Conference Call Q1 2010 Results - 30th April 2010

Roberto Vedovotto - CEO

Good evening to you all and welcome to Safilo's first quarter 2010 results conference call.
Francesco Tagliapietra and Barbara Ferrante are here with me today and together we will answer the questions you might have at the end of the presentation.
Q1 2010 has been extremely important for us, from both a financial and business standpoint.

Why?

1. Carrera continues to perform well. Our license portfolio is solid: in advance of its expiry in 2011 as you might have seen, we extended the global license agreement with Marc Jacobs and Marc by Marc Jacobs, by an additional four years until end of 2015.

2. We improved our operating profitability, registering EBITDA and EBIT growth primarily driven by a more efficient manufacturing set-up, lower incidence of SG&A costs and the effect of the sale of non-performing retail chains;

3. The retail business is now at break even point and the wholesale business is performing better;

4. We generated a little positive cash flow in the quarter: this is key to continue to improve our performance and it is primarily the result of better working capital management (73% reduction in working capital cash outflow) in addition to more selected investment activities;

5. We successfully completed our recapitalization plan, and have now a net financial position of € 315 million vis-à-vis €588 million at the end of last year. We need to continue to capitalize on our strengthened capital structure;

6. However, the business and macroeconomic environment continue to be challenging, uncertain, and volatile: US and Asia are improving, Europe continues to be lukewarm. We saw positive signs in the US at our Solstice stores and both the prescription and sunglasses segments are showing some encouraging signs of recovery;

But we need to remain focus and cautious, as these signs of improvements in Q1 2010 are not enough to trace a clear upswing:

As discussed a month ago, the market environment improved in the first quarter 2010 in a number of countries:

- America was healthier than in previous quarters, with some evidence in the US;
- Comps sales at our Solstice sunglasses stores were also ok;
- Asia performed well in all the key markets of the region, except for Japan;
- Europe was more difficult, flat at constant exchange rates and perimeter.

The main sales drivers in the quarter were:

- Volumes growth, partially counterbalanced by still negative price/mix effects;
- Strong Carrera and expanding in Europe;
- Better results for a number of high-end brands also thanks to our broader product offerings.

Profitability improved in the period, thanks to:

- A more adequate industrial set-up in all of our European plants, following the implementation of the reorganization started last year;
- A smaller and more profitable retail business after divesting the loss-making activities at the end of last year;
- The Group's prudent approach in the wholesale business.

The financial leverage also improved due to:

- The completed recapitalization plan;
- Better working capital management;
- More focused investments in the core business.

All this has translated for Safilo into the following Q1 2010 FINANCIAL HIGHLIGHTS:

- Total sales were flattish, as expected, at 286 million euro;
  Let me remind you that at the end of last year we sold our non strategic, loss making retail activities in Spain and Australia. These chains registered roughly 9 million euro of sales in Q1 2009 with a negative EBITDA of 0.8 million euro.
  At constant exchange rates and perimeter, total sales in Q1 2010 would have been up by 3.9% over Q1 2009.

- Profitability improved:

  - Gross margin held well at 60.7% of total sales or 173.6 million euro, slightly improving as a % of sales as compared with Q1 09;

  - EBITDA reached 34.6 million euro or 12.1% of total sales, growing by 14.6% over Q1 09;

  - EBIT amounted to 24.1 million euro or 8.4% of total sales, up by 26.2%;

  - Net profit totaled 1.7 million euro, in line with Q1 2009.

- Net Financial position halved to 315.4 million euro:

  - 270 million euro proceeds from the capital increases undertaken between February and March;

  - Improved Free Cash Flow.

Q1 2010 IN SOME MORE DETAIL

Total sales were equal to 286.0 million euro in Q1 2010, growing by 3.9% at constant exchange rates and perimeter. This performance is explained by:

1. Good results achieved in the wholesale business. Here, revenues reported a growth of 1.9%; at constant exchange rates we were up 3%.
   Performance was driven by a nice recovery in volumes, still partially counterbalanced by the negative price/mix effect mainly evident in the European markets and in the sunglasses business.

   As said, Carrera kept its growth pace, registering an upside of over 25% in the quarter, further improving the performance of last year. It's a great satisfaction for us. We are pushing on it. It is the right time to do so as consumers are very focused on products and price points like those in our Carrera proposal.

2. Improved retail business.
   Constant exchange rates and perimeter, the retail business grew by 17.9% in Q1 2010, thanks to the performance of our Solstice stores, up by over 20% in the period, but also of the Mexican chain improving in the period at double digit rates.
   We closed the quarter with a total number of 219 retail stores.

From a product category and geographical standpoint:

In Q1 2010,
Volumes increased in both product categories, sunglasses and prescription frames.
The results of prescription frames are encouraging, with a growth in the quarter of 3.1%. The progress would have been 5.6% if we considered the performance at constant perimeter.
We are working a lot to strengthen this product category and we're receiving positive feedback on all the collections developed and launched in these months.
Sunglasses remained generally more impacted by negative price/mix due to the attitude of consumers to buy more moderate price point products and Safilo widening its product propositions to more accessible price ranges. At constant perimeter, the category would have been basically flat compared with Q1 2009.

In terms of markets,

America was ok in the quarter, growing by 1.6% reported and 5.1% at constant exchange rates.
We are encouraged by this recovery. In the US we saw some nice results in particular in the major department stores, in our own retail network as already mentioned, but also a good consistency at the independent opticians, further evidence of the strength of our prescription business in the market.
In America, both volumes and price/mix increased in Q1 2010.
Europe was again the weakest area also in this recovery phase. At constant exchange rates and perimeter, Europe would have been flat in the quarter. We finally had improving results in south Europe…Portugal, Spain…,while continental Europe remained more difficult, especially in the sunglasses business. Volume growths in different countries were generally counterbalanced by weak price/mix.
Asia reemerged somewhat. All markets but Japan grew in the quarter. The reported increase of the region was of 10.5%, plus 14.1% at constant currency. The best performances were registered by China, Hong Kong and India and also by the duty free business.

In terms of OPERATING PROFITABILITY,

EBITDA in Q1 2010 was 34.6 million euro (12.1% of total sales), growing by 14.6% compared to the 30.2 million euro or 10.5% of total sales registered in Q1 2009.
In particular, the retail business turned to break even in the quarter after having lost 2.8 million euro in Q1 2009. The improvement was related to the sale of the loss-making retail activities that, in Q1 2009, had recorded roughly 1 million euro negative EBITDA, and more markedly to the better performance of Solstice in the quarter.
EBITDA in the quarter was completely attributable to the wholesale business, which reached 13.0% of revenues, compared to 12.6% recorded in Q1 2009. The main drivers of the EBITDA performance have been:

- Gross Margin, which confirmed at 60.7% of total sales the industrial profitability achieved in Q1 2009 (60.6%). We worked with more appropriate productivity levels in all our European plants although they still remain underutilized in terms of processed volumes;

- SG&A expenses, which in this analysis exclude depreciation and amortization costs, weighed less on total sales. Their incidence decreased in fact in the quarter to 50.4% of sales, down from 51.9% in Q1 09, in spite of our prudent policy to accrue, also in the first quarter of 2010, a higher allowance for doubtful accounts in consideration of still volatile markets and the different retail environment

  Net of the allowance, SG&A costs decreased by 4.7%, as a result of:

  - the decline of sales and marketing expenses, thanks to the almost halved retail costs both for the partial sale of the loss-making business but also for the better performance of the remaining activities;

  - general and administrative expenses also benefitting from the retail business divestiture and declining by almost 5%.

From a financial standpoint:

below the operating line, the net income of the period was equal to 1.7 million euro, flat on last year, as a result of the Group's prudent policy not to accrue, also in the first quarter of 2010, deferred tax assets. For this reason, income taxes increased to 8.7 million euro in Q1 2010 against 2.6 million euro in Q1 2009.
On the other hand net financial charges were down, in the quarter, by 14.4% to 12.4 million euro from 14.4 million registered in Q1 2009. Pure interest charges, declined more markedly by 26.2%, thanks to the combined reduction of interest rates and of the average gross debt.
Free Cash Flow in Q1 2010 improved, generating a small cash flow of 3.1 million euro, compared to an outflow of 44.7 million in Q1 2009. This was the result of:

- Improved working capital management. Here, we had the further reduction of inventories, also thanks to disposal of part of the retail business, while sales growth and mix explained the increase of trade receivables as well as trade payables;
- The outflow from investing activities halved in Q1 2010, standing at 6.1 million euro versus 12.7 million in Q1 2009;
- Capex in Q1 2010 was mainly dedicated to the maintenance and further technological improvements of our production factories in Europe.

As a result of the above, at the end of the quarter, the Net financial position was 315.4 million euro, more or less in line with the pro forma Position we communicated at the end of last month and down 46% compared to the year-end Net Financial Position of 588 million euro, as a result of :

- around 13 million euro from the Reserved Capital increase subscribed by HAL and
- 250 million euro from the Rights Issue and around 7 million euro from the Rights Auction Sale

As we have just described, the free cash flow for the period provided an inflow of 3 million euro.

Before I turn to the operator for the Q&A session, I would like to once again underline that we have just extended, in advance to its expiry in 2011, the global license agreement with Marc Jacobs and Marc by Marc Jacobs, by an additional four years until end of 2015.
The extension was the result of the achievement of certain results, and is extremely satisfactory for both parties.
We are very glad about it as Marc Jacobs is one of the most promising and fast growing brands in the high-end, luxury landscape.