Betterware de Mexico, SAPI de CV

Fourth Quarter 2023 Earnings Conference Call

March 4, 2024

CORPORATE PARTICIPANTS

Luis Campos, *Executive Chairman*

Andres Campos, *Chief Executive Officer*

Alejandro Ulloa, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Eric Beder, *SCC Research*

Cristina Fernandez, *Telsey Group*

Andres Lomeli, *LCA Capital*

PRESENTATION

Operator

Good morning. Welcome to Betterware's Fourth Quarter 2023 Earnings Conference Call.

Joining us today are the Leadership Team members Executive Chairman, Luis Campos; Chief Executive Officer, Andres Campos; and Corporate Chief Financial Officer, Alejandro Ulloa.

Before we begin, I would like to remind you that the call will include forward-looking statements, which are subject to various risks and uncertainties that could cause actual results to differ materially from expectations, and any such statement should be considered in conjunction with 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 in the Investors section of the Company's website.

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

Luis Campos

Thank you, Operator, and good morning, everyone. Twenty-twenty-three has been a transformative year for Betterware. As a group, we have become stronger and more diversified, also leveraging our core competitive advantages such as consumer product and direct selling leader. This was reflected in a 5.2% year-on-year net revenue increase with a strengthened profitability, achieving a total of Ps.2,721 million in EBITDA, at the midpoint of our initial guidance and exceeding our revised guidance for the year and a strong full-year EBITDA margin of 20.9%. Our strong cash flow generation has enabled us to reduce debt and further strengthen our balance sheet.

I would like to commend the entire Betterware Mexico team for their success in navigating challenging post-pandemic headwinds. The stabilization we are seeing in Mexico's home solutions market, coupled with robust execution of our commercial strategy, enabled a 7% year-over-year increase in Q4 net revenue, our first quarter of growth since the third quarter of 2021. Today, we are well positioned for a new era of sustained growth.

I would also like to express my appreciation to our Jafra team. Jafra has surpassed our initial expectations as an acquisition that has proven to be highly accretive, delivering exceptional fourth quarter 2023 EBITDA, with a 45.3% year-on-year increase in Mexico and achieving almost breakeven in the U.S.

Initial implementation of our proven business model's key elements: product innovations, technology, and business intentions, has propelled the Company back into a growth phase, also with meaningful strategies resulting in cost savings across this business. The Jafra team, with the benefit of a strong new leadership, are well positioned for continued future success.

As Alejandro will discuss in more detail shortly, the Group's fourth quarter 2023 net revenue represents a 44% CAGR since the fourth quarter of 2019, representing an increase to Ps.3,402 million from Ps.791 million for the same period in 2019. Therefore, while our Betterware business achieved a 17% CAGR, the remaining CAGR reflects our Jafra acquisition.

Among these and the other milestones we will discuss today, we were pleased to announce in January that Andres has assumed the position of Betterware Group's CEO, which includes the Betterware and Jafra branches in Mexico and abroad. Andres has gained a deep understanding of our business over these 11 years with Betterware, successfully navigating our progress and development, and contributing to our overall success as a strong leader with a strategic vision. I look forward to my continued involvement in our Company's accomplishments and I am confident in our promising path ahead. Our strong foundation, built through decades as an industry leader led by our revitalized Management, is a winning formula for success.

With that, let me pass our conversation to Andres and I will return for some brief, closing remarks.

Andres Campos

Thank you, Luis, and good morning to everyone.

As Luis noted, particularly strong performance in the last quarter of the year drove our full year results. We achieved double digit revenue growth and continued our profitability in 2023 with robust cash flow generation that enabled a strengthened capital structure as we entered 2024 as Alejandro will discuss in more detail shortly.

I am extremely proud of the team's success in returning Betterware to our growth path during the fourth quarter of 2023. Our focused execution resulted in improvements versus prior year in 7% in net revenue and 17.6% in EBITDA, showcasing our ability to deliver results despite adversity. Our execution is stronger and 2023 results demonstrate the focus across the organization to enhance the customer experience.

I would like to highlight some relevant accomplishments which enabled our success.

Number one, we launched three new categories throughout the year: wellness, kids and pets. Wellness showed outstanding success and we have modified kids and pets to maintain the most effective concepts.

Number two, we saw renewed traction within our three core categories, namely home organization, kitchen products and home improvement through a deepened understanding of our customers' mindset and evolving needs, also responding to the ever-shifting environment. We are launching further innovation and market activation to capture the compelling, long term growth opportunities in the market we serve, leveraging our unique ability to analyze the extensive data we received through multiple channels.

Number three, price decreases implemented in September 2023, reflecting an improved exchange rate environment and moderating freight rate conditions, resulted in positive traction throughout the year with a positive spike in volumes sold by year end.

Number four, we are seeing a strong positive result from training and incentivizing the onsite field staff, we began reintegrating in February 2023, also from mentoring our distributors to improve their businesses and accompanying them on their routes.

Number five, we have continued to strengthen our BetterWare+ app through the launch of more than five new functions throughout the year. Importantly, this resulted in stronger activity rates and increased average monthly orders. This is normally driven by an increase in our Associate base. However, this did not happen in 2023 meaning the average order per Associate is increasing. This will result in a reactivation in the growth of the Associate base growth going forward. Betterware's strong commercial strategy enables us to reach more homes and increase our share of wallet.

Today, we have 25% total home penetration in Mexico and an estimated 4% market share, representing a significant growth opportunity which we are actively pursuing. I am confident that with Santiago's new leadership, which we also announced in January, Betterware Mexico's team is poised for success going forward.

Turning to Jafra Mexico, we've gradually implemented key elements of our Betterware success formula since April 2022 acquisition. Combined with a strong Management Team, this resulted in a double-digit growth in 2023. Importantly, this is the second consecutive year of growth for Jafra Mexico contracting a single-digit year-on-year increase in 2022 compared to 2021.

The team has been laser focused on our four operational success pillars which during the year resulted in, number one, accelerated innovation, representing 15% of 2023 net revenue from only 6% in 2022.

Number two, continued growth in fragrances, our main category, also with the launch of very successful lines and brand extensions during the year.

Number three, increased customer conversion rate resulting from an improved catalog graphic design look and feel which made our catalogs more enticing.

Number four, increased consultant acquisition through small, targeted and impactful incentive program adjustments.

Number five, ease in doing business for our leaders and consultants through the inaugural launch of our Salesforce app which we will continue to improve upon based on the team's feedback.

And last but not least, number six, improved more efficient interaction with our leaders and consultants through our newly launched chatbot, enabling us to expand our consultant base, reflected in a 2.5% year-on-year increase for the fourth quarter 2023.

Going forward, the Jafra Mexico team is well positioned to continue to capture the vast opportunity in the Mexico beauty market. And importantly, expand our 4% market share to become the number one direct sales beauty brand in Mexico. Continued execution of our four pillars will enable our success.

Finally, turning to our international operations, 2023 was an important year for Jafra US. While we began the year with operating challenges and declining revenue, we made swift decisions to recalibrate this business and correct our revenue levels in the second half of the year. We remain focused on reigniting our growth to gain market share within the sizable U.S. beauty space.

However, it is important to note that despite the year's headwinds within our U.S. operation, we successfully streamlined expenses for our return to profitability, achieving our most profitable quarter in the fourth quarter since acquiring Jafra. Further, we are well positioned to launch Betterware's U.S. operation in the second quarter of 2024.

I would like to take this opportunity to announce that we have recently hired our new CEO to lead Betterware US. Diego Isaza has considerable U.S. consumer product experience with companies including Procter & Gamble and Hershey, which, when leveraging Betterware's deep brand experience and proven business model, should result in continued success. Our planned investment for the initial launch phase of Betterware US operations is between $5 million to $7 million in the first year and do not expect a meaningful contribution in the first year of operations.

Our focus will be on the Hispanic market comprised of 60 million people representing US$3.4 trillion in estimated GDP, making it the world’s fifth largest economy and double the size of Mexico according to the Latino Data Collaborative Think Tank.

Finally, we made further progress toward our launch of Betterware Peru, hiring our General Manager, Ana Cecilia Augusto, who has more than 15 years of experience in the Peruvian and Latin American direct selling industry. We look forward to sharing further updates as they unfold.

Let me now pass the call to Alejandro who will review our financials in more detail.

Alejandro Ulloa

Thank you, Andres, and good morning, everyone.

I would like to review our fourth quarter and fiscal year 2023 results. I will then share perspectives on how we are approaching 2024 and discuss our capital allocation strategy going forward. 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. Additional details can be reviewed in our earnings release published yesterday. I will then share perspectives on how we are approaching 2024 and discuss our capital allocation strategy going forward.

Our consolidated results for the quarter are the following. Consolidated net revenue increased 5.2% compared to fourth quarter 2022, supported by positive performance of our two brands in Mexico, partially offset by a revenue decline in Jafra US. It is relevant to highlight that Betterware’s net revenue grew 7% compared to fourth quarter 2022, the first quarter of the year-over-year growth since third quarter 2021.

Consolidated gross margin was roughly in line with fourth quarter 2022, decreasing 48 basis points to 70%. This decline was mainly due to margin contraction in Betterware explained by unfavorable sales mix. In particular, promotions accounted for a larger share of sales than in fourth quarter 2022. However, this was mostly offset by margin expansion in Jafra Mexico, driven by favorable exchange rates, reduced costs from supplier negotiations and favorable sales mix.

Consolidated EBITDA for the quarter grew 36.7% to Ps.819.5 million compared to Ps.599.3 million in the fourth quarter of 2022. EBITDA margin expanded 556 basis points to 24.1%. Profitability improvements in all trade subsidiaries were achieved through successful efforts in expense optimization, allowing us to exceed our EBIT expectations for the quarter.

Consolidated net income was Ps.406.1 million, 62.5% higher than in fourth quarter 2022, mostly explained by net revenue growth and an increase in operating leverage, which allowed us to increase our earnings to Ps.10.09 per share. And for the year, consolidated net revenue increased 13.1% compared to 2022, explained by the consolidation of Jafra to our results for the full period this year compared to almost three quarters during 2022.

Outstanding net revenue growth in Jafra Mexico was partially offset by the decline of net revenue in Betterware due to lower average distributors and associate base and net revenue decline in Jafra US. Gross margin for the year expanded 265 basis points to 71.5% compared to 68.9% in 2022, boosted by Jafra's higher gross margin profile included in our results for the full year 2023, which was partially offset by gross margin contraction in Betterware due to unfavorable sales mix during the last quarter of the year.

Consolidated EBITDA for 2023 was Ps.2,721 million, 17.5% higher than in 2022 and exceeding our previous full year guidance. EBITDA margin expanded 79 basis points to 20.1% due to the positive performance in our three subsidiaries, driven by efficient expense control leading to margin expansion in all our subsidiaries and closing near breakeven profitability in Jafra US.

Consolidated net income increased 20.3% to Ps.1,049.5 million, driven by higher operating leverage offsetting the effect of higher interest rates on our debt.

Earnings per share for the year were Ps.28. 2. And finally, our free cash flow generation for the year, defined as operating cash flow minus CapEx, increased 79.6% attributed to a 67.9% increase in our operating cash flow from EBITDA increase, inventory turnover improvement in monthly businesses and improved payment conditions with suppliers in Jafra coupled with lower CapEx investments.

As for our balance sheet, the Company's financial position continues to improve as we reduced our total net debt by 11.9% during the year, closing 2023 with a net debt to EBITDA ratio of 1.8 times compared to 2.5 times at the end of the previous year.

As we have previously stated, while we are now comfortable with our conservative balance sheet, we will continue to use most of our operating cash flow to improve our financial position, aiming to bring our net debt to EBITDA ratio to approximately 1.5 times during 2024.

Having said that, and highlighting the confidence we have in our growth prospects, our Board of Directors has proposed a dividend payment of Ps.250 million for the quarter, which is subject to the approval at the ordinary general shareholders meeting to be held on March 6, 2024. We remain committed to returning value through dividends to our shareholders over the long-term.

We're confident and optimistic about the results achieved so far and the opportunities that lay ahead of us. For the full year 2024, we expect our consolidated net revenue to be in the range of Ps.13,800 million to Ps.14,400 million and our consolidated EBITDA to be in the range of Ps.2,900 million to Ps.3,100 million. Over the long-term, we remain confident in our ability to seize growth opportunities, which will allow us to continue to generate strong cash flows and maximize shareholder value.

I will now turn the call over to the Operator and we will take any questions you may have. Thank you.

Operator

Thank you. (Operator Instructions)

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

Eric Beder

Good morning. Congratulations on a solid end to the year.

Andres Campos

Hi, Eric, how are you? This is Andres. Good morning.

Eric Beder

Hi. I'm doing great. How about you? Let's talk about you continue to make significant strides in reducing inventory levels, especially when you compare it to the growth in the top line. How should we be thinking about inventories in 2024 and beyond?

Andres Campos

Hi, Eric. This is Andres, again. Yes, we feel positive about our ability to continue to reduce inventories during 2024. We think that 2023 was a great year in this regard, where we were able to reduce inventory in both companies, and we think we can reach normal levels by the end of 2024.

Eric Beder

Okay. So, there's still growth there. Are there still gains to be had there?

Andres Campos

[There is] still opportunity to reduce inventories, and we will continue to do so. A context of growing revenue will obviously help us to make that last impact in the inventory to return to normal levels.

Eric Beder

Great. When you look at the opportunities at Jafra, both Jafra Mexico and Jafra USA, obviously you have a very strong position in perfume. What other categories would you think make a lot more—would continue to make sense to add or to expand upon to capture more of your customer share of wallet?

Andres Campos

Yes. Eric, this is Andres again. Yes. Obviously, the fragrances category is the most relevant. As you can remember, today, in Mexico, we are the number one direct selling brand in fragrances in Mexico. The categories where we see a lot of opportunity are basically color, skincare and toiletries. They are three very big categories, both in Mexico and in the U.S., and we see a lot of opportunity to expand these categories and make them very relevant, such as we have made with fragrances. They will, in fact, be very important for growth going forward, and they speak about our great opportunity to grow going forward.

Eric Beder

And kind of a structural question on Betterware USA. You're rolling that in Q2. Are you going to be shipping product from Mexico? How do you look upon that as a rollout? And are you going to initially focus on kind of more the Southwestern regions or is it kind of nationwide? How should we [be] thinking about kind of the cadence of the rollout and how you're going to support it?

Andres Campos

Yes, very, very good question. As we spoke about, we are weeks away from launching in [Betterware USA] (audio interference). This will be based off Dallas in Texas. And it's very important also to know we're leveraging on many of just capabilities, such as (audio interference) distribution center and using some of the back office that Jafra (audio interference) synergies for our (audio interference).

Operator

We are experiencing technical difficulty. The conference will resume momentarily. Once again, thank you for your patience. We are experiencing technical difficulty, and the conference will resume momentarily.

Thank you for your patience. We are ready to resume. Go ahead, sir.

Andres Campos

Okay, thank you. Eric, this Andres, do you hear me there?

Eric Beder

Yes, we can.

Andres Campos

Okay, perfect. Thank you. As I was telling you, we are ready to launch in the U.S. We will begin selling only in the state of Texas to pilot test all our operations and everything. It is important to note that the first year, 2024, we should not expect any significant positive impact from our Betterware launch. It will be a year where we will basically focus [on] Texas in the first month and then maybe expand to other states in the following months.

I'd also like to state that we will focus at the beginning, mainly in the Hispanic markets. As we stated during the call, it's a very big market. According to some stories, it's a 60 million population market with huge potential, and it's a market that is very similar in many ways to the Mexican market. We think that we can be very successful in that market during the first years.

Eric Beder

Great. Again, congratulations and look forward to 2024. Thank you.

Andres Campos

Thank you, Eric. Have a good day.

Operator

(Operator Instructions)

Our next question is from Cristina Fernandez with Telsey Advisory Group. Please proceed.

Cristina Fernandez

Hi, good morning and congratulations on the good results. I wanted to see if you can put in context the results for the first quarter relative to your updated guidance in October. Where did the upside come relative to expectations? Did you see a significant acceleration or change in the trend of the business in November and December? Just wanted to understand what was different and where the upside came from. Thanks.

Andres Campos

Hi, Cristina. How are you? This is Andres. We saw significant impact of our commercial strategies in Betterware Mexico. I think that in first part, Betterware Mexico had a great fourth quarter. All the different commercial strategies that we had implemented and that we have mentioned really hit off. And then it helped, we did the price decrease in September, which kind of helped all the strategies to start streamlining up again and have a great quarter for Betterware Mexico.

Then, on the other hand, at the same time in Jafra Mexico, we had a great quarter as well. And especially in terms of profitability for Jafra Mexico, we had great impact from an increased gross margin in the fourth quarter, which helped our EBITDA results for the fourth quarter. Those were the main reasons, both revenue, we think that Betterware Mexico had a great impact to achieve the revenue. And in this case, Jafra Mexico contributed, was one who contributed more in the profitability with an increased gross margin of about 581 basis points.

Cristina Fernandez

Yes. Thank you for that.

Luis Campos

Yes.

Cristina Fernandez

Yes. Thank you for that. Sorry, go ahead.

Luis Campos

Yes. Go ahead, Cristina.

Cristina Fernandez

Yes. No, I just had a follow-up on the Jafra Mexico profitability. Was there anything that was like one time in nature that helped deliver that 31% EBITDA margin for that segment? And then as we look at 2024, how should we think about the EBITDA margins for Betterware and Jafra Mexico? I mean, given

Betterware has been sort of in that 20% range and down a little bit from first half of the year versus Jafra that has been accelerating the profitability.

Luis Campos

Cristina, [I will pass the call] to Alejandro to explain that extraordinary profitability of Jafra for the fourth quarter, and to give you what we can expect in terms of EBITDA margins going forward for 2024.

Alejandro Ulloa

Yes. Hello Cristina. Nice talking to you. This is Alejandro Ulloa. What's happened in the last quarter with our gross margin in Jafra Mexico, we had a significant improvement in this gross margin, basically because of a favorability in the exchange rate. The appreciation of the peso during this quarter was positive. We also had a reduced cost achieved through supplier negotiations with specific vendors, and that impacted almost 2% of points for gross margin. And we had a favorable variation in product volume in our manufacturing facility. Volume additionally had impact and the mix also of [the] products that we manufactured. That combination arises with this improvement in margins. But what we are expecting for 2024 is that this will be normalized, and we will be once again in margins between 80% to 82% range.

Cristina Fernandez

Thanks. And then the last question I had was on the revenue outlook for 2024, the 6% to 11%, what are you assuming as far as like industry growth? You talked about the home solutions market stabilizing. Do you think that market can grow in 2024, and how? Maybe you can talk about the overall consumer and the beauty market that's underpinning your revenue outlook for the year?

Andres Campos

Yes, Cristina, this is Andres again. On the (audio interference) we're saying, the market has pretty much stabilized. It is important to note that during the pandemic, after the huge market growth then came a very steep decline. And now from the market studies that we make year after year we see that it has stabilized. And with a stabilized market, there's a lot that we can do. It is important to remember that we only have around 4% of market share today and we also only have about 25% of home penetration today. There is a lot of room for us to grow with a stabilized market. What we're assuming, for Betterware Mexico, is that the market continues to be stabilized. We're not assuming huge growth in the market (audio interference) and that (audio interference) helps us even more.

Now, on the Jafra Mexico side, the beauty market in Mexico is a buoyant and growing market today. After the beauty market had some trouble during the pandemic and now after pandemic it's growing buoyantly, grew between 10% and 15% last year, the beauty market in Mexico, and we think we can ride this market growth and also expand our market share. In Jafra Mexico we also have around 4% market share. And it's important to understand that around 50%, five zero percent of the market is sold through direct selling in the beauty space in Mexico. We have a lot of room to grow, a lot of room to grow in Jafra, so these two combined will help.

Now, additional to this in our international operations, as I spoke earlier, we should not expect any significant contribution from Betterware US, but we should expect Jafra US to start growing again and contribute little by little to the overall revenue of the group.

Cristina Fernandez

Thank you.

Andres Campos

Yes.

Operator

Our next question is from Andres Lomeli with LCA Capital. Please proceed.

Andres Lomeli

Hello. Thank you for taking my question and congratulations again for the great results. My question is regarding the expansion to new markets. You mentioned that you want to keep margin stable. I just wanted to know if you could talk a little bit about how you plan on managing the cost associated with the expansions, maybe new hires, new offices, and maintaining those EBITDA margins stable throughout the years. Thank you.

Andres Campos

Yes, thank you, Andres. This is Andres again. For the Betterware US expansion, we are estimating within our projections (audio interference) million-dollar investments during 2024. It's not a very relevant investment as regards to our yearly EBITDA. And we are leveraging a lot on our capabilities in Jafra today. As I mentioned earlier, we are going to be distributing off Jafra's distribution center the excess capacity that we have there. That will not be a very relevant cost. We're also leveraging on all the back office to finance, HR, all the back office. And, this investment will be mainly in our commercial team for Betterware US.

One of the good things of our business model is that we can streamline expenses very efficiently when we launch in a new market. We are going to go step by step, not going to just go out and invest in one. We're going to go step by step and it will not be a relevant investment. Also in Peru, we're going also step by step. We estimated an investment of between $500,000 to $1 million to make all the preparations in the pre-operating expenses. In general, we don't expect this to be too relevant and it is already implied in our guidance.

Andres Lomeli

Perfect. Thank you very much. Once again, congratulations on a great quarter.

Andres Campos

Thank you, Andres.

Operator

(Operator Instructions)

That will conclude our question-and-answer portion of today's conference call. I would like to turn the call back over to Management for closing remarks.

Luis Campos

Hello, this is Luis. Hello, everybody. Thank you, Operator, and thank you everyone for joining us today. As we look forward to the year ahead, we expect 2024 will be transformative, expanding our Mexico businesses also with the launch of Betterware US and continue towards Betterware Peru in early 2025.

Our Company's strong fundamentals, led by a renewed leadership team, will drive accelerated growth and shareholder value. Thank you for your support and being on this journey with us. Thank you everyone, and have a good day.

Operator

Ladies and gentlemen, this concludes Betterware's Fourth Quarter 2023 conference call. We would like to thank you again for your participation. You may now disconnect.