Q4 2012 Earnings Call

Company Participants

- Claudio Bergamo, CEO
- Martim Mattos, CFO

Other Participants

- Lorre Serra, Analyst
- Nicole Nouri, Analyst

Presentation

Operator

Good afternoon. And welcome to Hypermarcas Fourth Quarter of 2012 Results Conference Call. Today with us, we have Mr. Claudio Bergamo, CEO, Mr. Martim Mattos, CFO. And Mr. Breno Oliveira, IRO.

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

(Operator Instructions) We would like to inform that questions can only asked by telephone. So if you are connected through the webcast, you should email your questions directly to the IR team at ri@hypermarcas.com.br. Today's live webcast may be accessed through the Company's investor relations website at www.hypermarcas.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 to Mr. Claudio Bergamo, who will begin the presentation. Mr. Bergamo, you may begin your conference.

Claudio Bergamo {BIO 16015846 <GO>}

Thank you very much, all. Good afternoon, ladies and gentlemen. Welcome to the Hypermarcas conference call to discuss the results of our Fourth Quarter, with the full results for the fiscal year ending in December 2012.

As we are going to start, please start on page five. In the Fourth Quarter, in the Fourth Quarter, 2012, Hypermarcas continues its strategic plan on sustainable and profitable growth with cash flow generation based on the organic growth of our brand, sustained by superior operating performance with strong cash flow generation.

Entering the page six, in the Fourth Quarter 2012, the Company reached net revenues of slightly above BRL1 billion, accumulating net revenues of BRL3.9 billion in the fiscal year. This result represents a 22% growth in the quarter and a 16.5% cumulated growth in the year.

Turning to page seven, the pharma division closed the quarter with net revenues of about BRL500 million, accumulating net revenue of BRL2.1 billion. This level of net sales represented a growth in the quarter of 21.2% and a 26.6% cumulated growth in the year.

Despite the weaker comparison base, even the destocking process conducted during the second half of 2011, as we can see on page eight, this '12 -- this selling performance in the year was supported by an evolution and the demand for Hypermarcas products, especially after the Second Quarter, when it reached a new plateau, surpassing BRL1 billion in demand, a trend which remained for the two following quarters.

In the Fourth Quarter 2012, the division reached BRL1.1 billion in demand, 27% above the Fourth Quarter of last year.

If we go to page nine. And we see at what happened at the consumer division, the net revenues in the quarter reached BRL530 million, cumulating net revenue of BRL1 billion in the year. The division's organic sales accelerating the last quarter reaching a 14.5% growth. The division cumulated a 6.7% growth for the year.

However, as widely known, the division got out a rationalization process for its portfolio which with a 40% reduction and the number of SKU, into focus efforts and resources in the divisions core brands. Excluding that effect, core organic growth was of 10.2% in the year, in line with the growth of our markets.

In terms of operating performance, as you can see on page 10, Hypermarcas closed the year with adjusted EBITDA of BRL865 million, 2% above the BRL850 million guidance, representing a 25% growth. This growth was above the sales growth because of improvements in performance -- in operating performance with growth margin expansion of 190 bps. And SG&A expenses contraction of 380 bps.

In terms of net income, the Company reversed the BRL65 million loss in 2011. And closed the fiscal year 2012 with net income of BRL204 million. In terms of cash flow, as we can see on page 11, the Company closed the fiscal year with BRL714 million in cash flow from operations, which were enough to finance its investment plan to consolidate its operational platform with CapEx of BRL250 million and to pay interest expenses of BRL229 million. Closing the year with BRL264 million in free cash flow after CapEx and interest, 184% above 2011.

In 2013, as you can see on page 12, the Company will continue to execute its strategic plan of sustainable profitable organic growth with cash flow generation. Our priorities will be to strength the market execution of our sales merchandise and medical (code fuelled) forces, aiming at streaming wide spaces, improving the exposure of our products and generating additional medical prescriptions.

Also, our priorities would be to increase the productivity of our marketing budget, especially in media, trade marketing and promotional expenses, aiming at getting more (reflect). Also the Company's new focus is to reduce costs and G&A expenses, leveraged on the consolidation of our operating platform, gains of scale and improved core processes.

Last. But not least, we will also focus on large new products, bringing our innovation pipeline to the market. Finally, we also will continue to disseminate the Hypermarcas way at all levels of the organization, strengthening our management model, based on ownership, accountability and meritocracy.

For 2012, as you can see on page 13, we reiterate our commitment our deliver adjusted EBITDA of BRL950 million for the year, keeping our focus on cash flow generation and sustainable growth.

I'll pass the word now to Martim who will talk about the numbers in more details. Thank you very much.

Martim Mattos {BIO 16015889 <GO>}

Good afternoon, everyone. Starting on page 15, we see that our net revenue achieved BRL3.9 billion 2012. And BRL1.027 billion in the Fourth Quarter with growth of 22% in the quarter and 15.5% in 2012. In the consumer division, there was a clear movement of growth acceleration compared to what we saw in the previous quarters of 2012, with a growth rate of 14.5% in Q4 '12.

Growth in core brands and segments was up 18% in the quarter, bolstering the segments related to diapers as well as to beauty and consumer health (care) units (foresight). The pharma division showed an organic expansion of 31% in the quarter with very strong growth in high value added segments. This, by the way, was also influenced by the fact that the comparison basis in Q4 '11 in this segment was very low and we also had good growth in the segments of generics and branded generics.

That growth led the pharma division to represent 48% of revenues in the quarter with positive impact on the quarter's average margin comparing to Q4 '11, as we can see on the next page. Consolidated growth margin was off 62.2% in 2012, with a 190 bps expansion compared to Q4 '11.

The margin in the quarter was up 61.5%, up 400 basis points expansion compared to Q4 '11, as a result of a mix effect of 280 basis point, given the higher pharma weight for the composition of revenue. And another 1.2percentage points, margin improvement especially related to diaper segment.

The pharma margin expenditures 73.7%, primarily as a function of higher weight of high-value added segments in the composition of the quarter's revenue. Consumer margin was 440 basis points, mainly because of a longer weighted improvement in margins in the diaper related segment.

Slipping over the to the next slide on page 17, beside the growth margin expansion as we have seen, operating expenses before marketing investment had a 5.6percentage point reduction in Q4 '12, compared to the same period of the previous year, because of a combination of capturing synergies from acquisition, operating leverage and the reduction of no recurring expense.

Therefore, even after our 90 days extension of marketing investments in the quarter, there was 6.4percentage points increase at the adjusted EBITDA margin in Q4 '12, to 22.4% of the net revenues in the quarter, or BRL230.2 million in nominal terms. Adjusted EBITDA reached BRL865.2 million in the year, with margin of 22.3%, in line with the guidance of adjusted EBITDA above BRL850 million announced in November 2011.

On page 18, we see that the net income in the quarter reached BRL125 million, or 152% above Q4 '11, a quarter in which we sold our food and home care operations with impact of BRL113 million over the net income of that quarter. Net income in the fiscal year of 2012 was up BRL240 million or BRL259 million above fiscal year of 2011. the improvements seen on the net income both in the year and in the quarter reflects the significant improvement of our operating results, with reduction of nonrecurring expenses and our financial results as well.

On the next page, we see that there was a sequence of the Company's consolidated cash conversion cycle, to 82 days from 87 days in the Third Quarter, this improvement comes mainly from first, the inventory base by the end of the year, related to the good sales performance in the quarter and second, increase that payable space which has now reached the terms currently adopted for new purchases from our suppliers. So now it matches -- the terms on the balance sheet match the new purchase times.

On page 20, we see that cash flow from operations in fiscal year 2012 was up BRL714 million. This is also a significant improvement compared to 2011. And is a result of the Company's strategy, initiated in 2011, of focusing on cash generation and sustainable growth.

In Q4 '12, cash flow from operations, in spite of being lower than Q4 '11, when we had intense reduction at inventory and receivables plus increase at the suppliers' payables was largely impacted by phenomenal increase of sales in Q4 '12, which is also seen here.

CapEx in the year was up BRL220 million and is broadly influenced by the investment related to the projects to consolidate our operations, mainly (matrix) projects. On the other hand, interest expenses were reduced compared to 2011, following the drop of the Company's average debt.

Consequently, as we can see on the next page, net debt which closed the year of 2011 at BRL2.745 billion was reduced by BRL264 million of free cash flow after interest expenses, which was equivalent to 31% of our adjusted EBITDA. On the other hand, the impact of FX variation and other non-cash financial expenses, led net debt to close the year of 2012 at BRL2.701 billion.

It's important to highlight that if we consider the current FX rate of around BRL195 per US dollar, the net debt would be approximately BRL7 million lower than the BRL2.701 billion. Anyway, that level of net debt represents a leverage of 2.8 times the adjusted EBITDA guidance for 2013. So we are comfortable with the current trend of our capital structure, actually considering the deleveraging track record, which we have pursued for the past two years. We should also continue going forward.

I'd like to thank everyone for the patience and attention. And we move now to the Q and A session.

Questions And Answers

Operator

Thank you. The floor is now open for questions from investors and analysts. (Operator Instructions) Our first question is Robert Ford, Merrill Lynch. Please go ahead, sir.

Q - Nicole Nouri

Yes, hi. Actually, it's (Nicole Nouri), from Merrill Lynch. I was wondering if you can talk a little bit about operating trends you're seeing in the First Quarter both in the consumer and in the pharma division in terms of sales and pricing and some of the competitive dynamics that you're seeing.

Hello?

A - Martim Mattos {BIO 16015889 <GO>}

Can you repeat the question, please, because I cannot hear you.

Q - Nicole Nouri

Yes, sure, no problem actually. I was wondering if you can talk a little bit about the operating trend that you're seeing in the First Quarter, both in your consumer and your pharma division, in terms of the sales and pricing.

A - Claudio Bergamo {BIO 16015846 <GO>}

Well the year started a little soft on January and February, below our expectations. We -- it seems that this is because of the specific factors such as early Carnival, with a few working days and a new tax law which was introduced in January. So far, we have now to wait to see how the year will move.

For the moment is that, for lower growth rates for the First Quarter. The debt continues very secure on our guidance for BRL950 million for the full year.

Q - Nicole Nouri

Okay. Great. I appreciate that. And you know, there's been a lot of news in the press about (Hache), about you being involved in a possible merger with HachÃ©. And I was wondering if you could comment a little bit on that?

A - Claudio Bergamo {BIO 16015846 <GO>}

Well as we said also in the Portuguese cart, Hypermarcas is very focused on its strategy plan for our organic sustainable growth. We are not participating in the sale process of Hache. A potential merger from a strategy sustain point, might make sense for both companies. But it would need to be accretive for Hypermarcas shareholders to happen.

Q - Nicole Nouri

Okay. Great, thank you. That's very helpful.

Operator

Our next question is Lorre Serra, Morgan Stanley. Please go ahead.

Q - Lorre Serra

Hi, yes. Thanks for the call. So I just want to make sure I understand, you're drawing a distinction between an acquisition and a merger. So you're comfortable having them as partners. But you're not willing to buy control? How may I understand the distinction you're drawing there?

A - Claudio Bergamo {BIO 16015846 <GO>}

Well that's not actually what we said. We said that we are not participating in the process. When we say a merger would be that a combination of both companies. From a strategy standpoint, even the complementation of the product line, it would make, might make sense. But it would need to be accretive for Hypermarcas shareholders.

Q - Lorre Serra

Okay. Okay. So let me jump to something else. We saw a good, or a very nice increase in gross margin in the quarter in the consumer division. And you talked about the diaper business in your comments. Can you help us understand kind of, what drove that improvement in the gross margin was related to, was related to the pricing you've taken in diapers, or was it related to the start of the consolidation project. And sort of how sustainable do you see that sort of 50% plus gross margin in consumer being for this year, please?

A - Martim Mattos {BIO 16015889 <GO>}

Okay, hi, Lorre. The margin in the Fourth Quarter was certainly helped by the diapers margin reaching a Fourth Quarter, achieve our peak, it was our best margin for the diaper-related segment throughout the year. So that certainly helped. And the, it was, we achieved that result because of the price increase we had. But also because of the productivity that we had for the production. And the improvements related to that over the year.

So the perception that we currently have is that in respect of the diapers, also considering that now in the beginning of the year, we are having another price increase, to follow the price increase of the rest of our segment. So that trend of margins in the diapers business, they should continue.

On the other hand, there is a seasonal effect on the Fourth Quarter which is a lot of sales sun tanning lotion, which our margins they should be better than the average. So there is a seasonal effect to get to the 50% for the Fourth Quarter.

Q - Lorre Serra

Okay. Then just Martim, in terms of the balance sheet, you finished with around three times the net debt to EBITDA. Can you just give us a sense of kind of where you see the dividend levels for the Company, looking out at sort of one, two years?

A - Martim Mattos {BIO 16015889 <GO>}

What we have been seeing over the last results of Hypermarcas, is our cash flow generation that is forecast to be an also more solid, more consistent. So the idea is certainly to increase how much we pay in dividends, especially considering that when we look at the leverage indicators for the Company, we've been seeing a very good trend.

So in accordance with that strategy, what we'll probably. And that's reflected on the quarter results, what we'll probably propose on the shareholders meeting, to discuss the subject, is a dividend distribution of BRL100 million based on 2012 net income, which represents a payout of 50% of net income.

Q - Lorre Serra

Thank you.

Operator

(Operator Instructions) Having no questions, the Q&A session is now closed. I would now like to turn the conference over to management for any closing remarks.

FINAL

A - Claudio Bergamo {BIO 16015846 <GO>}

Thank you very much all for participating of our call of the last, Fourth Quarter and for the full fiscal year. Our IR department is available if any of you would have any further questions. Thank you very much and have a nice afternoon.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.

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