Conference Call Q1 2009 Results - May 6th 2009

Roberto Vedovotto - CEO

Thank you very much. Good evening to you all. Welcome and thank you for participating into Safilo's Q1 2009 results conference call.

Today's agenda will be focused on the following topics -- Q1 2009 performance, current trading, ongoing projects and activities.

Francesco Tagliapietra, Christian de Felice and Barbara Ferrante are here with me. And all together, we're going to be ready to answer any question you might have.

Let's go into our key themes. The key themes for our Q1 2009 performance had been the following.

First, as expected, market conditions continued to be challenging and February and March showed improving results both in terms of sales and orders compared to the bottom that we had reached in January. Still, I wouldn't get too excited about it.

Our industrial operating performance also improved with a substantial progression of the growth margin. We actually inverted, and finally inverted, a long-lasting negative trend. We have registered the highest industrial margin since Q1 2006. And we think we are regaining control of this area.

Key initiatives undertaking our premium license brands, house brands and retail businesses helped us to achieve these results, and more specifically, I'd like to make the following comment.

We have been and continue to update the high-end collections of all our fashion brands with increasingly appealing propositions to meet consumer needs in terms of style, brand, and target price. And then tell you that we are registering positive results especially in the US and Germany.

Carrera. Carrera maintained double-digit growth rates also in this very tough quarter. Carrera advanced further its market position in Italy and achieved encouraging results in most of the other markets, particularly in Spain, where we intensified our marketing and commercial efforts. We are, of course, planning to further expand Carrera's geographical footprint.

And I would like to add that Carrera's sport division also performed extremely well, and performed extremely well both in goggles and helmets. I would like to stress the fact that Carrera's success at this point is not anymore just the result of a "lucky collection." But I truly believe that it is the overall success of the brand Carrera as a whole.

The retail business grew by 3.3%. Here we continue to maintain a strong commitment on cost-cutting initiatives and selective investments in our network.

Going back to the key themes, the restructuring plan announced back in March is ongoing. And as you might have seen, negotiations with trade unions have been finalized last Monday, two days ago. And we are happy that after very prolonged discussion with them and with other parties, social parties involved, we were able to finally sign an agreement which is satisfactory to all parties involved. This plan is expected to have a net cumulated benefit of EUR5 million to EUR8 million between 2009 and 2010.

A decrease of our free cash flow generation was another key theme for the quarter. And this was mainly related to a lower EBITDA and higher working capital level, although in the context of lower investment -- investing activities.

Last but not the least, our financial -- net financial position increased to EUR617 million.

Now, let's go into Q1 2009 results. I'm sure you all remember what I said previously, what I said back when we last spoke. I mentioned that first quarter sales were probably going to be down between 10% and 15%. Well, our first quarter performance was in line with the lower end of the range indicated in March. Total sales for the quarter were down by 11.7% reported, 14.9% constant currency.

The key drivers of our organic topline performance were the following. First, strong demand in Italy for Carrera. Carrera in the quarter registered an increase of over 20%. We are delighted with these results, and with, in general, the results we are achieving with this house brand.

I'm sure you realize that the pace of growth is even more significant considering how tough and volatile this quarter was, and considering the very challenging comparison base of Q1 '08, when I'm sure you will remember Carrera was already performing a double-digit growth rate.

Let's go into geographies for a second. Europe was the market hit the hardest by the slowdown; especially in sunglasses. The area declined 21% on the back of very difficult trading conditions. In a country like Spain, I think, incidentally you all have read today that industrial output in Spain was down 25%. But I will say we had difficult trading conditions in Spain, in UK, and in the Nordic region. On the other hand, on a positive note, we saw some resilience in markets like Germany and Greece.

Americas. The Americas were down 2.8% reported, minus 12.2% constant currency; registering challenging performance at the department-store level as well as at larger retail chains. Independent opticians were actually [pretty okay].

The market environment continues to be characterized by stronger promotional activities and strong price repositioning.

Asia. Asian sales were also down 2.8%, minus 11.9% constant currency. The real issue is Japan. Japan is especially [depressed], I don't need to tell you that, but -- and we have double-digit negative performances in Japan in the first quarter too.

Also the duty-free business is suffering and remain very challenging in the quarter. Emerging markets like China kept providing softer results, and we're not particularly happy about it.

Having said that, the Group is carefully monitoring solvency levels of its clients, particularly in this area. And in some cases, we have decided to be very tough on solvency levels, and that in certain occasions has [gone] to the expense of potential revenues opportunities.

Let's talk for a second about product categories. Sunglasses first. Sunglasses, as expected, and especially in Europe as I mentioned, were down 13.2% in the quarter. High-end sunglasses, priced over EUR200, continue to represent the weakest business segment of the industry with the consumers strongly preferring more affordable product propositions.

The environment remains in this area in this product category highly deflationary and we are acting quickly to provide collections to fine-tune with consumer demand.

Talking about prescription frames, I would like to say that the prescription frame business certainly showed a more resilient performance and a more resilient performance in all our priority markets. Prescription frame sales were down 7.8% in Q1 with softness in Europe in general, excluding Germany, and in Asia.

Going through sales channels. If we look at individual sales channels, net sales registered the following performance. Wholesale; in wholesale, underlying revenues were down in the first quarter by 12.9% reported and 16.5% at the constant exchange rate. In addition to the above, we continued to have a tight control of working capital and focused on quality of the receivable rather than sales percent.

The retail business. Retail business was actually up 3.3% in the quarter, both reported and currency neutral. Of course, as of March 31, 2009, we had total 324 stores versus total 258 stores at the end of March '08. And of course, comp sales were down 17% due to the totally unfavorable economic climate, and also due to the, I would define, very challenging '08 comps at our acquired stores.

Very weak consumer demand was also due to the shift into April of the Easter holiday, which has an impact, and if you associate to Easter holiday spring break sales, which clearly impacted our sunglasses business and particularly in Mexico, there you find the explanation of the minus 17%.

I will now go into profitability. In terms of profitability EBITDA stood in the quarter at 10.5% of total sales or EUR30.2 million compared to 14.3% in Q1 2008. EBIT 6.6% of total sales or EUR19.1 million.

We closed the period with a net profit of EUR1.7 million. And as I'm sure you all remember, small but improving our performance on both the previous two quarters, Q3 and Q4 '08.

I would like to spend a few words on the main drivers of our operating performance. And I start by saying that -- I start by commenting on gross margin. Gross margin actually improved 140 basis points compared to Q1 2008, reaching [50.6%] of total sales. I'm sure that you do realize that this is the highest level since Q1 2006.

And this was mainly driven by one, new product development; two, industrialization processes; and three lower levels of obsolete products in stock thanks to the cleanup activities of slow-moving items that has been implemented during the quarter.

On top of these, the use of social security cushions at our Italian factories has also given us the opportunity to reduce some inefficiencies typically related to the reduction of production output.

A few words on SG&A. SG&A remained high, in line with the previous two quarters, due to the higher impact of retail cost in stores recently opened, which were those that showed a particularly negative performance.

Wholesale channel. In the wholesale channel total SG&A cost declined by around 4%, also thanks to the ongoing cost-cutting initiatives that we have been pursuing to improve the operational leverage of the group. However, this cost continues to have a higher incidence of [second] sales.

Advertising and promotion expenses are a typical example of these, as they, unfortunately, relate to commitments towards licensed brands, which are not changeable, and which are clearly set on previous year's sales.

The retail business lost EUR2.8 million at EBITDA level, and this was mainly due to slowdown in sunglasses. Please remember that the majority of our stores and particularly and especially in the US sells mainly high-end sunglasses.

In the wholesale business EBITDA reached 12.6% of revenues compared to 15.5% recorded in Q1 2008. Given the very tough market environment we are proud of the 12.6% result. Below the operating line, net financial charges, excluding ForEx gain and losses, increased in the quarter to EUR13 million from EUR11.9 million registered in Q1 2008. And this was mainly due to the net financial position in the quarter.

A few words now on free cash flow. Free cash flow in Q1 '09 registered an outflow of EUR44.7 million, in line with Q1 '08. We had in the quarter two opposite dynamics. First one, the decrease of the investing activities, (inaudible) EUR12.7 million in Q1 2009 versus EUR37.1 million in Q1 2008, when Safilo acquired the Mexican and Australia retail chains.

Talking about CapEx for a second, CapEx in this quarter included about EUR6 million for maintenance of production factories and EUR5 million cashout related to the new plant in China. The remaining was due to retail network.

I was mentioning the two opposite dynamics. So first one decrease of investing activities, the second one is higher cash outflow from operating activities due to lower profit of the quarter and higher absorption of resources from working capital. Here rate payables were the main driver. Their higher than average decrease in the period was due to the different scheduling of payment, owing to the earlier arrival of vision product in our stock at the end of last year.

I want to be very clear on this. We are not at all under pressure from our suppliers, and we're not at all shortening payment terms. If anything, just the opposite.

As a consequence of all these, as I mentioned before, our net financial position at the end of March 2009 was 16 -- EUR617.7 million negative, fiscally higher than what it was at the end of 2008 when we had a net financial position negative for EUR570 million.

Let's now go into current trading. We're only five weeks off the period and I must tell you that the visibility is still very low on the current quarter. I'll give it a try anyway. April showed some improvement over March although registering declined on April 2008. No surprise there.

It is still too early to make any further additional comment on first half expected performance. I think we will have much more visibility only after completing all the collection for the new April releases.

As you would expect, we are devoting great effort to adapt to the new current economic context, which remain very challenging. As I said before I wouldn't go too excited about an early sign of a very, very small recovery.

Ongoing projects and activities. I thought I wanted to briefly talk to you about -- just to give you a short update here. As far as our premium licensed brands are concerned, I had anticipated to you a new management approach to some of the licensed brands back in February.

We are moving on with this project, which is primarily aimed to further exploiting the power of our smaller and exclusive luxury brands. We consider a privilege for ourselves to have brands like Bottega Veneta and Balenciaga in our portfolio. And we need and can extract high commercial and economic value from these brands. We're working out how to do it, and we're seeing the early signs of success here.

I also remember of talking to you about sellout and sellout needs remains our top priority with strong activities on merchandising and on monitoring visibility in the different point of sales. How are we doing this? We're doing this through a renewed dedicated consultant/representative commercial organization.

As far as our house brands portfolio is concerned, we have decided to push hard particularly on Carrera as promised. And on that front, we recently partnered with one of the most important worldwide provider of advertising and marketing services, leader in digital markets to give a stronger push to Carrera's and our other house brands' international development.

MRM Worldwide, part of McCann Group, is our new advertising and marketing agency, which is already working on the new autumn/winter collection campaign, and on further communication developments for next year.

I really believe that this digital marketplace can truly represent an additional opportunity for Carrera and particularly an opportunity for Carrera to advance further in Italy, and also further expand in most of the international markets. We will push more aggressively in this direction, because we've seen that the payoff is very, very interesting.

We are confident that this new agreement for advertising and marketing activities will help us dramatically and will allow us to accelerate the expansion of our house brands in the market.

Last, but not the least, retail. In retail, as I had anticipated, we maintain a strong commitment on cost cutting and very selective investments. We have revised our opening plan for the year. We will add 25, 30 stores and close down 15, 20 stores, for a net of 10 additional stores at year end.

We are downsizing our personnel with the aim to reduce it -- around in -- around at 15% by yearend.

We're also renegotiating the occupancy fees on many of our stores. We are currently after margins (inaudible) to the higher and higher penetration of Safilo's products in our stores. In Q1 '09, they represented about [60%] of Solstice stores sales versus 53% in Q1 '08, while their penetration in Spain grew to almost 50% in Loop stores, versus 37% in Q1 2008.

We can and we certainly do -- we will certainly do more in this area.