

Sonae 2019 results - conference call transcript

Moderator: João Dolores, Sonae SGPS, CFO

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Operator: Ladies and gentlemen, welcome to SONAE's full year 2019 results conference call. During the introduction hosted by Mr. João Dolores, SONAE's CFO, all participants will be on a listen-only mode. After the introduction there will be an opportunity to ask questions while pressing star one. And if any participant has difficulty in hearing the conference at any time, please press star zero. And I will hand the conference over to Mr. João Dolores. Please, go ahead, sir.

João Dolores: Thank you. Good afternoon, everyone. Welcome to our full year results conference call for 2019. Together with me on the call today, I have Rui Almeida, from Sonae MC; Paulo Simões from Worten; Miguel Moreira from Sonae Fashion; Luís Mota Duarte from Sonae Sierra; and Cristina Novais from Sonae IM; as well as our Investor Relations team.

I would like to start by saying that in normal circumstances, we would be celebrating a remarkable year for Sonae. However, given the current situation globally with the outbreak of COVID-19, these are quite extraordinary circumstances. So, I will give you a quick overview of the performance in 2019, I will try to cover our main milestones in the last few months in terms of portfolio management and then I will give you our perspectives in terms of outlook before opening up the session to Q&A.

So, starting with our performance in 2019. The year was quite successful for Sonae. We posted strong top line growth, just above 9% to €6.4 bn, with all businesses posting positive like-for-like figures in terms of growth. In proportional terms, we surpassed the €7 bn mark for the first time in our history.

I would like to highlight the strong performance of **Sonae MC, which also grew above 9% in the year and further strengthened its market leadership**. Worten and Fashion had also a quite strong end to the year, a quite strong Q4, in terms of sales momentum and also in terms of profitability.

Talking **about profitability**, it improved significantly across businesses. Total underlying EBITDA reached €599 M, a 22% year-on-year increase, mainly impacted by the improved performance of Sonae MC and also by the consolidation of Sonae Sierra's statutory figures. But even without Sierra's consolidation, underlying EBITDA would have grown 14%.

All businesses in the portfolio had operating margin improvements, with the exception of Sonae Investment Management, which was highly influenced by the acquisition and consolidation of a couple of new portfolio companies. This positive evolution in underlying EBITDA, coupled with an increase in the equity method results, led to an EBITDA increase of 7.5%, to €695 M in the full year.

Finally, **Sonae's direct results** stood at €215 M, practically at the same level of 2018, despite the extraordinary capital gains registered last year related with a number of operations, namely the Outsystems transaction, asset sales at Sonae Sierra and also sale of leaseback yields at Sonae MC.

In terms of **portfolio management**, I will highlight the following important milestones. The first would be the acquisition by Sonae MC of a 60% stake in Arenal in Spain, which significantly reinforced the company's position in the Health & Wellness segment in Iberia. Also, the sale of Saphety and Wedo by Sonae Investment Management were important milestones, and also the continued investments in several technology-based companies throughout the year.

At Worten, we had the acquisition of iServices, which will be important to further improve the company's service offering, particularly in the mobile phone repair space. And last but not least, Sonae Sierra. Sonae Sierra had a very important year in terms of portfolio management, and I will highlight the following transactions. First, the merger of Sonae Sierra Brazil with Aliansce Shopping Centers to create the largest shopping centre operator in Brazil; the successful conclusion of several transactions under its capital recycling program, which totalled €0.8 bn of OMV in 10 assets; 2 bolt-on acquisitions in the services business unit; and already in 2020, a key landmark transaction, the creation of Sierra Prime, a new leading retail real estate JV with APG, Allianz and Elo, which resulted in €525 M of cash proceeds to both Sonae Sierra and APG, and obviously very significant cash proceeds for Sonae.

This operational performance, including very tight working capital management, together with our portfolio management milestones, which I just described, were once again critical to ensure a strong cash flow generation and **reinforce our capital structure**.

Net debt reduced €167 M to €1.15 bn. Our average maturity profile is above 4 years now. Our average cost of debt continues to be quite low, and we continue to be fully financed for the upcoming 18 months. In addition to this, Sonae's consolidated net debt will also benefit from the cash proceeds of the Sierra Prime transaction, which was completed at the end of February. So, it will impact our Q1 accounts, and this will have a total impact of about €190 M in our consolidated net debt.

So, I will say that we face the near future with a very solid and conservative balance sheet, which gives us confidence that we will be able to navigate well through the turmoil of the coming months.

I would also like to point out that the Board has proposed a 5% **dividend** increase to €0.0463 per share, a total of €93 M, maintaining the dividend factor for the last few years, which equates to a dividend yield higher than 9% at current share price level.

Finally, I would just like to give you a final word regarding the **outlook** for the coming months, particularly in what regards the situation we are currently living in and which relates to the COVID-19 pandemic. We naturally expect the impact of this situation to be significant and widespread in the economy. However, there is still a lot of uncertainty today as to what exactly will happen, namely in terms of the spread of the virus, the measures taken by governments and also the profile and time horizon for the expected recovery. Our main concern right now is twofold. The first is to protect the health of our people; and the second is to continue to render essential services to our customers. With these 2 priorities in mind, we started monitoring the evolution of the situation early on and have implemented a set of measures to mitigate any disruptions that could potentially affect our people and our businesses.

As of today, it is still very difficult to predict the exact impact on our businesses. But although they are naturally being materially affected, we are witnessing a high degree of resilience on the part of our people and of our activities. I would like to start by acknowledging that, and once again, thank our teams for their courage and their efforts.

We have different realities in the portfolio, as you know. Sonae MC has been experiencing a very strong increase in demand, both in the stores and in e-commerce. The operations have endured quite well this added

level of pressure, and the business will continue to play a crucial role in supplying Portuguese consumers with essential products and services.

Specialty retail businesses should experience a significant slowdown in sales as some banners have already decided to close their stores for an undetermined period of time, and also as customers are driven away from commercial spaces. Nevertheless, digital channels should continue to grow at a strong pace, which will mitigate part of the effects felt at the level of physical channels. All our businesses have been preparing to respond to a significant increase in demand in e-commerce channels.

Regarding Sonae Sierra, the company's activity has been significantly impacted in multiple countries, given that shopping centres have either had to close all nonessential stores or are experiencing an increasing reduction in the number of visitors and sales. The company has been maintaining an open dialogue with its tenants and has already prepared several contingency scenarios.

Finally, NOS. NOS will continue to play a critical role in the Portuguese society, particularly in this context as it guarantees essential communication services for people and companies. As you can imagine, the additional data traffic has been tremendous, but the network has sustained this quite well. The company has implemented a number of measures that guarantee the smooth functioning of its activity in conjunction with all its operational partners.

This being said, I would like to say a final word about our balance sheet and our liquidity position. And it is a reassuring message. As you know, we have a very conservative capital structure, which is a result of years of strong cash flow generation and deleveraging. We also have a policy of prefinancing our liquidity needs 18 months in advance, and we currently have quite long average maturities and low funding costs. Therefore, at this stage, we do not foresee any additional financing needs for the next 18 months, and we have significant headroom in what regards debt covenants.

As of the beginning of March, and this already includes the proceeds from the Sierra Prime transaction, Sonae had just over €600 M of available line and over €580 M of cash. We are naturally running a number of stress tests and being very cautious and prudent in terms of cash outflows, namely in what regards investment decisions. But we are quite confident that even under more extreme scenarios, the resilience of our portfolio and our current financial strength will guide us through this storm.

I'm sure that we will overcome this challenging situation, and I hope that we can all resume our normal lives as soon as possible. Thank you, and you can now open the session to Q&A, please.

Operator: Ladies and gentlemen, to ask a question please press star followed by 1 on your telephone keypad. If you wish to retract your question, it is star followed by 2. To prepare to ask you question, please ensure your line is unmuted. The first question today comes from Tim Attenborough of Santander.

Tim Attenborough: Good afternoon. Thanks for taking these questions. I've got a few, if I may. The first one is: are buybacks now on the agenda? We had much discussion about this at the Capital Markets Day when the shares were sort of round about the €0.85 level. And now about the businesses, Worten in Spain now profitable? And at Sonae MC, you had over 6% new space contribution to sales. Okay, that was with Arenal in there. But going forward, are we still on for sort of a 3% new space? You didn't open 20 Bom Dias in 2019. I just wanted to get a feel on whether there's any sort of change to that, I'd say, current circumstances on one side. And the debt level within MC, one for Rui, is the sort of €590 M level the sort of optimal level of debt in the food retail business?

And one last one. What is the absolute level of Internet sales of digital sales for both MC and Worten? I'll leave it at that for now.

João Dolores: Thank you, Tim. A lot of questions. Let me take just a couple, and then I'll hand it over to the other guys to take the other ones. So starting with share buybacks. I perfectly understand the question. And particularly in a moment in time in which the share price is so low. But this is a very unusual context. And I have to say that this is currently not at the top of our thoughts for the time being.

Regarding the absolute level of digital sales, I can tell you that we have had double-digit increases in sales in 2019 for practically all the businesses in the portfolio. And together, all the businesses together currently have a figure, which is well above €100 M in 2019. And it keeps growing by the minute, and also this crisis that we are facing right now will obviously provide a boost to online sales.

Maybe I'll hand it over to Rui to answer the 2 questions on Sonae MC and also to Paulo to answer the question on Worten.

Rui Almeida: Hi Tim. Regarding the questions, if I understood correctly, regarding the questions of the expansion pace for Sonae MC. Yes, expansion pace, we continue to believe that 20 stores per year is the pace that we intend to continue, unless we pursue that this year, the expansion pace is on hold. But as soon as this context is overcome, our intention is to resume our ambitions and the investment will continue. We will maintain our ambitions to continue the investment that we announced during the previous years.

The other issue, we will continue to assume that our goal to maintain the targets for conservative capital structure as we said 2 years ago, meaning we will maintain a target level of having less than 3.5 times the average debt to total debt considering in IFRS 16, debt to EBITDA.

Paulo Simões: Hi, Tim, thank you for the questions. Worten, under the current context, has also pulled expansion and remodelling investments for the foreseeable future. That's what we will do. Then we hope as the Sonae MC restarts investment as planned.

Regarding digital sales, we are currently at high single digits, and we are leaders in e-commerce sales in Portugal on the sector. And we are seeing very significant growth over the past few days, and we are preparing our logistics to respond to that synergy in online. Everything is going well on that front. So, we expect e-commerce to continue growing over the next few days.

Operator: The next question comes from José Rito of CaixaBank. Your line is open.

José Rito: Good afternoon. I have 2 questions on the COVID-19. And the first related with the most impacted business, namely Sierra, Fashion and Electronics. Did you have performed any kind of stress test in terms of sales or profitability evolution for this year? Any kind of worst-case scenario and what could be the impact namely in terms of the group cash flow? I remember that in the past you gave some references that on that average the company was reducing debt by more than €100 M per year. Do you think that this could change this year because of this epidemic? That will be my first question.

Then on the positive side, I would guess that Sonae MC has been benefiting from kind of buying, stockpiling as we have been seeing in several other markets. So, I think that the sales impact should be positive in Q1. And can you give some reference how this has been evolving? So, how sales have been evolving, if it is the case? And also, if there's no major disruption in terms, for instance, out of stocks or logistic issues? That will be my second question.

Then finally on NOS, what you can say about the stake in the company. In the past, Sonae clearly mentioned that you will be interested in increasing your stake in the company. Is this still the case? What is basically Sonae's stand on its current stake in NOS and if this could change, let's say, over 2020?

João Dolores: Okay, thank you. So, I'll start with the last one. I'll also cover the first question that you asked, and then I'll hand it over to Rui for the Sonae MC one. So, starting with the NOS question. And just a correction there. I don't think we ever stated that we wanted to necessarily increase our stake in the company. So, we always said that we were comfortable with the stake that we have in the company given the level of control that we have in the company as well. And so, we were comfortable with the economic exposure that we have.

Regarding NOS, I think our key priority in this context is to ensure that the company is able to operate normally, implement its strategy and serve its customers. And that is definitely the case right now. And we have stated multiple times that we have full confidence in the management team. We are, again, happy with the level of exposure and control that we have. And we will always do whatever it takes to ensure that the company has the necessary stability to continue to serve its stakeholders and add value to the Portuguese economy. And so that's what we will continue to do.

Regarding the future, I don't know what is going to happen. But right now, this continues to be our position and continues to be our stance in the business.

Regarding stress tests, yes, we are running a number of stress tests in all the businesses, not only Sierra, Fashion and Electronics. And we are running a number of contingency scenarios to try to understand what the impacts would be in Sonae. Sorry, I'm getting a message here saying that the line is not okay. Can you all hear me?

José Rito: Yes.

João Dolores: Okay, you can hear me. Okay. So, the answer is, yes, we have been running a number of stress tests. Obviously, cash flow will be impacted. We don't know how, because as you said, we have some businesses which are actually seeing a surge in sales such as MC and others, which will obviously suffer in the coming weeks. It is still too soon to tell. Everything is still very uncertain. It's still too soon to tell what is going to happen exactly. But we are running a number of stress tests, and I can tell you that even under the most pessimistic scenarios, we are confident that we will endure the storm well over the next few months.

So we have, as I said before, we are fully financed for the next 18 months, and we have a number of buffers in this policy. And we also have a number of cash preservation initiatives, which we can pull if needed. And so, we feel quite confident that we will be able to navigate over the next few months well in terms of liquidity, and that we will resume the full implementation of our strategies in all the businesses whenever this situation is overcome.

Rui, do you want to take the question on stockpiling and the sales impact at Sonae MC?

Rui Almeida: Yes. Well, the immediate impact of COVID-19 in our turnover has been positive. Our sales rose over the last 2 weeks as customers stocked and prepared for the potential impacts of the outbreak. Yes, it is normal situation. And we think this is and we helped the transitory has particularly impacted our full retail business operations, for instance, the sales increased significantly, namely because people started to stock up. And for instance, we saw that people started to buy liquid soap, canned products, pasta, toilet paper, as you know, trash bags and gloves, rice, flour, frozen meats, diapers and related products, cleaning products, infant feeding, meat, fish, fruits and vegetables, bread, liquid essence, etcetera, everything that it could to stock up. And those things created a sort of a peak in terms of our operations that we are now trying to solve and we

are now trying to normalize our operations and trying to create a regular operation in our company. We are dealing with that situation because we feel that the situation has been probably one situation that created that people were stocking up a term, but it's probably transitory and now, we are dealing with this situation. Probably this situation, we realized in the last 2 weeks, will not be common in the next months or etcetera. So, we need to understand this situation is not very common.

José Rito: Okay. But let's assume that the positive is there because of the operation is holding well in the sense of no major disruption...

Rui Almeida: José, could you repeat? Jose, if you do not mind, could you repeat, please?

José Rito: Yes, I was asking basically that we are seeing the positive with no major disruption for the operations in terms of logistics and things like that.

Rui Almeida: No, no, no. There are no major interruptions in logistics. The operation didn't disrupt, and everything went normally without a huge labour impact in the operation as it is today. But everything went normally with a huge, as João said in the very beginning, with people working very hard to answer to this huge incremental demand from people. But we were able to answer to this peak of demand.

Operator: The next question comes from António Seladas of AS Independent Research.

António Seladas: Thank you, good afternoon. Regarding your operating margins that were quite nice over the fourth quarter. If you can explain a little bit better, providing more colour. It was more gross margin, it was more cost control in terms of Opex, and of course, I'm talking about Sonae MC, Worten and Sonae Fashion.

João Dolores: So, I will hand this over directly to Rui, Paulo and Miguel to comment on this topic.

Rui Almeida: From Sonae MC side, it was totally cost control. In our side, we are totally focused on the efficiency side. We are in a very competitive market. We are working very hard in the efficiency measures. We are totally dependent on efficiency. Efficiency belongs to our DNA. So, we are efficiency freaks. And we are totally dependent on the efficiency, and we continue to deliver efficiency results every quarter, every day. And we came up with very good results on efficiency. We got very good results on efficiencies as it could compensate all the investments we did in terms of the price, to overcome competition, in terms of the investments we did to continue to be the price leaders in the Portuguese market.

Paulo Simões: Regarding Worten, the performance on the fourth quarter was driven by a mix of effects. We had very good sales performance. And in addition, we had also efficiency improvements on the quarter. So, both aspects contributed to the results of Q4.

Miguel Moreira: Hello, António, regarding Sonae Fashion, it was obviously the sales improvement in the quarter and through control of costs and some measures to improve productivity. And we believe that we benefited from the Sonae Fashion's transformation program that we are implementing, and we are seeing now the benefits of that kind of initiatives.

Operator: The next question is from João Pinto of JB Capital Markets. Your line is now open.

João Pinto: Thank you for taking my question. The first one on the dividend that you have announced, proposed. I understand this is still early times regarding the potential impact from the coronavirus outbreak. However, at this stage, do you see the dividend announced as sustainable for the next year?

My second question on Sierra. Sonae will receive an important cash inflow from Sierra. What do you plan to do with the proceeds? Will they be used to reduce debt? If you could elaborate on capital allocation, it would

be great. Following this transaction at Sonae Sierra, do you expect further relevant transactions in the near future, of course, assuming that the situation stabilizes.

Finally, on Sonae MC, if you could tell us the basket inflation in the fourth quarter and full year and the sales of Arenal in 2019, would be great. Thank you.

João Dolores:

Thank you. So I'll start with the first couple of questions. First of all, the dividend, if it is sustainable for the next year. I mean, look, Sonae has a very stable dividend practice. It has had one over the last few years. And obviously, even during the downturn, the last one back in 2008, 2011, we maintained our dividend payment. And so we aim to continue to be able to sustain our dividend practice in the coming years. Again, it's still too early to understand the exact impact of this situation. But you can tell that the confidence that we have in our liquidity position and our balance sheet, given the fact that we have maintained our dividend practice this year, increasing by 5% the dividend per share.

In terms of the proceeds of the Sierra Prime transaction, obviously, part of those proceeds are being retained at Sonae Sierra. And Sonae Sierra will continue to run its activity and use that cash to fund its activity. And what relates to the dividends, which were distributed to Sonae? I think our main concern now is to make sure that we maintain a conservative level of debt and also sufficient liquidity for the next few months. And again, we are analysing different scenarios, different contingency outlooks. And so right now, that is our key priority.

Regarding further relevant transactions in the near future. As you know, Sonae is an active portfolio manager, and we are always looking at potential transactions that might add value to the group as a whole. And we have done a number of them in the recent past. And just in the last 18 months from the merger that we did in the sports business with the JV group in Iberia, the Arenal transaction, the deal that we did at Sonae Sierra, so we keep looking at alternatives to add value to the portfolio in terms of M&A. And right now, I have to tell you that, again, this is not our key priority for the time being. But we will obviously continue to analyse opportunities that might arise in the near future.

As for Sonae MC, I will hand it over to Rui again.

Rui Almeida:

Hi João. Well, regarding the inflation, the last quarter was pretty much the same comparing to the entire year, 0.3%.

And regarding the sales from Arenal in 2019 were approximately €130 M.

Operator:

The last question from the phone today comes from Beltran Palazuelo of Santalucia.

Beltran Barroso:

Hello, good afternoon. Congratulations for the strong results and the all our support from here for the difficult times. Well, maybe so a difficult question to ask, but I will ask it. Let's try and move forward, and let's say, the next 2 months forward when all this crisis is over, could we go over the Capex plan and over the potential returns? It just seems that the company is quite undisciplined allocating capital. It consistently allocates capital at lower returns than, for example, buying back shares. So, my question is, when you go to the Board of Directors and, let's say, ask for permission to allocate capital, what is the financial rationale apart from, let's say, investing only strategic Capex and maintaining the Capex in all the business for not buying back shares? Do you think there is maybe a problem of empire building? Maybe the corporate government is not adequate. So, you guys go and put the presentation that your value that, let's say, €2.0 per share; your equity, we see it at €0.60 per share; and then you consistently are in a lot of businesses, consistently invest more than your depreciation. And then it's never in your cards to buy back shares. So, it seems like maybe this company is not prepared to be a public company because it looks like only it's managing for its major shareholder and not the

minority shareholders or maybe you are not prepared to be a public company. So maybe for João, as Chief Financial Officer and as the main person of allocated capital, if you could maybe answer to all my questions.

João Dolores: Okay. We have obviously discussed this in the past, even in the Capital Markets Day. And I have to say that, again, this is a very unusual context that we are living in right now. And I must confess that all investment decisions have to be very well thought through, including share buybacks. And at this moment in time, we are looking at all our investment decisions, and we are analysing them carefully because this context demands that we have a very close management of all cash outflows in the group. And so, a share buyback right now is not something which is in our thoughts. As you can imagine, we are managing the situation and this crisis situation with the key priorities in mind, which is taking care of our people and taking care of serving our customers.

Going back to your point on how capital allocation decisions are made, we always make capital allocation decisions and investment decisions thinking about the long term. And it is with that principle in mind that we make our decisions. It may seem an unstructured process or suboptimal process for you, but I can assure you that we take it very seriously. And we make all capital allocation decisions having the best interest of all stakeholders in mind, but particularly shareholders. And at this point in time, I think this is what I have to say on this topic. The topic of share buybacks has been discussed internally, but I do not think, honestly, that this is the right time to talk about it right now.

Jake, if I may, we are always also conducting this or sharing this conference call through a webcast. And I had a couple of questions that were sent via webcast and I would like to answer them. One of them is, what is our economic outlook for Portugal in this crisis? It's a very valid and very good question, very difficult to answer at this stage. And so obviously, we have seen a number of scenarios built by a lot of people. But it's still very uncertain right now. We do expect that there will be a recovery. We do hope that this will only last for a few weeks or months, and that we will see a recovery still this year. But it's hard to tell right now, and we have to be prepared for all scenarios.

There's also a question on if there has been a run-on supermarket within the rest of Europe. I think Rui has tackled that one. We have seen a surge in the demand in our food retail operation with significant increase in sales, both offline and online. But fortunately, and due to the work of many, many people inside the organization, the company has been able to sustain this level of demand and to be able to operate with a very low level of stock-outs and with a logistical chain and operating model, which is functioning and providing essential products and services to our customers.

And then, there's another question on if we see this as a period of crisis or opportunities. I think the answer there is, right now, we're essentially focused on managing the crisis. But obviously, opportunities might arise, and we have the comfort of having a very solid position upon which to stand on. And if interesting investment opportunities arise, we will obviously look at them and explore them.

I don't know if we have any more questions.

Operator: We currently have no more questions on the phones.

João Dolores: Okay. So, we have just a couple of final questions that just came in on the webcast. One is, what is the level of promotions, I mean, and also, I'm assuming that question relates to food retail. What has been the performance of a couple of our competitors, Mercadona and also DIA. I will let Rui answer these questions in a minute. And then I would just like to say that although we are seeing a surge in volumes and sales at Sonae

MC, we are obviously not speculating or taking advantage of this situation. And so our key concern right now is to ensure that we serve our customers in the best way possible. But I will let Rui give a little bit more colour on promotions and also on the competitive landscape at food retail.

Rui Almeida: Regarding promotions. Promotions increased. The level of promotions increased in the last year according to Nielsen. And figures from Nielsen to the whole level of promotions was about 46% to 47% in 2018 and increased by 1 p.p. in 2019. Let's repeat from the beginning. According to Nielsen, the level of promotions was around 47%. And in 2019, increased by 1 percentage point to 48%.

Regarding the other competitors, we respect the other competitors. We respect Mercadona, because it's a very large competitor in Iberia. It's the leader in Iberia, the largest retailer in Iberia. Dia is one of the biggest retailers in Iberia as well. But we would prefer not to comment the performance of the other retailers. We generally don't comment the performance of the other retailers. Mercadona is a retailer that in Spain is doing okay. In Portugal, they launched 10 stores last year. They announced they are launching 10 new stores in 2020. In Dia, they closed several stores in Portugal last year. This year, they are focusing in price as well. But the level of performance is... frankly, we'd rather not comment. We prefer not to comment the performance of their operations.

João Dolores: Okay. I think we are out of questions in the webcast. And if there are no further questions also in the line, we can wrap up.

Okay. So, thank you very much, everyone, for taking the time to speak to us today, and we look forward to talking to you in May with our Q1 results, hopefully, under better circumstances.

Operator: Ladies and gentlemen, this concludes today's call. Thank you for joining. You may now disconnect your lines.

End
