

Q4 2014 Earnings Call

Company Participants

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

Other Participants

- Andrea F. Teixeira, Analyst
- Robert E. Ford, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. Welcome to the Hypermarcas Fourth Quarter of 2014 Results Conference Call. Today with us we have Mr. Claudio Bergamo, CEO; Mr. Martim Mattos, CFO; and Mr. Breno Oliveira, IRO and Treasurer.

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.

We would like to inform you that questions can only be asked by telephone, so if you are connected through the webcast, you should e-mail your questions directly to the IR team at ir@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 forth in the forward-looking statements.

Now, I'll turn the floor to Mr. Claudio Bergamo, who'll begin the presentation. Mr. Bergamo, you may begin your conference.

Claudio Bergamo dos Santos {BIO 16015846 <GO>}

Thank you very much, all. Have a good day, good morning. Welcome to the teleconference of fourth quarter results which also summarize the results for the full fiscal year of 2014. In 2014, Hypermarcas advanced some more steps on its sustainable, profitable growth strategy with strong cash flow generation.

We completed in 2014 the restructuring phase that we started back in 2011. More than BRL1 billion was invested in this period in the consolidation of our operations, modernization of our systems and processes, innovation and product launches.

We created a results-driven organization aimed at value creation through shareholders. The successful results obtained in fourth quarter, as well as for the full fiscal year of 2014, comes from the implementation of an improvement program carried under well-coordinated team work through all these years, resulting from deep efforts, persistence and perseverance.

We managed not only to deliver the financial and the economic results we set out for ourselves, but also to consolidate our leading position in the pharmaceutical industry of Brazil, surpassing the 10% market share in this market, consolidated as the number one player in the sector.

We also accelerated the growth of our consumer division through successful relaunches, improved cost-benefit relationship of our brands and better distribution and operational efficiency. Looking forward, we believe that the company's prepared to take advantage of the benefits of the investments we have made over the past few years.

In terms of our fourth quarter results, our net revenue increased 17% on a comparable basis reaching a little over BRL1.3 billion. We ended the fiscal year of 2014 with a net revenue of BRL4.645 billion representing a 11.2% growth on a comparable basis. The company achieved its guidance for the year reporting an adjusted EBITDA of BRL1.106 billion which represented, a 10.4% growth compared in 2013.

We had in the fiscal year an adjusted EBITDA margin increase of 0.1% to 23.6% of net revenues. That result was achieved with a 17% increase of our marketing investments to 21% of net revenues. This increase was financed by high efficiency in the company's commercial and logistics operations, which allow us a 1.6%, a reduction in the selling expenses as a percentage of revenues.

This situation of high marketing investments allow us to reinforce the support to all the brands in the media, in the points of sale and with the medical community, increasing the demand for our products. In the combination with low operating costs, this creates a strong competitive position in the markets, which supports our strategy of profitable organic growth with high cash flow generation.

On the financial front, we materially reduced our financial expenses from BRL583 million to BRL416 million despite of the increase of interest rates and inflation in the period in Brazil, in great part, because of our adequate hedging policy, which we implemented since the end of 2013. The combination of a strong operating result with financial expenses reduction resulted that our net income increased 57% in the fiscal year reaching BRL402 million in the period. In the quarter, this measure increased by 30% to BRL71.5 million.

FINAL

Additionally, both in the fiscal year and the in the quarter, the company increased its free cash flow which grew to BRL616 million in 2013 (sic) [2014] (08:23) vis-à-vis BRL452 million posted in 2013. In the quarter, the company posted a free cash flow of BRL182 million more than double of the previous year.

In 2015, the company will continue on its strategy based on three major pillars: Continuous productivity gains and operational efficiency and excellence, focus on demand generation and continuous and relevant innovation customized to the Brazilian consumers. And the increase in our distribution with broader presence in the retail channels and better exposure of our products in the point of sale.

The company intends to continue to explore its organic growth opportunities supported by its modern low-cost operation in the resilient markets which competes. These are the factors and despite the macroeconomic turbulences that we are facing, the company is to make - to be able by the end of the year 2014 (sic) [2015] (10:00) to deliver an adjusted EBITDA of around BRL1.2 billion.

I will pass to Martim, who will talk more details about the numbers.

Martim Prado Mattos {BIO 16015889 <GO>}

Good morning, everyone. Martim speaking. I would like to go quickly through some highlights of the main indicators we reached in the quarter. Starting on Page 3, net revenue was BRL1.301 billion, with 17% growth on a comparable basis, or 16.3% on reported figures. This growth was composed of 14.5% expansion in Consumer and 19.5% in Pharma. This quarter, our market share peaked in both divisions, indicating good flow of our products to the end consumers.

On the next page, we see that the gross margin went from 64% to 61.2% in the quarter. This margin decrease in the quarter was observed mostly in Consumer, mainly because of our strategy in high volume categories and consequently, of lower margin causing relevant negative mix effect over the consumer gross margin.

SG&A ex-marketing, on the other side, had an important dilution, reflecting our efforts to control fixed expenses in the company. This dilution more than compensated the reduction on gross margin. Marketing expenses, on the other hand, increased as a proportion of net revenue according to our goal of strengthening the support to our brands during 2014.

As a consequence, as we can see on Page 5, adjusted EBITDA was up 8.4% to BRL273 million with 1.5-percentage-point margin decrease. By the way, (12:07) magnitude of the marketing increase as a percentage of net revenue. With this result, our guidance for the year which was an adjusted EBITDA of above BRL1.1 billion could be achieved.

On the next page, we see that net income reached BRL72 million in Q4 2014, a 30% expansion compared to 2013, mostly due to the reduction of financial expenses. We had in Q4 2013 BRL133 million in expenses related to hedging costs, FX variation and the cost

Bloomberg Transcript

of repurchasing our bonds, expenses which were reduced to BRL21 billion in Q4 2014 as a function of the elimination of our dollar-denominated liabilities by the end of 2013.

Free cash flow ended the year with 100% increase to BRL182 million in the quarter as a combination of good cash flow from operation, important CapEx reduction with the completion of a great portion of our manufacturing consolidation project, and the sale of non-operating assets totaling BRL100 million.

As we can see on Page 7, following the trend of past years, leverage was reduced to 2.6 times. It is important to mention that during the year, we prepaid installments of tax liabilities in the order of BRL125 million, a reduction that is not related to our financial debt, but is a reduction of our liability.

Finally, following our track record in governance and balancing expectations, as we can see on page 8, we announced that we introduced in our earnings an adjusted EBITDA guidance of around BRL1.2 billion for the fiscal year of 2015.

Thanks, everyone, for the attendance and we can now proceed to the Q&A session.

Q&A

Operator

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

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

Thank you very much. Good morning, everybody, and, guys, congratulations on the big market share increases. Now, it's very impressive. In your earlier call, you made some comments with respect to capacity constraints, and I was hoping you could expand on those to the extent they're not strategic with respect to how significant they may be in terms of your ability to meet demand, what categories they may be in, and what you need in terms of the economic resources and time to address them, please.

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

Hey, Bob. It's Claudio.

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

Hey, Claudio.

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

Well, some of the capacity constraints was related, for example, the adult diapers, which when we changed our plant we had somewhat reduction of production until we could adjust the machinery properly. And on top of that, we had made some launches in the

mid-market a new variant. And so because of that, we have been kind of lagging with back orders in this sector for already around three to four months.

So the action we've taken now that we have been able to improve the productivity and we believe that we will start picking up now. And at the same time, we acquired a new line which should be implemented by somewhat by the mid (17:08) of this year. So that's one very specific market.

Another one that really was in the deodorant market. We already really with our proposition for Monange and Bozzano brands really have sky rocket. And there's a deep market and have been able really to grow very successfully now. And we are adding more machineries. So we have a new one that's coming in now, should be fully operational by at the end of this quarter, beginning of second quarter, and we shall have another one coming and be operational by the end of third quarter. And so, that we believe that we will end this year with around more than double in terms of sales volumes regarding the year we had before. I think two very specific. We have other ones that are, I think, less material.

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

Okay. That's fantastic. And then the marketing was higher, as you mentioned, but when you look at trade deals specifically, those really had a big jump. Can you discuss a little bit in terms of what you're doing in terms of trade deals and point-of-sale promotions, and maybe which divisions the heavier activity is taking place in, please?

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

Well, trade deals are more related to the Consumer as well, and a big piece of that is investment that we have made in order to gain shelf space in the retail, as well as being able to increase category management for the brands we are leader. That is somewhat a one-shop type of nature given that you have to make upfront investment really to be able to put across your valuable proposition in the marketplace. So that's pretty much the main reason of that increase.

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

So, Claudio, are these fixture improvements that you're making in the point of sale that promote the brands that you carry, in part?

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

Excuse me, can you repeat? Just - I don't know if I understood that.

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

Yes. I was just curious if this includes fixture investments, shelving that may have - that may display your brands in the point of sale because the...

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

Oh, yes.

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

(20:29) suggest that it includes a lot of POS improvements that may help your product and as you say it...

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

Yes.

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

...yes? Okay.

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

Certainly, certainly that's part of it that you have to put our displays in the shelf place as well as introducing new items and then as a mean to gain distribution. But very important is that investments that we have been paying off a lot. And the client had really enjoyed the positioning and become in a moment that pretty much retail leads to more smart choice positioning now as opposed to very high-end trade-up positioning. So it came in a good moment.

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

Okay, got you. And then, just lastly, if you could comment specifically on the sellout in those mass-market categories that are smart-choice position, please. I mean, it seems intuitive that they do well, but I was really surprised with the acceleration in the fourth quarter, and I was wondering how that product is depleting from locations.

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

Yes. I mean, let me take, for example, infant diapers, we are playing with three different brands now, the Sapeka, Cremer Disney, and the Pom Pom. The Sapeka, we are being able to roll out the Sapeka to the Southeast of Brazil, and it has become a leading - a very good option for the low-end market. Cremer Disney, we made a change in the product configuration with now soft-to-touch and we changed the packaging.

We make the Disney persona more appealing and really had worked out a lot. It's a brand now that is getting almost 10% of total market share. And Pom Pom brand also - now, we adjusted - this quarter, we have relaunch the Pom Pom, increasing the quality again. And I think Pom Pom will have very nice results for the year.

So, at this moment, we reached around 20% to 22% of the total market share for infant diapers in Brazil. A little over Nielsen numbers, because Nielsen number doesn't account the small shops, so our market share is being measured using the suppliers' numbers, and that leads in a good momentum. And it comes, like I said, in a moment like most of retail is looking for opportunities for smart choice in order to take advantage of the different momentum of the consumer now in Brazil.

FINAL

Similar to that, our proposition for deodorants, for Monange and Bozzano, and shampoo from Monange really is working out very well at this point. And we have been receiving inquiries from many clients to roll out our brands to their stores' networks. Some clients sometimes they want to start like doing as pilots, like they take like 20% of their total retail network to be sure that the objective of the proposition is working out, and they are finding out that it's working out. So, now, we have been receiving many inquiries from many clients to roll out for their full network.

So, I think this big category is now, finally - we are in the right track. We already reached in the deodorant, for example, we surpassed L'Oréal in Brazil. We are the number three, top three deodorant player now, and in shampoo, we already reached a little over 5% market share. And also in shampoo, Monange is growing very quickly at this point.

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

It's fantastic. Congratulations. That was very helpful.

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

All right, thanks a lot.

Operator

The next question comes from Andrea Teixeira with JPMorgan. Please go ahead.

Q - Andrea F. Teixeira {BIO 1941397 <GO>}

Hi. Hello again. And thanks for taking my second question following the Portuguese call. But I guess, I mean, one of the things that I wanted to explore more - and congrats again on this market share gains - is there any white space as far as getting more to this - more economical brands and more, like, it's not about being able to fill the gaps when the consumer needs especially now?

And one of the things you suggested is that as you get more capacity, there is smart ways to execute. But from the point-of-sale perspective, seeing some of the - on the São Paulo area, I mean, the pharmacies being able to push your OTC, so my question now is also on OTC side. We saw that the growth in the Pharma side was strong. Is there anything you can be executing on the point-of-sale? And obviously, in your Analyst Day, you did mention that some of the initiatives, but do you think that can be rolled out more intensively this year? Or is there anything that we should be looking at relative to your conservative guidance? Thank you.

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

Hi, Andrea. It's a good question. With the OTC, I think the opportunity to improve our client's execution is enormous. It's enormous. I mean, as you know, in the past, one of these issues, the regulation to put behind the counter, the OTC, many organizations decided to do that. And they changed that about already almost two years at this point. But many of the declines hadn't put us to the front.

Bloomberg Transcript

FINAL

So what we are having - we have been working a lot is in category management for this specific area. And as we became the champion for category management, we have been working with clients (28:03) for already almost a year and a half. We brought all the major technology from all around the world including Brian Harris, which was the creator of category management (28:26) to make a presentation.

So, we have been working very closely with the Abrafarma people, as well as the lower - the mid-sized drugstore chains, making many, many pilots in many stores. And there has been a tremendous success, tremendous success. And they've seen the power of the technique. They are seeing that - they're realizing that really there's a big value for them and obviously for us as well to really improve the exposure of OTC in Brazil as a whole.

And I'm very enthusiastic about this initiative, to be frank, very supportive. And I think, now, after many, many, let's say, almost two years now in this process, we have seen an endurance. So, I'll give you the next journey. The clients are joining us in this effort because they've seen the opportunities for them. So I think it's a good model for them.

Q - Andrea F. Teixeira {BIO 1941397 <GO>}

Okay. Thank you very much, Claudio.

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

We look to U.S. I mean, U.S. almost 30%, 30% to 35% of the drugstore sales is also OTC related, big, big spaces for OTC and they're quite well organized. Now that we have invested and then we show the technique, we'll do at the time as they run as well, I think it's really the opportunity (30:10) there. And so the big organizations, for example, (30:13) who already joined us in this process, we'll have other regional players such as the (30:25) in Minas Gerais, (30:29) the Northeast, (30:31) in the south, (30:34) São Paulo. They are all joining us in this effort. So I think we have a good the next two to three years this will be continuously a very good area for improvement.

Q - Andrea F. Teixeira {BIO 1941397 <GO>}

So would you say, Claudio, that you're like probably in the shelf space of this what the opportunity is, you are like 50% of it or now you're like two-thirds of it?

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

I think it's less. This is around probably 20% to 30% to what's the potential. Because, some of the clients, for example, they put in the half year (31:13) to see, but they put like in alphabetical order, for example. They don't apply technique like the Americans.

So what I have been investing is in certain showing that, look, you have to put the front plus you have to split between like flu symptoms, headache symptoms, stomach symptoms, so this type of more shopper-related layouts. And that's a long way to go for that, but now I think the trade has realized that the value is there.

Bloomberg Transcript

And now we have their support because they have, first, to bring and somewhat extract the concept for that, and now they're really bought in into the idea. So, now they're realizing doing that. So, we really took a very important leadership on that front, and they recognize our leadership, and they are giving us now the right to be the champion for this category and help to really make this category as good as in the U.S., for example.

Q - Andrea F. Teixeira {BIO 1941397 <GO>}

Now, fair enough. Thank you very much, Claudio, again.

Operator

As there are no further questions, the Q&A session is now closed. 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>}

Thank you all, guys, for the attendance and the support. And our IR department is available to further discuss any other questions or information you might have. Thank you very much, and have a nice day.

Operator

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

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.