

Conference Call (English Transcription)

Vulcabras Azaleia

Earnings Release 1Q20

June 9th, 2020

Operator: Good morning and thank you for waiting. Welcome to the Vulcabras Azaleia conference call to discuss results for 1Q20. Present today with us are Pedro Bartelle, CEO of the company, Mr. Wagner Dantas, CFO and Investor Relations Officer and our Investor Relations team, Mr. Valdinei Tortorelli, Ms. Leticia Marcellino Carvalho and Ms. Luciana Serrano de Oliveira

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

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

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

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

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

Mr. Pedro Bartelle: Good morning, welcome to the conference call of Vulcabras Azaleia. We are disclosing the results of the first quarter of 2020 in a pandemic environment, which caused a slowdown in activities worldwide, interrupting the Brazilian economy's recovery that showed signs of improvement in the first months of the year.

January and February were positive months, when the footwear and clothing segment had grown by almost 2% over the same period last year, according to IBGE data. In March, there was an abrupt slowdown, Brazilian industrial production fell 9.1% in the comparison between March and February, 3.8% compared to the same month of 2019.

At the beginning of the year, Abicalçados projected growth of up to 2.5% in the production of footwear, but, due to the pandemic, the forecast for the year was revised to a decrease of 26% in relation to 2019. According to the entity, in the first quarter, production in the sector has already decreased by 14.2%.

Vulcabras Azaleia also showed a positive trend for its results, which were mainly driven by the positive performance of the new Olympikus, Under Armor and Azaleia collections, which were very well received by retailers and consumers. Unfortunately, this positive trend was interrupted in mid-March, with the worsening of the pandemic and the establishment of state decrees that paralyzed economic activities almost throughout the country.

Aiming to preserve the health of our employees and to tackle the transmission of COVID-19, the Company was one of the first in the country to take the decision to shut down its units, on March 20, through the concession of collective vacations that lasted for a total period of 34 days. Only the crisis committee and some essential departments remained working, remotely and with reduced teams, on actions to mitigate the impacts on the Company's operation.

The shutdown of the factories and market, in national and international territory, in the second half of March was directly reflected in the results of the quarter. The total revenue of R\$ 238.6 million, presented a decrease of 20.4%, when compared to the first quarter of 2019. In the month of March, besides to the total stoppage of operations from the 20th, approximately 50% of the revenue of the month, billed prior to the adoption of restrictive circulation measures, was in transit, and due to the closing of retail, its delivery has not completed, thus returning to our inventories and not being recorded as revenue in the quarter.

The gross margin was 32.3%, slightly lower than that obtained in the same period last year (reduction of 1.7 p.p.).

EBITDA was R\$ 27.2 million, 42.3% lower than the same period last year, but with an EBITDA margin of 11.4%, which is 4.3% p.p. lower than the EBITDA margin obtained in the same period in 2019.

Even with a favorable cash position, given that during the first quarter most of the receivables from the Black Friday and Christmas sales of the previous year are collected, the Company sought to reinforce its liquidity by raising funds from pre-approved credit lines (up to the end of April in the amount of R\$ 126 million), reduction in operating expenses, reprioritization of its investments and at the end of the collective vacation period with adherence to Provisional Act 936, applying reductions in working hours and wages in factories and offices.

The DTC (Direct to Consumer) channel, despite being impacted by the stores closing due to the decrees, maintained its operations through its e-commerce

platform in the three brands Olympikus, Under Armor and Azaleia. Specifically for the Olympikus brand, at the end of April, the Corre Junto Brasil project was launched, the first 100% sports affiliate network in Brazil. The project aims to include all sports professionals as digital entrepreneurs to generate extra income through the sale of Olympikus products.

Almost three months after the worsening impacts of the pandemic, according to the Brazilian Association of Footwear Industries (Abicalçados), 72% of the footwear industry has returned to its activities, and with us, it was no different.

Vulcabras Azaleia's manufacturing operations resumed its activities at the end of April, partially and with reduced working hours, following a strict protocol with prevention and hygiene measures, which follow the recommendations of the World Health Organization.

The retail footwear market, in turn, also gradually return its activities, which according to information from ABLAC (Brazilian Association of Artifacts and Footwear Retail), 42% of retail are already in operation.

Faced with this scenario of recovery that is beginning, focused on its customers, Vulcabras Azaleia is sure of its solidity, even though it understands that there are still many challenges ahead in relation to consumption and the resumption of the macroeconomic scenario.

We have already adapted our product collections, reinforcing our position as a "smart choice" and we continue to be agile and flexible, assisting our customers in a more assertive replacement in the recovery of sales and the maintenance of inventory levels.

We are convinced that our product portfolios, the strength of our brands and the flexibility of our business model, will be the competitive differentials that will lead us to overcome this moment and, certainly, come out even stronger.

Now to presentation of our performance in the quarter. I would now like to give the floor to Mr .Wagner Dantas, our CFO and Investor Relation Officer, Thank you.

Mr. Wagner Dantas: Good morning everyone. We started the presentation with slide 5, gross volume of pairs and pieces. In 1Q20, gross volume billed totaled 4.7 million pairs/pieces, down of 20.1% compared to 1Q19 total of 5.9 million pairs/pieces.

The advance of the COVID-19 pandemic in the first days of March culminated with the enactment of social isolation measures in Brazil and around the world. As a result of this abrupt slowdown, sales in March were completely interrupted.

The impact of the interruption in sales led to a general decrease in the volume of the quarter, the main variations of the period are due to: (i) a reduction in Athletic Footwear sales, due to the fall registered in the domestic market and in branches abroad, minimized by the growth of sales to the foreign market; (ii) a decrease in Women Footwear, due to the fall recorded in the domestic and foreign markets

(iii) a decrease in Other footwear and Other, (iv) an increase in Apparel and Accessories, due to the expansion registered with the Olympikus brand.

On page 06, we present the net revenue per product category. In 1Q20, net revenue was R\$ 238.6 million, decrease of 20.4% compared to R\$ 299.8 million in 1Q19. Despite the beginning of the year having provided good perspectives for the performance of the quarter, and excellent results were obtained in the months of January and February, the advance of the COVID-19 pandemic in the first days of March culminated with the decree of measures of social distancing in all Brazilian states and the closure of all brick and mortar retail.

As a consequence of this abrupt slowdown, sales for the month of March were totally interrupted. The only sales channel that remained active throughout this period was e-commerce. With this stagnant scenario, some customers sought the Company to review orders that were no longer met and their future orders. Since then, the Company has endeavored to do everything possible to minimize the effects of this pandemic, alongside our customers, proposing strategies so that together they can overcome this difficult moment.

Athletic Footwear revenue decreased 20.5%, with a negative performance in the domestic market, which was mitigated by the increase observed in the foreign market. Both the revenue for Olympikus shoes and for Under Armor shoes decreased compared to the same quarter of the previous year.

The category of Women's Footwear presented an expressive fall of 21% in relation to the same period of the prior year. In the period, there was a decrease in domestic and foreign market revenue, due to the decrease in sales volume.

The Apparel and Accessories segment was down 12.9% compared to 1Q19. In the period, there was an increase in revenue with the Olympikus brand and fall in revenue with the Under Armor brand.

The category of Other Footwear and Other decreased by 29.4%, with a decrease in all sub-categories.

On page 07, we present the opening of net revenue per market. Net revenue in 1Q20, in the domestic market, totaled R\$ 203.5 million, a reduction of 26.0% compared to R\$ 275.1 million in 1Q19. In the foreign market, net revenue in 1Q20 totaled R\$ 35.1 million, 42.1% up compared to R\$ 24.7 million in 1Q19.

In the domestic market, the decrease is due to the general fall in almost all categories, with the only exception, the revenue from the Olympikus apparel, which increased.

In revenue from sales to foreign market, there was an expansion in revenue in 1Q20 compared to the same period of the previous year. In this quarter, there was an expansion in direct sales abroad, when compared to the same period of the previous year, mainly due to the resumption of business with the Argentine market.

In sales of foreign branches, a reduction was observed in relation to the same period of the previous year, due to the impact of the measures adopted to combat

the COVID-19 pandemic by Peru and Colombia, which led to the slowdown in all activities and the temporary closure of 43 exclusive Azaleia stores in those countries.

Going to page 08, we have the presentation of gross profit and gross margin. Gross profit in 1Q20 was R\$ 77.1 million, a reduction of 24.4% in relation to the R\$ 102.0 million recorded in 1Q19. Gross margin was 32.3% in 1Q20, 1.7 p.p. below the 34% recorded in 1Q19.

At the beginning of the quarter, the Company had good expectations for the current period. The new collections of Olympikus, Under Armor and Azaleia, which were presented at the end of the prior year, were well received by retailers and consumers and the order flow was as expected. However, as of the second half of March, the slowdown of the market, due to the COVID-19 pandemic, triggered the drop in sales and the interruption of production at the factories. As a result, the gross margin was negatively impacted, as a result of the lower production volume and higher costs.

Going to page 09, we present the selling and advertising expenses. At the top of the slide, we have the graphs of selling expenses (excluding advertising) decreased by 4.3% in 1Q20, compared to expenses reported in 1Q19. R\$ 33.5 million was recorded in 1Q20, against R\$ 35.0 million in the same period last year. As a share of revenue, selling expenses (excluding advertising expenses) accounted for 14% in 1Q20, compared to 11.7% in 1Q19, an increase of 2.3 p.p.

The relative growth in selling expenses in the comparison of the periods is mainly justified due to the significant reduction in revenue this quarter.

The perceived increase in freight expenses is due to the return to the factories of goods that had already been billed and were in transit when the restrictive measures to trading were implemented. The allowance for doubtful debts also increased. The other variable selling expenses were normal, in line with those presented in the last quarters.

At the bottom of the slide, we have advertising and marketing expenses, which in 1Q20 totaled R\$ 12.2 million, an increase of 1.7% over the R\$ 12.0 million in 1Q19. The share of advertising and marketing expenses over net revenue represented 5.1% in 1Q20, compared to 4.0% in 1Q19, an increase of 1.1 p.p. The relative growth in marketing expenses in the comparison of the two periods is justified by the lower revenue in 1Q20.

Going to page 10 we have the statement of General and Administrative expenses. The Administrative expenses totaled R\$ 24.7 million in 1Q20, practically identical to the amount reported in 1Q19. As a percentage of net revenue, there was an increase of 2.1 p.p, from 8.3% in 1Q19 to 10.4% in 1Q20, due to the reduction in revenue in 1Q20. In the quarter, there was a reduction in personnel expenses, third-party services, IT/telecommunications and an increase in other expenses.

On page 11 shows the behavior of the financial result and the net debt. Net financial income in 1Q20 recorded an income of R\$ 4.9 million, compared to

expense of R\$ 1.8 million in the same period in 2019. In the comparison of the quarters, the main variation was observed in the increase in foreign exchange revenue, due to the effect of the devaluation of the Real in the consolidation of the results of foreign branches.

At the end of 1Q20, the Company had a positive net financial position of R\$ 60.0 million, 174.0% higher than that observed at the end of 12/31/2019. Gross debt totaled R\$ 63.9 million, with an increase 48.3% in relation to the balance of 12/31/2019. There was a 94.7% increase in cash and cash equivalents.

In the face of an impending crisis scenario, the Company maintained its financial discipline and sought to reinforce its cash with contributions made to credit lines that were pre-approved. Such measures aim to face the negative impacts that the COVID-19 pandemic may cause on the Company's activity level.

On page 12 we have net income and Adjusted ROIC. Net income in 1Q20 was R\$ 8.9 million and represented a decrease of 66.0% over net income of R\$ 26.2 million in 1Q19. The net margin reached 3.7% in 1Q20, compared to the 8.7% achieved in 1Q19, a reduction of 5.0 p.p.

Annualized adjusted return on invested capital (Adjusted ROIC3) reached 14.0% in 1Q20 - LTM (last twelve months ended 03/31/2020), with a 4.3 p.p. decrease over the 18.3% result obtained at 12/31/2019.

On page 13 we present EBITDA. In 1Q20, EBITDA was R\$ 27.2 million, a reduction of 42.3% compared to the R\$ 47.1 million obtained in 1Q19. The EBITDA margin decreased by 4.3 p.p., reaching 11.4% in 1Q20 compared to 15.7% in 1Q19. This result is mainly due to the decrease in net revenue in all the Company's businesses due to the general slowdown caused by the spread of COVID-19.

On page 14 we present Capex. In the 1st quarter of 2020, R\$ 17.5 million was invested in property, plant and equipment. The investment in intangible assets in 1Q20 was R\$ 0.7 million. The investments made this quarter should support the Company's operations, as well as the continuity of the modernization project of the manufacturing plants.

In 1Q20, the Company concluded the sale of the subsidiary Vulcabras Azaleia SE, as disclosed in a material fact at the beginning of the year. As of April 1, the manufacturing plant in Sergipe became the sole responsibility of the purchasing company.

On page 15 we present the cash flow. Cash generation in the period was R\$ 61.6 million, and was reduced by R\$ 2.7 million due to the effect of the conversion of investees abroad, making the positive cash variation of R\$ 58.9 million. The variation presented was essentially due to the following events: EBITDA of R\$ 27.2 million; reduction in the need for working capital of R\$ 29.3 million; an increase in bank liabilities of R\$ 20.9 million; investments in property, plant and equipment and intangible assets of R\$ 18.2 million and an increase in long-term liabilities of R\$ 10.3 million.

The main variation in working capital in 1Q20 is due to the reduction in accounts receivable from customers due to the seasonal effect of year-end sales, which end up concentrating a greater volume of receivables in the first quarter of the year.

We conclude our presentation and open space for questions.

Thank you

Question and Answer Session

Operator: Ladies and gentlemen, we will now begin the question and answer session. To ask a question, please press asterisk 1. To remove the question from the list, press asterisk 2. Again, remembering that to ask questions just press asterisk 1.

Mr. Pedro Bartelle: I thank you all for your presence and I affirm that the Company's management will be attentive to all events and whenever necessary, it will inform the market of the measures adopted. We remain at your disposal to personally clarify through our IR team any other points or questions that may have been pending, thank you.

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