Betterware of Mexico, S.A. de C.V.

Fourth Quarter and Fiscal Year 2020 Earnings Call

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Eric Beder, *SCC Research*

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Joe Feldman, *Telsey Advisory*

Phil Kim, *Private Investor*

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PRESENTATION

Operator

Thank you and welcome to Betterware's Fourth Quarter and Fiscal Year 2020 Earnings Conference Call. With me on the call today are Betterware's Executive Chairman, Luis Campos; Chief Executive Officer, Andres Campos; and Chief Financial Officer, Diana Jones.

Before we get started, I would like to remind you that this call will include forward-looking statements, which are subject to various risks and uncertainties that could cause actual results to differ materially from expectations. Any such statement should be considered in conjunction with the Cautionary Statements and the Safe Harbor statement in the earnings release and risk factors discussed in reports filed with the SEC. Betterware assumes no obligation to update any of these forward-looking statements or information. A reconciliation and other information regarding non-GAAP financial measures discussed on the call can be found in the earnings release issued earlier today, as well as the Investors section of our website.

Now, I would like to turn the call over to the company's Executive Chairman, Luis Campos.

Luis Campos

Thank you, Operator. Good morning everyone, and thank you for joining us today.

I will begin my remarks by providing a summary of our performance for the fourth quarter and 2020. Then Andres will discuss the progress we have made against our strategic pillars to increase efficiency and elevate our operating platform in support for the continued growth we see for the Company. Diana will then review our financial results and our Fiscal 2021 outlook.

Before turning to our results, I want to start by thanking the entire Betterware team for their hard work and contributions all year. I am so proud of all that they accomplished in 2020, amidst the challenges presented by the global pandemic. Their hard work and determination in a difficult operating environment allowed us to maintain continuity of our operations and meet our customers' changing needs.

The COVID pandemic demonstrated even more clearly the strength of our people, business model and operating platform. Indeed, we delivered record results and made significant progress on our strategic growth pillars. And, while the pandemic caused families to change the buying preferences which benefited us, our strength in the fourth quarter was achieved with families resuming more normal lifestyles in the markets we serve and we remain confident in our ability to continue double-digit rates of growth in 2021.

Turning to a review of the full year, for the full year we achieved record sales and EBITDA growth, exceeding the increased guidance that we provided last November. The year marked significant milestones for Betterware including growing revenues over 135% to 7.3 billion pesos and EBITDA over 154% to 2.16 billion pesos, achieving record annual EBITDA margin of 29.8%. This growth was driven by 187% increase in distributors and 195% increase in associates during 2020, as we leveraged our technology that allows our distributors and associates to conduct business remotely. As of year-end, we had more than 59,700 distributors and 1.23 million associates, another record achievement. We are confident in our ability in continuing to grow our distributor and associate network and expect our larger and stronger team will drive our business forward in the near and long term.

Equally exciting for our company is that we entered the public markets trading on the NASDAQ exchange in March 2020 and we launched our new web marketing platform in December 2020.

In addition, we made significant strides to strengthen our financial health and positioning during the year. We reduced our leverage ratio of net debt to Adjusted EBITDA to minus 0.01 from 0.5 at the end of 2019, and increased our liquidity to 650 million pesos at year end.

Turning to our fourth quarter results, we had an outstanding finish to a strong year of growth for our company. We achieved record sales growth of 229% and an EBITDA increase of 254% year over year. While our results continued to benefit in part from COVID as consumers spent more time at home, the continued momentum from the first three quarters into the final quarter of year, especially into December, is a testament to the strength of our business and the significant progress we have made against our four strategic pillars.

Finally, returning value to shareholders is a top capital allocation priority for us and we again have proposed an annual dividend of 1.4 billion pesos to be paid in four instalments. This implies a dividend of 9.57 pesos per share for this quarter. This dividend was approved in the Ordinary General Shareholders´ Meeting held on February 18, 2021.

In summary, we are very pleased with the strong end to the year and the underlying momentum of the business. Despite the challenges the pandemic presented, our distributors and associates successfully conducted business from home and capitalized on the increased demand of our products. At the same time, we remained focused on our strategic pillars, invested in key areas of the business to improve our efficiency, and made strides to strengthen our financial position. As we begin 2021, we believe we are poised for continued growth, including double-digit sales and profit growth which Diana will discuss in more detail.

I will now turn the call to Andres, our Chief Executive Officer, who will highlight our progress on our four growth initiatives and plans for 2021.

Andres Campos

Thank you, Luis, and good morning everyone. Before I review our strategic initiatives, I would like to also personally thank our team for their grit and determination this year as we navigated a challenging environment. Their continued dedication to our customers and our brand drove results for the year that exceeded our expectations from a sales and profitability perspective, in addition to record results for both the fourth quarter and full fiscal year.

I will now discuss the progress made in 2020 on the four strategic pillars, as well as our plans to advance these priorities in 2021. As a reminder, these pillars are centered on market penetration, category expansion, business intelligence and technology investments, and geographic expansion. These initiatives, along with our web marketing and the new campus, which I will discuss momentarily, are expected to support our future growth and increase efficiency.

Starting with market penetration, in 2020, we significantly increased our market penetration to 20% driven by our deliberate actions to drive growth with high impact innovation combined with the increased demand for our household and cleaning products as a result of the COVID-19 pandemic. This growth is a testament to our strong competitive positioning as the category leader in Mexico and a deep expertise that drives customer loyalty. As we look ahead, we believe we can continue to increase our market share and double our market penetration from 20% to 40% in the next five years as we focus on innovative products that continue to resonate with our customer base.

Our second strategic pillar is category expansion. In the fourth quarter, we launched three catalogues and introduced 98 new products. Customers continue to be receptive to our new products and we are excited about our product launches for 2021. Before the end of the second quarter of 2021, we will introduce our new category of home renovation solutions that will let our customers improve their homes at low costs, including products such as curtains and tapestry. This new category will allow us to increase our share of wallet of our customers, which we currently estimate to be at 20%. In the coming quarters we will announce more new categories that we plan to enter to achieve our growth goals.

Next, business intelligence and technology investments

Within business intelligence, we started using Power BI, one of the most advanced platforms of data visualization available in the market. This tool allows us to optimize day to day monitoring of the business and transform millions of data points into business strategies. We also made great strides using Knime, our artificial intelligence and data science platform. Additionally, we've started working together with Bain and Company to improve our forecasting methodologies. This project will help us optimize our service and inventory levels, allowing us to allocate capital in a more efficient way.

Within technology, we launched our new web marketing platform in December 2020. Although it´s still early, new customer sales have been increasing weekly since the launch. We also consolidated our new WMS platform, BlueYonder, and launched our new AI-enabled bot. This year, we plan to launch our 3.0 version of our proprietary salesforce app, Betternet, and develop strong natural language processing capabilities with our bot. We also plan to launch a 2.0 version of Pipeline, our proprietary product innovation platform. Finally, we will consolidate all technologies within our new campus, which should yield productivity gains in our day to day operations.

Our last pillar is geographic expansion. In 2020, we ran a successful pilot test in Guatemala where we saw consistent sales, EBITDA, distributor and associate growth. While Guatemala is a relatively small market with its total market representing only 5% of Mexico´s market size, our pilot test proved that we can successfully replicate our business model in other geographies. We see continued opportunity to expand into other countries, mainly Colombia and Peru, in the coming years through both organic and inorganic growth as we assess M&A opportunities in these countries.

Going deeper into our web marketing, we launched our new and improved transactional website betterware.com in the fourth quarter. We are very pleased with the early results of our new site, which acts as a tool for our distributors and associates to grow their sales and earnings by continuing to reach additional customers. They are able to do this by, number one, connecting new customers based on location to a distributor if they don't already have an existing relationship with one; and two, the new platform allows the distributors and associates to share a personal link that will automatically assign them any purchase completed through their link.

It is relevant to highlight that penetration of ecommerce in Mexico remains low, representing less than 6% of total retail transactions, but is rapidly increasing. With this new platform, we are ready to offer customers the most convenient way for them to buy our products, while giving our distributors and associates the opportunity to increase their earnings.

Touching briefly on our new campus, the new campus opened in the fourth quarter in Huaxtla, Jalisco. Currently, almost all of our operations staff, which is approximately 70% of our collaborators, is working from there and the rest of our people will move by the beginning of March 2021. This will give us operational efficiencies, including consolidation of all warehousing and distribution processes, optimization of space usage and inventory management efficiency, backed by new technology, and allow increased collaboration and therefore quicker decision making across our organization.

After the triple-digit growth in volume during 2020, the new campus will reach full capacity sooner than expected. We decided to keep a 24,000 square meter rented warehouse to complement our capacity, and are currently analyzing, together with Bain and Company, the most efficient way to expand our capacity to support our growth. This could mean an expansion of our campus or a new distribution center located near Mexico City. We will keep you posted on any new developments in this regard.

Lastly, on January 15, we launched our biggest marketing campaign to date. This campaign includes paid and open TV video advertisements, radio commercials, out of home media and social content, which all highlight Betterware's vast array of easy to use and accessible products for organization and practicality. We are excited to share our values and product solutions for the home with more families and individuals across Mexico through these advertisements. Overall, we expect the new marketing campaign to expand our customer base as we showcase how consumers can benefit from our line of products.

So, overall, I am very pleased with the significant progress made in 2020 against our key strategies. As we begin 2021, we enter the new year from a position of strength and remain confident in our ability to drive strong double-digit sales and profit growth. Our priorities remain the same: we are focused on executing against our four growth pillars, while also continuing to invest in key areas of the business, and returning value to shareholders through our quarterly dividend program.

Similar to 2020, we will continue take a strategic approach to expand our household penetration and our share of wallet as we focus on further strengthening our market positioning in 2021 and beyond.

I will now turn the call over to Diana to review our fourth quarter and 2020 financial results.

Diana Jones

Thank you, Andres. Good morning, everyone.

I would like to take this time to review our fourth quarter and Fiscal Year 2020 results. I will then share perspectives regarding our outlook for Fiscal 2021. Please keep in mind that the currency I will refer to when reviewing our results and guidance is the Mexican Peso, which is our functional and reporting currency.

I will provide highlights of our results, which are detailed fully in our 6-K filed yesterday.

The Fiscal 2020 included a 53rd week and compares to a 52 week year in Fiscal 2019. The 53rd week was included in the Company's 2020 fourth quarter and added 160 million in net revenue and 63 million in EBITDA.

For the fourth quarter, total net revenues increased 229% to 2,601 million from 791 million in the prior year period. It is important to highlight that 4Q20 had 14 weeks compared to 13 weeks for 4Q19. The additional week represented 160 million of net revenues. Comparable net revenues for 4Q20 were 2,441 million, an increase of 209% compared to 4Q19.

EBITDA for the fourth quarter 2020 increased 254% year-over-year to 807 million compared to 228 million in the prior year and EBITDA margin expanded 220 basis points to 31% due to the increase in operational leverage. The additional week in 4Q20 represented incremental EBITDA of 63 million. Comparable EBITDA for the quarter was 744 million, an increase of 227% compared to 4Q19. We reported 18.64 in adjusted non-IFRS earnings per share.

For the full year, total net revenues increased 135% to 7,260 million from 3,085 million in 2019. Comparable net revenues for 2020 were 7,100, an increase of 130% compared to 2019.

EBITDA for 2020 increased 154% year-over-year to 2,164 million compared to 851 million in the prior year, and EBITDA margin expanded 220 basis points to 29.8% due to the increase in operational leverage. Comparable EBITDA for the year was 2,101 million, an increase of 147% compared to 2019.

Finally, we reported 43.36 in adjusted non-IFRS earnings per share.

Now, turning to the balance sheet, as of December 31, 2020, we had 650 million in cash and cash equivalents, a 204% increase versus the prior year period. Inventory increased 269% year over year with increasing support of our sales expectations.

At year end, our leverage ratio of net debt to EBITDA was minus 0.01, down from 0.5 at the end of 2019.

In the fourth quarter, we had 275 million of capital expenditures, and for the year end, we had capital expenditures of 736 million compared to 183 million invested in 2019. For the year, 615 million were investments in our new campus.

We expect Capex in 2021 to be 460 million, which includes additional equipment for our new campus, technology and other investments.

In terms of our outlook for 2021, as disclosed in our press release, we expect revenue for 2021 to be in the range of 10,100 million to 11,100 million, and expect EBITDA to be in the range of 3,000 million to 3,300 million compared to the 2,164 million in 2020, and EBITDA margin to be approximately 29.7% versus 29.8% in 2020. Over the long term, we expect our stated growth strategies supported by a strong infrastructure and talented team will enable our company to deliver consistent growth in sales and EBITDA in future periods.

I will now turn the call over to the operator and we'll take any questions you may have.

Operator

Thank you. At this time we will be conducting a question-and-answer session.

Your first question comes from the line of Eric Beder with SCC Research. Please proceed with your questions.

Eric Beder

Good morning.

Luis Campos

Good morning, Eric.

Eric Beder

For the new website, what customers are you seeing? Are the customers different, either demographically or geography-wise, from your core areas and where do you see that going as kind of a percent? And the other—that's one question.

The second is there was a slight, I guess, decline in (inaudible) cost of item per unit in terms of how much was spent. Is that a shift to more basic products? What is kind of the focus there?

Andres Campos

Hi Eric. This is Andres.

In terms of the web market insights, we think it's too early to give—tell specifically about this. But, it's very important to note that after six weeks of operating the platform, the sixth week we have five times the number of customers that we had in the first week. So, it's growing rapidly but obviously it's still a very—it's had lots of traction and we still have to see it develop in the coming weeks and months.

Eric Beder

Okay. Guatemala, when is that going to—I know it's small. Where does that start to come on to the financial statements and what should we be looking for as guideposts going forward? Again, I know it's small; I'm just curious where—what should we as investors be thinking about as more signs that it's working and it can work in other areas?

Luis Campos

Hi Eric. Remember that during the pilot test, Eric, they were operating as distributors in Guatemala. Beginning in March 1, we are going to begin operating at Betterware Guatemala and then we will include, even when these are very small figures, we are going to include it separately in our reports, and we will begin reporting and giving guidance also about Guatemala even when this is very small.

What I can tell you now is that they continue very well and growing very well down there in Guatemala and we expect to replicate, totally, totally replicate the business in the first half of this year. I mean, we have not still replicated 100% of our business model but by the end of the first half I think that we are going to accomplish that.

Eric Beder

Great. Thank you. Congrats on the quarter. Good luck for the year.

Luis Campos

Thank you.

Andres Campos

Thank you.

Operator

Your next question comes from the line of Jorge Lagunas with Apalache. Please proceed with your question.

Jorge Lagunas

Okay, thank you. Good morning, Luis, Andres and Diana. Congratulations to all their results.

I've got two questions. The first one is does the expected growth in revenue only contemplate the operations in Mexico, or are you already considering (inaudible) some operations in Guatemala?

The second question is if you could share with us your expectations of growth in distributors and associates for this year. Thank you very much.

Andres Campos

Hi Jorge, this is Andres. First of all, our projections only include Mexico for 2021. Second, the expected rate of growth for distributors and associates, you have to keep in mind that growth rate in sales is very closely related to the growth in distributors and associates, so we expect that correlation to continue in the future.

Jorge Lagunas

Okay. That's all for now. Thank you very much and congratulations.

Operator

Your next question comes from the line of Joe Feldman with Telsey Advisory. Please proceed with your question.

Joe Feldman

Great. Thanks, guys, and congratulations on the quarter.

I was wanting to ask with regard to the Capex forecast of 460 million pesos this year, it's a bit higher than what we were thinking. Is that residual from the new corporate campus, or can you talk a little bit more what's going into that 460 million of Capex?

Andres Campos

Yes. Hi. Capex is mainly divided in three parts, I would say, for 2021. The first part is the remainder of some business we have to do in the campus. That is about one-quarter of the Capex. The second is technology investments which it's about one-third of the Capex. The third, we have estimated the Capex to open a new distribution center in Mexico City due to the recommendations that we want expand the company, so the opening of this distribution center is already accounted for in the Capex. We are still in final evaluations of doing so, but it is within the Capex expected.

Joe Feldman

Okay, got it. That's helpful, thank you.

Then, another question I wanted to ask was about freight costs. Did you guys see any incremental pressure? We hear a lot about freight coming from China and other parts of Asia having been very expensive in the past quarter or so, and we've seen freight prices increase significantly for product coming to the U.S. I'm assuming it's the same for you guys, coming over across the Pacific. Has increased freight cost been a pressure point? How should we think about it for 2021?

Andres Campos

It is a reality that there have been a temporary—according to experts it's a temporary effect on freight costs due to spike in demand and shortage of containers, but that said, within our 2021 projections it's already taking into account and we don't expect any significant impacts on the 2021 projections.

Joe Feldman

Got it, okay.

Luis Campos

However—this is Luis. However, if this price increases will continue for freight from China, we would let you know, but as Andres said, we are including that impact in our guidance.

Joe Feldman

Okay. That's in the guidance already, thank you. Then, maybe the last one from me, can you share a little bit more about the new app, the version 3.0? What will be different and when you plan to launch it?

Andres Campos

The main thing that will be different—there are two things. One is user experience in general is going to be a lot more friendly, especially for new users, all the incoming distributors and associates, so that they understand rapidly how to use it, and the second part is a lot of new features for associates, which we believe will help to retain associates and diminish churn. Those are the main two things I would say, and we expect to launch in the fourth quarter of 2021.

Joe Feldman

Great. Thank you and good luck with the current quarter. Thanks, guys.

Andres Campos

Thank you.

Operator

Your next question comes from the line of Phil Kim, Private Investor. Please proceed with your question.

Phil Kim

Good morning, guys. Very impressive quarter and 2020.

I had a few questions for you. One of them revolves around your days payables. How has Betterware been able to maintain days payables over 120 days when 90% of your goods come from China? Almost all supply relationships in China are within two month terms with the majority requiring up front deposits and LCs. How has your relationship developed in China that allows you to buy that much time?

Andres Campos

I think it's a matter of two things, mainly. The first one is we have developed the relationship with Chinese vendors for over 20 years, so this is not a matter of sudden movements; it's something we have built for many years.

The second thing is that we have taken into account a credit line with banks where the banks are the ones who pay the money up front to the vendor and then we have to pay the bank in 120 days. The interest of that debt is paid by the vendor, but this way the vendor can obtain their money immediately after they ship and the bank is always providing the loan for the 120 days.

Phil Kim

Got it. Okay, thank you for that.

I guess the industry in general, the consumer product companies around the world, we're used to seeing 40% returns on invested capital, 12% operating margins. How has Betterware been able to achieve what looks like 200% returns on invested capital in the last quarter and 30% operating margins?

Andres Campos

Well, you know, I think that we have a very—we have two things in terms of returns. I think that on the one side we have a very unique business model, that it's not only based on one single thing; it's based on multiple things. It's based on a very unique product line, a very unique and proprietary technology that we have developed, very unique way of managing the opportunity for all the distributors and associates, so it's a combination of things to achieve it.

On the second thing in terms of return, I think that we have a very clear strategy and we really stick to the strategy and go deep into executing it correctly.

In terms of margin, I think that something that helps a lot is that we have very low fixed cost expenses. Our model is based on variable costs. We outsource many things such as distribution, among other things, so this helps a lot as well.

I think the combination of these two things is what is driving returns and what allows us to have a better margin than other consumer goods companies.

Luis Campos

This is Luis. Something I will add to that is we have a—we are very disciplined in the finance area of the business. We have very tight control on the manufacturing costs with the factories, we work with in China, and we are very, very close to the expense control system we have here. We are very, very disciplined in that area. Most of our expenses are variable expenses and only like one-fourth of our expenses are fixed, okay?

Phil Kim

Got it. Okay. That's helpful. I want to get to that as far as the China relationship, but you mentioned your associates and distributors. That's very impressive growth. You're talking about 1.2 million associates. On the topic of market penetration, we're looking at 84 million, roughly, people in Mexico between the ages of 15 and 64, call it the working age population if we're being generous here. Your numbers suggest one in 67 people, working age people in Mexico, is an associate of Betterware, and so roughly six times your largest employer in Mexico, which is Walmart Mexico. How have you been able to really achieve that type of market penetration, and why do you feel like you can double that to 40%, which would result in, call it, one in every 30 working adults, or one in every 15 households. I mean, at some point don't you think there would be some sort of ceiling there?

Luis Campos

Remember that our market penetration strategy is based on very solid data that comes from our BI area in the company. We have a very clear growth map of market penetration and we just stick to these strategy based on very solid data from our BI. Then, we know the way we are going to penetrate the market this year and the next year and the next four or five years, and this is a very disciplined and very well organized strategy based on this roadmap.

Remember that we have segmented the country in approximately 56,000 AGEBs, then we know exactly the direction we are going to take in the years to come in order to increase in a very organized way this market penetration, and avoiding cannibalization among our distributors.

Phil Kim

Mm-hmm, mm-hmm, got you. Got you.

When you look at your relationships in China, ABRAMS world trade data shows that Betterware had imported 182 million in total value of shipments from 2013 to today. Your COGS numbers just in the last three or four years is 300 million and that doesn't even include the inventory on your balance sheet which is another 500. I guess how do you explain this gap of 500, 600 million dollar difference there in the total value that was imported from China and other countries including Hong Kong and Taiwan versus your COGS and inventory?

Luis Campos

What is exactly the question? You mean the source…

Phil Kim

When you look at the lading data, which every company that imports or exports into a country has to provide that data to the state. It shows US$182 million total value that's been imported for Betterware into Mexico in the last eight years. But if you look at the last three years of your COGS and the inventory on your balance sheet, we're closing in on call it US$900 million. There's a $700 million gap there of where is that excess inventory and COGS coming from versus what's been shipped to you from your suppliers?

Andres Campos

You know, we don't know the source you are talking about, but we will gladly check into it and look at that source. Just to mention, between 80% and 90% of our COGS is imported from China, so it should reflect this, but we would like—gladly go into that source and check the differences.

Our Investor Relations Team will get back to you and give clarity on that.

What is the name of the source you spoke about?

Phil Kim

It's called ABRAMS world trade data and they log all the bill of ladings, import/export information for countries and companies.

Andres Campos

Okay. We will gladly look into and get back to you.

Phil Kim

Thank you very much. Appreciate your answers today.

Andres Campos

Thank you.

Operator

Your next question comes from the line of Andres Alvarez with Betterware. Please proceed with your question.

Andres Alvarez

Hello. Thank you, guys, and congratulations on the results. Sorry for the background noise.

My question is related to a previous question that was asked regarding the increase in freight costs from China. I was wondering what was the amount of extraordinary expenses coming from this increase in freight expenses from China, and how did you account them in the P&L, and if you accounted for it above or below? I'm just wondering if the EBITDA should be maybe adjusted on those expenses, or could you just give some color on that side? Thank you.

Luis Campos

As we said before, we have been posting the impact of this very valuable freight costs from China over the last weeks and our results for 2020 have been negatively impacted by that. However, we have included in our guidance numbers for 2021 the potential impact we expect in this year. What we know is that prices will begin going down again probably by beginning of the second quarter, however, we are being conservative regarding our guidance and the potential impact we can have this year. We have been conservative and if things go better, well, our results could improve a little bit.

Andres Alvarez

Okay. What about just specifically about air freight extraordinary expenses? Can you just …

Luis Campos

We do not expect a major impact—a negative impact this year. I think this will—this could be a more normal year in that aspect, more predictable year in this aspect. We do not expect high expense in air freight this year.

Andres Alvarez

Okay, understood. Thanks a lot and congratulations again.

Andres Campos

Thank you.

Operator

Ladies and gentlemen, we have reached the end of the question-and-answer session, and I would like to turn the call back to Mr. Luis Campos for closing remarks.

Luis Campos

Thank you, Operator. Thank you everyone for joining us today. We look forward to speaking with you when we report first quarter results and meeting with many of you at upcoming investor conferences we will be attending. Thank you very much.

Operator

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.