Sonae SGPS
1Q18 Results
Conference call Transcript

Moderator: Luís Filipe Reis
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Operator: Thank you for standing by, and welcome to the Sonae First Quarter 2018 Results Call. Before we begin, I must advise you that this call is being recorded today and all participants are in a listen-only mode.

Our presentation will be followed by a question and answer session. To ask a question at this time, please press star one, on your telephone keypad and wait for your name to be announced.

Should you wish to ask a question throughout the conference, please type into the Q&A panel to the left of your screen. I would now I would like to hand the conference over to your first speaker, Luís Reis, chief corporate center officer. Please go ahead.

Luís Filipe Reis: Hello. Good afternoon, everyone, and thank you for attending Sonae's First Quarter 2018 Results Conference Call and Webcast. Together with me, I have Fernando Guedes de Oliveira, the CEO of Sonae Sierra, Rui Almeida, the CFO of Sonae food retail division, Miguel Águas, CFO of Worten, Carlos Silva, CFO of Sonae Investment Management, João Dolores, our central planning and management control area manager and all of the IR team of Sonae.

First of all, I'd like to mention this fact. Today's call is only about our first quarter results. I know that some of you might be curious about our announced potential IPO, the one we are studying since our last earnings announcement, but as of today, there are no additional news or additional information to the one already provided to the market. So I will not answer any question related to it or make any further announcement related to the IPO. And obviously, when and if we will have additional information on that particular subject, it will be properly communicated to the market.

Entering directly into the results. It's another strong quarter of Sonae's performance. We continue following our 3 key strategic pillars, strengthening and leveraging our key assets and competencies in our core markets, driving international expansion. Just a quick note on that international expansion to mention a significant partnership that Sonae Sierra made, in Italy, a 50-50 joint venture agreement with Impresa Pizzarotti to develop a new shopping district with a shopping mall and outlet or a retail park in Parma.

And the third one, which is to diversify business models and investment approach of Sonae, which we've been doing quite significantly over the time.

Entering directly into the results, four main notes. The first one to highlight, the very solid evolution of our turnover, 8.7 percent year-on-year, backed significantly by the contributions that come from mostly Sonae food retail division, Sonae MC, and Worten. A second note on profitability, with underlying EBITDA growing 11 percent and EBITDA growing 9.5 percent, both of those figures growing ahead of the sales numbers. A third note on net income before minorities, that more than doubled to 21.2 million euros. And finally, and also very relevant, the fact that our capital structure continues to maintain and reinforce a very strong profile. We have decreased net debt by 113 million euros and our financial leverage stood at 38 percent, less 2.9 percentage points when compared to the first quarter of last year. Our balance sheet is obviously fully financed. We have a long maturity profile that is currently, as it was on our last announcement to the market, around 4 years.

Entering into each one of the businesses, a glimpse on each one of them with more detail on our retail businesses, starting with food. We believe that we're posting a very solid performance on the first quarter of 2018.

It's indeed a very good start of the year, proving once again the resilience of our business there, but also the winning market value proposition that we have. Once again, we've significantly gained market share. We've grown, in absolute terms, more than the market, and we've outgrown all our major competitors.

In the first quarter, turnover increased by 10 percent, 5.3 percent of like-for-like sales growth, obviously, both these figures are influenced by the calendar effect. You might deduct from these figures, if you want, to isolate the Easter effect, a number flat, would be slightly south of 3 percent.

We continue to expand our store network. We've opened three Continente Bom Dia stores, following the strategy that has been sharing with you in all our previous announcements.

And finally, with the good result of the underlying EBITDA margin level, where, obviously, fueled by the growth in sales, we managed to present a 3.7 percent EBITDA margin, 10 bps more than the same quarter last year.

And, actually, even more relevant than that, an absolute number of 34 million euros in absolute terms, a growth of 12.7 percent when compared with the same figure posted last year.

Regarding Worten, again, a very strong set of results. A growth of 9.3 percentage points in our Iberian operation. Also a strong growth in like-for-like, 8.8 percentage points, fueled also by the Easter effect impact, which is smaller in Worten than what it is in Continente.

Once again, our e-commerce operation continues to grow double-digit and continues to gain market share. And finally, also a positive evolution of the underlying EBITDA to 3.3 million euros, a 27.5 percentage points year-on-year growth with an improved margin of 1.4 percentage points.

Sonae's Sports and Fashion have a tough and challenging quarter, mostly driven by the unusual weather conditions. As you know, we had a very strong winter. And the fact that Easter is on the first quarter also has a negative impact when compared, the performance of Easter, with the performance of Easter last year.

Nevertheless, the combination of effect led us to post a growth of 1.4 percentage points, which according to all our sources of information, is pretty much in line with the fashion market or the with fashion markets where we operate and even shows some market share gains in our most significant internationalised brands, Salsa and Zippy.

Underlying EBITDA amounted to 2 million euros, a 5 percent growth when compared to last year and an improvement in EBITDA margin from 2.3 percent last year to 2.4 percent this year.

I note now, a clarification note, on Sport Zone. As you know, as of the end of January, we've merged our operations with JD Iberian operations, including all their JD operations and Sprinter operations.

We will, as of next quarter, start to present the full results of ISRG consolidated through the equity method. But there is a calendar mismatch between the way we report and the way that JD reports. We will be consolidating, in our next quarter, the quarter of February, March and April, which is a reporting quarter of JD in the UK.

Regarding Sonae RP, very stable. We continue to have a gross book value of above 1.27 billion euros, American billion Euros, a net book value of 908 million euros. Slightly increasing turnover, also a slight increase at the underlying EBITDA level.

We didn't post any sale and leaseback transactions during the first quarter, but there is still an interesting appetite for the real estate assets of Sonae RP. So we might announce more, or some operations here, since our freehold is still very comfortable and aligned with our strategic guidance.

Also, a note on financial services, which continues to post a very positive momentum. Turnover had grown more than 29 percent. EBITDA has also grown significantly.

And the number of customers of our flagship product, the credit card Universo, is now, or was at the end of the quarter, 637,000 customers, a growth of 182,000 customers when compared with the first quarter of 2017, showing that we continue to have a significant traction in customer acquisition in the Portuguese market.

Sonae Sierra, very positive figures. I've already mentioned the important partnership that further reinforces Sonae Sierra development activity. But also, a mention to the strong operational indicators. Global occupancy rate stood at 95.6 percent and tenant sales grew 5.7 percent in Europe and 4.8 percent in Brazil. If you consider those figures in local currency, which is a quite a significant and very positive result for Sonae Sierra.

NOS has also posted already its results on May 10th. As you probably are all aware of, again, a very solid set of results from NOS, a growth in operating revenues, significant growth in EBITDA. Also a significant growth, even bigger than EBITDA has grown 3 percent, EBITDA minus CapEx has grown 5 percent, and net result increased 3 percent. So, all in all, a very solid set of results in our telecom participation.

Sonae Investment Management of that, as you know, manages a quite broad portfolio of tech-based and cybersecurity companies.

An overall note to state that turnover increased 1 percent to 33 million euros, underlying EBITDA margin also grew to 2.9 percent, and a very positive note for S21Sec, which is our cybersecurity company based predominantly in Spain but serving customers globally, but mostly in Spain, Portugal and Latin America, which has posted a 14 percent year-on-year growth and is approaching breakeven at EBITDA level, a quite significant achievement for a cybersecurity company in Europe.

I would like now to conclude by reinforcing that our perception is that Sonae is posting a very solid start to the year. We are very pleased with the results, and we are quite confident on the following quarters. And having said that, thank you again for being on our conference call and webcast. And I will open now to questions. Thank you very much.

Operator: As a reminder, if you wish to ask a question, please press star, one on your telephone keypad and. If you wish to cancel your request, press the hash key. OK, we have a question from José Rito. Your line is open.

José Rito: Yes, good afternoon and thank you for taking my questions. Just a clarification on the Easter effect, I think that's for the full retail, you mentioned that it was 3 percent, just to confirm this. And also, if you are noticing any signs that customers have been trading up. So, this will be my first question.

The second question related to EBITDA margin uplift in food in Q1. How sustainable do you see this? And also, what should contribute the most for the margin evolution in the coming quarters? Should it be gross margin, fixed cost dilution, maturing selling areas? So, what should be the driver if you see this margin uplift as sustainable?

And my last question on Worten. Worten has maintained a very good sales momentum, is this performance similar both in Portugal and in Spain? If you could give some highlights on this. And also, if the physical stores are facing any signs of cannibalization from online. I would assume this is more relevant in Portugal. And also on this business, when do you expect positive EBITDA less CapEx figures? Thank you.

Luís Filipe Reis: Thank you, José. Regarding your first question, I said it's slightly south of 3 percent. It's always a very difficult figure to compute, but it's slightly south of 3 percent. As a matter of fact, we are not seeing trading up. The market continues to be very, very competitive, very aggressive in terms of promotional intensity. So there is not really trading up. And regarding the margin uplift in food, I think that it deserves a longer explanation.

So starting with: it's obvious that having such a positive performance in terms of sales in a company that is very driven by efficiency, when we have bigger sales, obviously, we tend to have a better performance at the EBITDA level. There is, obviously, the contrary effect to that, which is the aggressiveness of the market. We still face a very tough competitive environment. But obviously, I've been telling, for those that are following us, I've been telling all of you that Sonae was managing its operations in a way that we thought we were reaching an equilibrium point at our EBITDA level, which we believe we did reach. Please bear in mind that this quarter, we only opened three stores. And you know that the opening of stores tends to have a slightly negative contribution to our EBITDA margin and compared to other quarters where we open seven or eight stories, having only opened three stores, that's a slightly less negative effect. So when we approach such a stability point, as I've been happily mentioning to the market over the last three, four quarters. This quarter, yes, we did have, because of all these effects, a positive notch in our EBITDA margin. We are not overly confident that we will, actually, I think that if you want to infer something from what I've been saying, we are prudent on EBITDA margin. We still guide the market by saying we believe we are on stability, at a stability point, but we might be influenced in a given quarter or other by positive factors like we were this quarter. Now I will hand it over to Miguel Águas, which will answer you, your question on Worten.

Miguel Águas: Hi, good afternoon. Thank you for your questions. Regarding the question on performance being similar or not similar in Portugal and Spain, we have strong like-for-like performance in both markets. It was a bit higher in Portugal than in Spain. But in both cases, we actually grew above markets. So we have like-for-likes above the market performance in both Portugal and Spain.

As for your question on cannibalization in physical stores, and your question was mostly targeting Portugal. We monitor this closely. Right now, what we experienced is actually the opposite, where you have online driving traffic to stores. And we are gaining share both in physical stores and within in the e-commerce channel as well. So in Portugal, we are gaining share in both channels. It is obvious that there's been sales change and evolution in our store portfolio in terms of some of its characteristics, but overall so far, what the online has been doing in Portugal is driving more traffic to the stores and enabling also the range to be expanded with products that we don't need to have physically available in the stores.

As for your last question on EBITDA minus CapEx, we are not going to have a forecast here shared with you. We don't have that, a forward-looking perspective, here in the call.

José Rito: OK, thank you very much. So on this Worten issue and the penetration of online, so you are still seeing quite positive like-for-like at your store network, so you don't see, let's say, over the next two to three years, need to shut down stores in Portugal? So that should not be an issue?

Miguel Águas: Presently, we don't see that as being a likely scenario. We do have plans to adapt our store portfolio. We are having, as a normal day-to-day business, we are having some adjustment in some stores. And in some of the larger stores, we have done some area reductions that have helped us to increase significantly sales per square meter. But again, our like-for-like figures are very healthy in Portugal even if you account only for our physical sales, we are above market. And this is coupled with a performance that, within e-commerce, is very strong as well. So no signs of important cannibalization as of now.

José Rito: OK. Thank you. And then, so just, a follow-up on the trading up in the market. Well, we have been seeing retailers enlarging the basket and having more healthy products, and actually, Sonae has opened recently a store, supermarket more focused on organic product. It isn't this a sign of trading up?

Luís Filipe Reis: Yes. Well, when I mentioned trading up, I was using the pure definition of trading up, which is a consumer within the same precise range of product buying a product at a premium price. Obviously, I was not mentioning an effect that you've described, which is the fact that consumers are more responsive to trends that might end up in acquisition of more expensive product. And actually, we do see an important trend on healthy, on the consumption of healthy foods.

As I already mentioned, I suppose, in these calls, we are now by far the largest player in Portugal on distribution of bio and healthy nutrition. And it's indeed a category that is growing significantly above the growth that we posted for the total food retail division.

So that happens. But it's, I was not mentioning that as a trade up, but also, but on the side of that, as a response to consumers to new trends in consumption.

José Rito: OK. Understood. But the penetration of this product is still quite small, right? And…

Luís Filipe Reis: Penetration is quite small, yes. It's quite small and it doesn't have a significant impact in our total sales. But it's true that the category of healthy and nutritional product is growing above our total sales.

José Rito: OK, thank you.

Luís Filipe Reis: You're welcome.

Operator: Thank you. Your next question comes from Filipe Rosa. Your line is open.

Filipe Rosa: Hi, good afternoon everyone. So three questions for me as well, if I may. The first one on MC, just trying to understand a little bit this very positive like-for-like. Of course, there is this Easter effect. But excluding the Easter effect, could you just give us an idea of what has been the split between basket inflation and number of tickets?

And taking in, just trying to have an update, do think that this expansion into proximity that you have been doing, is this allowing you to have more consumers, consumers of Continente, the Continente brand, or are you seeing that you are basically increasing the share of the wallet of the consumer that you already have before?

So that will be my first question. My second question relates to your comment regarding Sonae RP. You said that you might do some you maintain the same message, there might be the opportunity, due to the strong demand, to do some more deals. I believe that you ended the Q1 with 47 percent of ownership. How low could you go typically in order to take advantage of this strong demand in the market? And my third question relates to fashion. OK, it seems like the only weak spot. I don't know if you could update us on what are the measures being taken by Sonae, apart from, of course, Salsa, which we don't have detailed data, but it seems that it continues a bright spot. But what are the measures that you could take to the legacy of MO and Zippy in order to improve the performance and the contribution to the consolidation, to the consolidated results of Sonae?

Luís Filipe Reis: Filipe, thank you very much for your questions. Actually, the second one, on Continente, it's really tough to answer. I think that we are witnessing both effects, a slight increase on basket total, so some customers that are coming more frequently to our stores because it's indeed, we don't have in the areas where we are, we tend to serve basically the vast majority of the population, at least, in any regular basis.

Because consumers in Portugal tend to shop in almost all the different brands that they have available in their catchment areas. Regarding like-for-like, as I've already said, you have a like-for-like growth of 5.3 percent, you have to deduct from there, slightly south of 3 percent, as I said. And our basket inflation and that we have more precise figures, is around 0.7 percentage points. So if you deduct that, you will see still a very positive number in like-for-like, especially when considering the fact that we are the one retailer that is having more square meters, and we are having those square meters in a surgical matter, as I've explained over the last couple of comments to the market.

Having said that, I believe also that what you are witnessing and we are witnessing is a strength of the measures we took, like, two years ago, to strengthening our value proposition. We are continuing to be seen by the Portuguese customers as the retailer with the lower prices, with the best variety and also with the best own-brand products.

We are improving now and trying to be better at fresh, where we still don't lead the market in terms of quality perception. We are very close to that, and we will continue to invest on that particular area. But all in all, the strength of our value proposal in terms of food is very much in these figures.

Regarding Sonae RP, we've always said to the market that our intention is to remain on a figure that is broadly close to 50 percent. But that, to achieve that broad figure, we will continue to use RP as our investment branch. So the new stores that we are opening, a significant part of those stores will be owned and invested by Sonae RP. So in order to keep the figure broadly at 50 percent, and in anticipation of more investment that we have planned in Sonae RP, and bearing in mind that the market is showing some strong appetite for some of our current real estate assets, we might sell at good prices now or and then keep investing in more stores.

So there is not really a tactical guidance that I can give you. We still have a broad long-term guidance of keeping our freehold close to 50 percent, but that has to be achieved with selling at good prices, making good capital gain, profiting from good market moments and then having a steady investment flow in new Sonae MC stores.

Finally, regarding fashion. Indeed, it's true. Salsa continues to perform quite well. Then we have a three other brands, Losan, MO and Zippy. The three of them, I'd say, they are not in need of any more measures than the ones we took in the past.

They are improving slowly their performance in terms of sales and EBITDA. We were now hit by a tough quarter, which probably will also translate into a tough half. But we are confident that overall, 2018, if you look at the final figures, will be a very positive year.

And you will see the full impact of the measures that were taken already last year and continues to be taken in this year, and they are mostly around optimization of the store network, optimization of the product, optimization of logistics. All in all, we are very confident that we will end up year with quite, quite positive results also in that side of our retail portfolio.

Filipe Rosa: Thank you very much Luís, very helpful.

Luís Filipe Reis: You're welcome.

Operator: Thank you. Your next question comes from (Tim Attenborough). Your line is open.

Timothy Attenborough: Hi, good afternoon Luís, and well done on the numbers. Most of my questions are answered, but just a few sort of follow-ups, if I may. On the weather impacts at MC, and I'm really thinking in the context of what DIO was saying about proximity stores in March suffering.

I mean, where you seeing a significant like-for-like difference, big stores versus small stores, parking versus non-parking? Is there any trend you saw? Second thing is quite a significant new space contribution in the first quarter at MC.

What should we be thinking in terms of new space for the full year? I think you were clear on the food margin. And congratulations on the first positive food margin evolution for, I think it was since second quarter 2013.

So I've been waiting for a long time for that. So well done. But should, you were clearly saying be prudent to measure stability, to forecast stability there, keep it forecast flat. Are the levels of promotional intensity easing off here?

Is the market becoming a little bit more rational? And I do appreciate Q1, that was, obviously, you've got our balance that, Easter versus weather versus new space costs. One last one, just on Worten. Is Spain heading back into profit now? Is it no longer such a drag as it was? I'll leave it at that for now.

Luís Filipe Reis: I think you have it, Tim. So thank you very much for your questions and for your comments. Well, I probably going to disappoint you, but in our network of stores, we don't see big differences between small versus big stores. Actually, if we had to make a full disclosure, it's actually the opposite.

We are seeing better like-for-likes in proximity stores when compared to the big ones. So maybe our locations are, since we're having our location based on a very robust methodology, maybe our locations are better picked. But we are seeing really a very good performance of our smaller stores. And it's really driven by that good performance and good evolution of like-for-likes. On those that are already having like-for-likes, therefore, we are adding more stores. I'd like to mention that it's, we keep saying what we said last year and the year before, we plan to add around 20 stores per year at these types of stores.

We still think that there is ample room for that type of controlled expansion on stores that will be around 800 to 1,000 square meters. At the same time, whenever we remodel a big hypermarket, and we did that last year and we'll continue to do that this year, we tend to slice a part of the biggest store. And because, as you know, our bigger stores, they are predominantly big food stores with more variety. And regarding the levels of promotional intensity, no, there is no more rationality in the market.

And we are also very happy with the results we are posting because we are able to post those results in a very intense and very competitive market. We've prepared ourselves over the last two years to face these level of promotional intensity. The market is indeed very irrational. We don't see any player becoming more rational, actually quite the opposite. We are seeing some signs of more irrationality.

We are even afraid that posting such positive results, showing that we are winning significantly in terms of both market share and comparable profitability vis-à-vis all the other players in the Portuguese market, we might even provoke more irrationality from some more emotional players.

But that's life. I think we are very well-prepared, our operations are very robust, and we are showing a very strong and resilient food business. And even in a very intense promotional market, I believe that we are able to sustain our margins, as I've been saying over the last two years. Thank you very much. Oh, regarding Worten, I will hand it over to Miguel.

Miguel Águas: So the structural factors behind Spain are still in a positive trend. We have had, in the first quarter, most of the, or the improvement that we have at a consolidated level was coming from Portugal.

In Spain, this was a quarter where we invested, well, significantly for a quarter, in a major change. We actually have just completed a change in the warehouse, in all the distribution center infrastructure, that introduced someone one-off costs in the first quarter. And therefore, we did not have that same improvement as we did in Portugal. But again, the structural drivers behind, it's our belief that we will bring it back to profitability are still in place.

Timothy Attenborough: Sorry, just repeat that last bit. When did you say you would be back to profitability?

Miguel Águas: So no, I did not say a timing as we have never been reporting a timing. Again, focusing on the Iberian operation as a whole, we have been meeting the targets that has Sonae sets. And this is what we are delivering, what we are focusing on delivering.

Timothy Attenborough: OK, it was worth the try. Thank you and thank you Luís for the clear answers. OK, thanks.

Luís Filipe Reis: You're welcome.

Operator: Thank you. And your last question comes from (Jose Martins Soares). Your line is open.

José Martins Soares: Hi, there. Hope everyone's well. I'll be very quick. I have two questions. One is, well, we're already in May, and I was wondering if you could share with us a little bit of what's happened in April and in May on a like-for-like perspective.

I mean, you clearly have had very good numbers across all fronts, the three fronts. So I was wondering if you could lift the veil a little bit about these two months. And the second question is, and I keep asking this all the time, are you on track to reach breakeven in your online sales this year? Thank you.

Luís Filipe Reis: First, yes, I don't think that you should expect, we are not witnessing nor an improvement, nor a deterioration of performance in this quarter when compared to the first quarter.

Things are pretty much following the same trends in terms of like-for-like if you discount all the effect that I mentioned, namely the calendar affect. So we are still heading for positive like-for-like ahead of inflation as we did in the first quarter.

Regarding online operations, they are very different. So just to give you a glimpse of our three most relevant operations, starting with Worten. Worten is better flow, completely integrated on the entire operation. As Miguel has just said, we look at Worten as a single entity. It's an Iberian operation, and e-commerce is part of that operation, so we don't follow e-commerce separated from that. We are mostly focusing on the entire EBITDA of the business. On operations, we have a very, very strong and very profitable and growing very fast online operation. And it's already very, very profitable. And on the food business, we are very close to breakeven. So it might be this year, it might be next year, but we are already very, very close to breakeven. And in food, we do consider online as an independent channel and we fully allocate all the costs to the online business.

José Martins Soares: Very clear, have a great weekend. Thank you.

Luís Filipe Reis: Thank you, you're welcome.

Operator: Thank you. We have no further questions. Please continue.

Luís Filipe Reis: OK. Thank you, once again, for attending and for all your questions. Hope to see you again on our half year results, if not before. See you guys.

Operator: Thank you. That does conclude your conference for today. Thank you for participating. You may all disconnect.

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