

Sonae 9M19 results - conference call transcript

Moderator: João Dolores

14 November 2019

3:00 p.m. GMT

Operator: Welcome to Sonae's first nine months 2019 results conference call. During the introduction hosted by Mr. João Dolores, Sonae's CFO, all participants will be in a listen-only mode. After the introduction, there'll be an opportunity to ask questions. If any participants have difficulty in hearing the conference at any time, please press the "star" followed by the "0" on your telephone for operator assistance.

I will now hand the conference over to Mr. João Dolores. Please go ahead, sir.

João Dolores: Hello. Good afternoon, everyone. Welcome and thank you for attending Sonae's results conference call for the third quarter of 2019. Together with me today, I have the CFO's of our businesses: Rui Almeida from Sonae MC, Paulo Simões from Worten, Miguel Moreira from Sonae Fashion, Luís Mota Duarte from Sonae Sierra, and also our investor relations team. I will start by giving you the performance highlights for each individual business, and then I will cover Sonae's consolidated figures for the quarter before opening up to Q&A.

Starting with **Sonae MC**, Sonae MC maintained a very positive performance with strong top line growth which equates to market share gains once again and sustained its level of profitability. In the quarter, turnover grew 9% year-on-year with a like for like of 2.4% despite the (food deflation) in Q3. In year-to-date terms, growth stood at 9.5% year-on-year, reaching €3.4 billion with a like for like of 3.4%. So strong growth levels once again on the back of a clear value proposition which is increasingly valued by our customers.

The company continued its expansion path and opened 58 new company operative stores since the beginning of the year, including 9 stores of our proximity format Continente Bom Dia, and also 3 Arenal stores, thus expanding our health and wellness network in Spain.

In terms of profitability, Sonae MC's underlying EBTIDA margin remains stable and reached €340 million in the first nine months of the year. I would also like to highlight Sonae MC's working capital management and cash flow generation which was a main driver behind Sonae's net debt evolution. Sonae MC generated an additional €196 million in cash flow in the first nine months of the year when compared to 2018.

Moving on to **Worten**, Worten reached €744 million of turnover in the first nine months of the year with retail sales in Portugal and the Canary Islands with positive performances despite the negative evolution of seasonal categories in August, mostly due to the unusual low temperatures in Iberia. In Spain mainland, as already stated last quarter, we have taken the decision to adjust our operation, and as planned 9 loss-making stores were closed in Q3, and two additional ones already in November. We expect an improvement in performance in this geography in the coming quarter.

Already in Q4, it's worthwhile mentioning that Worten reached an agreement to acquire 100% of the share capital of iServices, a leading smartphone repair company operating in Portugal to a network of 15 stores. This transaction, which is still subject to antitrust approval, will reinforce Worten's capabilities in its services offering and contributes to strengthen its customer experience and omnichannel value proposition.

Sonae Fashion continues to show up positive operational performance, turnover increased 4.2% in Q3 and 3.8% in the first nine months of the year. This was supported by a strong omnichannel like for like growth, 8% in total in the first nine months, which means that the business achieved an increase in market share in Iberia for the fifth consecutive quarter. I would like to mention the strong growth rates that all our fashion banners have been achieving in the ecommerce front, namely MO and Zippy which have registered 45% and 62% rates of growth respectively recently. Concerning underlying EBITDA, Sonae Fashion increased its level of EBITDA by €1.1 million in the quarter and €3.4 million up to September, reaching a margin of 7.9% versus 7% in the first nine months of last year.

Moving on to **ISRG**, we continue to be quite pleased with the performance of this joint venture in sports retail. Total sales of ISRG maintained a double-digit growth rate in the quarter, and this was achieved despite the ongoing refurbishment of Sport Zone stores. In the first nine months of the year, turnover increased by 15.5% year-on-year, surpassing €500 million in total turnover. EBITDA also improved significantly with a margin doubling versus last year from 4.6% to 9.2% this year with positive evolutions from all brands. All in all, equity method results included in Sonae's accounts in the first nine months of the year

stood €10 million above last year at €7 million, and our outlook for this business continues to be quite positive for the next few quarters.

Regarding **financial services**, it remains a growing business both in operational and financial terms. Turnover increased 18% year-on-year to €27 million, and underlying EBITDA was up by €2.4 million, which corresponds to a margin of 24%. The Universo credit card has already surpassed 820,000 users with a reinforced market share of total credit card production of 12.6% at the end of September.

Regarding **Sonae Investment Management**, during the first nine months of the year, the company has invested in six new ventures, three of which at seed stage and also this year in alignment with its active portfolio management strategy, Sonae IM sold 100% of Saphety shares to members of its management team and also in Q3 it sold 100% of WeDo shares to Mobileum Inc. Both transactions generated important capital gains for Sonae, and at the end of September, Sonae IM had €119 million of cash invested in respective portfolio which is now composed of 30 companies and the participation in two investment funds. It has a track record of 4 exits that has resulted in a total of €140 million in terms of cash inflow and quite attractive returns on investment.

Looking at **Sonae Sierra** now, Sierra continues to register solid operational performance both in terms of tenant sales and also in terms of rents and also a good performance of its services division. Direct results in the nine months was stable versus last year despite the sales of assets which occurred in the last 12 months. Indirect results in Q3 amounted to a negative €10 million, and this was mainly a reflection of secondary asset revaluations and also accounting impacts from the merger in Brazil with Aliansce. I will say that this is a conservative approach of the valuation of our assets, and we see valuation upside in both our core assets and also in Brazil.

Regarding Brazil, I would like to highlight the very positive reaction of capital markets in the merger. The market cap of the combined entity has more than doubled since the announcement of the merger. And the first signs of the integration process gave us even more confidence that the valuation creation's potential that was identified will be materialized in the coming months. Looking at capital recycling, Sierra concluded in Q3 the sales of its stakes in 3 assets, Algarveshopping Albufeira Retail Park and Alexa generating total proceeds of €45 million in the quarter.

Regarding **NOS**, as you know NOS has already published its Q3 results with operating revenues increasing by 2.1% year-on-year to €403 million driven by a solid telco

performance and also by a strong growth in audiovisuals and cinemas. EBITDA increased by 3.4% above the pace of revenue growth totaling €173 million and leading to a margin increase to 43%. Net income increased 5.7% year-on-year in the quarter and 10.4% in year-to-date terms therefore showing an increasing contribution to Sonae's results.

Finally, looking at our **consolidated figures**, Sonae maintained overall a solid performance in the third quarter underpinned by positive contributions from practically all the businesses in the portfolio. Consolidated turnover increased by 9% year-on-year in Q3 to €1.7 billion. And EBITDA increased 41% to €106 million driven by the positive contributions of fully consolidated businesses with underlying EBITDA increasing 21% year-on-year in Q3 but also by the high contributions of equity method consolidating businesses, namely ISRG and NOS. And also by capital gains on assets sales in particular WeDo disposal by Sonae Investment management. All in all, net income group share more than doubled in Q3 to €50 million and RoIC stood at 9.8% very close to our long-term target of 10%.

Our capital structure remained solid with net debt decreasing €20 million year-on-year and €113 million on a comparable basis to €1.5 billion at the end of Q3. Cost of debt and maturity profiles also remain at a very comfortable level. And all the companies in the portfolio maintained conservative balance sheets. Sonae MC posted a 1.9 times financial net debt to underlying EBITDA level. NOS registered a financial net debt to EBITDA also of 1.9 times. Sonae Sierra's LTV decreased to 28% and the holding LTV stood at 14%. So I think this evolution demonstrates the group's cash flow generation ability once again despite the strong level of investments that we continue to deploy to constantly improve our value propositions and the experience of our customers.

Overall, we remain confident in the ability of our businesses to continue to outperform their respected markets. And we expect to reach the end of the year with at least the same level of performance than in the first nine months. I will now end this brief overview of our Q3 results and invite you to ask questions. You can please open the **session for Q&A**.

Operator: Thank you. If you wish to ask a question, please press "star" and "1" on your telephone keypad and wait for the automated message (inaudible) your line is open. Please then state your first and last name before you ask your question. If you wish to cancel your request, please press "star" and "2."

Once again, please press “star” and “1” if you wish to ask a question and “star” and “2.” to cancel that request. We will now take our first question. Please go ahead. Your line is now open.

João Pinto: Hi. Good afternoon, everyone. João Pinto from JB Capital Markets. Thanks for taking my questions. The first one on food retail, could you tell us, what was the basket inflation in the quarter? Also in food retail, your like-for-like was higher versus your main competitor, and your top line growth has been higher than the increase of food and beverage retail sales in Portugal. Based on your estimates, can you confirm that you have accelerated market share gains this quarter versus the previous quarter? My third question on this news today in the Portuguese press saying that Sonae is analysing the new REITs regime in Portugal, could you please give us some color about the interest that you’re seeing for commercial real estate in Portugal? I mean, do you feel that there is interest for your assets at your NAV levels? And finally, if you could give us some details on Worten’s acquisition such as the economics of the new business and the amount of the transaction would be great. Thank you.

João Dolores: Hello. Sorry, apologies for this technical glitch. I hope you all can hear it now. And we had a couple of questions from João Pinto from JB Capital Markets. A couple on food retail and then one on the REIT regime and then one on the acquisition made by Worten in the last few days or agreed by Worten in the last few days. So, I will ask Rui, Luís and Paulo to cover the three blocks of questions again.

Rui Almeida: OK, hi. Going back to – well, I will try to summarize the questions, regarding the inflation rate in our basket at Sonae MC in the third quarter was slightly negative by minus 10 basis points in the third quarter in our basket. Regarding the growth in terms of market share, accordingly also to the information we got from the Portuguese National Institute of Statistics, we increased our market share about 40 basis points, from the information we got from ourselves and the information we got from this site. We increased our market share. So now I will pass the speaker to Mota Duarte.

Luís Mota Duarte: Hi, Luís Mota Duarte from Sonae Sierra. Taking your question on the current REIT regime and on the valuation of our assets. So in terms on the actual REIT regime in Portugal, and we welcome the introduction of it so we see the strong support of the Portuguese real estate market which will drive further visibility and liquidity which is a positive for all investors and players in the sector.

From a Sierra point of view, we are actively assessing this opportunity as we believe that we are uniquely positioned to create vehicles which combines high cash yielding assets with a strong track record, but we also believe that our domestic and international track records put us in a position where we can combine international investors and Portuguese investors in Portuguese listed vehicles. The answer to your question whether we think we can place the assets at the yields at which we are currently valuing them, the answer is of course, I mean, that's our role to value the assets at their market value. So that's why it should reflect that.

Paulo Simões: OK, João, thank you for your question regarding iServices. iServices is a small company that is very good at repairing mobile phones as its main business. And this acquisition is very important for Worten because it will allow us to accelerate the execution of our strategy to expand our services area and improve customer experience related to these services in Worten. The company has 15 stores in Portugal, 11 in Porto and Lisbon metropolitan areas. And the investment was immaterial when compared to Worten's size. So, it's a small company.

João Pinto: Thank you everyone. Just to follow up on the market share Rui, these 40 basis points was during the third quarter and can you tell me how much was year to date? Thank you

Rui Almeida: Thirty basis points.

João Pinto: Thank you very much.

Rui Almeida: On a year to date basis, 30 basis points.

João Pinto: Thank you.

Operator: We will now take our next question. Please go ahead, the line is now open.

Artur Amaro: Hi, good afternoon. I have three questions if I may. One of them is related with the average basket size of Sonae MC, if possible to know, to have an idea. The other one if related with Arenal, if I'm correct, I heard that you opened three stores during the quarter, or was it on the nine months? And just to have an idea, what can we expect for the coming years in terms of stores expansion regarding Arenal. And finally, I heard the CFO commenting on the press that the minimum wage increase could have a significant impact. The question is, what was the assumption that you were working for next year? Is this figure above what you expected for the coming year? And that's it, thank you.

- João Dolores: Thank you Artur. I will take the last question and then I will hand it over to Rui to take the questions on MC. Just a quick – a slight correction, I didn't say that it would have a significant impact, I said that it was a significant increase in the minimum wage, which is slightly different. In terms of the impact on our top base, it will have a slight impact which we expect to be able to fully accommodate with productivity and efficiency gains. So, at the end of the day, we do not expect the material impact of this measure in our overall profitability level.
- Rui Almeida: Well regarding the questions you raised, well, it's very difficult to give you a figure because in our portfolio we have several assets, from Bagga to Continente stores. The average basket size of each asset is so different, that give you an average basket for the entire portfolio of assets is something that doesn't have any meant. So you need to understand that comparing, for instance, proximity stores to one-stop shop stores and to cafeterias and to pharmacies it doesn't make much sense, to compare anything, to give you a figure in terms of average basket size. So, I would prefer not to give you an average figure from our portfolio of assets. If you don't mind.
- Artur Amaro: OK, point taken.
- Rui Almeida: In terms of Arenal expansion of Arenal. We feel that we will be able to conclude this year with more three stores until the end of this year. We are working very hard to in 2019 with 3 more stores comparing to the stores that we are having today.
- Artur Amaro: OK. Thank you, very much, for the three.
- Operator: Thank you. We will now take our next question. Please go ahead. Your line is now open.
- António Seladas: Hi. Just one question related with Sonae Sierra. The performance of Sonae Sierra over the third quarter, if you can explain more, add more color? And if we would expect more of this in the coming future? Thank you.
- Luís Mota Duarte: Sure, it can be a long answer. But basically, in short, operational we have businesses performing very well which recorded good like for like in terms of sales but also in rents growth as João said. And we have been witnessing good dynamics in our portfolio, so we don't expect that to change. I suspect you're also wondering about the indirect results in terms the asset evaluation. In short, the negative 10 million that you're seeing in our proportional indirect results is a reflection of asset reevaluation, which I will explain in a

second, but also a conservative merge accounting of Brazilian merger. I mean if you think about the Brazilian merger it was completed in August, in the first week of August. It's a complex merger, we're talking about the largest shopping center of Brazil and we're talking about the business with 2 billion of market cap, €2 billion. And from an accounting point of view we account for all of our assets at fair market value. Unfortunately, the combined entity, Aliansce Sonae, does not account at fair market value and therefore we have decided to take conservative approach to valuation on the Brazilian side. Which therefore means that assets, the Brazilian assets in our accounts do not reflect the synergies that we're expecting to achieve. But also do not fully reflect the dynamics that we're currently witnessing in Brazil in terms of yield compression, liquidity significantly rising and overall generally favorable capital market. Even operationally the business is doing very well even announced results today as well with a very strong performance. So, from a valuations point of view, I think we overall are very conservative in Brazil but given the nature and the stage of the merger we believe that our approach is appropriate and consistent with our practices. I would just like to point out at the reference point that the average share price of Sonae Sierra Brasil in 2018 was around 22 Brazilian Real and today Aliansce Sonae is trading at 40, 41 Brazilian Real. In term of the European portfolio and by way of context we are, as mentioned before, we are seeing some yield expansion mainly in the secondary assets and tertiary assets particularly in countries like Italy and Spain and as a result of this dynamic we have once historically with valued assets on a semi-annual basis only, this is the first quarter in which we have valued or introduced the concept of valuing the assets on a quarterly basis. As this is a gradual process, we did value a large part of our portfolio but not all of the assets. We have not valued the core assets which have the most significant gain, and which do not see this yield expansion potential that I mentioned before, and therefore the results are biased towards the negative in terms of valuations. We expect that to be normalize in the next quarter. Having said this in one important message is that our house view, and is a quite firm house view, is that the yield expansion that we are witnessing right now is purely driven by the Anglo-Saxon sentiments and not a reflection of the performance or the long-term outlook of our portfolio. I can give you two reference points to support that. One, as I mentioned, our portfolio operationally is consistently doing well across all the different regions. But also despite this performance the premium between shopping centre yield and the risk free rate beats any historic levels and excesses by any measures. A long answer for a short but important question.

António Seladas: OK. Thank you, very much.

Operator: As a reminder, ladies and gentlemen, it's "star" and "1" if you wish to ask a question. That's "star" and "1" to ask a question. We have another question. We will now take the next question. Please go ahead caller. Your line is now open.

José Rito: Hi, good afternoon. José Rito from Caixabank BPI. I have two questions on Sonae MC, so basically this should be the second year in which the like for like is close to 3%. How sustainable do you see these going forward? How do you see this strong performance over the last two years and how sustainable do expect this to be let's say in 2020? I know that you don't provide guidance but nevertheless just try to have sensibility of how much recurrent this like for like evolution could be. And then a follow up question on the minimum wage increase, you mentioned that you don't expect any major impact from this. Could you provide some reference if you need any specific like for like in, the let's say, in food division to absorb this wage increase next year or if through the cost measures initiative that you expect to apply basically with like for like of zero eventually the margin will still hold. That would be my two questions on Sonae MC.

Then regarding Sierra, basically you mentioned in terms of outlook for yields that we start to see some increases in Italy and Spain. So for 2020 how do we see this evolving for the core markets, so for Portugal, Spain and Continental Europe. And also, to understand what you mentioned regarding Brazil, if I understood right, basically previously you were using market references for Sonae Sierra Brasil, but that is not the case for the new combined company. Could you confirm this and, if that's the case, so you are basically saying that the synergies expected will not be capturing terms of NAV over the coming quarters, right? So that will be my question.

João Dolores: Thank you, José. Let me just take the one on the minimum wage because it affects several of our business, it potentially affects several of our businesses. It's still hard to give you an estimate on the exact impact and what would have to be a like for like growth to compensate for that, because as you we do not pay at minimum wage, we pay above minimum wage, it also depends on how we reflect this increase in minimum wage in our cost base – so it's still early to tell, were still analysing the topic, but we do expect with the productivity gains that we're implementing that we will be able to absorb the extra cost that might come with this measure.

I will now hand it over to Rui to talk about the like for like, the sustainability of like for likes going forward and then to Luís to take the Sierra questions.

Rui Almeida: Hi José. Thank you for your questions and considering the answer João gave to you regarding the minimum wage – this is also one of the answers that we will also have to take into consideration to forecast the like for likes for next year, because, for sure, we'll have to take also into consideration the disposable income that families will have next year for consumption, to have available to consume or are at least to trading up in our stores. And we need to consider that in our forecasts. But again, those type of movements as João was considering, we were considering as well, when we gave our ambitions and our guidelines three or two months ago. We were already considering this type of movement forecast for the economy, that's why we were already considering this movement that Joao was mentioning, the productivity gains and the efficiency initiatives we were already implementing in our company. But again, the like for like that we were gaining in the last years, is the result of all the initiatives that we implemented in last year that were very well received as João said in the introduction, we were receiving from our customers because they are recognizing very well the value proposition as we are offering them and this value proposition that is very well perceived, very well received, very well accepted, and we are collecting the gains from our customers and like for likes are growing and the sales are evolving quite well, and the levels of awareness are evolving positively and I feel that we have some room to continue to evolve in the Portuguese economy. That's why we are feeling so confident to continue to evolve in Portugal according to the figures and the ambitions that we provide to in the capital market days.

José Rito: OK, thank you, just to follow up on this, so basically can we conclude that the net promoting score has been increasing for Sonae MC?

Rui Almeida: Well basically NPS is an internal measure is not public, this is not public; it is not fair to give you that measure that is measure internally, but it is evolving positively since we started to measure that indicator in 2014.

José Rito: OK. Thank you.

Luís Mota Duarte: OK, your questions around Brazil and around yields. In terms of yields expansion, pressure we have seen in secondary and tertiary assets, it's in Italy and in Spain, mainly, but there is also some pressure in Portugal, but less so. The core assets we are not seeing any pressure and definitely no pressure that justified changed on the fundamental and strategic performance of those assets. Brazil, and thank you for asking those questions that is worth to clarify. In Brazil, we will continue to value the assets at fair market value. We value all of our operating assets at fair market value. What happened is that Sonae Sierra Brasil had nine

assets and Aliansce has 20. So now we have to value a portfolio of 29 assets, of which 20 we are getting closer to and to learning better. Until we do that we have a very conservative approach to those valuations.

José Rito: OK, understood, thank you.

João Dolores: Thank you José.

Operator: There are no further questions, please continue.

João Dolores: OK so if we have no further questions, thank you very much everyone and looking forward to speaking with you at our full year results conference call in March. Thanks everyone. Bye.

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