Local Conference Call

Vulcabras Azaleia

4Q18 Earnings Results

March 12, 2019

Operator: Good morning and thank you for standing by. Welcome to the conference call of Vulcabras Azaleia to disclose the results of 4Q 18. Today here with us we have Pedro Bartelle, CEO and IRO; Mr. Andre Camargo Bartelle, member of the Board of Directors; Mr. Wagner Dantas, CFO and our team of IR, Mr. Valdinei Tortorelli and Ms. Leticia Marcellino Carvalho.

This conference call is being recorded and all participants will be collected in listen only mode during the company's presentation. Then we are going to start the question-and-answer session when further instructions will be provided. Should any of you need any assistance during this conference call please request the help of an operator by pressing star zero.

This conference call is also being simultaneously transmitted on the Internet via webcast at the www.vulcabrasazaleiari.com.br , where you can find the slide pack. The selection of slides will be controlled by you. A replay of this conference call will be available right after it is ended. As a reminder the participants of the webcast may ask questions to Vulcabras Azaleia that will be answered after the end of the conference call by the Investor Relations Department.

Before continuing we would like to clarify that statements made during this conference call relative to Vulcabras Azaleia business prospects, operational and financial projections and goals are beliefs and assumptions of the company's management and are based on information currently available to Vulcabras Azaleia. Forward-looking statements are not guarantees of performance because they involve risks, uncertainties and assumptions because they refer to future events and therefore depend on circumstances that may or may not occur.

Investors and analysts should understand that general economic conditions, industry conditions and other operating factors may affect the future performance of Vulcabras Azaleia and may lead to results that will be materially different from those expressed in such forward-looking statements.

Now I would like to turn the conference over to Mr. Pedro Bartelle, CEO and IRO of the company, who is going to start the presentation. Please Mr. Bartelle, you can continue.

Mr. Pedro Bartelle: good morning. Thank you and welcome to the results audio conference of Vulcabras Azaleia.

2018 brought many difficulties, but also brought the beginning of a significant partnership for the future of Vulcabras Azaleia. This is the first quarter in which numbers from the Under Armor operation in Brazil are consolidated. We expect this operation to bring us positive results as early as 2019 and we have good expectations about future results.

With the Under Armor brand, renowned for its high technology and innovation, we established an operation in the premium segment of the sports market as from October 2018, increasing our share in this market in an organic manner.

As part of the agreement, we are creating and developing together with Under Armor, specific products for the Brazilian market, the production of which started in the first quarter of 2019 while sales will begin in the second quarter of 2019.

The fourth quarter of 2018 maintained the trend for improvement although it was modest in terms of retail sales. Numbers for the year, however, still reflect the negative effects of atypical events that have substantially affected the economy and consequently the Company's performance.

In the Athletic footwear segment, competition for consumer loyalty has been driven by the growth in imports throughout the year. In the meantime, the Company's sales picked up again at the beginning of the second six-month period, was consolidated this movement in the last period of the year with positive data on Athletic footwear, women's footwear and apparel.

Abroad, the performance of the Peruvian and Colombian subsidiaries was positive but the economic crisis in Argentina, the main export market, caused a sharp reduction in foreign market revenue, further affecting the Athletic footwear category.

Throughout 4Q18, we staged significant marketing activities for each brand. Olympikus intensified its communication in the consolidation of its running shoe platform, in the launch of new technologies and the Kids line with broad exposure on TV, social networks and points of sale.

Under Armor emphasized its high-performance characteristics in a national training competition and films featuring Brazilian athletes as part of the `Will Finds a Way´ global campaign.

Highlighting lifestyle sneakers such as the `chunky sneakers´, Azaleia continued with versatile fashion communication on digital channels, focused on its e-commerce.

The manufacturing plant´s modernization plan was still in progress in 4Q18, and R$ 17.1 million was invested, in a project intends to increase the productivity and efficiency of industrial plants. It is important to stress that the plants are ready for the production of Under Armor sneakers.

We closed 2018 with certain that we have overcome many challenges and have taken important steps, such as the acquisition of the Under Armor brand, which will allow us to expand our business.

We remain attentive to new business opportunities to continue to grow and create value for our shareholders.

We are ready for a new cycle of Company achievements.

For the presentation of our numbers and performance in the quarter I would like to pass the floor to Mr. Andre Bartelle.

Mr. Andre Bartelle: good morning everyone. We start the presentation here with slight five, gross volume of pairs and items.

In 4Q18, the gross amount billed totaled 7.2 million pairs/pieces, an increase of 21.9% compared to the 4Q17 total of 5.9 million pairs/pieces.

The variation in the period is due to the growth in footwear and sportswear, mainly in the domestic market, driven by the beginning of sales of products under the Under Armor brand, which became part of the Company's portfolio in that quarter and complemented sales of Olympikus shoes.

The Women's footwear also showed growth in all markets. The growth in the domestic market was partially overshadowed by the significant fall in foreign sales of Athletic footwear.

In 2018, gross volume totaled 25 million pairs/ pieces, an increase of 2.4% compared to the volume for 2017, which was 24.4 million pairs/ pieces.

The variation presented in 2018 was mainly due to the following factors:

(i) the decrease in Athletic footwear in the domestic and foreign markets, due to the increase of imports and the challenging business environment in Argentina;
(ii) the expansion of Women's footwear, mainly driven by the performance of the domestic market, due to the launch of new products, among them, women's sneakers under the Azaleia brand;
(iii) decrease in Other footwear and other articles due to the fall in shoe component sales to Argentina; and (iv) increase in apparel, mostly due to the beginning of Under Armor brand sales.

In the page 6 we present the net revenue by category of products.

The improvement in retail sales of footwear in the domestic market, observed since the beginning of the second six-month period of the year, was maintained during the fourth quarter. Order intake remained at a satisfactory pace, allowing the order backlog to remain at the appropriate level for full plant operating capacity, and consequent optimization of production.

The Athletic footwear market remained extremely competitive due to the discount activities taken by some competitors, which negatively affected the sales performance of the Olympikus products mainly in the bands at the top of the price pyramid, leading to a reduction in the average price.

In 4Q18, net revenue was R$ 354.0 million, an increase of 12.5% over the R$ 314.6 million recorded in 4Q17. Athletic footwear revenue increased by 6.0%, mainly due to the start-up of sales under the Under Armor brand. Olympikus revenue remained stable in the domestic market and continued to face many challenges in sales abroad, caused mainly by the Argentine economic situation.

The category of Women's footwear presented an expressive growth of 19.3% in relation to the same period of the prior year, obtaining a positive performance in all the markets of operation. Apparel and Accessories showed strong growth, also influenced by the start of sales of the Under Armour brand, increasing 171.8% in relation to 4Q17.

In Other footwear and other articles there was growth of 7.8% in revenue on a year-on-year basis.

In 2018, net revenue was R$ 1,249 million, a decrease of 1.1% over the R$ 1,263.1 million recorded in 2017. Athletic footwear revenue fell 4.8%, influenced both by the fall in the domestic market, due to the weak consumption coupled with increased competition, as well as the decrease in sales to the foreign market, a result which is mostly due to the economic difficulties faced by Argentina, which is the main export market.

The Women's footwear category increased 7.5% year-on-year, achieving a positive performance in all markets of operation particularly from the third quarter of the year, when the new product collections began to showcase new Company trends for this segment.

Apparel and Accessories showed remarkable growth, with an increase of 80.1% year-on-year.

In Other footwear and other articles there was growth of 1.9% in revenue year-on-year.

On page 7 we present the net revenue by markets.

Net revenue in the domestic market totaled R$ 324.0 million in 4Q18, an increase of 12,9 million… sorry, 12.9% compared to 4Q17 when net revenue was R$ 287.0 million.

In the foreign market, net revenue in 4Q18 reached R$ 30.0 million, an increase of 8.7% over the R$ 27.6 million recorded in 4Q17.

In direct sales to third parties in the foreign market, despite the fact that the share is not very significant, there was a marked decrease in revenue in 4Q18 year-on-year, especially in Olympikus shoes. The economic crisis in Argentina, the main Athletic footwear export market, resulted in a reduction in consumption and led to a decrease in revenues for that market.

On the other hand, the sales of the subsidiaries in Peru and Colombia increased in 4Q18, not only in terms of volume but also in terms of revenue, more than offsetting the negative effect of the Argentine market.

Moving on to page 8 we have the presentation of gross profit.

Gross profit for 4Q18 was R$ 133.7 million, an increase of 11.7% compared to R$ 119.7 million recorded in 4Q17. The gross margin was 37.8% in 4Q18, down 0.2 p.p. from 38.0% in 4Q17.

Gross margin in 4Q18 maintained its trend for recovery observed as from the prior quarter.

In 4Q18, a fall in the average price of Athletic footwear was also observed, due to the change in the sales mix, due to fiercer market competition, which was partially offset by the improvement in the profitability of Women's footwear, which continues its trend for recovery.

In 2018, gross profit was R$ 448.6 million, a reduction of 7% on the R$ 482.4 million obtained in 2017. The margin for 2018 was 35.9%, 2.3 p.p. lower than that obtained in 2017, equivalent to 38.2%.

The main factors that influenced the gross margin in 2018 were: (i) a fall in production caused by the forced plant shutdown in June due to the truck drivers´ strike; (ii) cost pressure due to the rise in the US Dollar; (iii) decrease in the average price of Athletic footwear, as a consequence of the change in the sales mix due to increased competition in the market; this was partially offset by the productive and technological advances as a result of the modernization plan for industrial plants.

On page 9 we present the behavior of selling expenses and advertising and marketing expenses.

On the top of the slide we have the selling expenses who increased by 13.2% in 4Q18, compared to 4Q17. R$ 39.4 million was recorded in 4Q18, against R$ 34.8 million in the same period of the prior year.

In 4Q18, advertising and marketing expenses amounted to R$ 19.2 million, a increase of 54.8% over the R$ 12.4 million in 4Q17.

During the course of 4Q18, the Company maintained its strategy of intensifying its marketing investment and reinforcing point of sale material. Throughout that quarter, the Olympikus brand campaign was launched with commercials on pay-TV channels FOX, SPORTV, GNT and MULTISHOW, on social medias and billboards in major cities. Furthermore, in 4Q18, as a result of the acquisition of Under Armor Brazil, the Company started to consolidate the marketing expenses of the brand.

The share of advertising and marketing expenses over net revenue increased by 1.5 p.p. comparing 4Q18 to 4Q17.

In 2018, expenses totaled R$ 59.0 million, an increase of 20.9% compared with 2017, when expenses totaled R$ 48.8 million. Faced with a challenging market scenario and increased competition for consumer loyalty, the Company has chosen to intensify its marketing investment and strengthen point-of-sale material. As of 4Q18, as a result of the acquisition of Under Armor Brazil, the Company started to consolidate its marketing expenses with the brand.

In the year to date, there was a 0.8 p.p. increase in the share of advertising and marketing expenses over net revenue, reaching 4.7% in 2018, compared to 3.9% in 2017. Although the advertising and marketing expenses has an expressive growth, it is not expected that 2019 expenses would be significantly higher than 2018.

In 4Q18, as a result of the acquisition of Under Armor Brazil, the Company started to consolidate the selling expenses of the brand's operations. In addition to sales to retailers, there is also a retail operation consisting of seven exclusive stores of the brand and an e-commerce channel.

Freight expenses continued the upward trend due to the new legislation in the sector, but the impact was softened in that quarter by the adjustment of provisions in December. As a share of revenue, freight expenses represented 3.8% in 4Q18, compared to 3.4% in 4Q17, an increase of 0.4 p.p.. If it were not for the adjustment of provisions mentioned just now, freight expenses would be in percentage of revenue similar to that in 3Q, that is, higher than we were in this quarter.

In 2018, the increase amounted to 2.7%, rising from R$ 133.0 million in 2017 to R$ 136.6 million in 2018.

In that year, there was an increase in market share of 0.4 p.p., reaching 10.9%, compared to 10.5% in the same period of 2017. The main factors for this increase were: (i) increase in freight expenses, as previously stated, due to the new legislation; (ii) start of Under Armor brand operations, beginning in 4Q18, with personnel expenses from the 7 stores and e-commerce channel.

On at the bottom of the page we have lists of advertising and marketing expenses who in 4Q18, amounted to R$ 19.2 million, a increase of 54.8% over the R$ 12.4 million in 4Q17.

The share of advertising and marketing expenses over net revenue increased by 1.5 p.p. comparing 4Q18 to 4Q17.

In 2018, expenses totaled R$ 59.0 million, an increase of 20.9% compared with 2017, when expenses totaled R$ 48.8 million.

In the year to date, there was a 0.8 p.p. increase in the share of advertising and marketing expenses over net revenue, reaching 4.7% in 2018, compared to 3.9% in 2017.

Although the advertising and marketing expenses have an expressive growth, it is not expected that 2019 expenses would be significantly higher than 2018 on the percentage of revenue.

Moving on to page 10 we have the presentation of general and administrative expenses.

Administrative expenses were R$ 31.9 million in 4Q18, an increase of 62.8% compared to R$ 19.6 million in 4Q17. As a percentage of net revenue, there was an increase of 2.8 p.p., from 6.2% in 4Q17 to 9.0%. The main variations were under the categories of third-party services and rent, mainly due to the consolidation of the expenses of the Under Armor operation.

In the fourth quarter of 2018, there was a recognition of R$ 5.0 million in "non-recurring" expenses, due to the process of corporate restructuring for the incorporation of Under Armor Brazil, of which R$ 0.9 million represented personnel and restructuring expenses and R$ 4.1 million in other expenses due to the "write-off" for goodwill adjustment purposes for Under Armor Brazil stores, the latter without cash effect.

In 2018, as compared to the same period in 2017, there was an increase of 18.1% in general and administrative expenses, from R$ 77.2 million to R$ 91.2 million. When comparing the percentage over net revenue, there is growth of 1.2 p.p. in 2018 year-on-year. The increase in administrative expenses in the course of 2018 was mainly due to the increase in third-party services and rent expenses and the "write-off" for goodwill adjustment purposes for Under Armor Brazil stores, mainly because of the consolidation of the Under Armor Brazil operation as of 4Q18.

On page 11 is shown the behavior of the financial results and net debt.

Net financial income in 4Q18 amounted to an expense of R$ 6.9 million, a decrease of 37.3% year-on-year, when financial expenses amounted to R$ 11 million. The financial expense recorded in 4Q18 is mainly due to the foreign exchange variation, which occurred in the consolidation of the results of the subsidiaries in Peru and Colombia.

In 2018, net financial income represented a financial expense of R$ 6.2 million, an 87.5% decrease from the financial expenses of R$ 49.6 million recorded in 2017.

The reduction of the indebtedness observed throughout the year 2018 contributed to the reduction of the expenditure with interest paid and also resulted in a significant reduction in the cost of banking services.

On page 12 we have the net income and the adjusted ROIC.

Net income for 4Q18 amounted to R$ 46.2 million, an increase of 1.8% over the net income in 4Q17 of R$ 45.4 million. The net margin reached 13.1%, against 14.4% achieved in 4Q17.

In 4Q18, "non-recurring" revenue of R$ 13.6 million was recorded in "Other Net Operating Income (Expenses)", of the same nature as in 4Q17, with revenue of R$ 7 million. In both periods the result was obtained by the increase in Vulcabras Azaleia´s equity interest in the investee PARS Participações Ltda. In 4Q17, there was a 25% increase in equity interest to 33.3%, and in the 4Q18, it increased from 33.3% to 50.0%.

In the fourth quarter of 2018, there was recognition of R$ 5.0 million of "non-recurring" expenses, due to the corporate restructuring process for the incorporation of the newly acquired Under Armor Brazil, as already specified in the items above.

For analysis purposes only, when adjusting net income, excluding these "non-recurring" results, in 4Q18 the figure would have been R$ 37.6 million, with a net margin of 10.6%, as compared to the same adjusted result of 4Q17, which would have been R$ 38.4 million with a net margin of 12.2%.

Net margin was reduced by 2.8 percentage points, from 15.0% in 2017 to 12.2% in 2018. Net income for 2018 totaled R$ 152.1 million against R$ 188.9 million in 2017.

As a result of the adjustment of net income, excluding "non-recurring" results, in 2018 net income would have been R$ 146.3 million, with a net margin of 11.7%, against R$ 164.9 million with a net margin of 13.1% in 2017.

On page 13 we present the Ebitda, which was R$ 69.1 million in the 4Q18, a reduction of 1.8%, as opposed to the R$ 70.4 million obtained in 4Q17. EBITDA margin decreased 2.9 p.p., reaching 19.5% in 4Q18, compared to 22.4% in 4Q17.

Excluding non-recurring items, that is, non-recurring expenses of 5 million in revenue bargain purchase 13.6 million previously explained the result of 4Q EBITDA would be 60.5 million, with a net margin of 17.1%, compared to the similarly adjusted figure for 4Q17, which would have been R$ 63.4 million and margin net of 20.2%.

In 2018, EBITDA was R$ 218.0 million, a decrease of 26.5% over the R$ 296.5 million recorded in 2017. The EBITDA margin decreased by 6.0 p.p., reaching 17.5% in 2018.

Adjusting EBITDA to exclude "non-recurring" effects, the result for 2018 would have been R$ 212.2 million, with a net margin of 17.0%, compared with R$ 272.5 million, with net margin of 21.6%.

On page 14 we present the capex.

In 4Q18, R$ 17.1 million was invested in property, plant and equipment, particularly in connection with the industrial facilities heading, which grew 51.4% in relation to the same period in 2017. This is due to the continuity of the modernization project for plants.

Intangible assets in 4Q18 totaled R$ 0.7 million, an increase of R$ 0.4 million compared to 4Q17.

Because of the acquisition of Under Armor Brazil, in 4Q18 was additioned R$ 18.2 million in addition to Capex in the quarter..

In 2018, investment in property, plant and equipment totaled R$ 94.5 million, 53.2% higher than the R$ 61.7 million invested in 2017, without considering the increase in fixed assets obtained by the acquisition of Under Armor.

On page 15 we present cash flow.

Operating cash generation in 2018, resulted to EBITDA of R$ 218.0 million, was parcially applied in working capital increase, because higher "Trade Receivable", repayment of R$ 34.8 million of gross debt, acquisition of Under Armour Brazil and investments in property, plant and equipment and intangible assets of R$ 96.7 million, related to the modernization of plants.

So we finish our presentation and we would like to open for questions. Thank you.

Q&A Session

Operator: ladies and gentlemen we are now going to start our question-and-answer session. If you want to ask a question please press star one and if you want to take your question from the list please press star two.

Our first question comes from Ms. Helena Villari, Bradesco.

Ms. Elena Villari: Hi Guys Good morning and thank you for picking up the question. I just wanted to understand two points: First, I wanted to know if you are expecting to recognize some type of ICMS credit on PIS COFINS and if so, what would be the size and the expected consumption of it.

The second point I wanted to understand better the consumption of working capital, which was a little above what we had in our numbers. I just wanted to understand what impacted working capital and if it does, it's related to the purchase of Under Armor, thank you.

Mr. Andre: Hi Elena, André speaking, I'll answer the two questions. First with respect to working capital at Under Armor is related to this increase in working capital obviously, basically, mainly because we consolidated the revenues only from the 4Q, but we consolidated the entire working capital of the operation.

If you annualize the 4Q in terms of revenue and look at days of revenue you will see that about half the increase over last year can be explained simply by this annualization of numbers.

Otherwise, there was an increase in the effective term. We had already had this in Q3 as well, and we also had an increase in the term related to foreign operations, mainly in relation to Argentina, where we still have reasonable accounts receivable volume, but we no longer have any revenue since we grant deferrals to our customers in Argentina. This does not bring us any type of credit risk because they are insurance transactions, but in relation to the term and this had a reasonable effect within our accounts receivable.

With regard to PIS COFINS credit, we expect to account for part of these credits at some point. We have, due to the shareholding structure, the corporate structure of Vulcabras we have a set of large processes, there are more than eight processes, nine processes in total and each of them with different tempo.

We are beginning to see some of them already being tried and we are going to start accounting for something like this in the 1H. The values I would rather not open, because it makes a lot of difference the way you are calculating these values, you have credit less debt or if only the debt is considered; but we can already say that these values are higher than $ 100 million in a somewhat conservative expectation - but exactly the value people do not feel comfortable yet to pass the exact numbers.

Ms. Elena: It's great and if I may just do one more follow up: I just wanted to understand a little bit about what you said in the release saying that the freight expenses that increased were partially offset as a provision that you made some adjustments. I just wanted to understand what provision this is and just understand a little better, more details regarding that provision.

Mr. André: Actually we made a kind ... the freight is being accounted for by provision and according to the payment the provision is being lowered, and at the end of the year we had an excess of supply in front of the total freight that we had, so in fact the only thing is that our freight of the year as a whole value is correct. We had some excess provisioning that was made in previous quarters that was written off in Q4.

So basically our freight expense should be a little higher in Q4 if it were not this reversal of supply - but the 2018 data as a whole is adjusted.

Ms. Elena: I understand, it's great, thank you very much.

Operator: Excuse me, remembering that in order to ask a question just type star one, star one.

We are closed at this time the question and answer session. I would now like to turn the floor over to Mr Bartelle for the final remarks. Please, Mr. Pedro, you may proceed.

Mr. Pedro: Well, thank you all for attending this audio conference and we remain at your disposal to clarify in person through our IR team any other points and questions that may have remained outstanding. Good morning everyone.

Operator: The audio conference of Vulcabras Azaleia is closed. Thank you for your participation, have a good day and thank you for using Chorus Call.

Operator: We are now ending our Q&A session. I would like to turn the conference back over to Mr. Pedro Bartelle for his closing remarks. Please Mr. Bartelle.

Mr. Pedro Bartelle: Thank you. Well I would like to say that we are still going through an offer period. We want to improve our website and our publications and our new Investor Relations Department is available to answer any questions you may have. Please do not hesitate in contacting us, thank you all very much.

Operator The conference call of Vulcabras Azaleia has now ended. We thank you all for your participation, have a good day and thank you for using Chorus Call.