

Conference Call (English Transcription)

Vulcabras Azaleia

Earnings Release 1Q19

May 7th, 2019

Operator: Good morning and thank you for waiting. Welcome to the Vulcabras Azaleia conference call to discuss results for 1Q19. Present today with us are Pedro Bartelle, CEO and Investor Relations Officer of the company, Mr. André de Camargo Bartelle, member of the board of directors, Mr. Wagner Dantas, CFO and our Investor Relations team, Mr. Valdinei Tortorelli and Ms. Leticia Marcellino Carvalho.

We inform you that this event is being recorded and that all the participants will be only listening to the conference call during the presentation of Vulcabras Azaleia. Then we will start the Q&A session, when further instructions will be provided. If you need any assistance during the conference call, please request the assistance of an operator by entering a * zero.

This event is also being transmitted simultaneously through the internet, via the webcast, and can be accessed at www.vulcabrasazaleiari.com.br, where the respective presentation is available. The selection of the slides will be controlled by you. The replay of this event will be available soon after its closure. Please note that webcast participants will be able to register, via the website, questions for Vulcabras Azaleia, which will be answered after the end of the conference, by the IR area.

Before proceeding, we would like to clarify that any statements that may be made during this conference call regarding Vulcabras Azaleia's business prospects, projections, operating and financial goals, constitute beliefs and assumptions of the Company's Management, as well as information currently available for Vulcabras Azaleia. Future considerations are not performance guarantees and involve risks, uncertainties and assumptions as they relate to future events and therefore depend on circumstances that may or may not occur.

Investors and analysts should understand that general conditions, industry conditions and other operating factors may affect the future results of Vulcabras Azaleia and may lead to results that differ materially from those expressed in such future conditions.

I would now like to give the floor to Mr. Pedro Bartelle, CEO and Investor Relations Officer of the company, who will begin the presentation. Please, Mr. Pedro, you may proceed.

Mr. Pedro Bartelle: Good morning, welcome to the conference call of Vulcabras Azaleia. The rhythms of the Brazilian and Argentine economies

significantly influenced the company's result in 1Q19, especially in the sports segment.

In Brazil, many retailers had to maintain excess inventories existing at the end of 2018, which impacted, in particular, the month of January. The positive reaction came in March, but below the ideal. The foreign market, reflecting the Argentine crisis, exerted the main influence on Olympikus' results.

Total revenue, of R\$ 299.8 million, increased by 2.7% over 1Q18. The margin, however, was slightly lower, given the market situation.

Although the economic situation was not advantageous, the company is prepared to face any scenario.

We started selling shoes developed and produced in Brazil under Under Armor at the beginning of the 2Q. The third largest in the world and focused on technology, the brand counts on the operation of Vulcabras Azaleia and its knowledge of the Brazilian market to operate in this, which is one of the most relevant and complex countries in the athletic segment. This brand entered the company in the premium sports segment, with prices starting at R\$ 300.

Under Armor's communication has been based on presenting its state-of-the-art technology for high performance. In the 1Q, these aspects were emphasized when launching the new uniforms for the Sport Club of Recife and the Fluminense Football Club, in actions of engagement with the faithful fans. Also deepened the relationship with the public of the brand, in promotional actions of exchange of collection and the international women's day.

At the same time, Olympikus has gained more admiration from opinion leaders relating to lifestyle and running, and has launched collections that expose brand technologies to fitness and running categories.

Of note are the "collabs" with the brands À La Garçonne and ÀLG, which gain space in the physical stores of the brands and in the site of luxury products Farfetch. And the launch of Crew, the first own collection signed by the head of style of the company, Alexandre Herchcovitch, and which marks the expansion of the apparel and accessories division of Olympikus. Both releases have had quite a stir in the fashion world.

Azaleia, which is growing, has also focused its marketing efforts, involving social media and POS.

Our steps related in Under Armor, Olympikus and Azaleia remain firm. We have great materials, highly qualified expert teams and a lot of capacity to operate in this very peculiar market that is Brazil, where we are present in more than 12 thousand customers, as well as the e-commerces of each brand.

We remain committed to continue growing and creating value for our shareholders.

Now for the presentation of our performance in the quarter, I will give the floor to Mr. André Bartelle.

Mr. André Bartelle: Good morning. We started the presentation with slide 5, gross volume of pairs and pieces. In 1Q19, the gross volume invoiced totaled 5.9 million pairs / pieces, an increase of 5.7%, compared to the total of 1Q18, of 5.6 million pairs / pieces. The change in the period is mainly due to:

- i. drop in athletic footwear, mainly due to the decrease in sales to the external market, is partly offset by the addition of Under Armor footwear sales in the domestic market,
- ii. the increase in women's footwear,
- iii. growth in other footwear and others, despite the significant decrease in exports of parts of Argentine footwear, and
- iv. increase in apparel and accessories due to the expansion registered with the Olympikus brand, mainly due to the inclusion of new products in the portfolio, as well as the addition of Under Armor brand sales.

On page 06, we present the net revenue per product category. In 1Q19, net revenue was R\$ 299.8 million, an increase of 2.7% over the R\$ 292.0 million in 1Q18.

Athletic Footwear revenue decreased by 1.6% and was significantly impacted by the drop in the foreign market. In the domestic market, weak consumption and fierce competition in retailing have resulted in a reduction in the average price of Olympikus. Under Armor footwear revenue was not very significant this quarter as sales were made with the remainder of inventories obtained with the acquisition of Under Armor.

The category of Women's Footwear showed a reduction of 7.5% in relation to the same moment of the previous year. In the period, there was a drop in both domestic market revenue and foreign market revenue. Although there was an increase in volume sold, the fall in the average price practiced, due to the characteristics of the new collections, led to a decrease in revenue.

The Apparel and Accessories category showed strong growth, with 181.3% expansion compared to 1Q18 due to the increase in revenue with the Olympikus brand, and also by the addition of Under Armor brand revenues. The 'Other Footwear and Other' line remained stable, presenting the same 1Q18 revenue of R \$ 15.3 million.

On page 07, we present the opening of net revenue per market. Net sales in 1Q19 totaled R \$ 275.1 million, 8.0% more than in 1Q18, when revenue was R\$ 254.7 million. In the foreign market, net revenue in 1Q19 resulted in R \$ 24.7 million, a sharp decline of 33.8% over the R \$ 37.3 million registered in 2018.

In the domestic market, the growth is due to the increase in footwear and apparel revenues under the Under Armor brand, and also to the increase in

Olympikus apparel, both of which are overshadowed by the reductions in Olympikus footwear and women's footwear due to the average price reduction.

While domestic market growth of 8% has been good given market conditions, sales of Under Armor products produced in our factories are expected to boost our sales going forward. In direct sales to third parties in the foreign market, there was a significant decline in 1Q19 revenue compared to the same period last year, especially in Olympikus footwear and footwear pairs. The economic crisis in Argentina, the main destination of exports of sports shoes, resulted in the temporary interruption of business with that country. In other markets there was stability in revenue.

Going to page 08, we have the presentation of gross profit and gross margin. Gross profit for 1Q19 was R\$ 102.0 million, up 1.6% from R\$ 100.4 million in 1Q18. Gross margin was 34pp in 2019, down 0.4pp from 34.4% in 2018.

The difficulties faced in the domestic market throughout the whole of 1Q19 led to a reduction in the average price practiced, both in Athletic Footwear, due to the change in the sales mix caused by the greater competitiveness of the market, as well as in Women's Footwear, which continues in its restructuring process, with profound changes in the composition and variety of products offered.

The increase in the cost of the products produced, due to the increases in some raw materials, in addition to other production costs, eventually put pressure on margins, without any possibility of passing on sales prices, due to market conditions.

Going to page 09, we present the sales and advertising expenses. At the top of the slide are the graphs of sales expenses, which increased by 14.4% in 1Q19, over expenses presented in 2018. As a share of revenue, sales expenses represented 11.7 pp in 2019, compared to 10,5 pp in 2018, an increase of 1.2 pp. Sales expenses in the comparison of the two periods are justified as a result of the increase in personnel expenses, due to the consolidation of the Under Armor Brasil structure, as well as freight expenses, which maintained the upward trend, due to the new legislation of the sector. Increases in personnel and freight were partially offset by the reduction in commissions expenses, which represented 3.6 percentage points in 2019 versus 4.1% in 2018.

At the bottom of the slide are advertising and marketing expenses, which in 1Q19 were R\$ 12.0 million, an increase of 12.1% over R\$ 10.7 million in 2018. The share of advertising and marketing expenses on net revenue represented 4.0% in 2019 compared to 3.7% in 18, an increase of 0.2 pp

Under Armor, especially at the start of the operation, is expected to have marketing expenses higher than the company's average business. However, we do not expect significant increases in the percentage of marketing expenses over revenue compared to the previous year.

Going to page 10 we have the statement of General and Administrative expenses. Administrative expenses were R\$ 24.8 million in 1Q19, an increase

of 27.2% compared to R\$ 19.5 million in 1Q18. In percentage terms, there was an increase of 1.6 pp, from 6.7% in 1Q18 to 8.3% of revenue in 1Q19. The main variations were recorded under the following headings:

- (i) rents refers to the expenses of Under Armor condominiums and rents as a result of the addition of Under Armor's acquisition stores in Brazil and also to the new commercial office in São Paulo of Vulcabras;
- (ii) third-party services, mainly due to the logistical costs of the Under Armor operation, which should gradually decrease with the start of own footwear production and with the distribution being carried out by the factories.
- (iii) And also IT and Telecom, for the addition of Under Armor's IT expenses, especially for the cost of maintaining e-commerce software. In contrast to the aforementioned increases, there was a decrease in personnel expenses, the effect of the adjustment process that occurred after the integration of Under Armor operations.

Here, in order to comply with IFRS 16 CPC 06 - Leasing Operations, as from 01/01/2019, the lease expenses are recognized in the "amortization" account.

Page 11 shows the behavior of the financial result and the net debt. The net financial result in 1Q19 was an expense of R\$ 1.8 million, a reduction of 14.3% compared to the same period of 2018, an expense of R \$ 2.1 million. There was no material change in the financial result. During 1Q19, or better, at the close of 1Q19, gross debt totaled 52.2 million, a reduction of 13.0% compared to the balance of 12/31/2018. There was an increase in the availability of 59.8%, reaching a net cash position at the end of the period of R\$ 60.0 million.

On page 12 we have net income and Adjusted ROIC. Net income in 1Q was R\$ 26.2 million, representing a 21.6% reduction over 2018. Net margin reached 8.7% compared to 1Q18 of 11.4%, a reduction of 2.7 pp

Annualized adjusted ROIC reached 22.2% in 1Q19, with a 1.0 pp reduction on the result of 23.2% obtained at the close of 2018.

On page 13 we present EBITDA. EBITDA in 1Q19 was R \$ 47.1 million, down 5.4% compared to R \$ 49.8 million in 1Q18. The EBITDA margin decreased by 1.4 pp, reaching 15.7% in 1Q19, compared to 17.1% in 1Q18. Here, it is worth mentioning that, as previously stated, the adoption of IFRS 16 caused EBITDA to be positively impacted by R\$ 3.1 million due to the amortization of rental expenses.

On page 14, we present Capex, which in 1Q19 was R\$ 24.4 million, especially machinery and equipment and molds. This is due to the continuity of the modernization project of the plants. Intangible assets in 1Q19 were only R\$ 0.1 million.

On page 15 we present the cash flow. Cash flow in 1Q19 was R\$ 41.0 million, with EBITDA of 47.1 million, working capital improvement of R\$ 33.0 million, reduction in bank liabilities of R\$ 7.8 million and investments in property, plant

and equipment and intangible assets of R\$ 24.5 million. The decrease in accounts receivable was mainly due to a seasonal effect in 1Q.

So, we finish our presentation and open space for questions, thank you.

Q&A Session

Operator: ladies and gentlemen, we will now begin the question and answer session. To ask a question please type asterisk(*) one and to remove the question from the list type asterisk(*) two.

Our first question comes from Helena Villare, Bradesco.

Mrs. Helena Villare: Good morning, André, Pedro, thank you very much for taking my question. In fact I just wanted to have a little more visibility as the 2T is going in regards to orders and also understand a little better how has been the acceptance of Under Armor, if it is in line with the plan that you have, if it has even surpassed a little high expectations. I wanted to understand just how Under Armor's acceptance is now that you're already producing at the factory, thank you.

Mr. Pedro: Hi Helena, it's Pedro, thanks for your question. The 2Q has a little better than the first point we have already talked about, January was a very difficult month, some expectations of Christmas were not as expected and then January was a bad month, February stable, but it already started with a improvement. The expectation of 2Q is better. We have launched our new collections and have managed to keep the wallets satisfactorily. In addition, in the 2Q is one of us will start selling or delivering and invoicing the products of Under Armor produced in Brazil, which in the sell-in are within our expectations and the sell-out will begin as of this month. This month is the delivery month. It's the beginning of Under Armor, it's a brand new within Vulcabras Azaleia's portfolio of brands, it's a more expensive, more premium brand that will complete the product portfolio in a price range of R\$ 300 to R\$ 500 at first with national products. There are other releases to be made throughout the year, but at the beginning there are six models and our first evaluation and ordering has been within our expectation.

Ms. Helena: I understand, and if I may just ask one more question about Azaleia. I understood that the volume is actually growing, but the issue is the average price that is a bit lower. We had not seen it yet in the 3Q and 4Q when it was growing already; do you think that from the 2t now I will not so much see this effect? That is, I will already have the average price base a bit lower and I will start to have revenue growth?

Mr. Pedro: Well, Helena, I need to go back a little bit to explain why the average price dropped in Q1. We had problems with returns and order confirmations at the end of the year.

With the slowdown this happens a little in the market, I think that with us was a little stronger in the female sector and we ended up receiving some returns and had to do some negotiations, which decreased our price of this expectation that we came from growth, which was not confirmed in the last quarter by 100%.

This affected our price, but in the repositioning of the Azaleia brand and the women's sector we are focusing a lot on our specialties and industrial, which are production of EVA, slides, sandals, "papetes" and also making women's sneakers. Tennis shoes have a higher average price, the lower average price sandals - but they are simpler products, less manufactured, products that we expect to have better margins.

They are selling well, they are a part of growth, an important part of growth. The sneakers have come since last year, is a reality in the female market that did not work with sneakers. They are not sneakers, they are casual sneakers and this has also been helping to maintain Azaleia's product portfolio and growth.

Azaleia's plan has already come a long time from this restructuring. I think we had, we had this momentary problem that were these returns and renegotiations of old productions of the last quarter and from now on I think sales will be cleaner.

The average price should not increase much by the representativeness of the simpler footwear, but we expect to continue in the rhythm of restructuring of growth.

Mrs. Helena: Okay, fine, thank you very much.

Mr. Pedro: Thank you.

Operator: Excuse me, remembering that in order to ask questions just enter the asterisk (*) one, star one. Again, to ask a question please enter an asterisk (*).

We have now closed the question and answer session. I would like to turn the floor over to Mr. Pedro for the final considerations. Please, Mr. Pedro, you may proceed.

Mr. Pedro: Well, thank you all for the presence and we remain at your disposal to clarify in person or through our IR team any other points or doubts that may have been pending. Good morning everyone.

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