Local Conference Call
Springs Global
Third Quarter 2019 Earnings Results
November 14th, 2019

Operator: Ladies and gentlemen, thank you for waiting and welcome to the Springs Global conference call to discuss the earnings results of the third quarter 2019.

At this moment all participants are in listen only mode. After a brief introduction, we will hold a Q&A session where further instructions will be provided. Should you need assistance during the conference call, please press star 0 and an operator will assist you off-line.

To obtain a copy of the financial statement, webcast presentation, please go to Springs Global website that is: www.springs.com/ri. Before proceeding you should be aware that forward-looking statements reflect the current perception and also the management's outlook on the evolution of the business, which are based on the evolution of the macroeconomic environment, industry conditions, the company's performance and financial results.

Changes in such expectations and factors may imply in results that may materially differ from current expectation and may present risks and uncertainties.

With us today we have Mr. Josué Gomes da Silva, CEO all of Springs Global, who will comment on the performance of the company.

Now I would like to give the floor to Mr. Josué.

Mr. Josué Gomes: Good morning to everyone, (I have here with me) Roberto Cristofanilli, (and) Alessandra. First and foremost, I would like to welcome everybody that is here, we have a major group (and I am happy) that we have this level of interest in the results of the third quarter.

I can say that the third quarter very clearly demonstrates how assertive we were in consolidating 2 industrial units, and we had to make this decision, this was something necessary, but the positive result in cost reduction that was provoked by the consolidation of the ~~Montes Claros~~ (Natal) finishing unit and also the Campina Grande (weaving) unit we can see these results.

We still haven't been able to attain 100% of the savings during the third quarter because you have to remember that we closed the units in June and obviously we have a ramp-up of training and increase of productivity in Montes Claros that took over the production that in the past were done in Campina Grande and Natal, but certainly, the positive results are being observed during the third quarter and we will see them even stronger during the fourth quarter.

And I believe the fourth quarter will be impacted by the reduction of cost of raw material in dollar and you will see the comparison between the past quarters, therefore, the Ebitda has evolved 40%, be it in comparison to the same quarter last year or in comparison to the first and second quarter, and it also shows us that we are on the right path to achieve our Ebitda guidance of 2019.

It's very important to highlight the reasonable growth in our direct sales to the consumer that are around 9%. This is (basically) same-store sales because the variation of stores has been very low when we compared this quarter to the third quarter last year. It is very important to observe that this year the company is going to…and with consumer sales considering the sellout (price) and this will be R$610 million, and this is an average (compounded) growth of 10.1% (per year in the last three years) and this is growth in (mostly) same-store sales because we didn't open a great amount of stores during this period.

During this period, sales in the Internet had a significant performance and cooperated with this growth of 10.1% and (it used to represent) 2.5% (of direct sales to consumers) in the beginning of the 3 years, and now we are ending (this year) with 15% of direct sales to the consumers.

We are very proud of our position, with our brands regarding how we respect our consumer. Now we are growing through an omnichannel model, we are confident in our brands and our company, and most importantly we are very proud to say that the Santista brand occupies the first position for the 6th consecutive year, and our other 2 brands occupy the second and third position in this ranking, and this only shows the strength of our brands and how confident we are regarding our brands.

So the Internet sales of Santista is already reaching a record, especially during Black Friday, that shows a growth, and that's why we are very confident in achieving our target of over R$90 million on Internet sales this year, and we started with less than R$10 million 3 years ago and the Brazilian economy throughout this period didn't make great progress.

This is important to mention because the company's transformation is important, now we are a multi-channel company, we respect our multi-brand retailers, we are building our brands through a direct contact with our consumer working with the retailers or multi-brand as a distribution point of our products, and we are using an in-house technology, we are owner of this, that is PIX, that is very mature and works properly.

So we have to see the exchange rate variation because of the devaluation of the peso vis-à-vis the dollar, and of the real in comparison to the dollar, that was very important. But this doesn't really worry us. During this quarter we had a total variation of R$43.4 million negative, but we have to highlight that ~~over 80%~~ (100%) of this exchange variation is non-cash, but 80% these are companies that are controlled by Springs Global because of accounting reasons.

(The proceeds from the sale of our North-American operation to) the Keeco (were brought to Brazil through an intercompany loan), (in this way) the Brazilian operation (has a debt with the North American operation, all controlled companies under Springs Global)… in the past when you had an exchange variation of investment abroad (it used to impact earnings) and afterwards it (changes) our ~~asset~~ (equity in the balance sheet). But, you know, this is not the right accounting technique and this variation has to go through losses and profit, but analogously, the exchange variation was a foreign investment because of an exchange variation, and when you have an operation in the United States and when there is a devaluation of the currency. Well, we did have an accounting non-cash effect (and that will never have a cash effect) because these are operations that are controlled by Springs Global.

The same thing happened with Argentina, in order for Argentina to be able to finance its operations, in order to eliminate the financial debt in local currency, we obviously broadened the payment terms of our supply towards Argentine subsidiary, but these accounts receivables are registered in dollar. When there is a great devaluation of the peso, the Argentine operation loses with this. Now when you translate this into reais, there is an impact, but this doesn't mean a real loss for the consolidated value, but it's how we register. And I would like to restate that out of the R$43 million of exchange variation, all (100%) non-cash (and of which) 80% are within the group, and what is done with foreign investments, well, perhaps we could see this as (an equity) variation because of an exchange devaluation.

After my first words, I would like to highlight 2 (other) important aspects: We are offsetting the gain of the ICMS with PIS COFINS during the third quarter, this took longer than what we expected, but we have already offset during the third quarter part of this amount, and we are convinced that we will be able to offset the total amount of credits of PIS and COFINS and this will be R$220 million until the end of next year.

And this has already helped us to generate free cash during the quarter, although it's R$8.2 (million). But as of the fourth quarter with all the offset during (all months from) the (next) quarter ~~as of~~ and next year~~s~~, we believe that these R$220 million will be transferred to our cash and we will be able to reduce the net debt of the company that is being deleverage currently.

In addition to this, I can also communicate a real estate project in Natal that is very auspicious. The power center is being occupied now the revenue is around R$1 million a month as soon as all the grace periods are ended, and we are launching an outlet of 13,500 m² that as far as we are concerned this will generate initial revenues when it's totally occupied of (approximately R$1.3 to) R$1.5 million a month in revenue.

Now we have that area that is available to be broadened (by up to 50%) and there are retrofit projects ongoing in these projects are excellent. We are including the leaflets of our project in our presentation.

These are my initial comments. Now I'm going to give the floor to Alessandra that will analyze each one of the business units and then we will entertain questions.

Ms. Alessandra Gadelha: Good morning to everyone. On slide number 3, we are presenting the highlights of the third quarter of 2019, where the net revenue was R$380.4 million with a gross margin of 33.2%.

During this quarter, we attained the benefits of the cost reduction of raw material and the gains of synergy when we consolidated the 2 industrial plants, one of finishing in Rio Grande do Norte, and another plant in Paraíba, and they were absorbed by the industrial unit of Montes Claros in the state of Minas Gerais.

The operating results was R$28.6 million and a growth of 28.5% year on year in recurring terms excluding the tax value of R$14 million during the third quarter (of 2018). On the other side, we had a negative effect of the exchange rate variation of R$43.4 million with no cash effect, and 80% related to transaction amongst subsidiaries. The Ebitda totaled R$56.3 million with an Ebitda margin of 14.8%. We initiated this quarter the compensation of tax credit of PIS and COFINS.

Three of our brands won the Época Reclame Aqui award, as you can see on slide number 4. During the fourth consecutive year, Artex was third, MMartan second, and Santista was the champion that occupied the first prize in bedding table and bath.

We have (been gaining) value from São Gonçalo do Amarante. In 2018 we launched the power center with a R$1 million-(potential) revenue a month, we launched the first stage of the outlet with a potential revenue of R$1.3 million a month. During this quarter, we registered a revenue of R$2 million that come from the commercial complex and we (already) leased 26% of the area.

On slide number 6, you can see the consolidated results of the company. In terms of comparison, we are showing the quarters of 2018 reclassified excluding the discontinued operations. Between quarters, we had a 15.9% growth of revenue and 45.8% of Ebitda, with expansion in gross margin and Ebitda (margin). Ebitda grew 37.8% (yoy) in recurring terms, so we exclude the tax recovery plan registered during the third quarter of 2018.

On slide 7, here we have a financial deleveraging that is 2.3 times this quarter. The tax credits of PIS and COFINS, well, this was R$194 million (of Brazil Wholesale segment was habilitated) and now they are being offset. The credits of Brazil Retail segment are still going to be habilitated.

Now, the offset of these credits will contribute to generate more cash for the company and in order to reduce the net debt.

On slide number 8, we can see the highlights of Brazil Wholesale, and the net revenue was R$296.8 million with a negative impact (from) the higher share of intermediate products in the sales mix.

Now on the other side, we had a positive impact from the synergies of the consolidation of 2 industrial units and from lower raw material prices, and this will be intensified in the upcoming quarter.

On slide number 9, you will see the evolution of the results of Brazil Wholesale. I would like to highlight the improvement quarter on quarter, the revenue increased 14% with the expansion of gross margin from 21.3% to 27% and Ebitda grew 94% and it (EBITDA margin) went from 8.3% to 14%.

Now regarding Brazil Retail, that you can see on slide number 10, the sellout revenue was 9% higher than the third quarter of 2018, and this is a result of same-store sales because we only ~~closed~~ (opened) one store.

Now the net revenue was R$71.8 million with an increase of 6.2% year on year. We are growing our sellout revenue more than our net revenue because we are transferring sales to our franchisees through the digital franchise. There was an e-commerce growth of 54.8% year on year.

Although there was a quick expansion on our customer base, this indicator grew 27% between the ~~semesters~~ (quarters), as you can see on slide 11. Now the e-commerce sales presented a growth of 72% (in the first nine months of 2019) when we compare it to the same period last year.

On slide number 12, we see the increase of online sales share in sellout revenue, that went 2.5% in 2016 to ~~15%~~ 8.3% in 2018, (when we started the digital franchise,) and we expect to have a (share of) 15% ~~growth~~ this year.

Here on slide number 13, we can see an increase of 24% of Artex franchises, (in line with our strategy of sales) growth ~~of sales~~ through (new) franchises and through the digital channel.

On slide 14, we have the evolution of the Brazil Retail business unit. We would like to highlight the growth in revenue and also to see better gross margin (and EBITDA margin yoy). The Ebitda was R$6.8 million, ~~and~~ (with an increase of) R$13.5 million.

Now regarding Argentina, you can see on slide 15, our net revenue was R$41.3 million with a growth of 18% year on year. The Ebitda was R$2.8 million and (with an EBITDA margin increase of) 5.1% percentage points year on year, in terms of improvement.

On the slide 16, we see the financial performance of our Argentine business. We would like to highlight the growth of revenue and the expansion of gross margin quarter on quarter. The revenue grew 13% and the gross margin went from 21.9% during the second quarter to 25.2% during the third quarter.

Thank you very much, we are at your disposal to answer any questions that you may have.

Question-and-Answer Session

Operator: Ladies and gentlemen, we will initiate our Q&A session for analysts and investors.

In order to pose a question, please, press star 1. Your questions will be answered in order of arrival. If you would like to remove your question from the list, please press star 2.

Our first question from Mr. Carlos Herrera, from Condor.

Mr. Herrera: Good morning and thank you for taking my question. We are a bit confused when we read the press release because here we saw an increase of SG&A and we expected a gain in efficiency.

If there is room for improvement? In the case of the fourth quarter, when your orders are grander here? What would be the impact here?

Mr. Gomes: Thank you very much for the question and now I can clarify 2 things. When we consolidated the 2 industrial plants, of course, cost reduction is in the entry of cost of sold goods, so this increases the gross profit, but does not impact the SG&A.

Now when you say that the SG&A went up although these plants were closed, there is this impact, the consolidation of these plants causes a reduction of ~~sold products(~~cost of goods sold, but not SG&A), but there is also the exchange devaluation regarding costs that are legacy of the North American operation.

As you can remember, we sold the assets of the American operation, our company still maintains some legacy costs and they are considered general administrative noncommercial costs (G&A) because we have no longer any type of trade in the United States and the exchange rate variation carries out these costs.

So this is the reason why we've had this variation on SG&A, there wasn't an increase, part of this is due because we translated foreign exchange currencies into reais.

Mr. Herrera: All right, the other question would be regarding the expectations that you have for the year, because there has a ready been a reduction of your guidance last quarter, and now when we see the reported numbers, I believe that it is very difficult to achieve the lowest part, but you're going to deliver between 180 and 190 in Ebitda.

I don't know, is my assumption, right?

Mr. Gomes: There are 2 factors that will accelerate the Ebitda during the last quarter: The first factor would be that not all gains that can reduce costs because of the closing of the plants were attained during the third quarter, and on the other side, you have to hire people, who have to train people, and this training ramp-up does not provide us the productivity figures, so you can't reduce all the costs, and I believe that the results will be better during the fourth quarter; the second factor would be the drop of the costs of the main raw material of the company that was in dollars, that is cotton.

So on one side, we will have a raw material that was in dollar during the fourth quarter and it will be cheaper than what it was during the third quarter, and we will be able to absorb R$68 million on a yearly basis because we've closed the 2 industrial units.

So we are reassured or at least we believe that we will be able to meet our Ebitda guidance.

Mr. Herrera: Thank you very much.

Operator: Ladies and gentlemen, we would like to remind you that to pose a question please press star 1.

Mr. Gomes: There are 2 questions in our webcast, one from a real estate project in Rio Grande do Norte and one is the Argentine operation.

I believe that Argentina had a reasonable performance during the third quarter, part of this increase in sale is due to an interesting phenomenon that we see in Argentina: Every time that there is a strong devaluation of the currency and after the previous that confirmed the victory of Alberto Fernandez and you can see that there was a strong devaluation of the peso, and the Argentines, as they are aware that the currency market is a free market, sometimes they protect themselves by merchandising.

So we had the best month of volumes, sales in terms of volume, so the exchange rate devaluated and we sold greater volumes.

What I can see is ~~lack of~~ a stability of a market, and this is at a lower ~~l~~ level than what Argentina has had. Argentina has (already) sold R$100 million in one quarter and today they are selling R$40 million in one quarter. So in reais, our operation in Argentina has suffered a lot.

It is stable, there are some positive points that we can point out: Today the company doesn't owe any money to any financial institution, therefore, they do not owe money to the banks, their financing, for example, are to be paid in the long-term (related to the imports from the Brazilian operation), and they are also adjusted at the current level and there has been constant demand in the market, and Argentina can generate a small Ebitda under all of these conditions.

If the market conditions improve – when the market improves, because it is going to improve –, so when it improves, I believe that Argentina will be able to contribute (more) positively to our results.

This was a very difficult period, a period of adjustment, their production capacity shrunk, the operation has important idleness, nonetheless it has been adjusted to face these new times and it is prepared to grow quickly as soon as the market shows a signal of growth.

Now regarding the real estate project from Natal, once again, we have detailed material in the presentation that you may find in the company's site and you will be able to see this information, and you will be able to see the areas for the power center. Today the contracts represent a revenue of R$1 million a month as soon as the grace period comes to an end, this represents R$12 million a year, this is a good (very high) Ebitda margin.

We believe that the outlet will be launched during the last quarter of ~~last~~ (next) year, the architectonic project is beautiful, the retrofit operations will be very low cost, and I believe that the retailers will be able to lease at a very competitive prices, including condominium, air-conditioning. We believe that the price of this outlet is highly competitive, and it is already prepared for expansion.

This also will depend on the success of the 2-3 years that is the first stage, and the ~~realistic~~ residential project has a spectacular plot of land that represents almost 400,000 m² the commercial part has 300,000 m². I believe that this land is an excellent area, it is protected with walls, there is safety, the infrastructure is very good with water and sewage treatment, with power, and this doesn't represent any burden, and the commercial undertaking that is right beside it, it can give support.

Now, obviously, our purpose isn't to develop residential projects, we want to sell the land to construction companies that know how to work with this area. Now with the drop of the interest rate, and this is something that has been consistent even *Minha Casa Minha Vida* will no longer be (so) important (as market mechanism should provide house financing). And I believe that here we have a potential study by Urban Systems of 3,000 residential units. I believe that this is a 5-year project, a big developer would take 5 years to build it because Natal has a great inventory of residences that haven't been sold, so they have to sell these residences in order to think about this.

This is a unique plot of land, protected, properly located, with good water and sewage structure, it has power, and I believe that we will be able to accelerate this development because the real estate market has recovered in a number of cities in Brazil, so this can happen ~~here~~ (in the city of Natal) as well.

Operator: We would like to remind you that to pose a question, please press star 1.

Mr. Gomes: We have 2 questions here from our webcast, what would be regarding upward new products.

This is an important matter that I did not mention. Our company follows guidelines, not only to convert our sales on our (web)sites, but also to increase the value of our brands that would be the broadening of the distributed product lines, you know, using our logistics structure, using our sites, using the retailers that distribute our products.

Now in this segment, we would be growing our addressable market that would be R$12 billion market to R$80 billion at consumer price. Here we are including mattresses, here we are including furniture, we are talking about furniture that can be disassembled and can be assembled by the consumer, and these are furniture that (can change the) covers and electrical appliances and some things that we distributed through Santista, like table ~~cloths~~ (wares) and carpets.

Now mattresses and furniture, we developed the textile part. The textile part was developed by us so the cover of the mattress was developed by us, the cover of the couch is ours, now the manufacturing of the mattress and the sofa-in-a-box is not ours, we have the patent, we have the project, but we have a partner that manufactures this, and they have ~~allowed~~ helped us to develop this project, they produced a number of prototypes until we found something that we liked.

And we ~~finished~~ would like to launch this in October, as we want to make the best of the month of November when we will have lots of consumers coming to us. (But it was not ready, under our quality standard.) So we have postponed this launching for the first quarter (of next year) because the design is still not what we wanted, but we want that is competitive, robust and I believe that it will be a success.

So, yes, we want to increase the average ticket of our sales. Today our average ticket is reasonable. Each brand has its average ticket, we are talking about items of high prices, a couch of R$1,500 to R$2,000 depending on the items of the sofa, it is modular, they can, for example, choose a chaise, an armchair, a couch for 2 people, and ~~sometimes~~ they are modular.

We have the mattresses, we would manufacture the cover, and this is also for the first quarter of next year, and we have products for intelligent sleeping. We have a new product, this is an ingredient brand that will be added to our brand and this will be launched with MMartan, and these are pillows where the consumer will buy a pillow and we are talking about an intelligent pillow that they would be able to use a mobile apps that will give them the statistics of their sleep quality and mainly how engaged they are with sleeping.

Now these 3 initiatives that have ended, so we decided to launch them in the beginning of the next year because launching them now would probably cause more problems than solutions, we would have to increase the production in a period where it's very difficult to forecast the demand. So we have delayed this, everything is practically concluded and practicably ready to be sold to the end consumer, and these are 3 initiatives together with other categories, and here we are going to work like a marketplace and this will increase our sales direct to the consumer and this will also strengthen our brands next year.

Operator: Our Springs Global conference call has come to an end. Thank you very much for your participation and have an excellent day.