Q1 2014 Earnings Call

Company Participants

- Belmiro Gomez, Wholesale Business Officer
- Christophe Hidalgo, CFO
- Daniela Sabbag, IR Officer
- German Quiroga, Wholesale Officer
- Jose Roberto Coimbra Tambasco, Deputy CEO of Retail Business
- Libano Miranda Barroso, Vice Chief Strategic Development Officer
- Ronaldo Iabrudi, CEO
- Unidentified Speaker, Interpreter

Other Participants

- Bernardo Cavalgenchi, Analyst
- Gustavo Oliveira, Analyst
- Jerome Naggs, Analyst
- Melissa Byun, Analyst
- Ricardo Boiati, Analyst
- Tobias Stingelin, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Good morning. And thank you for waiting. Welcome to GPA's conference call to discuss the results for the First Quarter of 2014. This event is being broadcasted by a webcast. And it can only be accessed at www.gpari.com.br, where the presentation can also be available. This live selection will be managed by you.

The replay of the event will be available right after it is concluded. I would like to inform you that also these press releases available on the company's IR website. This event is being recorded and all participants will be on the listen-only mode during the company's presentation. After the GPA's remarks are completed, there will be a Q&A session, when further instructions will be provided. Should you need any assistance during this call, please press star, zero to reach the operator.

Before proceeding, let me mention that forward-looking statements that may be made during this conference call related to the business assumptions of GPI and financial and operating assumptions are -- relates to future events and also information that are currently available, depend on circumstances that may not occur in the future because they involve risks and uncertainties that may affect future results.

And investors should also understand the general economic conditions, industry conditions. And other operating factors could also affect the future results of GPA and therefore, could lead to results that differ materially from those expressed in such forward-looking statements. Now I would like to turn the floor to Ms. Daniela Sabbag, Investor Relations Director of the company.

Ms. Daniela, you may proceed.

Daniela Sabbag {BIO 18861490 <GO>}

This conference call to discuss the results for the First Quarter of 2014 of GPA. We will just proceed, as we always do, whenever we have a conference call to discuss the results. And so, we will initiate the presentation with remarks by Ronaldo, our CEO and then we give the floor to Christophe. They will refer to the figures. And after that, we will have the representatives of each business speak about their own results. We have Hidalgo representing (inaudible) and Undacruz [ph] representing GPA malls. And certainly, Libano Barroso on behalf of Via Varejo will also take the floor. So Ronaldo, we may proceed.

Ronaldo Iabrudi {BIO 5151863 <GO>}

Good morning. I would like to, once again, thank you all for participating in this conference call. And I would like to thank analysts and investors and other participants. I would also like to thank Daniela and her team who organized and prepared this event.

I already talked to each business owner in person. But formally, I would like to congratulate the team for the good results. And now you will have the opportunity to see the numbers that are going to be discussed during this call. Before I give the floor to Christophe, I would just like to make a few comments regarding what happened during this First Quarter. Our evaluation of the quarter is that it was a very positive quarter.

The results, I think you have it in your hands. And they are in keeping with what we have planned. For us, the budget is something very important. So being -- in keeping with the budget, is something very important. Assai experienced very good growth and Nova as well and also the other business, Via Varejo are also in line with all of the objectives that have been defined in our business plan.

Also, maybe Tambasco can elaborate more on this subject. But in the non or on the food side, we had an important calendar effect. But excluding that seasonality effect, in general, growth is in keeping with the plan. I think there are still a few points that will be recurrent. And I already talked to you the first time that I participated in this conference call because I said that this is a plant of continuity. But it always good to reinstate that. The company is constantly focusing on prize competitiveness, because this is very crucial to us.

We are permanently focusing on the optimization of processes, rationalization of expenses. And you will see that we highlight administrative expenses in that quarter. And also we were able to experience synergy gains, be it on the procurement side, logistics side. And also IT. And I am referring to all of our business, including malls, e-commerce. And the food world and Via Varejo. If we are to speak on a business-by-business case, I think Multivarejo, we focus on profitability, because this is what we did last year.

And we were very disciplined when it comes to searching and maintaining an expense level that is adequate and in line with the competitive strategy of the company. Now looking at Assai, I have to talk about and refer to the level of growth and how this has been recurrent, considering the number of stores that we managed to open in the last 12 months. So this organic growth merits a special mention and highlight.

Every time I look at the figures of Assai I can't help but just being pleased when I look at the numbers. And Nova, well, they do not have a brick-and-mortar store. But we also saw significant growth, due to a larger conversion rate. And also at the same time, we saw a larger number of clicks and visits. And Via Varejo, I think we talked about it yesterday and most of you participated in the event, the highlight of Via Varejo is its profitability. The company was able to experience good efficiency gains.

And certainly, I must mention how pleased we are after we heard that Libano Barroso is now in charge of the company. I said yesterday that we believe that is just a natural move for him to now be in that position, due to his own background his history in the company. He was VP of strategic planning and he also participated in the construction of all of the budget plan and the midterm plan with all of the other business units. He is very familiar with all of the guidelines in Via Vadejo's strategy.

And together with his history and his experience in the company, I also said yesterday that he had the full support of all the members of the board, be it the Klein family and also independent board members. Libano, there is also a continuity brand because he is very familiar with the team and the team welcomed him without open arms. So I am firmly convinced that we are heading towards what he had initially planned. And there is another important aspect that I would like to mention to you. Libano's position is very -- is strategic within GP-8. everyone that reported to him logistics, IT. And procurement, there will be no like to me. But now we are looking for someone to take that position.

But you know, in terms of the corporation, that is a very important position. And to conclude and then give the floor to Christophe, I would just like to highlight that, in addition to all of the things that I just said, that the company is totally focused on the (inaudible) and we are focusing on the processes, which means that we are continuously working towards looking for more gains and synergies, looking at working capital, looking at our CapEx. So that every single saving can bring us better returns and can, in turn, give better returns to our shareholders and investors. So that's all I have for now. And we'll be available during the meeting. But I will now give the floor to my team, starting with Christophe.

Christophe Hidalgo {BIO 17982648 <GO>}

Thank you, Ronaldo. Good morning. Good morning, all of you. And so we'll now begin the presentation on the First Quarter of 2014. We'll start on slide number two with the highlights of the First Quarter. Gross revenue is $16.6 billion. And counting for and increase of 10.8% despite the negative effect of the Easter holiday. During that period, during the last 12 months, I mean, we opened 124 stores were inaugurated the last 12 months, 21 in the First Quarter. Same-store growth was 6.3%.

And I would like to remind you that this growth was adversely affected by 1.3% of that Easter period. Gross margin was down by 1.1 basis points, 24.9% of sales. And that was adversely affected, according to our expectation, by the continuity of the events in competitiveness at Multivarejo and all of these investments were gradually compensated by efficiency initiatives.

There was also an impact on our gross margin and greater share coming from Assai and Nova which we're operating with a gross margin that was then also lower. In the same period, operating expenses were down by 1.7 basis points. This (inaudible) refers to the continued efforts to optimize prophecies in a greater discipline when it comes to managing expenses of Multivarejo and also efficiency gains that we referred to yesterday in Via Varejo. As a consequence, the company's EBITDA in the First Quarter went from 21.7. I mean, it grew 21.7% of growth.

The revenue growth in the period, it grew twice as fast as the revenue growth the EBITDA margin was up by .6 basis points, reaching 7% of sales. And that was due to efficiency gains at Via Varejo and also better operational activities in Nova Pontocom. Net income was up by 22.9% and the gross was approximately 70% in Via Varejo and Nova, going from food GPA. And we would like to say that, despite the Easter effect, the profit was very close to the same level of the First Quarter of the year before.

Now let's take a look at the consolidated figures on slide number three. So very briefly, we already talked about it. Okay, 10.8% growth, 6.3% for same stores. EBITDA was BRL1 billion and 50 million representing and increase of 21.7%. The margin was 7% net income, experienced similar growth, BRL338 million with a margin of 2.3% being up by 22.9%.

Also, on the same slide, we see the continuity when it comes to deleveraging the company. So net-debt, at the end of the period was 0.85 times EBITDA, whereas in the same period of the previous year, that was 1.6 times EBITDA. Net-debt is now at BRL3.41 million, that that's the number for the end of that period. And that was despite the Easter effect. So that -- the Easter effect impacted sales. But Easter also has its effect on inventory and working capital. So net-debt, this deleveraging is taking place without any significant reduction in investments because our investment line is still being maintained for the First Quarter.

Another point that I would like to highlight is net financial -- net -- consolidated net financial expense which reached 2.3% of sales, in keeping with our expectations, I would like to remind you that that growth of 33% of net financial expenses comes together with an increase in the reference rate of 48% during the same period that is CDI.

Now on slide number four, I would like to mention the acceleration of opening of stores. That means that our organic growth is still in keeping with the strategic objective of the company. GPA's food encompassed the opening of 13 new stores, six Minimercado extras, three extra (inaudible), two Assai. And two drugstores. So at the end of the period, we had 1,007 stores and almost 1.7 thousand square meters accounting for a growth of 6.5% in the last 12 months.

In brick-and-mortar world or food Via Verajo, we opened eight new stores, carrying the Casa Bahia banner. So we have 1,001 stores and close to 1 million square meters of sales area by the end of the period. Now looking at slide number five, I'll give the floor to Tambasco here. We have consolidated figures for Multivarejo and Assai. So we see the following trend. Sales of almost BRL8.9 million, which is a growth of 9.1% vis-a-vis the year before.

The EBITDA margin was 6.5% of sales or was up by 3.2%, when compared to previous year and net income was BRL172 million, which is relatively stable for the period with a margin of 2.1. I would just like to remind you that in regards to net income here, we have the impact of the Easter effect. Now I'll give the floor to Tambasco. Good morning.

Jose Roberto Coimbra Tambasco {BIO 3635014 <GO>}

Good morning. At Multivarejo in here we are including extra in (inaudible) banners in all of their formats. Christophe here already said that the First Quarter presented good results and these results were in keeping with the First Quarter of the year before. Despite that Easter effect, that this year took place in the Second Quarter. So we saw a reduction in gross margin of around 1.3 basis points, which is due to our competitive strategy that it has been deployed as of last year, which has also led us to experience reductions in the gross margin.

But on the other hand, from the very beginning, we've been trying to sustain this new policy, searching for better efficiencies and a better control on our -- of our expenses. And in this First Quarter that was translated into one basis point. This compensation is not higher for the reasons already listed by Christophe. The lower dilution of expenses due to changes in the seasonal Easter effect. However, if we consider that our net revenue is growing 5.2%, we see then our expenses growing by 0.3%. But despite the Easter effect, we still see a significant dilution of expenses.

And as Ronaldo said, it is mostly focused on admin expenses that do not impact the store directly. In that First Quarter, I would just like to say that in addition to the expansion of Minimercado which is currently the focus of the expansion of Multivarejo in the First Quarter, we opened three new markets. One was in Quiroga [ph] which is our second store in that city and we are already the leaders in that market in the city of Quiroga.

Another service opened in Goias and in the state of Goias, where we then consolidated our leadership in that market with the fourth hypermarket store. And the third was in Sao Paulo in the northern part of Sao Paulo where, up to now, we didn't have yet any hypermarket. These stores are performing quite well in their initial months of activity, which ensures further consolidation of market -- there's market expansion, carrying the extra banner.

Along the past few years, we've also noticed through figures by associations, (inaudible) and also from some new research figures. We've noted some market share gains in all of the regions and in all the formats. By doing so, we will ensure a continued share gain. All of this work is being sustained by a very tough job to control expenses. And by doing so, we will ensure our profitability. And I would like to reinstate that in spite of the fact that we had a lower cost dilution, we can still maintain our profit levels at the same levels of last year. Now I'll give the floor to Belmiro. And after that, I will be available to answer questions if you have further questions.

Belmiro Gomez

Thank you, Tambasco and good morning. In keeping with what Ronaldo and Christophe said, we had a very strong quarter for Assai. This First Quarter and the success of that quarter comes from organic expansion in 2013. We inaugurated 14 stores in this new model. The model is a different model from the existing Assai model. This stores are better equipped to keep inventory and better equipped to serve the client.

These 14 stores are more than 167,000 square meters and 70,000 square meters of sales area. Then we doubled the number. So this effort, both you know, in organic expansion and the performance of same stores was very strong. So that in this First Quarter, we were able to experience a sales increase of 38% in our gross revenue. So we were able to add an additional BRL1 billion of sales in that quarter alone.

The performance of the same-store sales was still very strong and that helped us to bring a balance to the number of stores. There was a series of new stores, which are part of the Assai business. So even with that, our net profit experienced 38.8% growth above the net income and a reduction of expenses of 0.2percentage points, vis-a-vis last year. All of the factors including organic expansions and dilution of same stores helped us to increase EBITDA to 47%, vis-a-vis the First Quarter of 2013. So Assai is very much focused on organic expansion. This organic expansion will still continue through 2014. We want to grow, we want to grow strong. We want to increase our footprint.

We want to grow space in the market and we also want to gain new clients. In 2014, we already opened two very important stores. These are two strong stores, one in Basia [ph], Grenge [ph] and Mato Gross [ph] and the other one in Senso [ph] in Sao Paulo. These two stores alone cover 28,000 square meters of built area and a large sales area. So we want to keep growing same stores. And we want to continue promoting organic expansion of Assai and mainly we want to lower expenses. The wholesale business is a low-cost business.

Expenses of Assai on the First Quarter represented in terms of growth sales less than 9% or %9.63, which is a very significant number. We strongly believe that our model is playing a very important role in terms of supplying to small and mid-size companies in Brazil who can count on quick inventory replacement and they -- they can optimize their working capital. We know that Brazil is a country of micro and mid-sized entrepreneurs. So the work we do is very important to supply this micro and small-size companies. We trust them, we trust the expansion and we are very confident that we will be able to continue growing this business. Thank you very much. And I'll give the floor to Christophe.

Christophe Hidalgo {BIO 17982648 <GO>}

Thank you. Now going to slide number six, now we will look at the consolidated number for Via Varejo and Nova Pontocom. So growth sales was BRL7.7 million, which it translated into a growth of 12.7%. In that same period, EBITDA was BRL516 million, almost of 50% growth when compared to the previous year, with a margin of 7.6% of net sales. Net income was BRL167 million in the period. Meaning a growth of 60 -- almost 68%, reaching margins of 2.5%. And now, I'll give the floor to Libano.

Libano Miranda Barroso {BIO 4670536 <GO>}

Thank you, Christophe. Good morning. In this First Quarter, Via Varejo's performance in terms of sales growth, when compared to the same quarter of last year of 6.1%. This growth was boosted by our growth strategy, increasing the number of stores. We opened eight new stores, carrying the Casa Bahia banner in the period. We are also looking for a selective growth in regions where we see good opportunities for growth, like the Northeast and the Midwest. But also our intention is to strengthen our footprint in the Southeast markets as well.

Another important highlight for the period was a reduction of 1.8 basis points in SG&A, as part of the net revenue. And this stems from our search for more efficient processes. For process efficiencies, we are constantly seeking for gains in processes in all of the areas, commercial, admin, logistics. And general corporate expenses. And due to this effort, we were able to see increases in our EBITDA margins reaching 8.9%, accounting for a significant growth of 44% with an (inaudible) 2.4 basis points when compared to the same period of the previous year.

Another source that we constantly look for is that, in addition to our internal processes, we constantly look for synergy gains with the other companies from the group. And still talking about the quarter, I would like to highlight the impact of operating gains which can also be translated into a very strong and fierce financial discipline and our surge to deleverage the company. And because of this effort, our net income was able to grow, reaching BRL169 million, posting a growth of 67.8% and an improvement of 1.1 basis points when you compare to the same period of the year before.

Now, referring to the strategy, we are still very much committed to the continuity of our strategic plan, as Ronaldo said at the beginning. And my commitment and the commitment of the team of Via Varejo is to execute that strategic plan for short, mid. And long-term. And I am part of that, as an executive of GPA and also a board member of Via Varejo. We are fully committed to search for a balance between growth-growth with competitiveness and balance with good profitability.

The Second Quarter is an opportunity because we have two very strong seasonal events in our sector. One of them is Mother's Day, which is a very important day. And the World Cup in Brazil. The World Cup highlights even more our performance, particularly in the TV categories and also smartphones. Smartphones and TVs keep on being the leading products. In terms of improved efficiency for the year, in addition to what I've said before the process that I mentioned before, we still are trying to have more synergies in joint sales with (inaudible).

Actually, we're already working on this. We've just started this year. And we're also planning to capture logistics efficiency. We already have two initiatives like a shared distribution center in Baia [ph], Camacai [ph] and also in Costagine [ph], Minagirize [ph]. And we keep on searching every opportunity that makes sense to have a joint operation for the benefit for a vertical cycle and to revert gains to we can also be competitive and increase customer traffic in stores and provide better products, better service. So customers can come back and remain loyal.

Lastly, there are two highlights. One in the segment of furniture. In furniture we have a very clear focus. This quarter, we acquired Barteda [ph]. We have Barteda's control. This segment has proved to show and deliver very significant margins. And we also have the opportunity to keep on growing as leaders for flat-screen and also smartphones. I give the floor back to Christophe.

Christophe Hidalgo {BIO 17982648 <GO>}

Thank you. Now I give the floor to Quiroga

German Quiroga {BIO 17954249 <GO>}

Good morning. Thank you, Christophe. Nova Pontocom, once again, had great revenue growth. This quarter had 54% growth, vis-a-vis, the First Quarter of last year. This growth was supported by an increase in customer traffic and improved conversation rate in our websites. The increase in traffic was possible due to better market our online marketing action and a better conversion rate comes from improved assortment and better processes in our website. We also mentioned that this growth is also followed by a significant increase in the bitamaraljean [ph] operation, from 0.9% last year this quarter, to 1.6% this quarter, growing 77%, basically due to improved processes and also very effective management of expenses.

Another good piece of news is that our operation goes back to our historical levels. We exceeded, therefore, the impact of our D.C. in Rio late last year.

And now we also have a new D.C. in Rio, rented from GLT, with 122,000 square meters, very well located, high-end. So this is our second mega-D.C. in our operation.

By the way, we have several D.C.s but it's the second most significant in terms of size. We have one in Sao Paulo and another in Rio. In addition, we also have a D.C. in Vayaconaserik

[ph] shared with BL-varasia [ph]. It's the first from many D.C.s we want to share with Bontesuca [ph] Group.

Another highlight is the performance to capture commercial synergies with the group, something we always wanted to have. And now is more concrete.

Part of this synergy is not reflected in our income statement because the majority of goods, although they were purchased with a benefit of a commercial rate or the commercial price, they have not been sold yet. That's why they're not reflected in our income statement.

I would like to thank Nova Pontocom team. Overall this year you have been doing more with less.

And I also thank GPA for support, which is instrumental to our results.

BJ Area is that Nova keeps on delivering on the strategy to improve market share allied to an operation at the break-even point. And it continues that generation.

Thank you very much.

Christophe Hidalgo {BIO 17982648 <GO>}

We are moving now to the question-and-answer session. Thank you.

Questions And Answers

Operator

We open now the floor to the Q&A session. We kindly ask you to ask all your questions at once and await for the company's answer.

If you want to ask a question, please press star-one.

Mr. Jerome Naggs [ph] from Santander Bank has a question.

Q - Jerome Naggs

Good morning, everyone. I have two questions.

First of all, I'd like to have a better understanding of the next steps of the price investment strategy. What about a drop in prices? We've been seeing this for one year now. And over this time frame gains of efficiency more than offset in some moments the investment made.

I have a hard time to understand something, considering the mid -- to long-term horizon, what is the limit or the approximate limit in which gains can offset or support your operation?

In other words, I want to understand the minimum limits for those operating expense over sales ratio. That's my first question.

Second question. What about margin performance? If you look at each one of the business units this quarter, we can see that margin, well, despite the negative effect of the calendar, they are stable. So possibly on an adjusted basis the margin will be extended.

On the other hand, when you check consolidated numbers, the change in mix has contributed to lower margin due to the strong growth of Assai. I understand Assai will keep on gaining more room. So I'd like to understand if we could possibly see a drop in margin, even though each one of the business units is stable or even with a slight growth, due to the higher contribution by Assai, or do you envisage a better margin gain despite the investment in price in each business unit. So you could offset the change in the sales profile increasing Assai's participation?

These are my two questions. Thank you.

A - Jose Roberto Coimbra Tambasco {BIO 3635014 <GO>}

Jose Roberto Tambasco speaking.

Let me talk briefly about Multivarejo. Over recent quarters, we have a more significant drop in the gross margin. And that's because we started the new strategy in May last year. For the future, on a comparative base or compared to last year, we expect to see a lower reduction, in line with what we have shown in recent quarters.

However, it is not a decrease that will remain quarter on quarter. We understand that today our competitiveness level was quite good. Obviously we always see room to further lower our expenses. We do have goals to work on the level of efficiency that becomes higher and higher. And I see room and opportunity for us to bring our expenses to lower levels compared to what we have in the First Quarter.

By the way, the First Quarter is not the best quarter in the year. So we do have a higher dilution we expect to see, even -- particularly in the Second Quarter of the year.

Naturally, we are very keen on paying attention to the markets. If there is any need to increase competitiveness, then we'll have to set new expense parameters in order not to negatively affect the company's profitability. But I can assure you that for the following quarters, we don't expect to see, compared to last year, any reduction as we had in the First Quarter. And that's because now we are already comparing to a base in which we had already started working this last year.

(inaudible) -- well, Christophe would like to say something.

A - Christophe Hidalgo {BIO 17982648 <GO>}

Good morning, Jerome. Thank you for your question.

As you said, there was a drop in margin. That is being mainly driven by two effects. The first effect accounts for approximately half of the margin drop, which is the mix effect. And this is part -- this is the part our -- of our economic model in the development of a business unit portfolio that has to be balanced.

So this decrease has to take into account Assai's increased participation and also new businesses. So the new approach possibly will be to measure the returns on invested capital.

I would like to highlight that we invested particularly in formats that have a high rate of return, or higher than the company's average. And I'm referring to Assai, Minimercado. And also Fongiezuca [ph]. These formats the organic growth has been the focus of the group.

In addition, I would also like to underscore that for the future Mondevarejo [ph], Multivarejo will keep on focusing on competitiveness. This is absolutely key. And we do have opportunities to finance this investment with improved efficiency in expenses and at the same time maintaining the level of profitability that we currently have.

I would also like to say that at Moltivoltacon [ph] the investment policy in competitiveness will be maintained. And always bearing in mind our will to maximize sales growth in a balanced scenario -- in a break-even scenario, without burning cash.

So these are the two highlights that I would like to say.

But to conclude, this doesn't mean that profitability and particularly return will be adversely affected.

Q - Jerome Naggs

Perfect. Crystal clear. So the drop is not for a bad reason, right? Quite the opposite. Very clear.

Thank you very much.

Operator

Bernardo Cavalgenchi [ph] from Goldman Sachs has a question.

Q - Bernardo Cavalgenchi

Good morning, everyone. I have two questions. First question is a follow-up about Jerome's question, related to G&A reduction.

You had a significant reduction in G&A as a percentage of revenue. But it also in nominal terms, going down between 20 or 24%, actual terms, from the Fourth Quarter.

So what -- where are these significant cutdowns taking place?

Maybe I can ask the second question later. Thank you.

A - Unidentified Speaker

Thank you for your question. I'm not sure I understood your full question. But the reduction in G&A, as we said before, this is taking place in logistics, back office, central offices in general.

And this reduction tries not to interfere with stores or level of services delivered at the stores. But being actually concentrated in what is not directly in contact with the customer. Well there is not a magic recipe. We don't have specific topics or expenses. But rather a summation of activities around discipline or many details.

So we are capturing the opportunities that the company has that are not specific numbers. But it addresses with all topics, with discipline, trying to keep a focus and to focus on services to consumers. But simplifying our back office processes in general.

I won't get into details. I could speak a lot about any of the lines of our financial statements and revenue, line by line. Basically, that's it.

Thank you.

Q - Bernardo Cavalgenchi

My second question is about Nova Pontocom. Quiroga made comment and Christophe also made comments about better profitability of Nova. However, if you look at the numbers at nine months in 2013, when Nova was still reported within Via Varejo, the gross margin was around 15%. Then it was reported by Fontesuca [ph] in 2013, closed at 9% gross margin. I don't know if that was a negative margin in the Fourth Quarter. And now the gross margin is 8%.

In addition, the loss was BRL22 million and it was 80% of the annual loss in 2013. So I'd like to have a better understanding.

And simultaneously, we had a very strong growth, 50%.

So what is the strategy to reinvest? Are you buying. So to speak, market share, investing in market share?

And could you comment also on the expected profitability of these lines for 2015? Is there any strategy in mind?

Thank you.

A - Christophe Hidalgo {BIO 17982648 <GO>}

Thank you for your question. Hidalgo speaking.

Just to clarify, we have a change in how we're reporting this. Right now, we are reporting with a freight cost included in the margin, you can see.

The commercial margin alone increases and when you check, the gross margin is also increased, year on year. When I checked the gross margin, it was 7.2 to 8, a slight improvement but a competitiveness, aggressiveness level.

In our case, any improvement is welcome, as to say to buy market share. We're trying to improve market share, increasing or improving our commercial and gross margins. We have even more opportunities, like I said before in my speech. We haven't even got started to reflect on our statement, our commercial synergy.

So we have opportunities for growth in the future to improve our margin, to gain more market share. And regardless of all that, we are heavily invested, heavily been investing like Christophe said, with a lot of discipline in order to check our expenses, understand every expense line, see room for improvement, particularly processes and process automation. We do have a long way to go.

Logistics, for instance, we haven't started yet. We have a benchmark with France. They have very strong automation in logistics. And we have a lot of opportunities and also opportunities to have logistic synergies with a group in several different (inaudible).

So we believe we have a lot of -- we're very well equipped to be very strong and maintain our operation at the break-even point. On the other hand, we keep on generating cash, at least not burning cash.

Thank you.

Operator

Ricardo Boiati from Bradesco Bank has a question.

Q - Ricardo Boiati {BIO 16528742 <GO>}

Hi. Good morning, everyone.

My question has to do with the use of resources generated by the company, considering the comfortable position of the balance sheet that is very much deleveraged.

Considering you have already been significantly investing in expansion and this has not compromised the company when it comes to leverage, would it make any sense or would you consider increasing the payout or to pay out more resources or funds to shareholders?

A - Christophe Hidalgo {BIO 17982648 <GO>}

Thank you, Ricardo, for your question.

As today, the company, like we said before, is being deleveraged and is following up this deleveraging policy, even though we don't have a high level of investment. Almost 3% of sales were invested last year and we search for the same level this year.

We believe that having a deleveraged company under this scenario of high interest rates is not negative. But we want to be reactive and be ready for any opportunity that might come up.

In other words, well, does that mean that we are going to increase the payout in the future, at least in the short term?

The answer is no. There is no reason to increase payout considering it is within the market practices. As a result, we don't feel this need.

The value of the stock is more related to the company's economic fundamentals rather than based on return measure by payout.

Q - Ricardo Boiati {BIO 16528742 <GO>}

Great, Christophe. Thank you.

Operator

Tobias Stingelin from Credit Suisse has a question.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Good morning, everyone.

My first question, I would like to have a better understanding, not only short term but also the Easter effect -- there was a lot of expectation about how things behave during the Easter and how it keeps on growing to the second and Third Quarter. Apparently the following quarters would be more challenging. We talked to Abras [ph] too and they show that there is a slowdown (inaudible).

So my first question is I would like to understand the Easter effect.

And the second question, I would like to -- well, Quiroga is here and he talked about the margin that expanded without considering the evaluation. So what about the dynamics for negotiations with Via Varejo, what about the committees to define price policies and what about the status of the process?

Maybe you can crown this by saying when we expect to see any novelty about the operating agreement between Nova and Via Varejo.

And lastly, what about now? You've been consistently assessing your models. Assai is a great success story. You have a history of over a year now and you can clearly see the returns of the system.

Do you do the same analysis for Mini Mercado? Do you have conditions to say that the returns are as expected?

Thank you.

A - Jose Roberto Coimbra Tambasco {BIO 3635014 <GO>}

Tobias, Tambasco speaking.

Let me mention briefly the Easter effect and also talk about Mini Mercados.

First, Easter. Whereas Easter is within our expectations, now what really happened -- and by the way, the market is saying Easter was not so good -- this year, we had a migration in sales, Easter eggs into conventional chocolates like chocolate bar and other kinds of candies.

So this is where the market as a whole felt. We had a significant increase in this category of candies in general, which offsets the specifically drop in the sales of Easter eggs.

Now when you speak of the Second Quarter, we cannot assume that the Second Quarter will be bad. Quite the opposite, in addition to the Easter effect that was displaced to the Second Quarter, we also have Mother's Day -- Libano mentioned that before -- and we also have the World Cup. (inaudible) even with non-foods or TVs but also with foods, our expectation is to see a very good quarter thanks to these events.

So we add two or three events, considering or including Mother's Day. And we are confident in our -- with a very good performance for the Second Quarter.

Now what about Mini Mercado? We made a number of adjustments to the model and we are very comfortable with the actions and our improvements in the model.

At the stores for more than one year now our EBITDA numbers are in line with our goes to the model.

So now we're very confident in terms of accelerating the expansion and that's why the group is focusing very much on Mini Mercados for expansion. We are still focused in the regions of the greater San Paolo, San Paolo state and a couple of cities close to San Paolo City. But our expectation as of next year is to move into other states where we see a lot of opportunities in the store model.

Now this model, in Brazil at large, has been growing thanks to consumers' behavior. Consumers are increasingly searching for the choice of where they shop, of the place where they shop. It's not only a matter of being loyal to the brand but it's important to think about convenience. So we believe this model meets that need by consumers for proximity and convenience so they can supply.

For the future, starting this year, we expect to speed up the process and grow the number of stores -- of Minimercado.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Out of curiosity. So what about this migration's specific about chocolates? So chocolate is too high and then they decided not to buy Easter eggs? So it is a rational decision by consumers?

A - Jose Roberto Coimbra Tambasco {BIO 3635014 <GO>}

More rational than we might assume. But you are right.

You know what? The kilogram of Eastern chocolate is almost four times higher than -- or compared to a candy bar price. And this has to do with logistics involved in the operation. This consumer has perceived this price difference and therefore there is this migration this year in a more remarkable manner and particularly for other kinds of chocolate. We invested more in these categories like chocolate units so we could have a good Easter season.

Last year, we had a lot of Easter eggs left in more significant stores, Easter eggs that were not sold. So we were more careful this time, just to make sure that in the candy section in general, we would cater better to our customers' needs.

This year, we had a coincidence. We had another historical holiday very close to Easter. This cannot be compared to last year to tell whether performance was good or bad because it didn't happen last year. So we had Easter and three days later, we had another historical holiday in Brazil. Maybe that was -- that had an impact to the market.

Thank you.

A - Unidentified Speaker

Nova now. Yes, (inaudible).

Your question about the negotiation dynamics and price policy, I think it's important to clarify that we are searching for synergies first, not only with Nova and Via Varejo. We understand there are opportunities at Nova, Via Varejo and Extra so we've been focusing on these three performances.

And we understand we also have opportunities in procurement, logistics. And I.T. The first important point to mention. And I think it has to be clear. And by the way, Hidalgo mentioned this before. We're already capturing synergies. (inaudible) not fully identified in the result yet because we have the inventory fact.

(inaudible) Particularly, procurement synergy. This will begin to be more perceived in following quarters. Now, you also made another question. And if I understood it correctly, you wanted to know how we will break down these gains, right? We are having all the areas involved. All the areas that have an interest, Tambasco team, Hidalgo, Via Varejo and we hire Mackenzie that has been working now for us for six weeks trying to identify benchmarks in the world. And also the best practices in the world.

And in a timely manner, they will be showing the results for the people in charge of every business unit. And we will follow the example of the best governance possible. In other words, we will share to all governance bodies that are directly involved in these three companies. And as soon as we have information and the definition of how the status will be, we will announce it to the market.

For the moment, it's important to say that these synergies, particularly for procurement, they are already been captured. For logistics, we are working on it.

Libano mentioned yesterday by the way, we have our D.C. commissary first on experimental basis. And for I.T., well, it takes a little bit longer. But we also have goals to capture synergies over the year.

Now, when you ask about expenses and Christophe answered the question, we are very much focused on every process at the company. And naturally, synergy includes processes among different companies. And we want to optimize and do our best to deliver the best returns possible.

So this is what we have to say about this topic.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Okay. Thank you very much.

A - Unidentified Speaker

In terms of operating results, I -- I think we already talked about the synergies. But in practical terms, Nova just put a new commercial team. I'm talking about commercial synergies within Via Varejo. Negotiations are now occurring real time and full time together and the extra people are very close to that negotiation. So we are not losing touch with consumers.

Both teams are -- are helping one another to get better commercial conditions. And also they are there to identify a better opportunities and products and negotiations in several other areas. So this is something that is already happening. And I would like to thank Huazin [ph] for -- for the way that he is conducting the business. He is expediting things in -- in practical terms, things are already happening.

So for all common suppliers, we already provide equal commercial conditions. As it was said here before, we are operating in several areas processes, logistics. We are mapping and conducting some studies, even though a few things are already in place, like hamasadee [ph], distribution center was expended in terms of all of the other bases, we are already including that in our combined study of all of the business of the groups trying to optimize our investment in logistics.

Now, in terms of the agreement and also the -- the benefits that we can get from all of the surge -- synergies the company is already with a study underway. So for now, if we do not see that impact in your margin. And you already improved the margin in the First Quarter vis-a-vis the year before, with all these benefits. So it should be fair to say that in the Second Quarter, your margins will improve more or you will invest more.

What is your line of thought here? Okay. We want to grow as much as possible. And at the same time we want to generate cash. But that doesn't mean that I would necessarily just focus on price, because there are many other opportunities that will allow me to -- that will also gear towards further growth. So together with the other companies, we are working to establish the pricing strategy.

Thank you very much. Good morning.

Operator

Mr. Gustavo Oliveira from UBS has the next question.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Good morning, everyone. My question is addressed to Belmiro. Belmiro, I recall a discussion about Appacareju [ph] and Appacainadacadu [ph] about the business model, concerning leaving the companies to request a purchase through using their CPS or their registration number, taxpayer number. Thank you very much.

A - Belmiro Gomez

In fact, we are monitoring that.

And let me try to summarize that topic. The cash and carry segment is growing a lot in Brazil. And certainly it is growing without reducing the traditional brick and mortar space that's when the truck would go and deliver door to door.

But when it comes to this distribution, cash and carry, we experience increased traffic and increased logistic costs in the large markets. It was very common in the past to mention the exeppen [ph] of the reds truck like Coca Cola delivering on the streets. And we don't see that anymore because large urban areas can no longer receive door to door during the day, as the distribution changed.

So what we are doing, we have to have a D.C. around the margins. The differentiating factor for a small and mid-sized companies to come to us is that they do not have to have a minimum order. They do not need a truck stopping at their door. But they can replenish their stores going to the nearby D.C., although the items are already subject to a tax collection.

So the tax is already collected at the source. We -- we see this new measure now. But it will not render a good service because we already have a very complex operation. And so we do not believe that there will be any significant impact in that regard.

I think there are two states where this is mandatory. And do you have stores in these states. And what is the behavior of the stores in these locations? The stores that adopted that system with (inaudible)? We do not have any units there. But the information that we received is that even in other segments, they are still growing.

The motivating factor behind the cash and carry growth in Brazil is in logistics. You know, cash and carry is been very important. And so in this case, as also in these two states that already endorse the regime of tax replacement, this is not within -- I mean, our expansion plans. Not even our expansion plan envisions that distributors in wholesales, they have a special regime. And cash and carry does not use the same regime, or cannot use the same regime. Because there are more taxes collected when you -- when goods go through the cash and carry system.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay. It's very clear to me, thank you very much.

Operator

Ms. Melissa Byun from Bank of America has the following question.

Q - Melissa Byun {BIO 15128570 <GO>}

Good afternoon, I only have one question about the competitive market, especially concerning supermarkets. I know that you are gaining share in all of the markets in all divisions. But I just want to understand that with all of the investments that you had in the last few months, how did the competition react? Did you see them lowering their prices as well. And now, with the current price structure, is your cheaper in every location, or some regions you are more expensive. And how much room you still have to reduce prices further? And what is your objective to reduce prices further?

That's all I had.

A - Jose Roberto Coimbra Tambasco {BIO 3635014 <GO>}

Good morning. This is Tambasco. We, ever since we started this move towards price competitiveness, of course the market reacts to that. Especially amongst large players. They are announcing more promotions. But this is part of the business. Every movement we make or the competition makes is followed by a reaction. I believe that this change in our policy occurred given to the long tail of our assortment. In fact it has stemmed from the private assortment. And we try to ensure competitiveness in the entire product line of the store.

It is more difficult to start a price struggle, because that price war happens more on the promotional side, or products that have more visibility.

Therefore, our current policy does not necessarily imply that there will be a price war based on the current price, because it occurred in the long tail.

Well certainly that when your competitor feels a reaction and changes in the sales scenario, they will certainly come up with stronger promotions. So far, what we've heard is that we are having some advantages, because some of these players, some domestic players, have not yet found what their correct positioning is.

So amongst large players, some of them acquire networks. But they haven't been able to integrate the operation yet. And this has been seen as an opportunity for us, given the fact that their reaction hasn't been as quick as could be expected. So all the work we did in search for more competitiveness does not only involve a reduction on the assortment line. But it also encompasses other strategies.

We are adopting different strategies in different regions. In some regions, we feel the need to be more aggressive because of the local competition. And therefore you have to draw specific strategy for that location. And in some other geography, you do not have to do the same work.

So with that, we try to keep a mix that can ensure productivity gains in all the regions without affecting the margins. I don't know whether I was clear enough, yet it's very clear.

Q - Melissa Byun {BIO 15128570 <GO>}

But what about the flow? What about the flow in the stores? Can you measure that? You know, can you really see whether that price move caused or affected the flow in the store? Because it seems like this price move has been even stronger in the First Quarter.

A - Jose Roberto Coimbra Tambasco {BIO 3635014 <GO>}

Well we can measure it. But what we've noticed the most in these past few months is not that consumers will pay more visits to the store or the flow has increased. But the most important gain that we perceive is in the number of items that consumers buy when they go to the supermarket. This is very positive and it just shows that the strategy has been proved right.

And clients are noticing a better price position. And that's why they can buy more per ticket. Every time they go to the supermarket, they increase the number of items per ticket. But we see in the general market a change in consumer behavior.

Consumers are paying less visits to the supermarket and hypermarkets. In our case, it's not so aggravated as we've seen in the rest of the market. But better than that reduction, even, because that's the strategy. The important thing is that we want them to buy more every time he goes to the market.

Q - Melissa Byun {BIO 15128570 <GO>}

Very good, then, thank you.

A - Unidentified Speaker

I would just like to take this opportunity to revisit something that Tavea [ph] said concerning Minimercado. And somebody just called my attention to that fact, because that store is not ready yet. But Tavea's, in the case of Minimercado, we are now launching until early next month a new model of proximity stores.

And this is like a signature of Ponjasuca [ph]. We see good opportunities in regions where you have A-B individuals. And that gives us good opportunities to have proximity stores very similar and with the features of a Ponjasuca. The difference between Minimercado Extra and in terms of the assortment that if offers is different because we want to offer a good assortment of products and a good purchasing experience, unlike with the Minimercado Extra.

What we want is to replicate in that model all of the features of a Ponjasuca. But now in a model of a proximity store. This gives us even further opportunities to expand this model with better adjustments to the model to make it more fit to the consumers in that area.

Next time, we will talk more about that model because we will be opening our first store in early June.

Thank you.

Operator

Our next question comes in English.

Mr. Scott from (inaudible) has the next question.

Q - Unidentified Participant

(inaudible) by 1%. I was just wondering if you could give us an idea of how that was breaking down between the performance of food and non-food items. Were both of those categories similar to the 1%, the minus%? Or were -- or was one weaker than the other?

And the second question, again, is a follow-up about the proximity stores. Are you considering at some point doing a franchise operation for the Minimercado stores? Or is it still too early for that?

Thank you.

A - Unidentified Speaker

Could you please repeat it a bit slower?

Q - Unidentified Participant

Yes, sure.

So the first question is about Hypermarkets.

A - Unidentified Speaker

(inaudible).

Q - Unidentified Participant

Overall, the sales fell around 1%.

A - Unidentified Speaker

I think you talked about food and non-food -- the performance. And you talked about proximity model. But the sound was very poor so I couldn't really understand it. But I think you were referring to franchising in the proximity model.

I'll allow the other executives to answer that.

A - Jose Roberto Coimbra Tambasco {BIO 3635014 <GO>}

This is Tambasco again.

So referring to the proximity model and the possibility of implementing a franchising model, we've been looking at these alternatives or models that will allow us to increase our expansion model even using the franchise model. But we're also looking into other models that we see in other countries like in Colombia, where it's not franchise per se. But it's just means to ensure efficiency gains, logistics and procurement that we have in the company. And also apply that to small merchants that are already owners of small grocery stores.

And they could then take advantage of our own scale and with that we could create our own brand. Well certainly it will not be a Minimercado (inaudible) our brand. But it will be still a third brand that we will be launching.

The study is still underway. But to date, we haven't yet made any decisions about which way we will go. As soon as we have any decision on that matter, we will certainly share that with you.

Operator

With that, we conclude our Q&A session. And I would like to turn the floor back to the company executives for their final remarks.

A - Unidentified Speaker

Thank you very much for participating in this conference call. I would also like to say that our investor relations department is certainly available to take any additional questions.

Just to conclude, Ronaldo would like to say the final -- some final remarks.

A - Ronaldo Iabrudi {BIO 5151863 <GO>}

Well once again, I would like to thank you very much for joining us today. I would like to thank my team and also to say that we are very confident it will be a complex year, I know. We all know that. This year will demand from every business owner and also our corporate team a great effort. We are all engaged in looking for the best possible solution so that we can deliver the results that we -- that we have in our plan.

But we are doing all we can. The company is. And the teams are working hard together to add more value to the company's stakeholders and shareholders. So we're very confident. I would like to thank once again the teams that were able to give us all of these good results.

So I'll see you next time. Thank you, all very much.

Operator

The GPS conference call is now concluded. The group's investor relations team is available to answer any other questions you may have. We would like to thank you all for participating and have a very nice afternoon.