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

Second Quarter 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

Luis Campos, *Executive Chairman*

Andres Campos, *Chief Executive Officer*

Diana Jones, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Eric Beder, *SCC Research*

Cristina Fernández, *Telsey Advisory Group*

Alvaro Garcia, *BTG Pactual Equity Research*

Kazuo Okamoto, *Mapache Investments*

PRESENTATION

Operator

Thank you, and welcome to Betterware's Second Quarter 2021 Earnings Conference Call.

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 statements 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 yesterday, as well as the Investors section of the Company's website.

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

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 second quarter performance, then Andres will discuss the progress we have made against our three strategic pillars to increase efficiency and elevate our operating platform in support of the significant growth we see for the Company. Diana will then review our financial results and our 2021 outlook.

We are pleased to share another quarter of outstanding results, with strong double-digit growth, even as we anniversaried the surge in demand in last year's second quarter. I will share some highlights of the quarter and first half of the year, that we are particularly proud of, including revenue growth of 81% from Q2 '20, and EBITDA growth of 92% from Q2 '20. For the first half of the year, revenue grew 130% and EBITDA grew 166% from the first half of 2020.

We ended the quarter with a strong balance sheet and strong cash flow generation, which gives us the opportunity to invest in our organic growth, evaluate possible M&A opportunities and expand internationally, after the initial positive results of our operations in Guatemala. We are also pleased to be in a position to invest in our growth, while returning value to our shareholders through our ongoing payment of a quarterly dividend.

Also, at the end of the first half of the year, I am pleased to announce that Betterware is the largest active salesforce in the direct-to-consumer market in Mexico, and we expect to continue to grow. We also continue to grow our household penetration, moving toward our goal of reaching 40% household penetration by the year 2025.

As it relates to our salesforce, we are pleased to have ended the second quarter retaining the majority of the distributors and associates we added over the past year, with average distributor growth of 109% over the second quarter of 2020, and average associates increasing 110% over the second quarter of 2020. During the quarter, we completed the consolidation of our salesforce, and by quarter end our distributor and associate base returned to growth. With our consolidation complete, we expect to deliver increases in our salesforce sequentially going forward, as we remain a highly attractive organization for which to work in Mexico.

During the quarter, we remained focused on executing against our three strategic pillars of product innovation, technology and business intelligence. Andres will expand on our progress from the second quarter in a moment.

Regarding capital allocation, as I mentioned, we remain committed to returning value to shareholders and our strong balance sheet, including cash and cash equivalents balance of Ps. 520 million as of quarter end, afforded us the opportunity to propose an annual dividend of Ps. 1,400 million, to be paid in four installments, of which the first two were already paid in March and May. We are proposing the payment of the third installment of this dividend, which implies a dividend of Ps. 9.38 per share for this quarter, which is subject of approval at the next Ordinary General Shareholders Meeting, to be held on August 13, 2021.

In summary, we are pleased to finish the first half of the year above our expectations of revenue, EBITDA, and our distributors and associates base. As we enter the second half of the year, we are confident about our business prospects. Our strong results year to date, that reflect the success of our growth pillars, combined with the flexibility and liquidity of our balance sheet, has us well positioned to capitalize on M&A and international expansion opportunities that may come our way. Our differentiated business model has driven consistent results to date and we believe we are poised to capture additional share as we increase our household penetration and our share of wallet over the near and long term.

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

Andres Campos

Thank you, Luis, and good morning to everyone.

We are very pleased with our strong results in the second quarter and the first half of 2021, and the continued progress we have made towards increasing our two avenues of organic growth, household penetration and share of wallet.

This year's challenge was clear, consolidate our salesforce to ensure we have an efficient platform and the processes in place to service the significant growth we have achieved over the past year and continue to drive strong rates of sales and earnings growth as people go back to normal. We are proud to have accomplished this objective, as we sustained our salesforce and activity levels, which means we have successfully consolidated 2020's gain (phon) penetration. This confirms a new level on which we can continue to drive penetration and share of wallet going forward.

That said, I would like to give more insight on the strength of the strategies that support future growth. To do so, I will elaborate on our three strategic pillars; namely, product innovation, technology and business intelligence.

Starting with our first pillar, product innovation, we have two key initiatives.

Starting in September 2021, we will increase the number of catalogues per year from 9 to 12. Having a monthly catalogue will help us increase the purchase frequency from our customers, increase the amount of product innovation, and increase our ability to adapt to seasonality throughout the year. This means more total and new SKUs exposed to the consumer, increasing our consumer's need to purchase Betterware products.

Second, we are reorganizing our product categories by functionality, rather than by areas of the home. This new categorization will take our home solutions score into a whole new level. On one hand, it increases our innovation capabilities, as it expands our product range potential, thus increasing our total market potential. At the same time, it will make it easier for customers to understand our product offering, thus increasing their need to buy. The new categories under this new functional dimension include: number one, home organization and simplicity; number two, home improvement; three, home comfort; four, food preparation and conservation; five, cleaning and hygiene solutions; and six, commuting solutions.

Regarding our second pillar, technology, we view our investments in two buckets, commercial initiatives and service initiatives.

On the commercial side, we are on track to launch by the end of the year the third version of our proprietary salesforce app, Betternet 3.0. This new version will more user-friendly, which should drive associate and distributor motivation and loyalty. It will also have new features, such as better points calculator and simulator, quick buttons and personalized indicators, timely personalized notifications, among many other new functions.

We are also expanding our chatbot capabilities, integrating natural language processing technology. Betty, as we call commercially our bot, has been instrumental to efficiently serve and motivate our salesforce, and will continue to differentiate us from traditional salesforce management systems.

We will also launch the second version of our innovation platform, Pipeline 2.0 later this year. This new platform will make a key difference as we embark into a new era of more and faster innovation with our expansion to 12 catalogues per year.

Finally, we continue to roll out and improve our recently launched e-commerce platform. A recent study shows that while e-commerce is growing fast in Mexico, its penetration is still very low in the home solutions category, representing less than 1% of the total market. This confirms we started this front on time, giving us the opportunity to lead the growth of e-commerce in our category. With this mind, we expect the sales from the platform to be increasingly relevant over the next three to five years.

On the service side of our technology initiatives, after some delays due to the worldwide shortage of chips and semiconductors, our new pick-and-pack tower will start operations in the fourth quarter of this year. This new tower will be almost 100% automated and will double our pick-and-pack and sell capacity.

Regarding capacity expansion, we have reached the decision to open a new distribution center near Mexico City. This new distribution center will almost double our capacity as we continue to scale the business. It will also reduce delivery times for central and southern regions, which represent approximately 40% of the total market. Finally, it will give us resiliency by having two distribution centers instead of one. We will work towards starting operations during the first quarter of 2022, and it is worth noting that we will operate this new distribution center in a rented warehouse, thus it will not lead to a significant increase in Capex.

To improve our service, we have introduced Drivin (phon), our new technology that provides real-time shipment updates to our distributors, providing a two- to three-hour window of order arrival. This new technology has been received well by our distributors, who are now able to free up time during their days that they receive the orders.

Moving on to our third pillar, business intelligence. Our BI Team is constantly analyzing data from a 2.4 terabyte database generated from 1.3 million active associates and distributors, and more than 6 million associates and distributors historically, to make the best decisions, focused on increasing our household penetration and share of wallet. They analyze more than 430,000 weekly transactions and 4 million weekly units sold in more than 5 million households and 25,000 neighborhoods.

In terms of household penetration, we received a recent study noting our household penetration was approximately 24% as of May 2021, up from our estimated 20% at the end of Fiscal 2020. We remain confident that we will increase our household penetration to 40% in the next five years, as we capitalize on our category leadership positioning in Mexico and strong associate and distributor base. To achieve this objective, our Business Intelligence Team has segmented the country in more than 63,000 neighborhoods and estimated we have presence in approximately 40% of those neighborhoods, which indicates we have good room to expand our neighborhood penetration and a clear roadmap on how to do it.

Furthermore, based on what I have already mentioned regarding our three strategic pillars, we feel confident on our strategies, which have us poised for sustainable growth in the years to come. After a first half of 2021 of consolidation and setting the stage to revamp growth in household penetration and share of wallet, we are confident in our outlook, which is reflected in our increased guidance.

I will now turn the call over to Diana to review our second quarter financial results.

Diana Jones

Thank you, Andres. Good morning, everyone.

I would like to take this time to review our second quarter 2021 results. I will then share perspective on how we are approaching the remainder of 2021. Please keep in mind that the currency I will refer to when reviewing our results and guidance is in Mexican pesos, which is our functional and reporting currency.

Our second quarter results included strength across all key operating metrics, with strong growth in sales, expansion in gross margin, and disciplined expense management. This fueled a 92% increase in EBITDA. I will review the highlights, as the full results are included in the 6-K we issued yesterday.

For the quarter, total net revenues increased 81% year-on-year, gross profit margin expanded 512 basis points to 56.8%, EBITDA increased 92% and EBITDA margin expanded 172 basis points to 28.8%. Operating cash flow was Ps. 435 million, or 58% of EBITDA, and free cash flow was Ps. 645 million for the quarter.

For the first half of the year, total net revenues increased 130% year-on-year, gross profit margin expanded 373 basis points to 57.1%, EBITDA increased 166% and EBITDA margin expanded 413 basis points to 30.4%. Operating cash flow was Ps. 945 million, or 57% of EBITDA, and free cash flow was Ps. 669 million for the first half of the year.

We are an asset-light business, with high free cash flow generation, which historically has represented approximately 65% of EBITDA. For 2019, 2020 and year to date 2021, free cash flow was impacted due to material investments to open our new state-of-the-art campus. Even with this investment, we delivered Ps. 669 million in free cash flow for the first half of the year. With this investment behind us, our Capex will normalize and, as such, we expect our free cash flow generation to increase significantly and go back to historical levels.

Having said that, our cash flow generation for the first half of the year allowed us to finish the second quarter with cash and cash equivalents of Ps. 520 million, in line with the prior year period, even after dividend payment of PS. 700 million year-to-date, a 312% increase, compared to the first six months of 2020.

Due to our business model, considering the favorable payment terms with our suppliers and the terms to collect receivables from our distributors, we have a negative days of cash flow cycle that fully funds our organic growth. This is reflected in our strong balance sheet that includes a low leverage ratio of 0.02 times net debt to EBITDA and gives us the ability to continue to return value to our shareholders with our ongoing dividend payments.

As previously announced, and to enhance our financial flexibility, we are working on a note issuance in the Mexican market of approximately PS. 1,200 million to Ps. 1,500 million. This will allow us to refinance our debt at an attractive interest rate, as well as serve as an additional source of capital to fund future geographic expansion and M&A opportunities. After this note issuance is complete, our leverage ratio of net debt to EBITDA will remain unchanged at approximately 0.02 times.

In terms of our outlook for 2021, as disclosed in our press release, we are raising our revenue guidance for 2021, to be in the range of Ps. 10,800 million to Ps. 11,300 million, which implies net revenue growth to be in the range of 49% to 56%, and expect EBITDA to be in the range of Ps. 3,200 million to Ps. 3,400 million, compared to Ps. 2,164 million in 2020, which implies EBITDA growth in the range 48% and 57%, and EBITDA margins to be approximately in the range of 29.6% and 30.1%, versus 29.8% in 2020. Over the long term, we expect our stated growth strategies, supported by a strong operating platform 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 will take any questions you may have.

Operator

Thank you.

Our first question comes from Eric Beder with SCC Research. Please proceed.

Eric Beder

Good morning. Congratulations on the quarter.

Andres Campos

Thank you, Eric.

Eric Beder

Could you talk a little bit about (a) inventory, and (b) what are you seeing in terms of (audio interference).

Diana Jones

Hi. Inventory has increased Ps. 948 million, from 2020 to 2021, reflecting abnormally low inventory levels in the second quarter of 2020, due to unexpected sharp acceleration in demand. Inventory days in 2020 were 47, versus 99 in 2021.

Eric Beder

Okay. Could you talk about—last year at this time you were dealing with very high Fx (audio interference). Yes, I'm sorry.

Andres Campos

Sorry, can you repeat the question, Eric?

Eric Beder

Sure. This time last year, the U.S. dollars was much stronger than it is right now. What is the opportunity for you, and I guess what is the opportunity, also, in the shipping costs for you going forward now?

Andres Campos

The peso is stronger this year than it was last year. As you know, we always hedge the U.S. dollar, to make sure that that is covered for in the year, as regards to our hedging policies. In terms of freights, we also have contracts with the companies, to make sure that we have a hedge price in the shipments. So, we feel confident it can remain at normal levels for the rest of the year.

Eric Beder

Great. Last question. Do you see a need for (audio interference). Sorry. All right, guys, thank you.

Luis Campos

Thank you.

Operator

Our next question comes from Cristina Fernández with Telsey Advisory. Please proceed.

Cristina Fernández

Hi, good morning, everybody, and congratulations on a good quarter. I wanted to ask about product innovations going forward, particularly with the change in the number of catalogues. Should we think about it like a third more innovation? I mean, are you planning any additional sort of categories or, you know, businesses versus what you discussed in the past?

Andres Campos

Yes, sure. Hi, Christina. In terms of innovation, with this change to 12 catalogues, we will have more products exposed throughout the years, and among with those more products exposed, we will have more new products as a percent of those products exposed. In terms of categories, we talked about this change of viewing the categories as functions and we believe that there is a lot of room to expand innovation within those categories that we mentioned. So, I would say that we will focus on those new functional categories, and we have a lot of room to innovate within those for the coming months and going forward.

Cristina Fernández

Thank you. Another question I had was, with sort of trends normalizing and consumers kind of being more outside the home and there's so many more normal activities, are you seeing any change in the types of products they're buying, versus perhaps at this time last year or six months ago?

Andres Campos

Yes. So, I think there's two parts to this. The first part is that, even as people go back to normal, the home has taken a much more important role in people's lives. We are seeing, and we believe that it will continue, that people will invest in their homes, because now it's taking a whole new role in their lives.

Now, there are two important categories I would like to remark. One is cleaning and hygiene. I think that this category will remain to be a strong category, as people will have in their minds that it is very important to keep a clean home and hygiene home. The second category I would like to mention is the commuting solutions, that we were talking about. This is a category of Betterware that goes outside of the home, to help people solve everything within commuting. Either if they go by bus or by train or by car, bicycle, we have solutions for commuting, and we think that this, as people go back to normal, will continue to gain penetration. So, we think we're covered both in the home aspect and with these commuting solutions also outside of the home.

Cristina Fernández

Very helpful. Another question is, I wanted to see if you could expand on the new DC, maybe give us some data of what are the delivery times now for those regions and how that will change, I guess how much shorter (audio interference) once that facility is open.

Andres Campos

Yes. We are reducing from—right now, in the central and south part of Mexico, we are delivering between 48 to 72 hours, and we will reduce 24 hours all of those deliveries with the new DC.

Cristina Fernández

Great, thank you. I think that's it for us for now. I appreciate all the answers and the color. Thank you.

Andres Campos

Thank you, Cristina.

Operator

Our next question comes from Alvaro Garcia with BTG. Please proceed.

Alvaro Garcia

Hi, Luis, Andres, Diana. Thanks for the call. Good morning. Congrats on the results. I have a couple of questions, as well.

My first one is on input cost inflation, particularly resin, we've seen a lot of inflation around the world, and I was just wondering if you can give us a read-through of what your suppliers are saying, and as you position yourself on the pricing front for the second half of this year and for 2022, how you're—whether or not you might be employing strategies to sort of lower the takeaway to the gross margin for your salesforce, to manage pricing, or what strategies you might take to manage margins into 2022. That's my first question.

Andres Campos

Yes, hi. We have seen increases in raw material, commodity costs and freight costs, but we have been able to mitigate this effect due to increasing the volumes of every SKU, and also we have favorable contracts with the shipping companies and this has allowed us to mitigate the effect of price increases. Therefore, we don't expect significant impacts, but, obviously, we are closely monitoring the situation going forward.

Luis Campos

Yes, and, Alvaro, I would like to add that we have to remember that we are coming out from a COVID period of time three times the size we were before COVID, in terms of sales and EBITDA. As Andres was saying, due to this, we have somehow mitigated the increase, the price increase in raw materials with much higher volumes, three times or more than three times. We have not even needed to increase prices, generally speaking. I mean, just a few price increases in some given products. I think we will be able to sustain our gross margin and our EBITDA margin as time goes.

Alvaro Garcia

That's a great point on scale, specifically, Luis. My second question is on the consolidation of your salesforce at these levels, which has been quite impressive …

Luis Campos

Hello? Hello? Operator, do you still hear us on this side?

Operator

At this time, I'd like to turn the call back to Management for closing comments.

Luis Campos

Yes, I think Mr. Alvaro Garcia was going to make another question.

Operator

Okay. We have question from Kazuo Okamoto from Mapache. Please proceed.

Kazuo Okamoto

Hello, good morning to everyone, and congratulations for the results. My first question is—compared to the second quarter of 2020, we saw an increase of 110% in the number of distributors and associates. However, total sales for the period grew 80.7%, which implies that the average sale per distributor and associate decreased. What was the reason for this contraction?

Andres Campos

We don't see any significant impact from this contraction.

Luis Campos

Yes, I don't know the way you are calculating that. We have precise numbers that we can forward to you afterwards through Guillermo Armida, but our activity and sales and average ticket are very strong, I mean, as usual.

Kazuo Okamoto

Okay, thank you, I'd appreciate you forwarding the information, and I have another question. Has the pressure and continued costs by the transport of goods from China been maintained in recent weeks, or is (inaudible) already observed?

Andres Campos

Yes, as we were saying before, we have significant contracts with the shipment companies, which help us to have a good price and a fixed price in the freight costs, so we don't expect any significant impacts from this front different from where we are today.

Kazuo Okamoto

Thank you for taking the time to answer the questions. That's it.

Andres Campos

Thank you.

Luis Campos

Thank you.

Operator

Mr. Garcia, do you have a question?

Alvaro Garcia

Yes, can you hear me?

Luis Campos

Yes.

Alvaro Garcia

Great. Sort of getting back to my question on the 40% of household penetration, which is your long-term target, sort of what that implies in terms of new categories and productivity, and obviously you're amping up the catalogue 12 from 9, you're adding this functionality basis, which is great, and I was just wondering if that was just based on feedback or if that 40% household penetration implies you need to get to more categories to get there. Thank you.

Andres Campos

Hi, Alvaro. No, this 40% household penetration is solely focused on growing our salesforce and our associate and distributor base to reach those households. Those are households that do not buy from us today. So, with the same categories that we have today, we can reach those households and increase sales.

Alvaro Garcia

Great, thank you.

Andres Campos

The category expansion focuses more on increasing share of wallet per household.

Alvaro Garcia

Okay, wonderful. Thank you very much.

Luis Campos

Thank you, Alvaro.

Operator

Thank you. At this time, I'd like to turn the call back to Management for closing comments.

Luis Campos

Well, thank you for joining us today. We look forward so speaking with you when we report third quarter results and meeting many of you at upcoming investor conferences. Thank you, everybody, and have a good day.

Operator

Thank you. This does conclude today's teleconference, you may disconnect your lines at this time. Thank you for your participation and have a great day.