Sonae 1Q19 results - conference call transcript

Moderator: João Dolores

May 16th, 2019

3:00 p.m. GMT

Operator: Good afternoon, ladies and gentlemen. Thank you for standing by, and welcome to Sonae's First Quarter 2019 Results. During the presentation, we will have a question and answer session. At which time, if you wish to ask a question, you will need to press star and one on your telephone and wait to hear a brief message instructing your line is open. Alternatively, you can submit questions via the webcast. I must advise you this webcast is being recorded today, Thursday, the 16th of May, 2019. I'd now like to hand the webcast over to your presenter today, João Dolores (Sonae CFO). Please go ahead.

João Dolores: Hello, good afternoon, everyone. First of all, apologies for this delay, but there seems to be having a technical problem. And thank you all for attending Sonae's Q1 '19 Results Conference Call. Together with me today, we have the following CFOs of our businesses, Rui Almeida from Sonae MC, Paulo Simões from Worten, Miguel Moreira from Sonae Fashion, Carlos Silva from Sonae Investment Management and also our Investor Relations team.

As always and before the results of review, I would like to make a couple of remarks. First of all, as you know, from this quarter onwards, our reporting structure includes the new Sonae MC segment, which is comprised of the historical Sonae MC segment, Maxmat and Sonae RP's operational assets. Also the former Sonae Sports & Fashion segment was split into Sonae Fashion and ISRG, given the different nature and independent management teams of both businesses. Additionally, this will be the first full year of line-by-line consolidation of Sonae Sierra's accounts, so we will have Sonae Sierra's first quarter statutory accounts consolidated into Sonae's accounts for the first time. In addition, and as you already know, 2019 also marked the adoption of the IFRS16 accounting standard.

All in all, and for comparable reasons, historical figures were restated to include all the above-mentioned changes with the exception of Sonae Sierra's consolidation as the only acquired the additional 20% in September last year.

Given these initial notes, I will now make an overview of our results for Q1, starting with the highlights from the individual businesses and then finally covering Sonae's consolidated figures.

Starting with Sonae MC. **Sonae MC** had a good start of the year and outperforming once again the market with top line growth of 7.4% with the like-for-like growth of 1.1% despite the negative seasonal effect of Easter and thus reached a total revenue figure of €1.048 Bn. During this quarter, the Sonae MC continued expanding its store network with 14 new company-operated stores, including three Continente Bom Dia stores our proximity format. In addition, Sonae MC completed the acquisition of a 60% stake in Arenal in Spain, reinforcing its position in the Health & Wellness segment, one of its main strategic development pillars.

In terms of profitability, underlying EBITDA grew by 8.1% y.o.y to €81 M, implying a stable margin of 7.7%. You can see more detailed information, which was published by Sonae MC and is available on our website.

And at **Worten**, the first few months of the year as the business were impacted by the effects of a later Easter and also atypical weather conditions, both having a significant impact on total market growth in the quarter. Worten also had a challenging comparable with like-for-like growth stood at 9% last year. All this affects played a role in the year-on-year decrease in sales of 2%. This top line performance, coupled with both the store expansion in the last 12 months and also continued efforts towards digital transformation, led to an underlying EBITDA of €8.1 M, €1.8 M below last year. Still in Portugal, Worten further reinforced its market share, and the online channel continues to record strong growth.

Moving on to **Sonae Fashion.** After challenging year of 2018, the first 3 months of 2019 showed a resilient performance with Sonae Fashion growing above market references. Despite the calendar effects of a later Easter, like-for-like growth stood at 4.4% and total turnover increased 1% y.o.y., reaching €98 M at the end of Q1. This was mainly fuelled by a strong omni-channel performance that compensated lower wholesale and franchising sales. In terms of profitability, the adverse calendar effect had a slightly negative impact on underlying EBITDA having decreased 1.9% to €8.2 M in the quarter.

All retail businesses, the first half results will provide a better picture of the performance of the business.

Regarding ISRG, our partnership in the sports retail sector, the last quarter of the company's fiscal year produced a very positive performance with sales growing 12% y.o.y and EBITDA improving 2.9 percentage points to 10.3% at the end of Q4. For Sonae, these results are accounted through the equity methods, and in our P&L, we had €4.6 M positive impact when compared to Q1 2018.

In our **financial services division**, we continued to have positive evolution. Turnover increased by 17% y.o.y. to €8.1 M in Q1 and underlying EBITDA almost doubled to €2 M, which equates to a margin of 25%. The Universo credit card continues to have an important role in the payments market in Portugal, with a number of cards reaching 775,000 at the end of March, an increase of 138,000 cards y.o.y.. And this also means the reinforced market share in terms of the payments market that grew 1.3 percentage points over the last 12 months and reached 12.8% in March this year.

Sonae Investment Management. During Q1, Sonae Investment Management reinforced its participation in some portfolio companies, sold 100% of Saphety to a management buyout and invested in CB4, a company based in Israel that provides a patented artificial intelligence software solution for brick-and-mortar retailers. Regarding operational performance, Sonae Investment Management's turnover fuelled by the integration of Nextel and Excellium, recent acquisitions increased by more than 40% y.o.y. to €44 M and even on a comparable basis, turnover increased by 19% with positive contribution across most companies. Underlying EBITDA decreased €1.4 M or €0.4 M on a comparable basis to basically flat level of EBITDA in the first quarter. Total EBITDA actually increased €4 M to €4.9 M, underpinned by the capital gain generated by the sale of Saphety, which also has an impact on Sonae's consolidated results.

Regarding **Sonae Sierra**. The company once again showed a solid performance with proportion of EBIT increasing 8.6% y.o.y. to €29 M and direct results reaching €20 M, a 16% y.o.y. increase. This was fuelled by both the European portfolio performance and also by an improved performance in the services division. At the end of March, NAV stood at €1.48 Bn, a slight growth of 1.6% compared to the value registered at the end of the year. During the first 3 months of 2019, Sonae Sierra continued the execution of its capital recycling strategy with the sale of Loop5 in Germany and opened its first shopping center in Colombia, Cucuta, which is an important milestone for the company's international development activity. Beyond that, it continues the development of several projects in Spain and Morocco and Portugal. Also, on the services front, Sonae Sierra continue to accelerate its activity and acquired a 50% stake in Balmain, a Polish multiservice provider for retail and leisure assets.

Regarding **NOS**. As you know, NOS already published its Q1 results. Just a couple of quick highlights here. Consolidated revenues reached €385 M, a 0.6% y.o.y. growth, driven by more robust growth in the telco business. EBITDA increased more than total revenues about 2% y.o.y., which reflects solid cost discipline and also operating leverage. Net results increased more than 20% from €35 M last year to €43 M this year, and the company's transformation program is on track and that is reflected also in some of the profitability. Q1 has a seen good free cash flow momentum and thus the important of the company's solid capital structure.

Finally, looking at our consolidated figures, I would say that despite the unfavourable calendar impact in Q1, which particularly effect our retail businesses, total turnover posted of 9% y.o.y. growth surpassing €1.4 Bn in the quarter. Underlying EBITDA reached €105 M, an increase of 16% y.o.y. and this was mainly fuelled by Sonae MC and also the full consolidation of Sonae Sierra.

EBITDA reached €136 M, €34 M increase when compared to Q1 '18, and this was underpinned by the growth in underlying EBITDA and also by equity method results of €26.5 M with a particularly positive note to Sonae Sierra and also ISRG. And also non-recurrent items of €4.6 M, which are mostly related to the capital gain from the sale of Saphety by Sonae Investment Management. This good performance at the EBITDA level drove Direct results to €32.8 M, €24 M above 2018 and therefore, net income group share increased 6.5% to €18.3 M.

Regarding our capital structure and on a like-for-like basis, Sonae net debt decreased by €99 M y.o.y. to €1.167 Bn. Total net debt stood at €1.7 Bn, driven by the acquisitions of the 20% stake in Sonae Sierra and also the 60% stake in Arenal. Both the cost of debt and our average maturity are quite comfortable level. And since the beginning of the year, we have already refinanced €230 M in long-term facilities being currently financed for the next 18 months.

Overall, I would say that we are quite pleased with this solid set of results and also quite confident for the record year. I will now in this brief overview of our Q1 results, I invite to ask your questions. You can please open the session to Q&A. Thank you.

Operator: We will now take the first question.

Filipe Rosa: So three questions for me, if I may. The first one probably on non-food retail. I was curious because you said that you managed to take share on **Worten**. And I was looking at the data for the electronics market in Portugal, and I believe it grew in the first quarter. So I would like to understand if your sales in Iberia has dropped probably that would imply that the performance was very negative in Spain and in Portugal was positive, so just trying to understand between Portugal and Spain whether there has been a very different performance and why? Okay, I know that the comparable was tough, but we haven't seen in the market such a big effect from Easter. And few related with that. If you could give us evolution of sales up to April because I think that we didn't have a negative quarter for Worten in terms of sales growth for long time. That would be my first question.

Also on **Fashion**. I was seeing that clothing sales in Iberia didn't grow much, but they also grew more than the clothing sales of Sonae. So it seems like you continue to like in that industry. And I would perhaps compare with the performance you have of the adjacent formats from Sonae MC, which have a high single digit like-for-like despite the Easter effect. So I would just like to understand both for Worten and for fashion, why the top line performance has been so weak taking into account the overall backdrop that we have seen in Iberia, which has been quite supported.

The second question relates to **Sonae MC**. Whether you could update us on what has been the performance up to April? For us to have an idea what could be the impact from Easter? And as of today, with the information you have, whether you could elaborate a little bit on the competitive backdrop and what is the outlook for the full year in terms of like-for-like because you are doing very well if you adjust for Easter?

So just trying to understand whether you think that you could have a like-for-like, I don't know, higher or something similar to what you have in Q1, but adjusting for the calendar effect? And in terms of margins, whether you think that the trend in Q1 could be replicated for the full year because the overall like-for-like should be better than in Q1, okay?

And finally, my quick question relates to **net debt**. Net debt in Q1 is being above my forecast. Just trying to understand for the full year. Probably, it's better to put it this way. What you think it will be a reasonable evolution for the net debt? Taking into account that, of course, for the full year the impact of the acquisition of Sierra, we no longer be there? And I think that in terms of the acquisition of Arenal, these should be the big change versus 2018. So if you could guide us for the expected evolution for net debt for the full year?

João Dolores: Okay. Thank you, Filipe, for your questions. I will first hand it over to Paulo to answer the question on Worten then to Miguel to address the question on fashion than to Rui for the one on MC and finally I will take the net debt one.

Paulo Simões: Thank you. Good afternoon all. Thank you, Filipe, for your questions. Regarding the market behaviour in Iberia what we have seen from the data that we have and maybe we don't have exactly the same source, the market overall has been more or less flat in Iberia. So clearly, not showing the same kind of performance that it was showing last year. Regarding our turnover performance. Well, we already gave you the main effects. The calendar effect of Easter did impact Worten. We also felt unfavourable weather conditions that negatively impacted sales of seasonal products like drying clothes machines and heaters, for example. In addition to that, there were some aggressive promotional activities from some of our competitors in Spain, which we decided not to follow. In fact, we lowered our promotional activity overall in the first quarter versus last year in Iberia and improved our commercial margin in percentage points. So, it was a decision taken. So, it is a fact that we are gaining market share in Portugal and in addition to that, also in some regions in Spain like the Canary Islands. Most recent performance on turnover has been more encouraging. So, we are not really concerned going forward. And I think I've gone through your questions regarding Worten.

Miguel Moreira: Regarding Sonae Fashion, we know that we only grew about 1% our turnover but we have to look into to the sales to understand exactly the movement that we made because the performance that we have in our omni-channel operations was very positive, and we reached more than 4% growth in this first quarter. And that compares positively to the market to the referential that we have from the markets both in Portugal and in Spain, where we saw rates below this grow in both markets according to the information that we have. That's why we said that we have been improving our market share.

But on the other hand, we have some delays in our shipments in our performances of franchising and wholesale that we are recovering in the months after the first quarter, so we really believe we are gaining market share in our operations.

Rui Almeida: Now it's my turn. Hi Filipe and thank you for question. This is Rui Almeida speaking. Well, the impact of seasonal effect in our first quarter in terms of sales has been more than 2 percentual points. Excluding this effect, we can say that all formats are presenting positive like-for-like and growing in terms of volumes. Largest formats were being more impacted by the Easter effects, but re gaining momentum in April. So, they are now presenting very good figures in the year-to-date.

João Dolores: Now it's my turn to take the net debt question. Regarding the net debt evolution and as you know, we don't provide guidance for the future. But what I can tell you is that on a comparable basis, as I said before, we decreased our net debt level by approximately €100 M y.o.y., which is, in essence, the level of which we have been decreasing our net debt level in the last few years. And we remain confident that we will continue this riding path going to the future due to operating cash flow generation and also due to further potential assets disposals or dilution in our several sub holdings.

Filipe Rosa: Okay. Can I just follow up, just trying to understand in terms of competitive backdrop for the food business? Sorry, is there any change then?

João Dolores: Sorry. Could you repeat the question, please?

Filipe Rosa: On the competitive backdrop in the food business.

Filipe Rosa: Okay. Whether have you seen any changes because there are like the economy is quite supportive?

Rui Almeida: No, no, no. We have facing the same situation that we were facing in last year. The competitiveness of this market is being basically the same. In fact, for instance in terms of promotional activity, promotional activity increased slightly by almost 1.0 percentage points, and we are basically seeing same situation this first quarter of this year similar to the situation the last quarter of 2018 is pretty much the same.

Operator: We will now take our next question.

José Rito: I got some follow-up questions on Filipe's main points. So first, on the debt evolution, João Dolores just mentioned that decline on a comparable basis by €90 M in Q1. And the company is not seeing any change that should lead to any different evolution going forward. But the fact is that the seasonality in food and holding in Q1 was a little bit stronger than usual, and I think it was related to the Easter. So, my first question is this up until April, this seasonality because of the Easter has smooth. So that will be my first question.

Second also on this net debt evolution. It shows that the €90 M is a reference, but before you had no consolidation or contribution from Sierra. Now you are consolidating Sierra and Sierra also increased €100 M net debt versus the year-end. So, should this €90 M be a reference going forward now that Sierra is included or could eventually Sierra leads some additional seasonality going forward? Then on food final question also on the margin side. It was slightly up in Q1. Was this due to lower promotions due to the fact that we had no Easter in the quarter? How do you see this evolving? And also, if Arenal is accretive on margins? I know this is a small operation, but just to understand if this is accretive for the business margins?

João Dolores: Okay, José, thank you. On the debt question, as you said, it's normal for this time of the year, to have some seasonality in terms of working capital management, that is the case also this year. This year, we had slightly higher impact in terms of seasonality also because of a lower level of sales at Worten, which also play a role but we expect this to normalize in the future. Sonae Sierra also had an impact obviously with the first time in the first quarter, in which we consolidate Sonae Sierra net debt. And here, we have also some typical behaviour of debt at this time of year, driven by distribution of the dividends to the partners we have at the funds at our asset level. And this year, in particular, also due to the efforts done in a number of our development projects, namely expansions of our current shopping centres. But I think those are the main drivers explaining the deviations that you mentioned. Now I will hand over to Rui.

Rui Almeida: Thank you for your questions. Yes, Arenal is accretive in terms of our margins. And again, as you said, you are totally right. First quarter of this year is little bit, is not typical, as we were suffering, in terms of sales, we were not having the same calendar effect that we had last year. In terms of sales that impacted obviously the margins. But, again, margins are being kept at the level that we were having in last year and evolving accordingly with sales.

José Rito: Okay. So just a follow up on the net debt for us to forecast the evolution in Sierra. It was slightly more than €100 M in full year '18, the net debt that the company reported. How will this evolving be going forward? So, it increased in Q1. Should we assume that it will maintain roughly stable when you compared with 2018? Or what should be our expectation for this business going forward? And then also.

João Dolores: Yes, go ahead, go ahead.

José Rito: And then in terms of margins, so, what you are saying that, for instance, in Q2 because you have the Easter eventually, the margin evolution y.o.y could even be slightly higher than it was in Q1. Because I remember that last year, it increased slightly in Q1 and that was not the case in Q2. So theoretically, eventually, the comparable will be a little bit easier for the food for Sonae MC in Q2? Just to clarify this.

João Dolores: Okay. It's a bit hard to give you guidance on the net debt for Sonae Sierra given the momentum that Sonae Sierra is living in terms of its strategy execution, namely given the number of acquisitions that the company has done, also a number of development projects that are underway, and also the capital recycling strategy that has been implemented by the business.

So there is a number of factors that will probably significantly influence Sonae Sierra's net debt going forward. What I can tell you that on a like-for-like basis, yes, there is some seasonality at Sonae Sierra's as well, and we would expect this seasonality to play a role, particularly in the first quarter.

Rui Almeida: Regarding margins in the second quarter, as I said while ago to Filipe, the market is being a little bit more aggressive in terms of promotional activity. Yes, first of all, we need to consider that.

We are in May, too soon to give you some guidance for the second quarter, but we are very confident to maintain margins and continue to grow because we are focused in continuing to grow market share in our sales and keeping the margins at the same level that we were having last year.

Operator: There are no further questions coming through on the line, sir.

João Dolores: Okay. Thank you very much everyone and looking forward to talking to you again for the Q2 results.

Operator: Thank you. Now this concludes this webcast for today. Thank you all for participating. You may all disconnect.

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