Local Conference Call
Springs Global
Second Quarter 2019 Earnings Results
August 15th, 2019

Operator: Ladies and gentlemen, thank you for waiting. We welcome you to the audio conference from Springs Global in order to discuss the 2Q19 results.

Right now, all the participants are connected in listen-only mode. After a quick introduction, we will have a Q&A session and instructions will be given. If you need any assistance during the call, please press the star key followed by 0 and an operator will help you.

In order to obtain a copy of the press release, of the presentation and accountable statements, please go to www.springs.com/ir.

Before we proceed, let me mention that future considerations reflect the current prospection and perspective on businesses having as basis the outcome of the macroeconomic environment, industry conditions, performance of the company and financial results. Any changes in such perspectives and factors may render results that are materially different from the expectations right now and contemplate many risks and uncertainties.

Today we have Mr. Josué Gomes da Silva, CEO, who is going to comment on the performance of the company.

Now I give him the floor.

Mr. Josué Gomes: Thank you. Good morning all. We are here myself, Alessandra, our IR Director, and also the Controller Director, and I would like to thank you all who are here with us listening to our projections for the 2H of this year, but above all, our comments on the result of the 2Q that were disseminated yesterday.

This result has positive aspects; however, it is a result that is not what we expected for the 2Q19 when we organized that the budget in December. I believe that maybe we were a little bit optimistic in relation to this last quarter, especially because the 2Q18 had extraordinary impacts, especially because of the effect of the drivers' strike, Brazil was paralyzed for almost a week and had repercussion on sales, and we believe that 2Q19 will have growth YOY much better than we had.

We had a reasonable growth, after all, our sales in the case of Brazil ~~Retail~~ Wholesale was 9.8%, so it's considerable considering actual growth, but comparison basis was weak, and this is why we had better estimation.

Total sales grew 6.6%, again, actual growth has an impact on the lower growth of retail, and retail I think the main effect that impacted the sales on this 2Q were temperatures that were too high, much higher than historically speaking, and that impacted a lot in winter sales, and that is bad for the sales of quarter. And recovery in July was fantastic when we finally had cold weather, and July really grew in sales and e-commerce grew with very good perspectives of reaching a rate in e-commerce of 100%.

After all the accumulated YOY as compared to last year is ~~above~~ 83%, we reregistered this growth with a growth that may accelerate even more with continuous improvement of the conversion rates. Of course, in a moment where we are growing, our portfolio of clients in the way we are when the visits to the website are growing exponentially, the conversion rate would drop a bit.

But we already have positive effects of many things that are being done to improve conversion rates, and this also happens when we see that the average of July the conversion rate improved more than one third, 33%, and against to the average of the second quarter, and it's far beyond our conversion rate that we believe we are going to reach with the many things that we are doing.

So, of course, it's a growth, actions growing the basis of our e-commerce, but what we are doing with the introduction of categories in our most important brands and other things we're doing certainly will make this conversion rate to grow, and if it reaches a reasonable value considering the best benchmarks in the market, we still have potential of growth in e-commerce that is very strong.

So what really energizes us is expressive sales of an important parcel of our sales to the final consumer. Although sales were not good in our opinion considering the expectation we had, maybe we were optimistic, I'm repeating myself here, because the last 2Q18 was weak, we worked a lot and I think we constructed important things that will result in good things on the second ~~quarter half~~.

The consolidation of the 2 industrial units, we consolidate the finishing industrial unit from Natal, São Gonçalo do Amarante, Rio Grande do Norte, with the one in Montes Claros, and also one in Campina Grande with the unit in Montes Claros.

Many have asked how much costs we would have on this consolidations, not only rescission costs, but also the deactivation and energy and etc., but those costs have already been absorbed in the 2Q results. What impacted partially the gross margin of the second quarter against to the first quarter and the payback of this investment, the cost of this consolidation happens very quickly because we estimate in around 70, or a little bit less R$70 million per year the savings from these 2 consolidations.

In our MD&A we sort of described where the savings come from, monthly savings, that we achieved, and we reach the end of them that will be a total of around R$ ~~20~~ 70 million not only from reduction of labor and increase in productivity, but also undirect labor reduction, but mainly from savings with energy, with power, with thermal energy, savings in secondary like chemicals, since the batches are larger so the waste of secondaries drops and the waste of energy also drops, more efficiency in energy as far as lightning and refrigeration of the production sites also increases, and that has been described in our MD&A per cost that were saved, that add around R$70 million per year, and they bring great results for the company from ~~June~~ July on since we implemented the consolidations entirely until the end of June.

And all the costs for consolidation have been absorbed in the gross margin of the 2Q. And this is an extremely important factor because it opens up a perspective that is much better for the ~~2Q~~ 2H results, when you add the seasonality of our business that represent 60% of sales and results of the year during wintertime, so usually ~~2Q~~ 2H is 20% better than our second half… pardon me, is better than the first half in results and sales.

And this year 2 other factors will collaborate for the result of second half to be better than this 60% of the year result plus the consolidation of the 2 units: First of all, we have an average cost in the second half that will be less than what we spent in raw material of the first half, the commercial war US-China has affected raw material and has a drop in international market, and with that we profit from this drop in raw material; and also the introduction of new articles that are important, not only with more categories for us to work with, but also assets of higher unitary tickets, and I am talking about mattresses that we we'll be selling from the second half on.

Of course, the average ticket is more than bedding, bath, tablecloth top and bad, we will not be manufacturing those mattresses, we are licensing a very important brand, an international brand, so we will make the covers of the mattresses because we have technology, competitiveness and quality, but the mattresses and especially the investment in labor work for that will be from partners that will be selected and who can produce them in a competitive way only using our covers.

And we will also be launching a sofa that we call “sofa in a box”, it's a 2-side sofa that will be sold for the customer to be able to carry it in small boxes and assemble it in 5 min. with no need to look at the manual, and of course, we don't want to manufacture this sofa, but its cover. We have the patent for the product, we developed it, but we are not going to be manufacturing it; our partner will, and it's been introduced this second half.

And that with the categories that we are already distributing, like tables, kitchen utensil, decoration with partners, the best brands of this type of products in Brazil, and that makes us sure that not only our brands will gain importance, our websites should be even more relevant for the customers that will visit them. The conversion rates will go up and with that, of course, sales will improve.

~~June~~July, as I said, opened for a second half in the positive way, we had very good sales, in retail above 20% growth in July considering YOY, not only e-commerce, but also physical stores. What contributed to that were the temperatures that finally dropped in July, and that was quite positive.

The sum of that all leads us cautiously to change the guidance. We understand that we are going to reach an Ebitda that is above 200 million, but maybe the previous forecast considering results of the 2Q will not be reached, especially the intermediate part of the anterior guidance, and we decided to make a small change on it, trusting that we are going to deliver an Ebitda generation around 200 million, or maybe more, which is relevant figures, especially considering that the net indebtedness will be reduced considering the credit ~~to the unit~~ against the Government that has been charged with the beginning of the process of compensation in this third Q of a little bit more than R$200 million.

With those compensations we have higher reduction of the net debt since cash generation has been more than enough not only to cover that services, especially because of the renewal of short-term debt, but also Capex has been within the guidance expectation, around R$50 million per year.

And I would like to talk about the progress that we have had in real estate. We have today a revenue of rents from Natal that is close to R$1 million with excellent partners that are there or being settled there, but already have signed the agreement, the rent agreement, so the public is growing, and we also launched our ~~portfolio~~ outlet according to the price tables that have been approved according to the person that takes care of this area, that guides us on planning and selling that with an specialist, with an expert on that area, we understand that once the outlet is entirely hired and used we will have an additional revenue of R$1.3 million a month or 1.5.

So what we have mentioned that this ~~shopping~~ commercial center, this mall will give us around R$ 30 million in rent, 100% Ebitda rent and cost of occupation R$ 30 million year. So we are heading towards that. And that, besides the mall, it has an area that is very large for other developments, especially residential sites, so we are not going to implement anything on residential aspects, we are looking for partners and we, of course, will participate with a percentage of the portfolio that they sell our we will sell the land for that that will create a positive cycle of growth of more people having access and visiting this mall, what will attract even more, the ~~shopping mall~~ commercial area will grow because people will want to buy residencies on that area, it's around 900,000 m² terrain and 300 m² are dedicated to the commercial site and the other 600,000 may be used for residences.

So this is in progress, just like other revenues in the US that bring this result and that will be from now on, that will grow from now on, it will be a positive impact in our results.

And still, there is a downside on financial expenses, there is a concentration of short-term renovations that increase those fees, we are working with the support of important institutions in lengthening the possibilities. We hope to finish this in the next coming months and this will lead to less financial costs because of less fees and also more time for the administration to be dedicated to what is more important, which is our brands, our growing sales to the final consumer and relationship with our chain of retailers, the small ones that will use our technology of point-of-sale, that is a software that's being used a lot, it's been key in our model of multichannels, especially with our stores since 70% of our e-commerce sales are delivered in our stores or from our stores, and they started to be delivered from the multibrand chains of small retailers, and some of them started to use this technology, which is a property technology developed by ourselves, it is a point-of-sale software that operates in cloud, it's very robust, modern and it's really working.

These are my initial comments, now I'm going to give the floor to Alessandra for more detailed comments on each one of our business units, and we will be back to Q&A. Thank you.

Ms. Alessandra Gadelha: Good morning. On slide 3 we present the 2Q 2019, where we had a net revenue of R$328.2 million, a net margin of 28.8%. The adjusted Ebitda was R$38.3 million with margin of 11.8%. In this quarter, we had a negative impact with the absorption of all the consolidation costs from 2 industrial units, and also there was a negative effect in the adoption of the IFRS 16 norm from January on, R$3 million.

The results before taxes increased R$30 million in YOY, and this quarter we increased average prices from all product categories, we had a growth of 9.8% of Brazil Retail, and increased 48.7% e-commerce.

Slide 4 we show the consolidated results of the company. In order to compare, we present the 2Q 2018 as reported and also reclassified. Excluding the discontinued operations, considering only the continued operations, there was a growth of 6.6% in revenue and 6.8% of YOY Ebitda.

In the slide 5 we show the reduction or better deleveraging that was pushed by reduction in debt, the credits for compensation of PIS and COFINS R$209 million seen in 2018. We hope that this effect of this compensation will start in the third quarter of this year.

Slide 6 we show the highlights of Brazil ~~Retail~~ Wholesale and the net revenue was R$260.1 million with 9.8% growth YOY, and Ebitda as you can read, the Ebitda was a total of, as you can see on the slide… As mentioned before, in this quarter we had a negative impact with the acquisition of all the consolidation costs of 2 industrial units.

Slide 7 we present how we are going to obtain the cost reduction of conversion and consolidation estimated about R$5.5 million a month. And the most important items are savings in labor, energy and chemicals.

In relation to Brazil Retail presented on slide 8, the sellout revenue is ~~2~~3% more than what we saw last year, positively impacted by the growth of 48.7% of e-commerce sales. Ebitda added R$9.9 million, and in retail that marked our sales to final consumer through mono brands. In the last years, the company invested in developing digital channels to increase its customers' portfolio and also to increase their direct sales.

Slide 9 we have the changes of our customer portfolio in the last years. Visits to our website grew significantly, especially from 2018 on when we launched new channels and digital services. As a result of those initiatives, we had a strong growth in online sales, as you can see in slide 10, and we estimate that 20% of these services will be done online in spite of the quick expansion of the customer base, this indicator (conversion rate) was grew 33% (yoy) as considered last quarter.

As you can see on slide 11, the e-commerce sales accumulated into July had a growth of ~~32%~~ 82% YOY.

On slide 12, you can see that the virtual stores have larger market share in the last years, a 10% estimate in 2019. Our joint brands have a market share of 35% in Brazilian market for bedding, bath and tablecloth being very important because our products are well recognized and also service of customers enhance, they come back.

In relation to Argentina, on the slide 13, the revenue reached R$36.5 million with a reduction of 7.6% YOY with a negative impact with less sales and also because Argentina had a drop in their currency.

In slide 14 we present some factors that present the results of the second half of 2019. What we expect: we are going to launch new categories of products like mattresses, modular sofas and also tabletops through partners and also at low risk and low working capital aiming to have a larger market share and go from R$12 ~~mb~~illion that are from CAMEBA (Bedding, tabletop and bath) to R$ ~~36~~ 86 billion for housing and decoration.

In the case of sofas and mattresses, we will apply fabric on these products using our plants, while our partners with experience in those products will manufacture, stock and make the final product. Besides increasing revenue, we expect to strengthen our brands increasing the frequency of sales.

In relation to costs, a drop in raw material will affect positively in the gross margin in the next quarters, just like closing the operations of 2 industrial plants, reducing costs and that was estimated in R$70 million per year, so about R$35 million in the second half of this year.

And finally, the credits from PIS and COFINS recognized in 2018, R$209 million, will be compensated in the third quarter for 6 quarters; that will reduce our ~~contribution~~net debt. In spite of these positive factors, we reduced our goals because of the devaluation of the Argentinian currency and the situation of that country and less growth of Brazilian economy vis-à-vis our forecast.

Slide 15 we present our projection reviewed for 2019. Thank you.

Operator: Ladies and gentlemen, we here close the Q&A session, and now I give the floor to Mr. Gomes da Silva for his final considerations.

Mr. Gomes: I would like to once again make ourselves available if you have any questions for me, Roberto, Alessandra, and I want to thank everybody for having participated.

And I want to reinforce the invitation for those who are in São Paulo and have time, please go to our showroom because you are doing to see very rich collections that are really being enjoyed by our retailers, clients, and the most important ones are going there.

And hence I think that those who have time it's worthwhile to go there see how enthusiastic the customers are and our sales teams as well, and above all, the richness, the quality and the diversity of our collections in all the segments that we work today.

Thank you and have a good day.

Operator: So, we now close the audioconference of Springs Global. Thank you for participating and have a good day.