

## Sonae 1H19 results - conference call transcript

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**Moderator: João Dolores**

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3:00 p.m. GMT


**Operator:** Welcome to the Sonae's First Half 2019 results conference call. During the introduction hosted by Mr. João Dolores, Sonae's CFO, all participants will be on a listen-only mode. During the introduction, there will be an opportunity to ask questions. If any participant has difficulty in hearing the conference at any time, please press the "star" followed by the "0" on your telephone for operator assistance. I would now turn the conference over to Mr. João Dolores. Please go ahead, sir.

**João Dolores:** Hello, good afternoon everyone and welcome and thank you for attending Sonae's results conference call for the first semester of 2019. And together with me today, I have the CFOs 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 in the portfolio, and then I will cover Sonae's consolidated figures for the semester before opening up for Q&A.

Starting with the businesses.

**Sonae MC.** Sonae MC had another strong quarter of sales performance, market share gains and underlying EBITDA growth. In the first half of the year, turnover reached €2.2 billion, an increase of 10 percent year-on-year with a strong like-for-like growth of 3.9 percent, mainly driven by increased volumes. And a note, regarding the expansion program, which continued with 30 new company-operated stores, which includes 5 Continente Bom Dia stores, which is, as you know, our proximity format. In terms of profitability, Sonae MC's underlying EBITDA margin increased 40 basis points. This was driven by the positive impact of transportation lease agreements which were reviewed in Q2 and now fall under the IFRS 16 accounting standards. Without this effect, the margin would have stayed in line with last year at 9.1 percent. I would also like to highlight the integration of Arenal, in Spain, which is evolving according to plan. Arenal posted solid double-digit growth in the semester and is in process of executing an important expansion plan in Spain: it opened up 1 store – 1 flagship store in the first half of the year and already 2 stores in Q3.

Looking at **Worten.** Worten had a better sales performance in Q2 than in Q1, with 2 percent like-for-like growth. In the semester, turnover stood broadly in line with last year at €473 million. I would like to highlight the growth of online sales, which stood above 50 percent in the semester, which is good evidence of the efforts the business is doing in the digital front. On the other hand, profitability decreased when compared to last year's results, and the performance in Spain Mainland was particularly disappointing. We have decided to implement an ambitious program in Spain, targeted



at improving probability in this geography and this will happen in the near term. This program includes a reduction of local head office costs and also closing a number of loss-making stores in the coming months.


Regarding **Sonae Fashion**, the business achieved a very positive performance in Q2 across all brands, with a total like-for-like sales growth of 10.2 percent. In the first half of the year, turnover grew 7.5 percent like-for-like and 3.5 percent year-on-year. This was mainly driven by a strong omnichannel evolution across brands. This top line performance and also the ongoing transformation plan fuelled the improvement in profitability. Underlying EBITDA increased €2.3 million and reached a margin of 6.3 percent in the first semester. It's worth highlighting that all brands have been increasing in also e-commerce sales very strongly. In the semester, online sales increased by more than 30 percent year-on-year as a whole in the business.

**ISRG**, which as you know is the entity resulting from the merger between Sport Zone and JD Sprinter, maintained a strong track record and continue to post solid growth levels. Turnover in the 6 months ending in early May increased 41 percent year-on-year, and EBITDA almost doubled from €13 million last year to €25 million this year, implying a margin of 7.8 percent. JD and Sprinter continued to show very positive results and the refurbished Sport Zone stores are improving sales and profitability at high double-digit rate, which is also a very good sign. And this is happening by leveraging new store layouts and operating models as well as different assortments which are appealing to consumers both in Portugal and in Spain. The contribution of ISRG to Sonae's accounts increased €6 million year-on-year and we expect further improvements in this contribution in the near future.

**Sonae Financial Services** had another positive quarter with both financial and operational indicators growing significantly year-on-year. Turnover increased by 20 percent year-on-year in the semester to €17 million and underlying EBITDA was up by €2 million, reaching a margin of 23 percent. The Universo Card reached another important milestone in June, it surpassed 800,000 cards and market share of total credit card production reached 12.5 percent in June, up from 11.3 percent last year.

**Sonae Investment Management** continues to actively manage its portfolio of investments. In the first half of the year, the company invested in 4 new tech companies in different areas, such as cybersecurity, data analytics for retail and also telco technology, mainly mobile network automation, and has recently sold its stake in both Saphety and Wedo, with the latter transaction only affecting our accounts in Q3. Regarding operational performance, in the first semester turnover grew 30 percent to €93 million. This was fuelled by the integration of 2 new cybersecurity companies, which we recently added to the portfolio. In any case, on a comparable basis, turnover would have grown 13 percent year-on-year. Underlying EBITDA stood at €0.3 million in the first semester, mainly influenced by the consolidation of recently acquired companies and also by a less positive performance of Wedo, which still impacted our accounts in this quarter.

Moving on to **Sonae Sierra**. Sonae Sierra had a quite positive growth in operational terms, registering a 4.8 percent like-for-like growth in tenant sales and 4.1 percent in rents. Proportion of EBIT increased 5.7 percent year-on-year to €55 million in the first semester, and direct results were up 9 percent to €36 million. These results are driven both by the positive performance of the



investment portfolio and also the services division, which more than offset the impact from the sale of assets.


In terms of portfolio management, Sonae Sierra completed several transactions. The main highlight is the merger agreement between Sonae Sierra Brasil and Aliansce Shopping Centers, which was already completed in Q3 and which creates one of the largest shopping centre operators in Brazil. Additionally, during the 2Q, Sonae Sierra sold 3 shopping centres: Dos Mares, LeiriaShopping and Solingen. During Q2, Sonae Sierra recorded a one-off loss in the sale of one specific asset, which is the main driver behind the company's negative indirect income and also behind Sonae's non-recurrent line, which impact consolidated EBITDA. This was a plan failed of a relatively small nonstrategic asset in a secondary location in Germany, which we co-owned with a financial investor. I must stress that it was an isolated case, which reflects specific transaction dynamics. In total, Sonae Sierra has already sold 7 assets this year, 3 assets in Q3 and apart from this case, all assets, particularly the larger investments were all sold broadly in line with their book valuation. On the development front, we would like to point out the expansions of NorteShopping and Plaza Mayor, which are evolving according to expectations. The Designer Outlet at Plaza Mayor is planned to open in Q4 and NorteShopping opened in August, a brand-new food court, which represents Sierra's innovative and on-trend asset management capabilities. Those of you joining us for our Capital Markets Day in October will have the opportunity to see this new space first hand. NAV stood at €1.364 billion, reducing €91 million versus year-end 2018, mainly reflecting a dividend distribution of €115 million.

Regarding **NOS**. NOS, as you know, has already announced its first half results in July, but we would just like to stress its solid performance yet again in Q2. Turnover grew 1.8 percent year-on-year. EBITDA increased by 2.8 percent and net results also increased by 6.4 percent. The company's transformational plan is on track, and we are witnessing a good free cash flow generation momentum in the company right now.

Finally, looking at **our consolidated figures**. Sonae showed a solid performance overall in the first half of the year. Turnover increased 11 percent year-on-year to almost €3 billion, and underlying EBITDA grew €48 million, up 24 percent to €243 million. This positive underlying EBITDA evolution, coupled with a growth in the equity method results of €25 million, more than offset the negative evolution in nonrecurrent items and led EBITDA to increase 10 percent year-on-year to €284 million.

All in all, net income group share stood at €38 million, down from last year's €80 million, and this decrease is more than explained by the strong capital gain registered last year related to the Outsystems transaction.

Regarding our capital structure, and on a comparable basis, Sonae's net debt decreased by €131 million year-on-year to €1.19 billion. Considering all asset acquisitions and disposals in the last 12 months, total net debt stood at €1.76 billion at the end of June, after the dividend payments of €88 million. Gearing at the group level continued to decrease and reached 0.5x, and funding costs and average maturities remained at very comfortable levels. All the companies in the portfolio maintained conservative balance sheets. Sonae MC posted a 2.3x net debt to underlying EBITDA



level versus 2.7x last year. NOS registered a financial net debt to EBITDA of 2x, in line with last year, and Sonae Sierra's LTV decreased to 29 percent, and the holding LTV stood at 14 percent.

So overall, we are quite pleased with this set of results, and looking forward, we will remain focused on driving the good operational performance of our businesses up till the end of the year. And we will also continue to pursue our strategy of unlocking value across the portfolio, which should enable us to further strengthen our balance sheet in the near term. I will now end this brief overview of our first half results and invite all of you to ask questions. You can please open the session for Q&A. Thank you.

Operator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. If you wish to ask a question, please press “star” and “1” on your telephone keypad and wait to be advised your line is open. Please state your first and last name before you ask your question. Should you wish to cancel your request, please press “star” and “2.” So once again, “star” and “1” if you wish to ask question. We will now take our first question.

Tim

Attenborough: Can you hear me OK? It's Tim from Santander.

João Dolores: Yes. I hear you.


Tim

Attenborough: Good afternoon. A few for me, if I may. So great like-for-likes at Sonae MC. You say it is mostly volume. What was the grocer inflation in the quarter? I think it was a little under 1 percent in the first quarter. And can you quantify what the Easter impact was? And what sort of momentum should we look at going into Q3? Can you sort of tell us about what the exit rate is, please? And also, on MC, the €8 million IFRS Q2 impact, I mean what you're trying to say is realistically we should make a prior year adjustment, seems to be the message. So I was a bit surprised that there was not sort of a little bit more operational leverage coming through, given the very strong like-for-likes. And then on Sonae Sierra, perhaps €115 million dividend, can we expect to sort of repeat of that in the coming years? I mean, I think it's just a function of asset sales and capital recycling. So a comment on that, if I may? And one last one. No sale and leasebacks, I think, in the whole of the first half. Has this process stopped? Or is it just sort of on pause for the moment? I'll leave it at that for now.

João Dolores: Thank you for your questions, Tim. I will hand it over to Rui to answer the Sonae MC questions, including the one on sale and leaseback, and then I will ask Luís to cover the Sonae Sierra one. Rui?

Rui Almeida: OK. Hi Tim, this is Rui Almeida speaking. Regarding the inflation rate, in the second quarter it was around 0.1 percent. And the Easter impact, as we said in the last conference call where we had around about 2 percent, 2 percent points. Because the last time we were together, we said that the first quarter sales were impacted by the Easter effect so without that impact, our like-for-likes would be higher comparing to what we presented in the very first quarter.

Regarding the EBITDA margins, yes, they are impacted by the fact that we were reviewing and completing all the additional transportation lease agreements according to new standards of IFRS 16. Yes, we could – we are investing a lot, we are (growing) a lot – we grew a lot in terms of like-for-



likes during the first semester. We grew almost 4 percent. And we are very happy with the levels of EBITDA margins as we continue to present very high levels of EBITDA margins. And as we explained, they are very standard figures – sorry, benchmark figures that we will need to continue to have in our company and we need to maintain those levels that we feel very confident and very comfortable with. Regarding the third question you raised was related with the sale and leasebacks, right?

Tim

Attenborough: Yes. Yes, indeed.

Rui Almeida: So regarding the sale and leasebacks, what we said in the past is that basically, we continue to have the ambition to maintain 40 percent of our freehold in our portfolio of assets. We are very keen to continue to use assets to sort out very opportunistic bill that we intend to have in our portfolio. So if we see any very good opportunity to take it into account, we will consider that or to capital recycle in order to continue to have those 40 percent in our freehold in our portfolio. I mean, we continue to grow in our company because we will continue to invest heavily in the areas that we show underpenetrated comparing it to our competition and in Portugal as well as in the proximity segments in terms of supermarkets.

Tim

Attenborough: OK, Rui. Just can I just confirm, sorry, the inflation number that you first gave me, was it 0.1 percent or 0.9 percent?

Rui Almeida: 0.1 percent. One point.

Tim

Attenborough: 0.1 percent. OK.

Rui Almeida: Or at least it's the figure that we had.


Tim

Attenborough: OK. And just also on the exit rate, what's the momentum like going into 3Q and are you seeing people trading up?

Rui Almeida: Yes. Well – yes, people are continuing to trade up at least in the Portuguese market. There are several categories that are benefiting from that situation because the momentum – we have benefited from a very good momentum in the Portuguese market. So people continue to trade up in several categories in our stores. We are seeing a very positive momentum.

João Dolores: OK. Luís?

Luís Mota Duarte: This is Luís from Sonae Sierra. So in terms of your question around our dividends, our dividend policy reflects 2 factors. One is we typically distribute a percentage of our operational profit. And we distribute also part of the proceeds from sale of our assets. The part we distribute if we agreed on a specific basis. The €115 million you've seen, that we paid this year, is a result of the significant asset sales that we did over the course of the last year. We are currently in the market conducting asset sales. So the dividends that we will pay going forward represent that share of the operating profit, but also the rate at which we reinvest and the rate at which we do conduct asset sales.



Tim Atten.: OK. So I shouldn't be looking for a sort of a similar number for next year given that you saw significant asset sales last year?

Luís Mota Duarte: It's very difficult to say, Tim. It depends really on the rate of asset sales.

Operator: We will now take our next question.

João Pinto: Can you hear me?

João Dolores: Yes.

João Pinto: João Pinto from JB Capital Markets. The first one is on Sonae MC. Could you please tell us how the market share has evolved since the beginning of the year? And second question on Worten and this new program in Spain, could you please give us some colour on the amount of cost that you expect to spend in this program and how many stores do you expect to close?

João Dolores: OK. Rui, can you take the first question, then Paulo will take the second one.

Rui Almeida: Yes, sure. Regarding market share, we increased our market share according to our calculation, our estimates, between 20 to 30 basis points in the Portuguese market in the first semester of this year.

Paulo Simões: Hi João. Regarding Worten. So we have decided to move ahead with the transformation in the business. Adapting Worten to the competitive context we have in Spain and that we foresee going forward. So we have decided to close 9 stores that we saw that they are not economically recoverable in the foreseeable future. So we've decided to close them. Those 9 stores, with that movement, we should be able to – in addition to some savings in the headquarters, in total, we should be able to save on a yearly basis around €3 million. So that's our expectation.


João Pinto: Just a quick follow-up. You should save on yearly basis €3 million, but do you have costs, upfront costs with this program, with I don't know people and so on?

Paulo Simões: Yes. Obviously, with the movement that we are doing, we have some cost of closing the stores with the people that we have involved and some with real estate owners. But that's a bit too soon to say because we are still in the negotiation with all those parties. So it's a bit soon to say. Having said that we think that as far as underlying EBITDA level this year, it should have a neutral impact. Between savings and cost, underlying EBITDA should not move a lot for the year.

João Pinto: Thank you very much very clear.

Operator: We will now take our last question.

José Rito: José Rito from Caixabank BPI. So my first question is on Sierra, the cash in with the sale of assets in Q2, in the release it is mentioned €450 million of open market value, but how much was this in terms of NAV impact attributable to Sierra. If you could provide a little bit more colour on this, it would be good for us. Second question on Sonae MC. A question regarding Mercadona. If you have felt any



impact in the surrounding stores or in any specific category related to this? And also in terms of margin outlook, you mentioned that you expect greater flattish margin going forward, have you noticed any changes in terms of competition due to Mercadona? That would be my second question on this. And finally, on Worten. Just a follow up, you mentioned this €3 million potential impact at EBITDA level from the restructuring that you planned for this business, but is this enough to be at breakeven in terms of EBITDA in Spain? That's it.

João Dolores: OK. So let's start with Luís answering the Sierra question, then we'll move on to Rui and then finally to Paulo.

Luís Mota Duarte: José I'm not sure I understood your question, but let me try to answer it and if it's not what you're looking for, let me know. But the €115 million that was mentioned is basically dividend that Sierra paid to the shareholders (Grosvenor and Sonae).

José Rito: No, no, no. I was mentioning – in the release, you mentioned €450 million open market value of assets that you took, right? And I was asking how much is the NAV cash in attributable to Sierra?


Luís Mota Duarte: OK. The reduction in NAV from the sales is around € 62 million. So that's the NAV of the assets that we sold. I hope that was your question.

José Rito: Yes. €52 million?

Luís Mota Duarte: €62 million. 6-2.

João Dolores: OK. Rui, can you answer the second on Mercadona, please?

Rui Almeida: Yes, sure. Thank you for your questions. Regarding the Mercadona. Mercadona is a very strong player. As you know, we have a lot of respect for them. They have been doing a tremendously very good job in Spain and getting a very good market share – very important market share - in Spain as well. But it's too early to give you some very important conclusions about this and the first impression in Portugal. Because they only had opened 4 stores and the first in the beginning of July . It's too early to give you impact in terms of – to give you some figures in terms of impact. Up to now, there are no material impact now in our top line performance. There are only 4 stores, and this is not as important as other player that enters in the market or even a player in the Portuguese market that open a new store in the Portuguese market. Regarding the other issues that you were mentioning, regarding what is the most important conclusion that we get from a very important player entering the Portuguese market. Well, regarding the pricing policy, they have a very different pricing policy comparing to ourselves, they have everyday low price pricing policy. We use a totally different pricing policy, we have a high-low pricing policy that we believe this is more suitable to the Portuguese consumption patterns. We continue to have very good advantages because we have a loyalty program with a much more information that continues to give us very good advantage in terms of planning the promotional strategy and be very good both in terms of efficiency and effectiveness. And we feel very comfortable to continue to pursue our strategy to continue to lead the market even considering that this very important player, Spanish player, is coming to Portugal with ten stores as they announced for this year.



José Rito: Thank you. But just a follow up, as Sonae decided to be a little bit more aggressive on prices due to Mercadona in some specific regions following the openings, or are you seeing other players doing that or not exactly?

Rui Almeida: I cannot tell you that precisely because what the company generally do is a, sort of, promotional activity when competitors are launching a very specific store point. Because if we launched 1 store in the south, Continente Bom Dia, we see that some competitors, generally consider special campaigns and promotional activity in order to fight against us. Basically what competitors do across the country – across the world, in fact, in order to compete when a new player is entering in a specific market, frankly I don't know if we can say, I think it's very – too soon to say if we will have a different price positioning or a different pricing – different margin positioning towards this market because I think it's too soon. Even the range. We didn't change a lot in the – in fact, we didn't change the range. We are improving the range, as we are improving every day the range to offer to our customers according to the value proposal we offer to our customers. So frankly, I don't see much difference between what we were having last year, for instance, and what we are having today.

João Dolores: OK. Paulo?

Paulo Simões: José, thank you for your question. But as you know, we see Worten as an Iberian operation and we have a lot of integrated activities. So we are not seeing this in Portugal and Spain. And overall, obviously, the savings that we have with closing the stores and the restructuring central structure in Spain, will be supportive for the future results of Worten. But I will not add much more to that.

José Rito: OK. But can you confirm that you are – well, I understand that it's basically an Iberian operation, but it seems that the focus of the restructuring is in Spain. So basically, I was trying to get a little bit – some sense of how much it could represent Spain in the Iberian space in terms of EBITDA contribution?

Paulo Simões: Yes, we don't disclose EBITDA by geography. So we will not be doing that right now. Again, we see this as an Iberian operation. And obviously, what we have decided to do was to close stores that we didn't foresee as being economically recoverable in the future. So that was the main reason we have decided to close the stores. The Spanish market is clearly more aggressive and much more competitive than the Portuguese one. So there are some stores that we thought that will defeat this level of competitiveness, and we decided to move accordingly and adopt the business model in that geography. So we'll introduce going forward, but that's all.

José Rito: OK. OK. But can you confirm at least, following the closure of these 9 stores, all the stores will be positive EBITDA contribution, at the store level at least?

Paulo Simões: Well, it will depend a lot on how the market will evolve going forward, obviously, and we will be attentive as we were up to date looking at opportunities to improve the portfolio of stores in Worten, in whatever geography that we are working in and Spain is not an exception to that. So we'll be looking for opportunities to improve going forward. For the moment, these are the ones that we have decided that we should move ahead and close.





Operator: There are no further questions at this time.

João Dolores: OK. So thank you very much everyone for all the questions, and looking forward to speaking with you again in our Q3 results conference call.

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

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