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

First Quarter 2024 Earnings Conference Call

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CORPORATE PARTICIPANTS

Luis Campos, *Chairman of the Board*

Andres Campos, *Chief Executive Officer and Board Member*

Alejandro Ulloa, *Corporate Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Eric Beder, *SCC Research*

Cristina Fernandez, *Telsey Group*

PRESENTATION

Operator

Thank you, and welcome to BeFra's Fiscal First Quarter 2024 Earnings Conference Call.

Speaking on today's call are BeFra's Executive Chairman, Luis Campos, Chief Executive Officer, Andres Campos and Chief Financial Officer, Alejandro Ulloa.

Before they begin their remarks, the Company would like to remind you that today's 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 issued yesterday, and risk factors discussed in reports filed with the SEC. BeFra assumes no obligation to update any of these forward-looking statements or information.

A reconciliation of and other information regarding non-GAAP financial measures discussed on today's call can also be found in the earnings release, as well as in the Investors section of the Company's website.

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

Luis Campos

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

During the first quarter of 2024, BeFra maintained its growth momentum and its performance levels strengthened. Our increasing profitability is being driven primarily by the effective execution of our various strategies to sustainably drive top line growth and improve operational and financial efficiencies.

Our business strengths and the strategies we have been implementing across BeFra are evident in the results that we published yesterday. We achieved double-digit year-over-year growth in net revenues during the quarter, fueled by a revitalized promotional mix at Betterware, as well as through product innovation, and a special promotional campaign at Jafra Mexico. The combination of the strategic initiatives and financial discipline has greatly improved our profitability. Consequently, our EBITDA rose by 15.4%, compared to the first quarter of 2023, while our EBITDA margin improved 92 basis points.

It is the two-year anniversary of our acquisition of Jafra, which remains highly accretive. Jafra Mexico continues to exceed our expectations, delivering outstanding quarterly results once again. The double-digit growth in both the top line and profitability of this business is a result of outstanding efforts made by our commercial, operational, and administrative teams, which have worked intensively to transform the entire operation of the business, producing significant improvements across the board.

Among our many growth initiatives is international expansion. So, I am pleased to announce that Betterware US has begun operations as scheduled. We are very optimistic about the growth that we can achieve in the U.S. market, given its size, dynamism, and strong consumption levels. We believe we have the right strategy to effectively penetrate the U.S. home solutions market, and we will do everything necessary to maximize our results and return on investment.

Now, let me pass the call over to Andres to discuss more about the performance of BeFra's business units during the first quarter 2024.

Andres Campos

Thank you, Luis, and good morning to everyone.

We began the year with strong performance levels, delivering double-digit growth in consolidated net revenue and EBITDA, and generating cashflows that enable us to further strengthen BeFra's capital structure. We continued to improve our profitability by further optimizing direct and operating expenses at our Betterware and Jafra business units.

Betterware México achieved its second consecutive quarter of year-on-year growth in net revenues, which increased 12%, and reached our highest net revenues since the second quarter of 2022. Net revenues continued to grow due to the successful combination of our selected product offerings and promotions focused on providing more attractive and affordable products to associates in the lower income quintiles. This growth demonstrates the resilience of Betterware and its ability to navigate adverse environments and emerge a stronger business, reflecting Betterware's strength as a market leader as well as its potential to perform at high levels and contribute to increasing shareholder value.

It is important to add that our commercial strategies led an increase of 16% in average monthly orders per associate in the quarter. We continue to believe that this strength in order volume will stimulate growth in Betterware's Associate base during the remainder of the year.

I would also like to highlight new products introduced by Betterware. During the quarter, we launched our new Gurmy brand, which is revitalizing our food container category. Betterware has also successfully introduced new products in our hydration subcategory, capturing more share in this vibrant and growing concept, and among them is our official B Hero bottle for Mexico's Olympic Team, which will be available for sale in May.

EBITDA for the quarter was 7.3% below that of the first quarter of 2023. This was a result of a slightly lower gross margin which was impacted by a higher mix of promotional products in total sales, as well as more spending on promotions, and a temporary increase in distribution and shipping expenses, as larger volume items shipped resulted in lower efficiencies. This combination of cost increases was temporary, and we do not expect it in the coming quarters. Ultimately, Betterware is well positioned for a new phase of sustained growth and ready to capitalize on any emerging opportunities that arise.

With respect to Jafra Mexico, we have successfully increased efficiencies across the Company, and have also infused Betterware's DNA into Jafra's product innovation process and other commercial strategies, all of which we expect will continue driving double-digit top line growth. The business continued performing strongly during the first quarter, with net revenue increasing 11.3%, EBITDA growing by 38%, and the EBITDA margin expanding by 401 basis points to 20.7%. Jafra's gross margin improved by 293 basis points, due to a 54-basis-point benefit from a lower exchange rate and a 174-basis-point decrease in some raw material costs that resulted from our ongoing negotiations with suppliers. Additionally, the clearance of obsolete inventory last year contributed 63 basis points to the improvement in gross margin.

The renewal of Jafra's brand image, coupled with transformative commercial strategies, a new catalog concept, better promotions, enhanced incentives, technology implementations and continued product innovation, positively impacted the monthly activity rates of our Leaders and Consultants in the first quarter. Specifically, there was an increase of 1.1% in end-of-period leader base activity and a 5.7% increase of end-of-period consultant-based activity, both compared to last year's quarter. Additionally, average monthly orders experienced substantial growth during the quarter, with a 19.4% increase for leaders and a 14.5% increase for consultants. Accordingly, the Jafra Mexico team is well positioned for continued success and sustained growth in the foreseeable future.

Regarding our international operations, Jafra US continued to benefit from significant reductions in direct and operating expenses, which were implemented during part of 2022 and all throughout 2023. The company is now on a firm course to become profitable and grow faster, leaving behind years of poor results. We remain determined to reignite growth and increase of share of the vibrant U.S. beauty market. We expect the second quarter of this year to be a pivotal one as a result of our restructuring efforts and having set the stage for gaining additional momentum and profitability by the end of the year.

This month, we launched Betterware's U.S. operations, according to our plan. We selected Dallas, Texas, for our U.S. headquarters for several strategic reasons: number one, it is home to Jafra USA's distribution center, which we will be leveraging on for Betterware's U.S. operations; number two, it offers a strategic distribution location within the U.S.; number three, it is close to Mexico, and number four, it has a substantial Hispanic population, which is our primary target market.

While direct selling is core to Betterware's strategy and business model, we have decided to cater to consumers located anywhere in the continental United States through an online channel. Our U.S. website, betterware.com, offers a curated portfolio of over 200 products in a wide range of categories. This channel will coexist with our traditional direct selling model, offering consumers the option to choose the channel they prefer to purchase Betterware products.

On the direct selling front, we are adopting a new and evolved business model for the U.S. market. This model is based on a customer-first, digital-first approach. This enables our brand partners, which is how we call our salesforce in Betterware US, to focus on finding new customers and recruiting other brand partners, as well as executing selling strategies with them, while we, at the Company, take care of deliveries to each one of their customers. In addition, our new digital-first approach applies analytical feedback, offers meaningful compensation, and has zero up-front costs. As always, Betterware's direct sales program allows people to manage their entrepreneurial pursuits according to their own timelines and schedules.

The U.S. is the largest market for direct selling, with over 6.7 million Americans currently participating in it. Furthermore, Hispanics are among the biggest and fastest growing segment in the industry, and we thoroughly understand their specific needs and the opportunities available to them. As we have mentioned before, this segment of the population generates a GDP that is twice that of Mexico's GDP, representing an enormous opportunity for Betterware.

Although we aspire to operate across the U.S., the direct selling arm of Betterware US will initially focus on the cities of Dallas, San Antonio and McAllen, Texas, and we will expand to new cities and other states in an orderly fashion.

It is important to note that we have begun rolling out a cross-border incentive program, where our more than 700,000 distributors and associates in Mexico can refer new brand partners in the U.S. We believe this is a very unique opportunity for us and could accelerate building a strong base of brand partners in the U.S. achieving success in this market.

Peru is the other international market we are targeting. Led by General Manager Ana Cecilia Augusto, who has more than 16 years in our industry, we continue assembling a Management Team and preparing to launch the operations there, targeting the first quarter of 2025.

While we expect the U.S. and Peru to be significant sources of growth in the long term, we do not expect them to be profitable in the first year of operations. Our primary focus remains on the Mexican market, but we anticipate that these other markets, particularly the U.S., will become major contributors in the future as we build scale over time.

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

Alejandro Ulloa

Thank you, Andres, and good morning, everyone.

As I review our first quarter 2024 results, please keep in mind that all financial figures and projections being discussed today are in Mexican pesos, which is our functional and reporting currency. Additional details can be found in our earnings release published yesterday. I will discuss a few other important areas of our consolidated results.

BeFra's consolidated gross margin increased by 79 basis points to 73.6%, compared to the first quarter of 2023. This was due to a significant improvement in Jafra Mexico's gross margin, which rose 293 basis points over the first quarter of 2023. Key contributors to this consolidated enhancement included a favorable exchange rate contributing 27 basis points, lower material costs from supplier negotiations adding 89 basis points, and a reduction in obsolescence costs contributing 33 basis points. In contrast, Betterware Mexico saw a decrease in its gross margin by 117 basis points, largely due to a higher mix of low-margin SKUs in its sales, which negatively impacted BeFra's gross margin by 70 basis points.

First quarter consolidated net income was Ps. 294.1 million, 56.5% higher than in the first quarter of 2023. The strong increase in our profitability resulted from the top line growth and improved cost and expense management, that we have been discussing today, as well as from lower financing costs following the debt restructuring that we completed by mid-2023.

Free cash flow generation during the quarter, defined as operating cash flow minus CapEx, decreased 34.5%. This was due to a 30.6% decrease in our operating cash flow, that primarily resulted from increased tax payments made by Jafra Mexico, and in the case of Betterware, from higher spending on promotions and a temporary increase in distribution and shipping expenses, as explained before. The higher tax payments were triggered by a substantial 56.5% increase in income before taxes.

It is important to mention that we have finalized a purchase agreement for the property currently hosting Jafra Mexico's offices in Mexico City. The deal is valued at Ps. 385.7 million, with payments spread over a three-year term. These funds are destined for servicing the Company's outstanding debt. Jafra Mexico will move to a newly leased office building, starting in June 2024.

Turning to our balance sheet, our Company's financial position continues to improve. Compared to first quarter of 2023, our total net debt was reduced by 7%, closing the first quarter with a net debt to EBITDA ratio of 1.78 times, compared to 2.24 times at the end of the first quarter of 2023. We will continue to allocate most of our operating cash flow to further reducing debt, with the objective of lowering our net debt to EBITDA ratio to at least 1.5 times by the end of this year.

The strength of our balance sheet also enables us to pay dividends, another way we have committed to increase long-term shareholder value. Reflecting the confidence we have in BeFra's financial strength and growth prospects, our Board of Directors has proposed a dividend of Ps. 250 million for the quarter, which is subject to shareholders' approval at the Ordinary General Shareholders Meeting to be held on May 13, 2024. This would mark the 17th consecutive quarterly dividend payment since we went public in March 2020. The confidence and optimism that we are conveying today is based on our most recent results, as well as the many opportunities that lay ahead of us.

For full year 2024, we are maintaining the guidance that we communicated at the beginning of the year. We still expect BeFra's consolidated net revenue to grow between 6.1% and 10.7%, while consolidated EBITDA to grow between 6.6% and 13.9%. Looking beyond 2024, we remain confident in our ability to continue seizing domestic, as well as international growth opportunities, enabling us to generate stronger cash flows and maximize shareholder value over the long term.

I will now turn the call over to the Operator, who will open the call for any questions you may have. Thank you.

Operator

Thank you. (Operator Instructions)

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

Eric Beder

Good morning. Congratulations. The first question I'll talk about is inventory. The inventory continues to grow less than sales. How should we be looking at the inventory going forward, and how should we be thinking about that for 2024?

Andres Campos

Okay. I will pass the call over to Alejandro, so he can tell you about the situation of inventories, both in Betterware Mexico and Jafra.

Alenjandro Ulloa

Hello, Eric, good morning. Our expectations are that we will be slightly decreasing inventory during the year in both companies, Jafra and Betterware. We have been able to reduce inventory during the last five or six quarters, and we're expecting to reduce our excess inventory in Betterware around Ps. 200 million and Ps. 220 million during the rest of the year. In Jafra's case, what we have been doing is to focus on cleaning up the inventory in Jafra US by promoting most of the items that we have in the U.S., and in Betterware Mexico, we are increasing sales. So, those inventories are going accordingly to the plan.

Eric Beder

How does the Betterware USA impact your ability to kind of manage the inventories, and when you look at the ability to grow that business and get better leverage off of it, how do you think about that as a longer term kind of goal, because the way you're doing Betterware USA is going to be different than Betterware Mexico, and how does that translate in terms of inventory or margin potential going forward, and how should we think about that?

Andres Campos

Yes, thank you, Eric. This is Andres again. In Betterware US, right now, we are using the same SKUs that we have in Betterware Mexico. We made a selection of those SKUs. So, we are leveraging on Betterware Mexico's inventory of those SKUs. At the same time, as we mentioned during the call, we will go step-by-step in the Betterware US expansion. Right now, we're starting in Texas, very specifically, in Dallas, San Antonio and McAllen, to make sure that we understand how fast we can grow, what is the impact that we're having. We will be able to see by SKU which impact it is having, so we can prepare with inventories to start expanding to the rest of the U.S. So, basically, this is the way that we're managing it. We're sending the inventory from Guadalajara distribution centre to the distribution center in Dallas, and that is basically how we're managing. Obviously, eventually, as the Betterware US operation grows, we do think that there may come a time where the U.S. operation has its own inventory, its own SKUs, but for the meantime, we're managing it this way.

Eric Beder

Okay, and when you look at Jafra—I know you're the leading fragrance player in Mexico for Jafra. You've been rolling out the new products, you mentioned skincare, you mentioned color. When you look at the prospects for Jafra growth in '24, and going forward, what product categories do you think have the biggest potential, and, I guess, how you're going to recognize that? Thank you.

Andres Campos

Yes, thank you, Eric. There is a lot of opportunities in the rest of the category. As you just mentioned, we are number one in fragrances today in Mexico, and we want to become number one in the rest of the categories. We think that skincare, specifically as a category, has a lot of potential, and that we can at the same time be able to win in that category. We have a whole Development Team. We have the factory where we can manufacture these products and be very competitive. It's a category that takes a little bit of time, but we definitely think we can be very, very competitive in this category, and we will keep working on making this category great. The other two categories, which are color and toiletries, we also believe can grow, there's still room to grow, but the main focus, the number one focus, will be skincare.

Eric Beder

Okay, thank you, and good luck for the rest of the year.

Andres Campos

Thank you, thank you.

Operator

Thank you. (Operator Instructions)

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

Cristina Fernandez

Thank you, and good morning, everyone. I wanted to start with Betterware. The growth you saw in the quarter, double-digit, very good. How sustainable is this rate of growth? And I wanted to see if you can touch on two areas. The Holy Week that you call out being better in March and April, was that a big contributor to the growth; and then, also, the higher promotional activity, do you expect this to continue near term, and how do the promotions today compare versus pre-pandemic, that 39%? Is that normal or is that above historical terms?

Andres Campos

Hi, Christina. This is Andres again. First of all, talking about growth prospects, we have been speaking about the size of the market and our market share. According to our market research, we still have only about 4% market share, so we think that there is a lot of room to grow, to both gain more market share, and now that the market of household products is starting to grow a little bit again after the whole pandemic disruption, we think we can leverage on that, as well. So, there's still a lot of room grow in Betterware Mexico, and we're working on that, and we saw fourth quarter of 2023 growing, now we see first quarter 2024 growing, and we believe we can sustain double-digit growth going forward, just as we were having before the pandemic. That is in terms of growth prospects.

Now, in terms of the Holy Week, it's a very technical issue, but when kids are on vacation we normally have a slight decrease in sales. Holy Week is one. Christmas and New Year's is another one impacts us, because it's a very fast, you know, one- or two-week occasion. This year, Holy Week landed in March, in the first quarter. Normally, it lands in April. So, normally, it impacts our second quarter. Now, it impacted our first quarter. This is something that may help our second quarter, because this year we won't have Holy Week there.

In terms of promotions, we're basically maintaining the same strategies, the same fundamental strategies of promotions. Obviously, we're polishing them day-by-day, as we used to before the pandemic, but there's nothing fundamentally different there. That would be it.

Cristina Fernandez

Okay, thank you, and then my second question is on Jafra. I wanted to follow up on Eric's question. On the skincare lines that you've been expanding, there was a comment on the press release that it grew, but perhaps not as much as you expected, and you needed to work on the pricing. How did it perform, what did you learn from the launch you made, and what are you adjusting?

Andres Campos

Yes. This is Andres again. We made a couple of launches of skincare product lines last year, which were not as successful as we expected, but we have to remember that we acquired Jafra in 2022 and it took us a year to really start going. We have some new lines that are coming out this year. We just launched Jafra skin in the first quarter. We have another big line coming out in July. So, we have a pipeline prepared now that we think will start impacting the coming quarters.

Cristina Fernandez

Then, my last question was on the debt paydown. The target is to pay Ps. 800 million this year. How much of the proceeds of the Jafra Mexico business, the Ps.386 million, will be this year used for debt paydown, and how much is the rest of the business cash from operations?

Andres Campos

Thank you, Cristina. I will pass the microphone to Alejandro.

Alejandro Ulloa

Hello, Cristina, good morning. This is Alejandro. Yes, the idea is to destine every single peso that we got from divestments to reduce the debt. So, the Ps. 386 million that we will receive during the next three years will be destined to reduce debt. The idea is to pay during the year around Ps. 800 million, that most of that amount will come from cash flow generated by the companies.

Cristina Fernandez

Thank you.

Operator

Thank you, and that concludes the question-and-answer portion of today's conference call. I would like to turn it back over to Management for closing remarks.

Luis Campos

Thank you, Operator, and thank you again, everyone, for joining us for today's call.

We feel very proud of the significant progress we continue making, and we are very excited about the many opportunities ahead for Jafra, both near and long term.

We look forward to speaking with you on our next quarterly results call, as well as meeting some of you at upcoming investor conferences and here in Mexico. Thank you all and have a good day.

Operator

Ladies and gentlemen, this concludes BeFra's First Quarter 2024 Earnings Conference Call. We would like to thank you again for your participation. You may now disconnect.