only with the revenue that I mentioned earlier, but now in EBITDA, it's important to mention that, assuming that the consumption in Brazil was retracting, so the country is facing some difficulties in the economy. It's very important to have a good portion of our businesses coming from our international operations.

It's important remember that in the past 10 years, Alpargatas has been investing strongly in growing its international operations through Havaianas worldwide in Argentina, its part of our strategy to become this company an important Brazilians global player. And we now see that this strategy is being very successful and is helping the company to sustain and even growth margins even when we have in Brazil a more contracted consumption and economy.

Moving to slide number nine, we have a bridge of our net income. We had a net income of 100 -- almost BRL117 million on the first quarter. Again if we exclude the sale of a non-operating factory of 32 million, we have a net income of adjusted or recurrence of BRL85 million, which means a growth of 17% to the net income of this quarter that reached BRL99.2 million.

The main factors contributing to the increase of our net income was the growth of the change that we had of almost BRL22 million in our EBITDA. And the financial result decreased almost BRL8 million our net income and this is mainly due to lower volume of cash invested that resulted in the last financial revenue. We have invested our cash, as you remember last year, mainly in the acquisition of Osklen and also payment to our shareholders as we can see on the next slide, which is on number 10.

Here you have the main disbursement that we have in our cash in a period of one year from March last year up to March this year. The total EBITDA contributed to BRL492 million to our cash generation, we spend 109 million in working capital and almost 143 million in CapEx, reaching a cash of almost BRL1.1 billion in operating and catch the way we think. So that the operational generation reached 241 million as you can see there.

As I said the payment of Osklen and the payment to shareholders were the two main disbursements we had in cash in one year, representing almost BRL400 million disbursements. Because we have these two main or major disbursement as you can see one slide number 11, our cash net of debt position in March this year was positive again of BRL13 million. The cash balance was almost BRL590 million as you can see compared to BRL835 million cash balance one year ago.

Last year, we paid BRL231 million on a full year basis, not 12 months that I showed you in the previous slide, this is a period from 1, January 2014 up to 31, December 2014 representing a payout of 82.5% of our net income generated in 2014. This year we have already paid and approved the payment of BRL54.4 million, the first BRL27 million was paid in March this year and another 27.5 million will be paid in 12, June -- one month from now. The BRL54.4 million that we -- let's say that we have already paid represents 55% of our net income generated in the first quarter this year.

Finally, on the slide number 13. We have an appreciation of our preferred share was 40% from 1, January up to March, 31st and the voting shares 35% against a growth of 2% of

Ibovespa. So our share is performing very well. If we look at until -- let's say Friday, the growth was 45%, meaning that we have already recuperated the drop we had in our preferred share price last year that was 46%. So we are in uneven situation now in the beginning of May.

Now I end the presentation and I open the session for question. And feel free to ask any kind of information you need.

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'd like to invite Mr. Jose Salvio Moraes to proceed with his closing statements. Please go ahead, sir.

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

All right. So first of all, again, I thank you for your participation in our call. And what I could tell you just to finish our, this conference call is that the first numbers that we already have for the month of April compared to April last year is indicating that our consolidated basis (Technical Difficulty) continued in April, the same trend of growth in revenue and profitability that we presented in the first quarter this year.

Meaning that despite the difficult situation that we are having now in Brazil in consumption of Alpargatas with its brands that are very strong in each segment it operates with its international operation is performing very well and is -- it has all the ingredients I used to say to overcome a more contracted consumption situation in Brazil. But a more, much more hot and much more progressive growth that we have seen in our international operations.

Mariane and I are here for any other doubts that you may have. In the future when you come to Brazil, please let us know, it will be a pleasure to receive you here in our offices. Thank you again.

Operator

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