Local Conference Call
Springs Global
Fourth Quarter 2017 Earnings Results
March 23rd, 2018

Operator: Ladies and gentlemen, thank you for waiting and welcome to Springs Global conference call to discuss the earnings results of the 4th quarter of 2017 and the year of 2017.

At this moment, all participants are on listen-only mode. After a brief introduction, we will hold the Q&A session when further instructions will be provided. Should you need assistance during the conference call, please press star 0 and an operator will assist you off-line. To obtain a copy of the financial statements and webcast presentations, please go to Springs Global website at: www.springs.com/ri.

Before proceeding, we would like to inform you that forward-looking statements reflect the current perception and also the management's 0utlook on the evolution of the business, which are based on the evolution of the macroeconomic environment, industry conditions and the company's performance and financial results. Changes in such expectations and factors may imply in results that may materially differ from current expectations and may present risks and uncertainties.

With us today we have Mr. Josué Gomes da Silva, CEO of Springs Global, who will comment on the company's performance.

Now I would like to give the floor to Mr. Josué.

Mr. Gomes: Good morning. We are here Alessandra, Roberto and myself to talk about the earnings results of 2017 and to comment about the different initiatives of the company and that certainly are reaping results that are very significant but give us an outlook of growth that is very significant for the Company in a short period of time.

I will highlight our model, our digital franchise model and multi-channel model. This model started to be developed in the middle of last year, we announced to our store network at the end of last year September/October and it became operationally in January this year. The 1st delivery to digital franchise was on January 21, it is already showing a very significant result, a drop in the delivery days, so half of the delivery day, which gives us a better purchase experience to our consumers and also a drop of logistic cost at 65% when we compared to the original goal, and technologically not everything has been deployed, and we will have in the future other alternatives for delivery.

And as a matter of fact, we are highly encouraged, the team is strongly engaged, we have exceptional personnel full of talent that help us and in the new area (of Growth) and incorporation of new products to our brands and our distribution platforms, and we have no doubt that the results are appearing.

Last year our sales through the Internet, through e-commerce without deploying anything that I mentioned was announced, and as of January we had results and our sales grew over 65% and this year we expected growth of up 200%.

Although we are within our budget, the 1st quarter will increase around 90% vis-à-vis the last quarter last year, but the digital franchise was deployed on January 21, not all stores were incorporated to this model, we have to follow red tape to connect these stores. Our investment in digital marketing started in March and we have spent only half of our budget and we have attained very significant in ever growing results.

Well sales in March the growth will grow over 100% in terms of the digital franchise, so we are reassured that this model will strongly impact our operations, and it will contribute with the growth of our brands, the shares of our brands, the growth of our sales and this will have a strong repercussion in our industrial plants that when they have more work will give operational leverage that is very significant for the results of the Company.

But we are not only focused on this to transform the Company, we just concluded a project, a major project, and we are changing the way how our collections are built, are conceived, are exposed and communicated. Today we have 5 MMartan stores are undergoing a pilot test, I believe that the changes are very significant, they will provide greater value to our brands and also better experience to our consumers. We will probably have a drop of markdowns and an increase of the average price and margins.

This pilot project was initiated in February and March this year and I believe that our system will be totally deployed during the autumn/winter collection that will reach the shelves of our customers and our stores during the month of February/March of 2019.

We are absolutely convinced that these changes that were… and we received advise for highly-experienced consultancy in the industry even foreign consultant and I believe that this will give more value to our brands and our consumers will desire more our brands and our products, and we have intensely worked in the incorporation of technological aspects to our products, we have 2 focuses here: One would be to make our products more and more sustainable, we are highly concerned with the recycling aspect, the packaging as well, they have to be recycled, we will have a recycling process of our packages and we will drop the generation of solid residuals. This is a commitment with our customers and society to drop environmental impact; We also want to use renewable energy in our processes and we know that new technologies incorporated in our processes and products will make our company a sustainable company in 5 years, and within the internet of things we are incorporating sensors in our product that allow us to better engage with the consumers and we can give hence to the consumers to improve the quality of their sleep and to improve the quality of their day when they are awake, which is very important because they had an excellent night sleep.

We also have to mention our process that also started at the end of last year because we want to transform our company in an exponential organization, we have a process of 10 weeks, where 24 colleagues from the company that were selected through an algorithm among hundreds of people from the Company that enrolled themselves, they are divided in 4 groups and are being trained not only to develop a business project that will make us a leaner, a more rapid company, and they will be able to multiply these tools within the Company.

We believe due to the level of engagement of these collaborators that are participating in the process that, as a matter of fact, the process of this exo experience is extremely encouraging, is engaging. On a weekly basis, I have participated in the feedback and everybody's thrilled although they dedicate themselves more than what is normal because they do it outside working time and they have a hat to dedicate for 4-5 hours to certain activities.

Now, at the end, I would like to highlight the changes because of retirements and changes in our leadership in the US. I know that the new President (CEO) in the US and the new alignment of the American organization now that is more geared towards innovation and marketing and distribution of our products will provide us significant impact very quickly.

Jim has an excellent experience in the industry of production goods that sells to the great retailers in the US, also sells directly to consumers through mechanisms like franchise and also internet. Jim is establishing an excellent pace of transformation of the Company, team engagement and innovative ideas in our products, and the US organization is still supported by our former President (CEO) that is part of the board and he provides all his experience to Springs Global, US organization.

I believe with all of this we will have excellent results and it's not by chance that we have the date to put one of our major customers and we will instead of having a horizontal position this will go to vertical. The horizontal exposure negatively impacted our sales last year, but as there was a lot of work to do and the former team made a great effort to go back to a vertical layout within this great retailer, there is a date for this change, which will give us much better results as of the 2nd semester this year.

Now to bring my observations to an end, I would like to obviously talk about the outlook of capital cost with the SELIC at 6.5%. Now with this, the deleveraging position of the Company changes completely and now it will be more nimble. Last year there was this impacted not only because of the working capital contribution, and also because we paid debt. We know that the deleveraging process will accelerate it now. I believe the SELIC will be at this level, perhaps there will be a drop of the SELIC rate during the next meeting of COPOM because the central bank has communicated that this is possible in a cautious way that fed it.

Now, we can also extend the financing profile, we issued that debenture with 3 years of maturity that this affects the profile of the financing period because part of this debenture was used in order to settle a short-term liability and we have extended the profile of other financing line, and the drop of the interest rates naturally encourages financial institutions to extend the financial lines and with greater cash flow our net debt will drop.

We are also very encouraged with the property project in Natal. The leasers they are already putting the shelves and they expect to open the store in May/June. We have another signed contract that I still cannot give you the name, but we already have a signed contract and we are expecting to be able to inaugurate both stores simultaneously, and we are convinced that this area will be totally leased during the 1st semester, and these are 38,000 m^2 that suffered a slight retrofit, but that was excellent for a shopping full and it will be totally rented by the middle of this year.

We also have a very competent professional work in the conception, development and planning of the outlet that from commercial activities complements this shopping mall in São Gonçalo do Amarante, in Rio Grande do Norte, that will generate around R$1.5 million in rent per month. And I can tell you that according to leases that we have carried out and due to the level of lease per square meter, we are reassured that this commercial center due to the macroeconomic moment of Brazil, due to the drop in interest rate makes retailers to become attracted to this place and now they want to open new stores.

I believe that we will rent it totally, which will increase the Ebitda of the Company and this will value, these properties, something that in the past people didn't value. Although we've mentioned this in the number of calls in which we participated in the past quarters.

I believe that the value of this property will only increase together with all our property projects, and at the end, after Alessandra's explanation, I will give my final comments.

Mrs. Alessandra Gadelha: Good morning to everyone.

On slide 3 we present the highlights of the fourth quarter of 2017. The net revenue was aligned with the same period of last year with a gross margin of 26.4%, negatively impacted by the participation of the intermediaries of the sales mix.

There was an increase of 20% of Ebitda with better rentability. The Ebitda margin went from 10,1% in 2016 to 12,2% in the last quarter of 2017. The operating results had a difference of 30% and R$ 14.9 million of net profit, with an improvement of 20 million in earnings before taxes.

On slide 4 we can verify the evolution of the year results. The net revenue of 2017 was 5% lower than that of 2016, that was negatively impacted by lower sales volumes and the average price in reais of the utility bedding products. The Ebitda was stable amongst both years because the operating expenses presented a drop proportional to the gross profit.

On (slide) 5 we have results per business segment. The main segment South America Wholesale represented approximately 50% of the income and 70% of the Ebitda. Now the result of 2017 was lower than the guidance although the improvement of the performance of South America throughout the year. The result of North America was impacted by appreciated real and lower sales volume than what was expected.

Now the revenue totaled R$ 2,199 million in 2017, now 64% came from South America and 36% came from North America, as you can see on slide number 6.

Now the per type of product, bed, table top and bath was 45%, we had utility bedding 30%. As you can see on slide 7, the increase of the Ebitda in South America offset partially the lower Ebitda in North America.

On slide number 8 we present you the working capital needs that were R$ 910 million at the end of 2017, with a drop of R$ 35 million or 4%, because of the lower inventories.

Now on slide 9 we are presenting the capital investments; were R$ 71 million in 2017, mainly geared toward the operational improvement.

Now as you can see on slide 10, we had 33% of the debt in dollars at the end of 2017, aligned with our operating cash generation. Our target is to drop our net debt and to extended average period. In the last year we drop the short-term debt from 46% in 2015 to 32% in 2016 and 25% in 2017.

In February this year we issued debenture of R$ 150 million, with a remuneration of 100% of CDI plus 2.75% a year, with a 3-year maturity and quarterly amortization and the collateral is the property in Sao Gonçalo and its lease contract.

We ended 2017 with a financial leverage measured by net debt Ebitda of 3.2 times, as you can see on slide 11. Now the drop of this leverage indicator that we have observed in the past years will continue due to the operational improvement as you can see on slide 12, and lower financial expenses that are result of lower interest rates, both contribute to improve free cash generation.

We will present the main highlights of the fourth quarter of 2017 per business segment.

On slide 13 we can show you that there was an expansion above 10% of net revenue and gross profit from the South America Wholesale segment. We continue… we have a higher share of intermediate products in our sales mix, (with a negative impact on) gross margin, (which was) of 27,2%. The EBIDTA was R$ 50.6 million, 30% higher year on year, and an Ebitda margin ~~of 60%~~ increased by 2 percental points.

On slide 14 we have the yearly results, where there was an expansion of approximately 7% of the revenue, mainly due to the extension of intermediaries' growth, then we have 26% (of gross margin).

Now, South America Wholesales there was an increase of 12% in the sellout revenue. Due to the conversions year on year the net revenue had a lower growth, 6%. Now we opened 4 new franchise stores of Artex during the fourth quarter of 2017, and this totaled 10 new stores throughout the year.

The gross profit was stable with a reduction of gross margin because of greater participation of franchise. We drop 20% in our SG&A, this resulted in an improvement of R$ 3 million in EBIDTA year on year.

Now on slide 16 we can see that the results revenue and gross profit this year... last year were aligned with the last year. There were 231 stores, 71 own stores and the other franchises with presence throughout the entire country, as you can see on slide 17.

We have developed throughout the last year new technologies in order to improve the online purchase experience, as you can see on slide 18, and this contributed to around 60% of growth on online sales.

We launched in the beginning of this year the digital franchise, where the e-commerce sales will be served by the closest franchisees that have products in their inventory, giving better service to our customer at a lower cost.

We are the first Company with a franchise system that can offer the omni channel concept, where we have the complete view of the customer among the different channels, and a brick-and-mortar store is a place where you can pick up, change your purchase. This model will give more sales to our franchisees and better satisfaction to our customers through the exchange pick up shipping for online orders.

Now North America Wholesales, there was a drop of 15% of our revenue, as you can see on slide 20. We were negatively impacted by the (change in) product layout of (an important client) and this compromised the level of sales of our products. Amongst quarters, there was an improvement of 5% in revenues. The Ebitda was R$ 17 million and 14% lower than the value that was registered during the fourth quarter of 2016, with a stable Ebitda margin between both periods.

On slide 21, we can see that during 2017 there was a drop of 20% of the revenue and gross profit because of the reasons that I mentioned before and the appreciation of 8% in the real vis-à-vis the dollar.

On slide 22, we have the main opportunities of Spring Global for 2018. Now, the first would be expansion of consumption and sale of our products. The recovery of the Brazilian economy will leverage the growth of sales of discretionary products, which were postponed during the recession. We want to have more sales through e-commerce, driven by digital franchise and also investments in digital marketing and the increase of new franchise stores. We will use the installed capacity of our plans to dilute our fixed costs and we will also improve our operating margins. We will continue with the financial deleverage process through better cash generation from operations. We will have a reduction of the cost of the debt because of the lower interest rate and the monetization of non-operational assets.

On slide 23 we have our guidance for 2018, where we expect a revenue growth and an expansion of the Ebitda margin, and we continue the following assumption the average (exchange rate of) R$ 3.23; growth to 2.7% of (Brazilian) GDP and we will open 20 new franchise stores in the retail market.

Thank you very much we are at your disposal to answer your questions.

Q&A Session

Operator: Ladies and gentlemen, we will initiate our Q&A session only for analysts and investors. In order to pose a question, please press star 1. Questions will be answered in order of appearance. If you would like to withdraw your question from the list, please press star 2.

Our first question from Maria Paula Cantusio, BB Investment.

Mrs. Cantusio: Good morning to everyone, thank you very much for receiving my questions. I have three questions. Number one: I would like to talk about the digital franchise, you said that not all stores have this model. Could you give us a forecast when 100% of your stores will have this model? Then I would also like to know how you're working with your inventories together with franchises, because now they become a DC of the e-commerce. These would be my first question.

Mr. Gomes: Well, in reality, there's red tape involved here, because in our contract, our digital licensing contract we have a sub acquired and there's also a connection of the account receivables of credit cards together with a financial institution, and sometimes not all franchisees have an account with this financial institution, because a major financial institution very competent with reach throughout the entire country and they have a process that is very interesting to support this digital franchise model, but franchise models by and large where you have contact with the franchise management that this financial institution created, but yes, there's red tape to open the account. The franchisee, sometimes they don't work with this financial institution and this would take some time.

We are really not concerned about this, because our major concern was to have capillarity throughout the entire country. What we wanted was the franchisees that have this system connected to our model, and in reality, the proximity of the final consumers makes us drop delivery dates and also improve the purchase experience of the customer, and we already have this today.

So, we already have franchises that became signatories of the digital model for the entire country, and the other franchises will come according to time, sometimes depends on how long it will take them to open the account, they need a small investment, they need an investment connected to a scale, connected to the system in order to print the labels for the mail, so the franchisee buys the scale and also the packaging material.

There's a bit of red tape involved here, but what we are main concerned was to reach the entire country and we've done this. And as franchises receive orders, those that are still not part of the system will want to be part of the system because they will be missing sales opportunities.

Regarding our inventory, this is very interesting, because the model encourages the franchisee to have more inventory, because this is an algorithm that allocates the order to the franchise that will provide the best purchase experience to our customer at a better cost, but they have to have inventory because if they don't have the inventory, the order won't even reach them.

So, as we show how many allocation attempts were made and they weren't able to participate because of lack of inventory, I believe that with this, the franchisees will be interested in having an assorted inventory, because we don't want to transfer the inventory risk, because our better planning area will have to have an assorted inventory in each one of the stores.

The first franchisee that started to receive orders on January 21st, he was much happier in the beginning than he is today because he received so many orders, and now he sees that the orders are being diluted amongst other franchisees. So this competition was very healthy amongst them, and I believe that this is a good thing of this model, this creates healthy competition amongst franchisees, but with all of this they want better service to our customers, to provide them the best purchase experience to our consumer at a better price.

Mrs. Cantusio: I would like to know what is so different in the MMartan (pilot) stores (compared to regular ones) now.

Mr. Gomes: Oh, you have to visit them. I mentioned that this was an entire project that changed significantly our conception process, our construction of layout of collection communication. Well, a collection follows a timing between the conception, the idea of the theme of the collection until it's on the shop window, and this takes more or less one year. So what we are doing now in this pilot project is, you know, a little bit of everything.

We will see everything in October in the autumn/winter collection of 2019, and I believe that it will reach the stores in February/March 2019. To explain this, it would be better to visit a store. There is a store that just came to my mind, that is part of the pilot project in Shopping D. Pedro Campinas, it's beautiful, the store. If you go to Campinas I urge you to visit this store.

I believe that we have 6 stores that are part of the pilot project, I believe that you should visit these stores to understand the changes.

Mrs. Cantusio: OK. So, yes, I will visit the store. And at the end I would like to talk about the sales assortment. There was a major participation of intermediaries in 2017 which impacted the gross margin. So, how do you see your strategy of sales assortment for 2018?

Mr. Gomes: Now obviously, once again, if Brazil, as a country, maintains this interest rate at a level of 6.5%, and I believe that everything shows us that it will be this way, there is no inflationary pressure. We still have high unemployment, we have high idleness in the industry, fortunately we have a record crop from… it's about 245 (million) tons. Therefore, the price of commodities and the price of food will stay stable.

We have public price conditions energy, oil, byproducts totally aligned in the market, so there's very little inflationary pressures and we also have a labor reform that for experts, like professor Márcio Camargo, will drop the interest rate curve in Brazil in a constant way. This is a professor that studies this and he shows accurate data defending his thesis, and he believes that the Central Bank will surprise themselves and they will have to lower their interest rate more than what they expected.

So, all these factors make us believe that we will have normal interest rates, because this was abnormal. I believe that the Brazilian society will start realizing the beneficial impacts when you have a lower interest rate. People will invest in the real economy, we see that people are looking more for our franchises because people have more extra money, companies have more extra money for consumption and investments, without mentioning the impact of R$300 billion in the drop of the public debt.

So, the impacts are significant, and I also believe that this will result in a consumption improvement this year, and with this there will be an improvement of the risk profile of our customers that are retailers that during 2017/2016, well, we had to sell a mix of intermediary products. So this was an option, this was a safety measure, with this you also reduce your working capital because the average term to receive is shorter and you are also dropping the risks.

When you have a lower interest rate, I believe that the system improves by and large, and you can send or sell more end products to the different retailers, even though that's presented a greater risk, and all of them want to extend, a longer payment term.

Ms. Cantusio: Thank you very much.

Operator: We would like to remind you that to ask questions, please press star one.

There is a question through the internet about revenues with rent and the property of the United States if we sold it.

Mr. Gomes: Yes, this is a property in Georgia, was sold during the last quarter last year, and the revenues for leases this year we believe that the power center will be totally rented until the half of this year. As there's always a grace period to offset or partially the cost of the installation of the store owner, I believe that the power center will be completed by the end of the third quarter, September, October of 2018. So, the 650/700 thousand there are result of the power center will be considered during the last quarter of this year, and we have already been receiving a lease since last year.

Now, this rent that was a plot of land of power center, I believe that this represents R$800/850 thousand and then we will have the lease of the outlet that will be commercialized as of the second semester of this year. I believe that we will start seeing the results in 2019 (2Q onwards) and when the outlet, plus the power center, plus the plot of land we believe that we will have rent revenue not inferior to R$ 1 million a month, which is all Ebitda because this represents small cost and you also have to charge administration, the cleaning, lighting, all the condominium expenses.

Operator: We would like to remind you that to pose questions, please press star one.

Ladies and gentlemen, we are bringing our Q&A session to the end, I would like to hand it over to Mr. Josué for his final remarks.

Mr. Gomes: I would like to thank all, and not only Alessandra, that is available to answer further questions that you may have in the upcoming days or weeks, as myself and Roberto, we are at your disposal and I would like to tell you that we feel very reassured with the year 2018 and future years.

We had the capacity of attracting excellent talents to this digital area, the results are emerging strongly, the launch of our collection autumn/winter 2018 was an absolute success. The sales in the Brazilian domestic market during the first quarter increased vis-à-vis the last quarter last year, but of course, this doesn't surprise us because of the base of comparison of last year wasn't as good.

Argentina is surprising us a little bit, and today the challenge is of a recent shift in the price of the raw material of the Company due to factors that are not connected to the market. I'm talking about the price of cotton fiber and recycled polyester.

Of course, we have a significant part of our consumption that was fixed, and these oscillations are not directly impacting us as if we had all our needs not fixed. The factors that increase these raw materials were things not connected to a fundamental analysis. This was a Chinese decision to drop the import of products to be recycled, not only in polyester and steel, which provoked a strong reduction in the supply and an increase of price which impacts the margin, but there's a number of mitigating measures that are being taken by our team to reduce the impact.

In the case of cotton, it's another factor, it's a factor of specialized funds on volatility. Today, there are some investment strategies of financial funds; the strategy in terms of volatility, to sell long-term volatility and hedging the volatility in the short-term in the market. These are very dynamic and electronic strategies and the cotton commodity that suffers volatility in the long-term was prone to the part of these funds that used this asset in these strategies, so with this, the price of cotton increased and it went up to US$0.77 per pound, but the decision of Trump of creating a trade war with China can affect this because China is the greatest cotton importer in the world.

Let's see what the results are going to be, because they will create tariffs of US$50/60 billion and what will be the results on cotton, and I believe that perhaps there will be an increase of the demand of Brazilian product. As you see in steel, Brazil was exempt of these tariffs, like other countries. So the Trump administration is targeting China. In steel, there wasn't much impact on China because the analyst showed that less than 5% really wouldn't impact China.

Now he gave an additional stub, now we have 50/60 billion, there can be positive impacts increasing the demand for our products and we could export more, and there can also be a positive impact in the drop of cotton prices because China is one of the greatest importers.

It’s very premature to make an analysis, but I’m just making these two observations that are the two points in which the Company is focused on in 2018, and there are other factors that make us feel optimistic, and as I already mentioned, we are seeing very good results during this quarter.

I hope to be with you in the call of the results of the first quarter of 2018.

Operator: Now we bring Springs Global conference call to an end. Thank you very much for your participation.