

Conference Call Transcript 2Q22 Results

Pedro Zemel:

Good morning, everyone. Welcome to Grupo SBF webcast where we will discuss Grupo SBF's results for 2Q22.

This is Pedro Zemel, CEO of Grupo SBF. And I am here with Jose Salazar, CFO and IRO, Daniel Regensteiner, Director of Corporate Finance, and Luna Romeu, Investor Relations Manager.

Here on slide two, we will separate our presentation in three parts. First, we will give you an update on the main highlights of the quarter, then we will comment on the results, and finally, we will move on to the Q&A session. Questions can be sent through this webcast platform and will be answered after the presentation.

So, let us start on slide three. Within the creation of Grupo SBF sports ecosystem, strategic planning and important enablers to transform our current structure into a platform that allows the integration of new players with less and less effort.

In the future, we want it to be obvious to everyone in this market that it is better to be connected to this platform. In the 2Q22, we have taken important steps to make this reality.

Since the end of the Nike transaction in late 2020, we have been moving forward at a steady pace in integrating the two companies. After a first year with fundamental deliveries to create an integrated organizational structure of Grupo SBF, which allowed us to capture management and back office synergies, this year we began the first major deliveries of systemic integration, essential for the platform's strategy.

In this regard, during this 2Q, we have advanced with two relevant deliveries: the first is that Centauro successfully finalized the migration to SAP Hana, this first step for the business units' ERP is to be integrated, which in turn will allow the implementation of several other projects, such as Fisia's tax incentive and the creation of a wholesale channel serving the entire SBF Group.

The second is the migration of 100% of Nike.com's organic flow to Grupo SBF's proprietary platform, which represents 35% of the total flow of Nike.com. This paid flow will also be migrated by the end of August, and here we will have a single digital platform in the Group, which will allow us to capture expenses, synergies and the joint evolutions of the sides of the two business unit, unlocking additional growth at Nike.com.br.

It is worth noting that both the cloud ERP and the microservice digital platform are already prepared to absorb any new players that may join Grupo SBF in the future, and that with the completion of these integrations, the technology and innovation teams that were involved in these deliveries will return to work focused on another Company projects.

Now on slide four, within our marketing initiatives we have planned for this year, we are working to make Centauro's brand increasingly perceived as a sports brand. This quarter we highlight, among several deliveries, the sponsorship and acquisition of the broadcasting rights of São Paulo's women's soccer championship for the next three years, the first brand in the history of

soccer to buy the broadcasting rights of the sport, and with an investment that made the biggest award in the history of women's soccer in the country.

Another angle of the strategy is the approximation of the brand to the consumer during sports journey, represented this quarter by the inauguration of another, Centauro Arena, sporting spaces scattered throughout major cities that provide free sports experience as beach volleyball courts and skateboarding tracks.

Now, next slide, five. We have also initiated the execution of our World Cup strategy. Centauro, within its licenses' strategy, has already launch an exclusive line of official CBF products, an important progress in relation to past Cups, which allows us to expand the reach of the World Cup portfolio with entry level products that complete the portfolio of official shirts of the Brazilian football team, always the best-selling item. Fisia will launch the official Seleção collection in August.

Now people, this quarter we won the Great Place to Work seal, strengthening of Grupo SBF as an employer brand, which besides being a great indicator of the satisfaction of our employees, helps us to continue attracting and retaining the best talents.

As you may see, now on slide six, during 2Q22, we observed a significant, consistent growth of the Company of 31%. The main highlight was the Nike Digital Channel, which grew 123%, sustained by the same levers we have mentioned in previous quarters: marketing, strategic prioritization of the channel, portfolio, migration of sales from wholesale to 3P. With this growth, 31% of SBF Group sales is already made through our digital channels.

This migration of part of the sales to Fisia's direct to consumer channels, Nike.com.br, Nike Value stores benefit the Company's profitability, since the higher gross margin of these channels more than offsets the higher expenses.

This past quarter, the USD at a higher level than last year meant that the direct to consumer migration improvement in gross margin was not realized. In addition, on the EBIDTA margin, the net effect between the DTC migration and the currency devaluation was negative.

As expected, we also had other major impacts on expenses such as inflation, reduced rent, discounts and investments. Salazar will give you more details regarding our results.

We are attentive to the economic situation and always committed to our results, ready to react and to make adjustments, if necessary, to protect the Company's results.

Salazar, I give you the floor now.

Jose Salazar:

Thank you, Pedro, and good morning to everyone. Before I start, I want to remind you that this quarter we had both positive and negative non-recurring effects that are shown in our release. The results that I am going to present in the next few slides are adjusted for the non-recurring effects and, with some exceptions that are indicate at the time, considering the effects of IFRS 16.

Now on slide seven, as Pedro mentioned, we had good results this quarter. I emphasize especially here; I will start with indicators including the effects of IFRS 16. This quarter, we totaled a net income of R\$51.5 million, with a net margin of 3.5%. Fisia's gross revenue totaled R\$1 billion.

This is a growth of 38% vis-à-vis 2Q21. Online sales in Fisia's digital channel, Nike.com.br, increased 114%, totaling R\$329 million. And Centauro's gross revenue, which totaled R\$969 million, this is a growth of more than 25% when we compare it to 2Q21.

We can go to slide eight. The Group's net revenue of the quarter totaled R\$1.4 billion, a 31% growth compared to the 2Q21, and R\$2.8 billion year to date, growing more than 46% in comparison to the 1H21.

Now, in our next slide, we can analyze each business unit. Centauro reached R\$799 million during 2Q, 25% of growth compared to the 2Q21. Year to date, revenue grew 34%, totaling R\$1.5 billion. Our stores grew 32% compared to the 2Q21 and 39% year to date. This growth is explained in part by the remodeling of 14 stores to G5 model and the inauguration of another 17 new stores in the last 12 months, being one new store and five refurbished in the 2Q, in part by the recovery of the flow in the stores in 2022, since, during 1Q21, part of the stores were still operating with restrictions due to the pandemic.

In addition, the availability of products from the markets places continues to contribute to the 41% growth of sales via extended stock. The digital platform's net revenue grew 10% and 23% in the first six months of the year, in addition to omnichannel sales that grew 32% in the quarter and 34% in the year, representing 17% of the direct sales. The difference between revenue and GMV growth is explained mainly by Fisia's strategy of migration to 3P, which caused part of Nike's products to be sold in Centauro's marketplace and, as a result, presented a growth of 121% in the quarter.

Fisia totaled R\$783 million in this 2Q, growing 36% when compared to the 2Q21, and R\$1.5 billion in the year to date, a growth of 57% compared to the same period last year. The result was driven by a 123% sales growth on the digital platform, which continues to benefit from the portfolio, marketing, 3P and the strategic channel prioritization strategy, which we initiated in the incorporation of Grupo SBF, and the Nike Value Store Channel revenue growth of 33% in the quarter, 45% in the year is benefited from operational gains with the new processes that were implemented in 2021, and the optimization of assortment offered in the stores, which resulted in a same-store sales of 26%.

Since the beginning of Fisia's operation, wholesale seasonality has been volatile, both by the effects of the pandemic and the delays observed in the global supply chain. This quarter, we saw a growth that we consider more normalized, in line with the order of grandeur that we expect for this channel, taking into account the migration of some of those sales to digital by 3P migration.

Now, on slide ten, the Group's consolidated gross profit for 2Q reached R\$670 million, a 30% growth vis-à-vis 2Q21. For the year to date, six-month gross profit reached R\$1.3 billion, an increase of 48% compared to the same period last year.

Now on our next slide, we can see each business unit. Centauro achieved a gross margin of 50.4% this quarter, in line with the margin presented in 2Q21. Year to date, the margin reached 49.5%, an increase of 1.5 p.p.

Through a more assertive allocation in stores and more rational pricing policies, we have been able to improve the margin of physical store channels. Even with the market still discounted, the online channel achieved an important margin recovery vis-à-vis last quarter and returned to levels similar to those of 2021. These effects were offset by the end of the default difference in rate benefit in the 2Q, compared to a R\$12.4 million effect on 2Q21.

Fisia's gross margin totaled 36.4% in the quarter, also in line with the margin presented on 2Q21. Year to date, the margin showed a growth of 1.4 p.p. totaling 38.1%. The migration to the DTC channel, specialty digital channel, went from 21.1% to 32.8%, so it had a positive effect on Fisia's margin. This effect, added to the price pass-through, offset the pressure of the exchange rate on the cost of imported product.

It is worth remembering that, as we emphasized last year, we had on the 1Q21, the first half, a positive accounting impact coming from the acquisition stock price at lower prices than we have as a distributor. Even taking this impact into account, we managed to equal last year's gross margin, but the price path through was not enough to equal the impact of the effects on Fisia's EBITDA margin, as we will see on the next slide.

Now on the next slide, I want to highlight that we believe that our gross margins or EBITDA just stable themselves as of now.

Now this is slide 12, to talk about operating expenses. In the quarter, they increased 41% compared to 2Q21, and 39% compared to the 1H21. The increase is mainly explained by the 33.1% growth in our gross revenue, which has a direct impact on our variable expense.

As I mentioned, Fisia's gross margin maintenance came because of the DTC migration and the price increase, which is being enough to offset the exchange rate effect, and the acquisition inventory effect on the margin was not enough to offset the impacts on the EBITDA margin. This happens because Fisia's DTC channels, especially Nike.com.br, which went from 21.1% to 32.8% of Fisia, so it has higher expenses than the wholesale.

Relevant impacts were inflation of 11.89% in 12 months, a comparison base with a lower level of expenses in 2021, when part of the stores were opening in reduced hours and even counted on rent discounts; an investment in strategy necessary for the healthy growth of the Company such as marketing, logistic, technology and team growth.

The promotion line in our expenses note is a good example of the quarters impact. It grew more than the Company's growth because it is mainly composed of performance, marketing, which is much more correlated to the digital channel revenue.

It is also impacted by the investments made in Centauro's branding, as Pedro said. In addition, the contract with Nike provides for an increase in royalties during the life of the contract, which also impacts this line. In the six month accumulated period of the year, the revenue growth and the back office and logistics synergies obtained with the integration of Fisia and Centauro operational partially offset these effects. With this, we saw a drop, we went to 33.4 in the 1H21 and 33.8 in the 1H22.

The group EBITDA totaled R\$155 million for the quarter, with a margin of 10.6%, a contraction of 2.8 p.p. caused by the growth in expenses explained beforehand. On the other hand, in the year to date, we observed of growth of 82% of EBITDA, with a margin of 12% compared to the 1H21. This is an increase of 2.4 p.p.

Now, on slide 14, this quarter we have a net income of R\$36 million, a drop of 1.2 p.p. in the margin, explained by the drop in the EBITDA margin. Year to date, we have presented a net income of R\$66 million, an increase of 394% in comparison to the 1H21, with an improvement of 1.7 p.p. in margin.

Now on slide 15. Operating cash flow was negative by R\$69.9 million during 2Q, impacted mainly by the Company's growth that increased working capital consumption and by accumulation of ICMS credits and Fisia's situation. That will be circumvented with the tax incentive planned for the beginning of 2023.

The cash flow from investments was impacted by investments in technologies, logistics and projects of SBF Group's store openings, Centauro G5 and Nike Value Store, and by the investment of SBF Ventures. M&A's cash flow from the financing in the quarter reflected the new debentures issued by the Company in expected amortization of bank debt and a dividend paid in May.

We ended the 2Q22 with R\$407 million in cash and adjusted net debt up by R\$157 million. Our financial leverage position is comfortable at 2.8x EBITDA.

Now slide 16. CAPEX for the quarter was up 9% when compared to 2Q21, mainly reflecting investments in technology such as Centaurus ERP migration to SAP Hana, the migration of Fisia's digital platform to the Group's own platform.

In addition, we started the renovation of our logistic network with projects to improve the level of service in the North, Northeast and São Paulo regions. The store opening candle calendar, with a higher concentration planned for the 2H22 compared to the previous year, explains the slowdown observed in investment in store projects. In the quarter, five Centauro G5 stores were refurbished, and one Centauro G5 store was opened. Year to date, we had a 15% increase compared to the 1H21, mainly reflecting the acceleration of investments in structuring projects in technology and logistics.

Now we will initiate our Q&A session, which can be sent to us directly on this webcast platform.

Thiago Macruz, Itaú BBA (via webcast):

Fisia's channel migration has been very successful. This means the margin upside of this process has been offset by temporary items. How do you expect Fisia's margin by the end of the year?

José Salazar:

Thank you, Thiago. Ruben from Santander made a similar question, I will try to answer both questions. The DTC channel in the year and in the future years, will continue growing more than wholesale. And this is not only digital. I am also talking about the expansion of brick and mortar stores.

We will have an NVS expansion because we will open new stores by the end of the year, Nike stores with the Rise model, something that will be opened during the 2H. And in the upcoming years, we have a store opening pipeline, which is significant.

These two channels will absolutely give us a gross margin and EBITDA margin much better than the wholesale channel. So we imagine a certain stability and exchange rate, and here we can increase price. We believe that the effects of this expansion toward DTC, physical and digital will be followed by an improvement of Fisia's gross margin from here on. Therefore, we are optimistic that we will see the expansion of gross margin of Fisia because of the channel migration.

Salazar?

Pedro Zemel:

The margin of the DTC channel is much higher than the margin from the wholesale channel. This will generate a margin expansion in the Company, and we are optimistic with the penetration of direct to consumer in the margin of this channel. Our expectation is to continue expanding our margin in Fisia.

Irma Sgarz, Goldman Sachs (via webcast):

I want to now about the impact of the exchange rate on the gross margin. Can you tell us what the impact is and the prospects for the future?

Jose Salazar:

I would like to remind you, Irma, that when we talk about Fisia's gross margin, we always buy the currency in order to guarantee our price. This is done 12 months in advance. So specifically for the year 2022, all collections have already been hedged. Therefore, we do not believe that there will be any type of impact because of the exchange rate variation as of this moment.

Now, obviously, there are different levels of hedging, according to the seasonality and according to the moment where you carry out the hedging. On 1Q, we had a better hedging, and during 2Q22, the USD was higher than that of 1Q. And we did that a year ago in such a way that during quarters you can have slight oscillations, but when we think about our planning for 2022, we do not see major oscillations.

We have been able to buy the currency for the year according to what we had forecasted and budgeted. Now, should there be a major variation of the USD upwards or downwards for next year, we are now doing the hedging for the next year's collections. If it hits downwards, this will generate more gross margin because we will not drop prices, and upwards, we will be able to increase our prices in such a way.

And we believe here that Fisia's gross margin should not be impacted by the exchange rate, and it will improve because of the answer that Pedro and I gave to the last question. Thank you for your question.

Richard Cathcart, Bradesco BBI (via webcast):

Marketing expenses increased significantly on 2Q22, year on year. Is this something punctual? And payroll expenses increased year on year. Should this level be recurrent during the rest of the year?

Jose Salazar:

Leonardo Amaral also asked a similar question. I will try to answer these questions. The expense grew R\$10 million because of the increase of digital channels. Five are increases of prices caused by the ads market. We also invested in branding, as we have been mentioning, and we are starting to build a stronger Centauro brand, and this investment was of around R\$15 million because of the growth of the revenue of the Company and additional investment in the Centauro brand.

We spent approximately R\$20 million additional royalties vis-à-vis last year because of the growth of the Company and because of the increase expected in contract. So by and large, these are the major pillars that explain this migration.

The payroll expansion, we have also grown. In terms of structure, we have strengthened our logistics team. We are strengthening our logistic networks. So the executive logistics team has increased. We have a new person, this person has brought new executives to grow this area.

We are increasing our expenses in the marketing area. Therefore, we are building branding, and for this we need a structure that we did not have. In this a specific case, we do believe that the main actions have been carried out. So we started with a level, we did not have these areas in 2021, and now we have these areas, and this has been built throughout the last years. Currently, we do not believe that we will have additional growth in terms of these expenses.

Pedro Zemel:

I would just like to piggyback on your comment, and these investments are according to the growth of the Company. In the mid-run, the Company is growing, and this investment in terms of services should generate an increase of revenue and more profit.

And in the short, mid and long run, we manage our Company according to its result and the building of the long term. We expect margins to improve. So we do believe that the Company's margin will improve throughout time, and we are confident, and we continue focusing on this point and making our adjustments when it is necessary.

Your question, if this is a punctual effect or if this will be something more recurrent, some expenses will be recurrent, but we expect to deliver the margin of the year, and throughout the years this margin will continue growing. This is what we are aiming at.

Ruben Couto, Santander (via webcast):

Could you to elaborate on the licensing of the official CBF products because of the World Cup? How can this increase your margin during the 2H?

Pedro Zemel:

The World Cup is another Christmas. And here, the main SKU is the Brazilian jersey. This is for Fisia. For Centauro, it would be the jersey, and we also have the football and the licensed products.

Regarding a specific World Cup products, we are talking about over R\$250 million in sales only with a specific product. This is between both companies, 50-50. In addition to this, there is a there is a movement that we expect because the volume of the subject everywhere in the media, in sports, football increases, and this increases the flow.

And we are leveraging this moment. We will leverage Father's Day with the Brazilian soccer team's jersey. We also have children's day. We can leverage also Christmas. The Brazilian football team will be a present. Brazil will play during the last week of November.

In specific products, I am talking about around R\$250 million and an increase in volume. So we are getting prepared for a sales growth, which will be strong.

Gustavo Oliveira, Trade Asset (via webcast):

Could you update Fisia's withdrawal?

Jose Salazar:

We want to migrate visa during 3Q22. The expected date, we always joke around internally, we say September the 7th, that is our Independence Day. But this is what we expect. In addition to SAP, we do not depend on third parties, and Fisia depends on Nike, but everything is fine with Nike. So we believe that this will be done on September 7th.

Irma Sgarz, Goldman Sachs (via webcast):

And what about the consolidated EBITDA margin for 2022? It would be good to see your view.

Jose Salazar:

Irma, this is a good question. Consistently, since last year's quarter, we have answered this question. And in 2022, we expect to repeat, and we shall repeat an EBITDA margins similar to that of 2021, exactly because we invested in expenses, so we have not been able to dilute all of our investments.

We believe that this will give us future revenues and margin, and now we are growing Fisia's gross margin after these two quarters. Therefore, the prospects are to be able to deliver an EBITDA margin similar to that of last year. And consistently, we have repeated this expectation and we are confident that this will take place.

Irma Sgarz:

How to continue expanding this gross margin in the future. What are your prospects? What about Fisia's sorting? Have you increased the share of sourcing in Brazil?

Pedro Zemel:

This year, it will increase. It increased due to initiatives that we adopted, and because the Brazilian jersey, which is one of the SKUs, they are produced in Brazil. So we will go from 40% of national production this year. And we continue building more because of some specific products that will make us more competitive.

So these are the first steps of national sourcing. We have Pegasus tennis shoes, and then we are also paying attention to certain apparel that may help us to be competitive in certain areas of the market. But this year, we will exceed our national production plan.

Rafael Prado, Hix Capital (via webcast):

Congratulations on your result. Could you talk about the pipeline of Fisia in São Paulo and the benefits?

Jose Salazar:

I think I answered this. We expect to go live during the first week of. Of September. As of them, we have a stabilization period and we believe that in 2023 we will be able to use the tax incentive or the import channel, which is very relevant for Fisia.

On e-commerce, we are already using it. E-commerce has already been adopted since the 2H21. The import benefit, that is really important, will be adopted as of January next year, and one that is slightly smaller would be the wholesale incentive, and we are still analyzing the next steps. But the two main incentives for e-commerce and import channel, as of the beginning of next year, they will be fully adopted.

Pedro Zemel:

With this, we can bring to an end our Q&A session. Our IR team is at your disposal to clarify further questions. As we have highlighted since the beginning of the year, in addition to the challenges with exchange rate, 2022 is a year for investment, with a consistent investment in revenue with no additional leverage. We do believe that this is an important step that is necessary to deliver, with quality, to develop the sport ecosystem, consolidate Centauro as a sports destination, and to broaden the access of the Nike brand to the Brazilian consumers.

We are reassured that we will deliver sustainable results this year, and we believe that we will increase our earnings, our results to Grupo SBF.

We thank shareholders, board members, partners for believing in us. Thank you for participating in our call. We hope you continue following us in the future. Thank you very much.