CORPORATE PARTICIPANTS

Martin Schwartz
President & Chief Executive Officer

Jeffrey Schwartz
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CONFERENCE CALL PARTICIPANTS

Stephen MacLeod
BMO Capital Markets

Derek Lessard
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PRESENTATION

Operator

Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to the Dorel Industries Third Quarter 2019 Results Conference Call.

At this time, all participants are in a listen-only mode. Following the presentation we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up for questions.

If anyone has any difficulties hearing the conference, please press star followed by zero for operator assistance at any time.

Before turning the meeting over to management, please be advised that this conference call will contain statements that are forward looking and subject to a number of risks and uncertainties that could cause actual results to differ materially from those anticipated.

I would like to remind everyone that this conference call is being recorded today, November 8, 2019.

I will now turn the conference over to Martin Schwartz, President and CEO. Please go ahead, sir.

Martin Schwartz, President & Chief Executive Officer

Thank you. Good afternoon, everyone, and thank you for joining us for Dorel's Q3 earnings call for the period ended September 30, 2019. Joining me are Jeffrey Schwartz, CFO, and Frank Rana, VP of Finance. We will take your questions following our comments and, as always, all numbers are in US dollars.

It was a tough quarter. As we announced October first, Q3 was being affected by various tariff-related issues. We raised prices in the quarter and this has had several negative consequences. Retailers altered their purchasing decisions, which created considerable product mix imbalance. But, on the positive side, our segments have done an excellent job holding the line on most expenses and creative product development has resulted in many new exciting introductions. Cannondale's new line-up is driving Cycling Sports Group's success. The new product development process at Dorel Juvenile is delivering significantly improved time to market, although increased earnings are yet to materialize. Inventory reductions across all segments is a strong focus and is on track and new sourcing strategies are being implemented where appropriate.

Now some specifics on each segment. We remain very enthused with Dorel Sports. Bikes are selling well across all channels. All three divisions posted strong top-line growth with solid performance by CSG and Caloi. Revenue grew double-digits for the first time in five years. POS was up at Pacific Cycle; however, operating profits declined due to tariff-related issues, which impacted margins, primarily due to a shift to lower price point bikes. Holiday shipments to some key mass retailers traditionally in September were delayed until October. This resulted in a large shift in sales and profits from Q3 to Q4 and in much higher inventories and the associated warehousing cost until recently. Excitement surrounding Cannondale Model Year 2020 product innovation has translated into strong sales, with five new platforms introduced in Q3, including the all-new CAAD13 as well as two new e-mountain bikes, the Habit Neo and the Moterra CSG's US IBD business outpaced the industry and Europe grew primarily due to the e-bike category, which posted significant progress. In the UK, order levels were also good. Caloi also did extremely well with strong double-digit growth due to extensive sales to Brazil's bike sharing program and also a better mix. Increased Cannondale brand marketing is also contributing to Caloi success.

Dorel Home continues to adjust to market conditions, which reduced both revenue and operating profits and have delayed the segment's improvement. E-commerce grew slightly, representing almost 61% of total sales compared to 58% a year ago. Brick-and-mortar sales, which were strong in Q2, decreased in Q3. What we determined was that the higher Q2 sales were from retailers ordering more to beat the anticipated tariffs and higher prices. This caused their inventory levels to jump. To compensate it, they ordered less throughout the second half of this year. While Dorel Home increased its prices, not all suppliers raised theirs at the same time; therefore, we were not always competitive for part of the quarter. But pricing is now generally similar in the market and we are seeing a rise in sales again. As well, as the increased pricing took hold, consumers changed their buying patterns, choosing different SKUs with different price points and shying away from more expensive items. This caused an inventory imbalance, as we ran out of some of the lower-priced items and were left with too much higher-priced inventory. This also created a supply chain challenge, which is still being corrected. Inventory reduction is going well with an aggressive reorganization of operations continuing, which is expected to greatly reduce the impact of space and efficiency constraints in 2020.

Dorel Home is working on several initiatives, which are expected to be of benefit going forward. It continues to make headway with a major online retailer, which has been an excellent Dorel Home partner for launching new brands and we'll be introducing CosmoLiving in the UK and in Europe early next year. CosmoLiving was also just launched with a major online furniture retailer in China. There has been accelerated growth with all three brands Cosmo, Novogratz, and Little Seeds. They carry higher margins and are a way to differentiate Dorel Home as well as a better controlled price points.

Adjusted operating profit at Dorel Juvenile was up. This was encouraging news regarding a number of Dorel Juvenile divisions, although challenges remain in Europe. US retail sales increased over last year at most customers and additional market share has been captured from the competition. In Latin America, Brazil sales continued to grow double digits, driven by continuous e-commerce gains as well as the specialist store channel. Chile's retail same-store sales also increased substantially; however, current civil unrest there is casting a shadow going forward. At Dorel Juvenile Europe, new product introductions of car seats in new categories made throughout 2019 are gaining traction in the marketplace. We are now beginning to see accelerating sales and will launch two significant new platforms in the fourth quarter, including the award-winning Coral and another one early in 2020. In addition, we are replacing and/or refreshing our existing older products and initial reaction from our key customers is encouraging. With this combination of new items, expanded categories, and improved look and feel, our product portfolio in car seats will be the strongest it has ever been. With these great new products, a new way of working within Europe and reduced and more efficient footprint and organization, we look forward to improvements.

Jeffrey will now provide the financial perspective. Jeffrey?

Jeffrey Schwartz, Chief Financial Officer

Thank you, Martin. I'm going to comment on third quarter results, try and highlight a few key areas.

Consolidated revenues for the quarter increased by $15 million or 2.3% to $685 million. Organically, revenue improved by about 3.6% when removing variations from foreign exchange. Revenue and organic revenue growth really came out of Doral Sports. Very pleased with that. As Martin said, we had revenue growth in all three parts of that business. The Cycling Sports Group, with all its new products, doing extremely well, strong volume in the country in Brazil was on plan, and even at Pacific Cycle, despite not being able to ship the holiday orders, POS was very strong right through even up to today on bikes, and that helped us improve over last year. Over in Home, however, the supply chain issues that Martin talked about, they were caused by the higher tariffs on Chinese-sourced products. They resulted in a lot of changes in the way retailers purchased, the way customers purchased, and that certainly impacted our revenues negatively. In Juvenile, we had growth in Brazil, in Chile, in the US, but that was offset by declines mostly in Europe which, again, we talked about changes that we're doing in order to get in that changeover.

Gross profits for the quarter decreased 90 basis points to 19.8 compared to 20.7 last year. The decline was mainly in Dorel Home and Dorel Sports. Both of those divisions were affected by tariffs. Tariff pressure on the Juvenile business is light. Not that it's non-existent, but it wasn't a business that has the same level of pressures as the other two. As I mentioned the Dorel Home was affected. We have higher warehouse costs as well as the tariffs. In the Sports, really the pressure is almost all from the tariffs. We did pass on, but when you maybe didn't get 100% and then when you look at the mix as well, it's led to some sizable decreases in that quarter. And Juvenile, the unfavourable product mix in Europe was offset by some gains that we had in the United States. Included in our numbers this year is an impairment loss on trade and other receivables for the quarter of $3.4 million compared to only $250,000 in 2018. The largest single piece of that is Mothercare that just this week, I believe, went into administration. So, we've dealt with that already in these numbers, so it is a fairly significant number.

Finance expenses increased by $4.5 million to $12.8 million. Really what's going on there is you've got interest expense on lease liabilities of $2 million as a result of the adaptation of the IFRS 16 and we did not restate last year. So, that's part of that. And then the increase in actual interest due to higher average long-term debt balances and higher interest rates is about $2.3 million for the quarter.

During the third quarter of 2019 our net loss was $4.3 million or $0.13 per diluted share compared with $9.6 million profit or $0.29 per diluted share. Excluding restructuring and other costs, adjusted net income for the quarter declined to $2.4 million compared to $11 million last year.

Our tax rate was affected by some mix and some areas where we couldn't recognize the tax benefits related to some tax losses. But, at the end of the day, we believe that our annual adjusted tax rate this year will be between 35% and 40%.

If we now move over to the divisions, we'll start with Home. Dorel Home's third quarter revenue decreased by $9.2 million or 4.1% to $212 million. The decrease, as we said before, is really related to a lot of the different pressures we've had because of tariffs, not directly, you know, part of that would be, obviously, price increases, but a lot of it is inventories being bought in other periods, the market waiting for all the players to raise prices. So, in some cases we raised it before other people, so our product was higher. But, as Martin mentioned, that's starting to level out now and we're seeing that easing as we get into Q4, so we think a lot of that's behind us. In third quarter, e-commerce represented 61% of the gross sales compared to 58% in the same period last year. Gross profit at 15.2% in the quarter, decreased by 50 basis points from last year's third quarter. This is mainly due to higher warehouse costs related to the fact that our inventory is somewhat out of balance and, of course, it reflects the impact of the tariffs on the Chinese-sourced goods. Dorel Home's operating profit declined by $3.8 million for the quarter to $15.7 million from $19.5 million last year.

If we move over to the Juvenile, the revenue decreased by $6.8 million or 2.9%. Organic revenue only declined by 0.5%. There was a lot of negative impact of currency during the quarter. Gross profit for the third quarter was 25.2%, which was very comparable to what we had last year. The operating loss of $4.6 million during the quarter compared to last year where we had an operating profit of $1 million. Once we exclude restructuring and other costs, adjusted operating profit actually improved to $2.6 million from $1.7 million last year. So, although there was an increase, we were certainly expecting a much stronger increase. As we said, some issues in Europe as well as that write-down of our accounts receivable that I mentioned before.

Dorel Sports, a very strong 14.2% increase to $250 million from last year and then actually it's even higher when you take in the changes in foreign exchange of 15.6%. Probably, from a revenue standpoint, one of the strongest quarters we had. Part of that, but a small part, is tariff related, but we saw growth all over the world in various areas and certainly was well over the double-digit mark when we remove the tariff impact of it. Double-digit growth at CSG driven by the new models and the success that we're having. We talked before about Caloi doing very well. And, again, POS very, very strong, which is a little bit counterintuitive, considering we've raised prices on bikes at mass. Our customers are having a very good year selling bikes despite the fact that the prices are up. During the quarter, the gross profit did decline by 240 basis points. So, this is certainly, I guess, the big issue. The bulk of that is all in the mass area and it's all related to the tariffs in which mix has changed, SKUs have changed. We're selling a lot of bikes but not necessarily the same bikes that we sold last year. And, at the end of the day, the operating profit was down slightly, $6 million compared to $7 million. When you exclude restructuring and other costs, the adjusted profit declined to $5.6 million from $7.5 million.

If we start looking over at the balance sheet, we're really still focused on reducing inventories. We are actually on plan, slightly behind in some areas where we expected to ship goods, holiday season goods at the end of Q3. That's been moved into the beginning of Q4. We're still looking to maintain the same year-end inventory number that we were talking about earlier in the year. So, things are definitely moving in the right direction. The other balance sheet item I want to point out is that our revolving bank loan and term loan are now classified as non-current as of September 30th, because the maturity date has now been extended to 2021. So, that's a big deal for us that that is no longer a current liability.

With that, we'll open it up to—okay. I'll pass it back to Martin on the outlook and then we'll open it up.

Martin Schwartz, President & Chief Executive Officer

Okay. Thank you, Jeffrey.

In terms of our outlook at the Dorel Sports, the positive momentum in Cycling Sports Group's IBD business is expected to continue. With the shift of orders at Pacific Cycle from the third to fourth quarter, this provides the confidence that the segment will deliver a solid fourth quarter versus prior year in both sales and adjusted operating profits.

At Dorel Home, we are expecting similar earnings for the fourth quarter as throughout 2019. We are now seeing an easing of the pressure created by tariffs imposed in the US. Demand is growing again, our warehouse service levels are improving, and our inventory is being re-balanced to the right levels. We expect adjusted operating profits to improve early in 2020.

At Dorel Juvenile, new product introductions are beginning to have a positive impact and there are several key launches scheduled for the fourth quarter and early next year. From an earnings perspective, Europe is still transforming itself. The restructuring program in Europe is proceeding with most of the savings to come in 2020. Fourth quarter adjusted operating profit is at risk due to continuing civil unrest in Chile, which began in October and which is having a negative effect on all retail, including Dorel Juvenile's numerous stores. This could lower earnings in the quarter and impact the critical Christmas season in that country.

With that, I will now ask the operator to open the lines for questions, but I remind everybody again, on your first round of questions, please keep them to two. Operator?

QUESTION AND ANSWER SESSION

Operator

Thank you. Ladies and gentlemen, we will now conduct the question-and-answer session. If you have a question, please press the star followed by the one on your touchtone phone. You will hear a tone acknowledging your request. Your questions will be polled in the order that they are received. Please ensure you lift the handset if you're using a speakerphone before pressing any keys. One moment please for your first question.

Your first question comes from the line of Stephen MacLeod of BMO Capital Markets. Your line is open.

Stephen MacLeod, BMO Capital Markets

Thank you. Good afternoon. I just wanted to circle around on the Juvenile business. It sounds as though the US was strong. We saw some growth in Brazil. Can you talk a little bit about what you saw in Europe in the quarter?

Jeffrey Schwartz, Chief Financial Officer

Well, really the crux of our European issue is on the car seats. We are replacing the current product portfolio this year. So, what we're seeing is the older products are slipping in sales and the new products that we introduced are going to take over. The new products have all the right features. They have all the right price points. They're great. We really have had a great reaction to the introduction. And we're in that process where one is replacing the other. So, the velocity of each is not always the same at any given moment. We did introduce a number of items in September. We're shipping them, I believe now, November, so we're hoping that those items start to replace the old items and increase the velocity. So, that's really what's going on here. The items that we need to have to shore up our deficiencies in the portfolio are coming to market, either they're in the market now or they will be there within the next 60 days type of thing. So, it's that interim period that is choppy and that's what we're going through right now.

Stephen MacLeod, BMO Capital Markets

Okay. I see. And then on the restructuring in Europe that you're currently going through, when do you expect that to be fully implemented?

Jeffrey Schwartz, Chief Financial Officer

Fully implemented restructuring. Early next year, I would say? Early next year and the results will be coming in. I mean they're already—Q4 will have an impact. It's definitely starting in Q4. But we're going to see the full, full impact next year.

Stephen MacLeod, BMO Capital Markets

So you'll see a full year of the $12 million to $15 million.

Jeffrey Schwartz, Chief Financial Officer

Yes. So, we're seeing, like we're seeing costs coming down right now. Even though the profits aren't where we want them to be, we are seeing declining costs in Europe.

Stephen MacLeod, BMO Capital Markets

Okay. And then just finally, in terms of Mothercare, could you talk about what your sales exposure is to that, you know, I'm not sure if it's the whole business?

Jeffrey Schwartz, Chief Financial Officer

Yes. I mean it's maybe a $10 million issue. I mean the UK in general is not a good place for retail, specifically on the juvenile side. They're having an issue. We do think there are a couple of other people that might also be having issues. Our product is solid, our demand is good, but we have to get through the issues of Brexit, which has an impact on low currency as well as making sure that the survivors of the retail are doing well. So, I think the UK is also part of our problem and Europe as well. I didn't mention it before but that is certainly a big component. Interesting, on the bike side, we're actually doing well despite all the problems in the UK. But, as you remember last year in Q4, one of our biggest customers had gone into administration and came out of it, so maybe we had that pain last year. And it's actually going quite well this year, our bike business in the UK.

Stephen MacLeod, BMO Capital Markets

Okay, that's great. Thank you.

Operator

Your next question comes from the line of Derek Lessard from TD Securities. Your line is open.

Derek Lessard, TD Securities

Good afternoon, gentlemen. I just wanted to maybe just follow-up on the Juvenile business. You did mention some, I guess, disruption in Chile or social disruption. Just wondering how big that Chilean business is to the overall Juvenile segment.

Jeffrey Schwartz, Chief Financial Officer

Well, I mean it's not, as you know, we had a big loss last year. We are improving it significantly this year and we were hoping to get closer to the breakeven. We know in Q3, prior to all this, our same-store sales were up double digits. The problem, I think, what you're getting at, is how big an issue is this. We don't know. I mean we really don't know. We have 49 stores. Today, they're open, but they're not necessarily open all day. So, sales are down. How long is this going to go on? We don't really know how long it's going to go on. From a sales standpoint, Chile represents 10% of our sales or less. So, that will give you a magnitude. We really don't know how long this is going to go on, right? I don't even want to speculate.

Derek Lessard, TD Securities

Okay. All right. That's helpful, nonetheless. I've seen some of your products on the CSG side very strong, very strong showing. I was just wondering, I mean you did point to you guys outpacing the industry there. Just wondering if it's just been all product related or what's really driving that, I guess, that those share gains?

Jeffrey Schwartz, Chief Financial Officer

I'm going to say three things. Product, change in marketing. I think we've got a much better focus on our marketing today, which is helping the branding. And we've got a really good team of people. Really, really good team of people that I'm happy with and that are putting it all together. So, it's finally all clicking. And there's a lot of stuff that hasn't hit the market yet. I mean Q4 is going to be when we start delivering the e-bikes that we showed earlier in the year. So, we really haven't delivered our new e-bikes and obviously in Europe that's a big deal. And even in the US today, in Canada, e-bikes are moving. They're starting to move up. So, we have quite a bit of demand and we will only be really sending the new stuff in in Q4, so looking forward to next year as well at CSG.

Derek Lessard, TD Securities

Okay. And maybe just one final one for me: Obviously, you guys have had to put in mitigation efforts across the business, but just wondering, on the tariff front, if you guys have gotten any more clarity or clarity on the outlook or is it still very fluid out there?

Jeffrey Schwartz, Chief Financial Officer

Well, I mean I imagine we read the same articles and I don't think there's any clarity based on who's in charge. But I think one of the best messages from a tariff standpoint that it's the chaos that's caused by the implementation of a new tariff. So, once it's implemented, we'll figure out how to deal with it, because people are still buying bikes and they're still buying furniture. They're just doing it differently. And even our customers, the retailers we sell to, they're buying differently. Sometimes they used to do direct imports and then they said, "You know what? We want to do that with this tariff. We want you to bring it in and send it to our warehouse." And there's just all of the change is costing us money. But now we're sort of seeing, in Q4 already, you know, there hasn't been a change since let's say August of last year and we're already seeing things opening up and sales are picking up and our warehouse costs are starting to decrease and the imbalance of inventory is getting better. We're sort of aiming for the end of the year to hopefully have a much better balance of our inventory. So, if there's a brand-new set of tariffs in January, for instance, on furniture, well, that's going to cause chaos again. But if it stays even status quo, we should start to improve. So, I think that's probably the best way I can tell you. But I can't tell you whether there's going to be another roadblock or another crazy thing happening.

Derek Lessard, TD Securities

All right. Thanks for taking my questions, gentlemen.

Jeffrey Schwartz, Chief Financial Officer

No problem.

Operator

Ladies and gentlemen, if there are any additional questions at this time, please press the star followed by the number one. As a reminder, if you are using a speakerphone, please lift the handset before pressing the keys.

Mr. Schwartz, there are no further questions at this time. Please continue.

Martin Schwartz, President & Chief Executive Officer

Okay. Well, that concludes today's call. I just want to thank you all for being with us and everybody have a pleasant weekend.

Operator

Ladies and gentlemen, this does conclude today's conference call. Thank you for participating. Please disconnect your lines now.
