

Sonae FY18 results - conference call transcript

Moderator: João Dolores

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Operator: Thank you for standing by, and welcome to Sonae's 2018 Results Conference Call. During the introduction, hosted by Mr. João Dolores, Sonae's chief corporate centre officer, all participants will be in a listen only mode. After the introduction, there will be an opportunity to ask questions. If any participant has difficulty hearing the conference at any time, please press star followed by the zero 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 conference call for the 2018 full year results. Together with me today, I have the CFOs of our businesses, Rui Almeida from Sonae MC, Miguel Águas from Worten, Miguel Moreira from Sonae Sports & Fashion, Luis Mota Duarte from Sonae Sierra, and also our Investor Relations team.


Before we go over the results, I would just like to make a couple of quick technical remarks. The first one has to do with Sonae Sierra. As you know, Q4 was the first quarter in which we fully consolidated Sonae Sierra into our statutory profit and loss account, following the acquisition of an additional 20 percent stake in the business at the end of Q3.

A second note on our segments, this is the last quarter in which we will report Sonae MC in its former configuration. As you know, Sonae MC now has a new perimeter, which also includes Maxmat and most real estate assets which were under Sonae RP up until now. From Q1 onwards, we will begin reporting our accounts with this new configuration.

Having said this, I will now guide you through our 2018 results and then open up the session for Q&A.

Overall, Sonae had a quite positive year with strong growth, improving profitability and increased financial strength. I will start by covering the highlights from the individual businesses, and then I will go over Sonae's consolidated figures.

Starting with **Sonae MC**. Sonae MC had the best sales performance of the past 10 years, with turnover growing 7.1 percent and reaching € 4.2 billion. This top line performance was supported by a like-for-like sales growth of 2.8 percent, significantly above market inflation and means that the business



continued to gain market share in a highly competitive environment. Q4 was actually a quarter of acceleration with a like-for-like growth of 3.6 percent. Underlying EBITDA improved to € 228 million with a stable margin at 5.5 percent. This means we were able to offset the impacts of both the strong competitive environment and the continuing expansion effort, namely through our proximity formats, *Continente Bom Dia*.


Health & Wellness continued to be one of the company's main growth avenues. And already in 2019, Sonae MC acquired 60 percent of Arenal. I recall that Arenal is a Spanish player, operating in the parapharmacy and perfumery markets and is an important milestone in the development of our international strategy in the health and wellness space.

Sonae RP. As I said before, Sonae RP will start to be considered under Sonae MC's new segment from 2019 onwards. But during Q4, Sonae RP closed 2 sale and leaseback transactions involving 6 assets, generating total proceeds of € 83 million and capital gains of € 37 million. Freehold of Sonae MC stood at 43 percent at the end of 2018.

Regarding **Worten**. Worten also had a quite positive year, hitting a record sales level of over € 1.1 billion, an increase of 8 percent year-on-year and 5.6 percent like-for-like. Underlying EBITDA increased to € 35 million, which equates to a 3.2 percent margin, practically the same level as last year. This was an important year for Worten in what regards to development of its digital capabilities and also its online offering, namely with the launch of a new marketplace which enables the business to significantly expand its offering range. E-commerce sales continued to perform very well and grew at double-digit rates in both Portugal and Spain.

Regarding **Sonae Sports & Fashion**. 2018, as you know, was a challenging year for the whole fashion sector, but Sonae Sports & Fashion ended the year on a very positive note. In Q4, the business grew clearly above the market. Total sales increased 7.9 percent year-on-year and 7.2 percent like-for-like, implying a full year sales of € 369 million, a 2 percent growth when compared to 2017. Underlying EBITDA increased € 2.5 million year-on-year in the quarter, reaching € 15 million in the year, which represents a 4 percent overall margin.

Just a quick note on **ISRG**, which is reported under Sonae Sports & Fashion through the equity method. ISRG has a different calendar in terms of accounts closing, and because of this, we only consolidated 3 quarters of ISRG accounts this year and in these 3 quarters, turnover increased 9.5 percent year-on-year to € 411 million and EBITDA margin stood at 5.4 percent, a level which is below our expected run rate basically due to a number of one-off effects this year, namely the reconversion of Sport Zone stores in Spain to the Sprinter model, which meant that we had those stores closed for a number of weeks. In any case, this merger is proving to be quite positive in terms of value creation and already this year, we saw a € 12 million positive impact in our P&L versus 2017.




Regarding **Sonae Financial Services**, the business finished the year with positive evolutions in all its key indicators. Production surpassed the € 1 billion threshold, an increase of 23 percent versus 2017. Turnover increased 27 percent year-on-year to € 31 million, and underlying EBITDA almost doubled to € 5.7 million. This strong performance was underpinned, obviously, by the Universo credit card as it continues to enhance its role in the payments market with, I would say, impressive figures for an operation that was launched just 3 years ago. Universo practically reached 750,000 cards. And according to our estimates, it is already top 3 in the credit card payments market with a 13 percent market share in December.

Also reported under Financial Services is **MDS** through the equity method, consolidation method. This is our JV in the insurance brokerage sector, which also had a very positive year. Total revenues grew by 9 percent to € 59 million and EBITDA by 30 percent to € 9 million.

Sonae Investment Management. This sub-holding continued to be very active in terms of its portfolio development. In Q4, we had strong M&A activity in this company with several investments, namely in retail technology and cybersecurity where we continue to build a leading presence in Europe. In terms of portfolio development, this was also an important year regarding assets disposals or reductions in stake, namely with the sale of the indirect participation in Outsystems, which, as you know, produced very significant capital gains for Sonae. But we also had significant increases in valuation in several other assets in the portfolio. Already in 2019, Sonae Investment Management entered into an agreement to exit Saphety, one of its longest-held portfolio companies through a management buyout. In operational terms, Sonae IM's total turnover reached € 155 million in 2018, an increase of 23 percent year-on-year with growth in all opcos and underlying EBITDA grew € 2 million to € 6.6 million, which equates to a margin of 4.3 percent.

Regarding **Sonae Sierra**, the business showed a very positive operational performance throughout 2018. In terms of management accounts, which are expressed on a proportional basis and are therefore different from the statutory figures which we consolidate into Sonae's accounts, we saw a quite positive operational performance with EBIT increase of € 2.9 million to € 108 million. Direct results increased 3 percent year-on-year to € 67 million, supported by a strong performance of the whole portfolio and also of the services division. Regarding its capital recycling strategy, Sonae Sierra sold almost € 600 million worth of assets in 2018 and is expected to further execute on this strategy in 2019. In what regards developments of new assets, Sonae Sierra opened the Fashion City Outlet in Greece in Q4, and it continued to work on the expansion of NorteShopping and the Designer Outlet in Malaga. And already in 2019, Sonae Sierra opened its first shopping center in Colombia in Cucuta. Last but not least, I would like to mention Sonae Sierra's NAV, which stood at € 1.5 billion at the end of the year, a € 22.5 million increase versus 2017 despite the dividends paid and the adverse currency impact in Brazil.



Finally, **NOS**. NOS, as you know, released its full year results already on March 8. So I would only highlight that the company showed again a good set of results with a particularly strong performance from the telco business. Operating revenues amounted to € 1.6 billion, 1.1 percent year-on-year growth. EBITDA improved 2.8 percent year-on-year to € 592 million underpinned by operational leverage and also important cost discipline measures. Net results stood at € 141 million, a 16 percent increase year-on-year and free cash flow reached € 180 million. Net debt to EBITDA remained at a conservative level of 1.8x, while dividends increased by 17 percent versus the year before.

So overall, going on to the **consolidated view of our accounts, we ended the year, I would say an eventful year, with strong growth and an increase in profitability.**


Total **consolidated turnover** reached € 6 billion, an 8.1 percent increase year-on-year supported by growth in all our businesses. **Underlying EBITDA** totalled € 372 million, improving 8.4 percent year-on-year, which means a stable margin of 6.3 percent. **EBITDA** increased by a higher amount, by a higher percentage, 27 percent, to € 483 million, fuelled by capital gains from both Sonae Sierra's sale of assets and also Sonae RP's sale and leaseback transactions, as well as higher contributions from equity method consolidated businesses, namely NOS and ISRG, which I mentioned before.

All in all, **net income** surpassed € 220 million, a 34 percent increase versus 2017, with a particularly positive evolution from direct income, which increased 58 percent to € 209 million. Regarding our **capital structure**, in a year with important movements in our portfolio, we ended the year with a net debt of € 1.3 billion, highly influenced by the 20 percent stake acquisition of Sonae Sierra. On a like-for-like basis, net debt continued its decreasing path, having reduced 17 percent year-on-year. Our capital structure was further reinforced and is now financed by 71 percent of equity, which means our gearing levels further decreased to 0.5x.

Given this set of results and according to our **dividend policy**, the payment of a gross dividend of 4.41 cents € per share will be proposed in the next shareholders' meeting, 5 percent above last year, representing a dividend yield of 5.4 percent based on the closing share price at the end of the year. And this also represents a payout ratio of 42 percent of the consolidated direct results.

So with this set of strong results, I must say that we are quite confident for **2019**, which will be an important year to consolidate the group's performance, particularly given the recent changes in the portfolio, and also, as you know, the election of a new Board of Directors.

Sonae will remain committed to its mission and to its strategy, and we'll continue to be focused on unlocking value across the portfolio while generating benefits to society at large. I will now end this brief overview of our 2018 results and invite you to ask questions. You can please open the session to Q&A.



Operator: We'll now take our first question. It comes from the line of Filipe Rosa from Haitong Bank.


Filipe Rosa: So 3 questions for me, if I may. The first one on Sonae MC. I would like, if you could, just give us some colour on the evolution of the EBITDA margin, it was flat year-on-year in the year but could you explain a little bit what were the impact in terms of promotional intensity, whether there has been a deterioration, or it has been stable, and the impact from expansion, whether it has already been more neutral this year or whether it was still negative when comparing with 2017? And also providing a little bit how you see these 2 moving parts moving into 2019, in terms of promotional intensity, taking to account that there will be a new player in the second half of the year, and regarding the store openings, whether it should be incrementally positive versus 2018 given that you have more and more stores that are approaching maturity levels?

My second question relates to the recently approved REITs regime in Portugal. Whether you could give us an idea how can Sonae benefit from this new regime, both in terms of retail properties in Sierra, taking into account that I believe that you have almost € 2 billion in commercial real estate in Portugal, whether this new regime could help you monetize or at least try to save some corporate taxes in this process?

And finally, in terms of capital allocation: last year, you tried to place a stake in your food retail business. Going into 2019, is this still something that you will try to do it? What are you considering on that front? So those would be my 3 questions.

João Dolores: OK. So I will first ask Rui to cover the Sonae MC questions, then I will hand it over to Luis to cover the REITs question. And then I will cover the last one at the end.

Rui Almeida: Hi Filipe, this is Rui Almeida speaking. Regarding the first question, regarding the question due to margins. In 2018, we were flat in terms of margins, in EBITDA margin at Sonae MC. The reasons were pretty much the same, at least we didn't have much evolution in terms of incremental commercial aggressivity in terms of promotional activity here in Portugal, we stood at the level of 45 percent, 47 percent, 48 percent, 46 percent in terms of commercial activity now in our company. And in fact, what we did also is we have the impact of the new stores we launched during 2018. Plus as we were considering when we were having the IPO process for the prospectus, we were assuming and we were expecting to have a broadly, a stable margin and we did. It's pretty much what we had. And in fact, what we also had it was a very positive figure in terms of sales. We grew aggressively in terms of market share and in terms, also in terms of like-for-like, it was very positive for the company. Going forward, we are, as we stated also in the prospectus for the IPO process, the team, the management team



ambitions to maintain broadly stable level of margins going forward. That's what we stated, and we continue to ambition those figures for the company.

Luis M. Duarte: Filipe, it's Luis here from Sonae Sierra. I mean, in terms of the Portuguese REIT regime, we see it as a positive of course, that there is a REIT regime in Portugal. It's a positive not only for the capital markets but also for the real estate sector and for the economy in general. We have been looking and assessing the REIT regime in quite a bit of detail, and we are encouraged by the potential benefits that we see that are applicable to Sierra. Having said that, there are some unknowns currently in the regime, particularly around the actual composition of what could be included in the Sigi's but also specific tax aspects. And once these specific aspects have been clarified, I think we would be in a better position to be more specific about what it is we can do and we can't do.


João Dolores: OK. Regarding the capital allocation question and the IPO of Sonae MC, I think I'm going to restate some things we've said before. Although we did not conclude the transaction, we feel that Sonae MC, the balance is positive because we make Sonae MC a company which is more prepared for the future in terms of its autonomy, agility, governance model. And so we are quite happy with that aspect of the transformation that we were able to execute at the company. As we said before, we still feel that the strategic merits of the transaction are valid for Sonae. But we are quite comfortable in holding our investment in Sonae MC, and we will not do a transaction which destroys value at the end of the day for the group. So we do not have right now any short-term plans, again, to bring back the operation to market in the future. All options will be on the table for this and other assets in the portfolio.

Operator: Our next question is from the line of João Pinto from JB Capital Markets.

João Pinto: Good afternoon, thank you for taking my questions. Three, if I may. The first one on Sonae MC. You reported 11 net openings of Bom Dia stores. If I'm not mistaken, you had guided for 18 openings for this year. This difference is related to delays or to closures? If it is related to delays, can we assume that you intend now to open more stores than the guidance provided for the next couple of years?

My second question on Sports & Fashion. You are closing Berg. Could you please update us on your plans for other underperforming brands in Sports & Fashion? Are more divestments a possibility?

And finally, on Arenal. Just to confirm, Arenal is not included in the guidance provided for the adjacent formats during the IPO, right? How many stores do you plan to open in Spain? And do you have any specific targets you aim to reach? And finally, can you tell us the network sales in 2018?




João Dolores: OK. So I will ask Rui to cover the MC questions and then Miguel Moreira to cover the Sports & Fashion Berg question.

Rui Almeida: Let's start by the number of stores that we opened during 2018. Yes, when we gave some of the guidance for the number of stores that we will open in 2018, we expected that we were not counting with the 2 stores that we closed during the first semester of 2018. And the remaining stores, it justifies the fact that we were not able to open 18 stores during 2018, were justified by the fact that we were a little bit delayed. And in fact, we have already opened those stores in the first quarter of 2019. Regarding the Arenal figures. Well, those figures, we are anticipating that probably this year, we ended up having 42 stores. Sorry, we have this moment 42 stores of Arenal in the north of Spain. We expect to open more than 5 stores this year. And in 2018, the company was able to have a turnover above € 100 million. And I think that's basically what you ask us regarding Arenal.

Miguel Moreira: Well, regarding Sports & Fashion, we decided to put Berg, and it was the only adjustment that we have planned for the portfolio. And regarding all the other brands, we don't have plans for any other adjustments. All the other brands are mature and well established in the market. We have clear, long-term strategies for the brands, and we will continue to focus our attention and our energy in those brands and developing those brands.

Operator: And our next question is from José Rito from CaixaBank.

José Rito: Yes. So my first question on the food retail. I think that Rui mentioned that you had a relevant market share increase last year. Could you provide how much was, in percentile points, the increase in the market share? Also, in food retail, if you can comment on a recently news that mentioned that Mercadona is said to be applying everyday low-price strategy in Portugal and considering that you just mentioned that 45 percent - 46 percent of sales in Portugal are under promotion. What you think about this? And if you think this will be a little bit more positive from a competition point of view for the second half versus an entry in which Mercadona will be also apply discounts? Thirdly, on Sierra, we saw some news commenting on a possible consolidation in Brazil involving Sierra. Just to understand a little bit what is your long-term thinking on your stake in Brazil, could Sierra consider after a possible M&A to exit and divest from these assets? Or do you think this is a long-term holding for the company? And finally, on the company's leverage. You have not provided impact from the new accounting rule related to these operating leases. You mentioned in the releases that you should do in the short term, but net



debt to EBITDA could stand above 4x. Adjusted for this, is still the company comfortable with its debt structure?

Rui Almeida: Right. I'll just answer the first question. According to our research, we increased market share by 30 basis points in Portuguese market. And regarding the Mercadona, we respect a lot Mercadona. It is a new player coming to the Portuguese market. It showed that Mercadona will apply for Portuguese market different value proposals that is offering today in the Spanish market. We need to see. We need to test. We need to analyse, and then we'd come up having a very better diagnosis regarding what the Mercadona intends to do in the Portuguese market. But for now, we think it continues to be too soon to give you a proper answer.


José Rito: OK. So do you think that Mercadona will basically apply also discounts in Portugal?

Rui Almeida: It's difficult to give you a proper answer. I don't know. It's too soon.

Luis M. Duarte: Very good. In relation to Sierra Brazil, I mean, there isn't much more in terms of capital market that we can say in relation to the actual merger. The company made a statement today around that specific issue and bearing in mind that the company is listed. In terms of Sierra's long-term position around Brazil, Brazil is a market we like. Sierra Brazil is a business we like. It's a business that's been in our portfolio for a very long time. It's a business that has had a really good performance over the last couple of years and has got good current trading momentum. Obviously, the depreciation of the Brazilian real doesn't help, but it's an asset which has a strategic nature for Sierra. Having said that, we are active portfolio managers. We are active capital recyclers. So every capital market transactions on the table at any time always, so we would tend to be and will continue to be active about our portfolio.

José Rito: OK. Can you update in terms of yields evolution going forward for the overall countries?

Luis M. Duarte: All right. I mean, it's a tricky question. And I personally don't like to give guidance on things which I can't really control or which not only depend on me, and I'll break it down into 2 buckets. One around fundamentals, so if yields were purely driven by fundamentals. I mean, we've seen a very good momentum in our portfolio across the board. We've seen good occupancy rates, good trading momentum pretty much across most geographies. So from a fundamental point of view, things are progressing very well. However, there's a sentiment, mainly coming from the Anglo-Saxon market, which is not more than a sentiment which has been probably a bit exaggerated, and we're feeling it in



a bit exaggerated way across the board. But in our experience, the way we go around this sentiment is by sitting down with the different investors and by explaining to them the structural and cultural differences of the Portuguese market, exactly what it is we're doing in our shopping centers and what makes them different from the generalizations that happen in the Anglo-Saxon market. So it's overall a difficult question to answer because there are really 2 different winds pushing into different directions.

José Rito: Ok, ok. But at least in terms of recent transaction yields, are you seeing any, let's say, stabilization or declines or are still increasing, in this case, expanding the yields?

Luis M. Duarte: The yields, let me put it this way. The transactions we've made were in line with our expectations, and I really can't give much more guidance than that.


João Dolores: Ok. José, regarding leverage. As you said, we will obviously be disclosing the impact in our accounts of IFRS 16 which are relevant as for many other companies which have businesses in the sectors in which we operate. And we will give full disclosure and total transparency as to what the impacts are. Having said this, I said before that we are quite comfortable with our leverage level. We have a conservative capital structure, and as this is merely an accounting impact with no cash impact on our accounts, no economic value, really. Our view still stands, so we will still have a conservative level of leverage after we apply an accounting standard for our accounts.

José Rito: OK. So you don't expect any change in terms of perception?

João Dolores: No. And we know that all stakeholders that work with us will also be a bet to you because this is merely an accounting impact with no cash or economic relevance.

Operator: And our final question is from Tim Attenborough from Santander.

Tim Attenborough: Just a couple from me. First, can I just go back to what João was asking? Can we still assume a run rate of about 20 Bom Dia stores per annum going forward for the next couple of years as a new opening plan? Secondly, on MC as well, online, could you give us an absolute figure for sales? I mean, you've talked about average ticket size increasing. What is the average ticket size there? And lastly, just can you give us a CapEx view for 2019, please, including Sierra? That will be helpful. I'll leave it at those 3.



Rui Almeida: Tim, regarding Sonae MC, opportunities possible for the year, yes. So our ambition is to maintain that pace going forward in the next year, next couple of years. Regarding Continente online figures from the online business, unfortunately, I'm not allowed or we cannot give you the figures regarding the average ticket for the company. This is something that we are not giving the market. Regarding the Capex I believe this question is for Sonae Sierra.

João Dolores: No. I can cover that one.

Rui Almeida: Sorry.

João Dolores: Well, we do not give guidance. We won't give guidance on the CapEx. What I can tell you is that the level of CapEx we have this year, obviously, is quite extraordinary, because it includes the acquisition of a 20 percent stake in Sonae Sierra. In 2019, what I can tell you is that we will continue to invest in all our businesses significantly to maintain our value propositions, our competitive positions and also to ensure that we seize opportunities for growth.


Operator: (Operator Instructions). We just have another question from the line of Filipe Rosa from Haitong Bank.

Filipe Rosa: So just one more from me. Regarding electronics. So after 3 years of very strong performance in terms of sales and in terms of margin recovery, this year, we have had the stabilization of the margin and still a quite strong top line performance. Just if you could update us a little bit on how do you see the outlook for 2019. I know you don't give guidance, but it seems like it was a little bit disappointing that with such a strong improvement of sales per square meter, you were not able to improve again your profitability. Could you try to explain what happened in...

João Dolores: I think we lost you, Filipe.

Filipe Rosa: Sorry. Hello? I can hear you, but apparently, you are not hearing me.

João Dolores: No. We were not hearing you. Can you please go again, Filipe? Sorry.




Filipe Rosa: Yes. So I'll try to make it shorter. Maybe can we try to understand with the moving parts of the evolution of the margin in 2018 for electronics for Worten, basically very strong top line performance, very strong evolution of sales per square meter but no operating leverage. And basically trying to understand what could be outlook for the next couple of years based on what happened in 2018, okay. How do you see what happened? And what do you expect to happen over the next couple of years?

Miguel Águas: Filipe, this is Miguel Águas. Not providing guidance for the future. I can tell you that in 2018, as you said, we had a strong performance in turnover, in like-for-like growth. We did have, especially on the fourth quarter, some investment in terms of gross margin given the increased weight of the Black Friday phenomenon, both in Portugal as well as in Spain. That did take a bit of a hit in terms of our gross margin. And on top of that, and as we have said before, Worten is in a process of strong digital transformation that entails increased investment and increased costs dedicated and resources dedicated to that transformation, mainly on IT. And that has been also a contributor to the stable margin levels that we had. As you said, there was no operating leverage. I would say that there was, but it was sort of consumed by both the Black Friday effect and the added investments on the IT front. I would say, I mean, going forward, we've maintained our ambition to pursue a strong transformation in our business model being increasingly more digital. And therefore, our investments going forward will be more and more dedicated to technology and to the transformation of our business processes. And as regards for other elements of the business, I would not go into guidance considerations.

Filipe Rosa: But can you just trying to follow up? Do you think that what happened in 2018 could happen again in 2019 because you still need to allocate more resources to the business? So any guidance that you could have would continue to be reinvested into the business, basically, into this digital transition? Or do you think that, okay, 2018 was an exception. And so if in 2019, you continue to have some solid like-for-like growth, you could kick in again some operating leverage, over the next couple of years, it could benefit from that operating leverage.

Miguel Águas: Filipe, I hope you understand that we are not going to provide that much colour in the future. We do expect, in any case, that future investments to be increasingly focused on digital transformation and therefore, that part of resource allocation will definitely increase. But most likely, there will also be a reduction in other resource commitments that we used to allocate to, I would say, more traditional, physical business. But that being said, I would rather not go into quantifying or give you more color than this going forward.



Operator: There appears to be no further questions at this time. Speaker, please continue. Thank you. That does conclude the conference for today. Thank you all for participating, and you may now disconnect.

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