

Q3 2008 Earnings Call

Company Participants

- Arnaldo Faissol, IR Manager
- Leonardo Rocha, CFO, Strategic Planning Officer & IRO

Other Participants

- Irma Sqarz, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. and welcome to your conference call of Globex to discuss the Third Quarter 2008 results. Thank you for standing by. At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session and instructions will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to Mr. Leonardo Rocha. Please go ahead, sir.

Leonardo Rocha {BIO 16071703 <GO>}

Good afternoon, everyone. First of all, I would like to thank you all for joining us in our third Q conference call. We're very pleased to present our third Q '08 result and our year-to-date result as well.

We would like to address the presentation that's available in the Web. In the slide number three, I'd like to present the most important highlights of the third Q '08 results. And in this period, Globex continued its restructuring program, implementing better management practice and focusing on shareholder value creation. As a result, our total net revenue grew by 13.9% year-on-year basis in the Third Quarter, and due to the same-store sales grew 2.7% and the increase of 6.1% in our sales area.

We have seven new stores in the standard format and another three in the digital format. And we also invest and expand two more stores.

In the first nine months, we opened 28 stores and closed another 10 stores, following a program to close the stores without -- with poor performance. It is also worth noting that our net revenue for services, which moved up by 49.3%, thanks to our initiatives to enhance our sales by our sales force. And we also implemented some practices too, like

improving our managers' commissions and implementing a better training program. So this adds to a better revenue coming from services that's a very profitable revenue.

Our operating expense represented 2.6% of net revenue in the Third Quarter, 3.7 percentage points down from last year. One of the main reasons for this reduction was the conclusion of the deal of our advertising account, which will be shared between DM9 and FALA agencies, two very important advertising agencies here in Brazil, ensuring better and wider media exposure at a lower cost.

Another reason that we expect to reduce our operational expense was the program developed with National Management Development Institute, INDG, to support us in our cost-cutting program. Also, in the Third Quarter, we hired Accenture to help us implement best practices to -- for managing supplies and other indirect resources, leading to additional savings.

We also closed the first phase of our IT improvement program that we are handling with IBM and SAP.

And I would like to also emphasize that we have a very significant improvement in our figures -- financial figures regarding EBITDA, that we have an increase of more than \$9 million -- BRL9m, sorry, and also in our net revenue that we improved quarter-by-quarter at BRL20 million versus last year.

Finally, worth mentioning the impact of the financial market crisis in our operations. It's well-known that the credit is extremely scarce at the moment. And retail financial plans for durable goods have been forced to adapt to a scenario focused on cash generation and high interest rate installment sales.

Another fact much commented on our media, is the battle between suppliers and retailers regarding imported goods or dollar-backed durables and semi-durables. We are following a different strategy, in order to make sure that you have the right goods in our stores and negotiating case-by-case in order to accept the price that is 100% tied to the dollar variation. Up to now, we have only one increase in price in the computers and PCs and printers. So this is the only broad category that we have been able to have good negotiations in order to increase the price as need, and at the same time assure the good supply for the Christmastime.

Regarding exchange rate variation, we maintain close and good relations with our suppliers and we will be focusing on preserving our margins, which we have been working so hard in the last 16 months, since we started restructuring last year.

Regarding credit availability for our operations, we have a very strong joint venture with Unibanco that helps us to guarantee the credit availability for our consumers, and at the same time to have a very good relation with the bank sector in Brazil if we need any credit for our operations.

As an overall statement, we are cautiously optimistic about the crisis because, as happens in all crises, this one can bring so many growth opportunities for us, because we have some differentials as a public company and we have transparency, and we have very -- have been able to build very strong relationships with our suppliers. And we are sure that Pontofrio will be stronger after the crisis is over.

I'd like to invite Arnaldo Faissol to bring some comments about our financial figures and I'll be back at the end. Thank you.

Arnaldo Faissol {BIO 17305748 <GO>}

Good afternoon, everyone. Once again, welcome, everyone, to the call. And I will follow to slide seven, discussing revenue by business line. Total consolidated gross revenue increased 9.7% year-on-year in the Third Quarter of 2008. Gross revenue from service sales increased by 57.2%, from BRL19 million to -- in the Third Quarter of '07 to BRL30.9m, caused by initiatives on the sales force management front, such as improving managers' commissions and implementing frequent training events.

Gross merchandise revenue increased by 9.3%, from BRL990 million in the Third Quarter of '07 to BRL1,082.5 million in the Third Quarter of '08. Our gross revenue from credit operations consolidated by our 50% stake in Banco Investcred increased by 0.6%, from BRL48.6 million in the Third Quarter of '07 to BRL48.9 million in the Third Quarter of '08.

Our same-store sales climbed by 2.7% year-on-year basis, mostly driven by higher disposable income in Sao Paulo and Minas Gerais states, our strongest regionals. Also, as mentioned before, another factor was the sales area growth. Since October '07 we opened 77 new stores, which represented a 6.1% increase in our sales area.

Going to slide eight, I'd like to discuss our gross revenue from merchandise sales. This increased by 9.3% year-on-year, from BRL99 million to BRL1,082m. Store chain merchandise sales increased 10% compared to the Third Quarter of '07. The wholesale segment increased 14.5% year-on-year in the Third Quarter of '08, thanks to the expansion of the sales force, as well as introduction of new product categories and more up-to-date sales management processes.

Our e-commerce sales had a neutral growth in the Third Quarter of '08. In August '08, we -- our new executives began some changes in our e-commerce channel that will be discussed by the end of this Fourth Quarter.

Moving to slide nine, we can analyze sales by our financing plan. Payment Books being fastly replaced by sales with the Ponto Frio Flex Card since its inception in March '08. In September '08, Payment Books sales reduced its share in 26.8percentage points since December '07, while the Ponto Frio Flex Card represented 19% at the end of the Third Quarter of '08. Still, in the Third Quarter of '08, our cash sales represented almost 40% of our financing plans.

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Going to slide 10, gross profit, you can see that the total gross profit recorded a 53.2% increase, reaching BRL255.5m, which is approximately 27.5% of net revenue, versus BRL166.8 million in the Third Quarter of '07, which is roughly 20.4% of net revenue. We believe the best measure of our retail performance is the gross managerial margin, which considers the sales incentives obtained from our suppliers. If we include this value in our margins, they would increase by 7.7 percentage points, from 23.3% (sic; see presentation) in the Third Quarter to 30.9% in the Third Quarter of '08.

Some elements contributed to this performance -- to this improvement. And they were the partnerships we've been having with our suppliers, which led to better margins and more advantageous payment terms, and also our effort to recover ICMS sales taxes on products that are benefited by a reduced rate. We're also implementing more efficient processes and more efficient approach to our tax matters in general.

We also think it's worth highlighting that non-recurring events in the Third Quarter of '08 -- of '07 and also in the Third Quarter of '08 affected the analysis between these periods. We mentioned already that in the Third Quarter of '07, a strong correction due to the restructuring of our taxes.

And also, on the Third Quarter of '08, it's a different type of problem. We are actually having a good problem, which is taking advantage of all the tax benefits we can take, of course taking and paying attention to all regulatory and legislation applied. Not considering this effect, this non-recurring effect in both quarters, our gross margin would be (1.3) percentage points higher, which is a good, sound increase.

Going to slide 11, operating expenses, operating expenses in the Third Quarter of '08 totaled BRL217.3m, 1% higher than the BRL215 million recorded in the Third Quarter of '07.

Our selling expenses increased by 21.8% year-on-year, due to higher advertising costs, also freight and commission expenses, due to the strong store opening programs and sales increases we had during this period, and the rental costs of our main distribution centers. They were sold in December of '07 and began to generate rental costs after January '08.

Our administrative expenses fell by 32.5%. Another factor that contributed to the increase in operating expenses was the 57.3% upturn in provisions for doubtful accounts. They were around BRL30 million in the Third Quarter of '07 and they jumped to BRL47.5 million in the Third Quarter of '08. In the -- also here, between quarters, we have been effected by non-recurring events. Not considering these events in each quarter, operating expenses would have been stable, around 24% of net revenue.

Going to slide 12, I would like to discuss Banco Investcred results. Banco Investcred's credit portfolio closed in the Third Quarter of '08 with BRL1,398m, 34.6% higher than in the Third Quarter of '07. The portfolio's average financing plan comprised 10.4 installments, which is a slight increase compared to the 10 installments we had in the same period in the previous year. And the average ticket came to BRL736, which is 21.2% higher than the average ticket we recorded on the Third Quarter of '07.

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The total Ponto Frio branded card base exceeded the 1.4 million mark. This is due to the great effort we implemented in the Ponto Frio Flex Card issuing, which already passed the 1 million card mark. And also, we added to this base our 466,000 cards that -- the co-branded cards Ponto Frio had issued by Banco UNICAD, which is a controlled company by Unibanco.

The balance of provisions of doubtful accounts totaled BRL351.2m, which is equivalent to 25.1% of Banco Investcred's total credit portfolio. Expenses from provisions for our doubtful accounts totaled BRL89.9 million in the Third Quarter of '08.

It's important to note that in spite of the fact they are higher than in the Third Quarter of '07, as we already anticipated, they are 15.6% down on the BRL106 million we recorded on the Second Quarter of '08. So sequentially, we expect lower provisions for doubtful accounts moving forward.

We maintain our credit concession through first purchase option on the Ponto Frio Flex Card. So the utilization rates, both on the first purchase as well as the recurring purchases, are going well.

As a result of all these factors I mentioned, Banco Investcred recorded year-to-date net income of BRL4.4m, compared to the BRL48.1 million in the same period in the year before. In the Third Quarter of '08 it posted a zero result, which represents an improvement from the BRL4 million net loss we had in the Second Quarter but was well below the net income of BRL11.6 million in the Third Quarter of '07.

Going to slide 13, we can describe what's going on in our EBITDA. In the Third Quarter, EBITDA totaled BRL49.6 million on a consolidated basis, which is BRL86.6 million up on the negative BRL37 million recorded on the Third Quarter of '07. Year-to-date EBITDA jumped 300%, from BRL26.9 million in the nine months of '07 to BRL108 million in the Third Quarter -- I'm sorry, on the year-to-date through to September '08.

It's important to note that most of this EBITDA was -- is the result -- it's the exclusive responsibility of the retail operation. This was responsible for the bulk of this positive upturn. Year-to-date we have BRL108m, almost BRL109 million in our retail EBITDA, while in the nine months of '07 we had a negative BRL500,000 EBITDA in our retail operations. So we are very happy with this result.

On our slide 14, we discuss our financial results. Our net financial result was an expense of BRL28.6m, compared to revenues of -- a net revenue of BRL7.8 million in the Third Quarter of '07. This decline was caused by the partial rescission of an agreement in effect in the Third Quarter of '07 related to the purchase of tax credits by the Company. We generated revenue of BRL20.8 million in the Third Quarter of '07 while, due to this rescission, in the Third Quarter of '08 we generated this revenue reversal of BRL16.6m.

Our financial expenses fell by 34.6%, influenced by the increase in credit card sales, which can be noted by our administrative fees we're paying to the credit card company. They increased by 61.2%. But also, they were positively influenced by our funding expenses. In

the Third Quarter of '07, we were utilizing our Compror line, which is basically a financing line offered by our suppliers. And we ceased to use this financing line after December '07. So we had a good economy on this line.

On slide 15, we discuss net income. Globex posted in the Third Quarter of '08 net income of BRL7.4m, BRL20.1 million up on the BRL12.7 million net loss reported on the Third Quarter of '07. Year-to-date net income totaled BRL20.9m, 76.8 million -- I'm sorry, 76.8% more than the BRL11.8 million recorded on the nine months of '07.

Going to slide 16, indebtedness, Globex retail operations closed the Third Quarter of '08 with net debt of BRL89.6m, which is BRL57.8 million less than in the Third Quarter of '07. This cash utilization was basically to fund our expansion program and also our working capital needs.

This position, this net debt position, does not include amounts related to the optimization of our balance sheet and hiring of financial services, which gave us receivables -- high liquidity receivables of BRL395 million and BRL25 million from this balance sheet optimization. Also, in the Third Quarter of '08, we had the release of BRL34 million of financing line from Banco IBM, IBM Bank, to fund investments related to the implementation of our SAP retail system.

Going to slide 17, we can observe our focus on optimizing the use of our working capital. We extended the average supplier payment period by 11 days over the Third Quarter '07 average. Average inventories moved up 22.8% year-over-year, outpacing gross revenue growth and the cost of goods sold, due to the anticipation of Christmas inventories. We partially -- part of our purchases for the composition of our inventories for Christmas were made in September. And also due to the increase in our display items, which counts as inventory, due to the number of stores opened in this 12-month period.

Also, on slide 18, we describe our investments. Year-to-date CapEx totaled BRL69.2m, which is 29.9%, 30% up on the BRL53.3 million recorded on the same period in the year before. In the Third Quarter of '08, we invested BRL17.3 million in our store expansion program, adding seven stores in the standard format and three in the digital format, as well as expanding two standard stores. Also, we closed two stores with bad performance.

This finishes our discussion of the financial results and I'll pass on to Leonardo.

Leonardo Rocha {BIO 16071703 <GO>}

Okay. Thank you, Arnaldo. As a summary, I'd like to emphasize that we have a strong net revenue increase on our stores and mainly on our service -- coming from our services revenue. We have a very strong discipline in maintaining our expenses and as well our working capital. And we have been showing a dramatic change from the performance of our retail operation and we have taken the necessary actions to correct the performance from our joint venture with Unibanco, the Banco Investcred.

We have been seeing some reduction in indebtedness from our customers. And we also changed the way we grant credit to our consumers, even in the booklet sales as well in the (flag) sales.

So I'd like to -- after this comment, I'd like to pass to the Q&A section.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Ms. Irma Sqarz with Goldman Sachs.

Q - Irma Sqarz

Hi, Leonardo. Hi, Arnaldo. Thank you, very much for the comments. I just have a question regarding how you've seen the development of sales over the last couple of weeks. It sounds like you're still seeing positive developments there. But then also, if I look at your last quarter and at also the anecdotal evidence that seems to be coming out from the industry, is that for the larger ticket items that you sell there has been a bit of a slowdown.

Now, I can see your average ticket has been growing strongly, but your same-store sales are, well, compared to the Second Quarter, at least more on the modest side. So I was wondering if you could comment a little bit how you see current environment. When do you expect -- if you haven't seen any slowdown so far, when do you expect this to hit the consumers?

A - Leonardo Rocha {BIO 16071703 <GO>}

Okay, Irma. In fact, you ask many questions. I'd like to split them in order to provide a better comment. Regarding the currency crisis in our business, we haven't seen some very strong effect so far. And we are going to comment next quarter, but in October we have been keeping a good performance on our sales, and as well in September. And as we have already mentioned, we took the necessary actions to improve the profitability of our joint venture with Unibanco. So we changed the way we grant credit to our consumers without having very significant effect on our sales.

So we are sure, as our financial results show this quarter, that we are bringing profitable sales. This is our intention to keep doing this. We are looking for profitable sales and the right customers for -- regarding our strategy. Okay?

And as we have already mentioned, we -- so far, we have not seen very strong effect on sales reduction. But we are keeping a close track in our sales, in order to guarantee that we will make the right adjustments in our inventory in order to cope with -- to keep the good relations that we have in our inventory versus our payables, in order to manage in the right way our working capital.

So we have been able to guarantee our supply for the Christmastime with our suppliers. We know that some other retailers, in fact, are fighting with the most important suppliers in the market. We decided not to follow this strategy. We decided to follow the strategy to guarantee the supplies for our Company, to have the right product at the right time in our stores, and also negotiate any price increase on a case-by-case basis.

A - Arnaldo Faissol {BIO 17305748 <GO>}

Hi, Irma. I also would like to add to Leonardo's comments that one of the reasons why we had timid same-store sales in the Third Quarter of '08 is that we adapted our credit offering to a more adverse delinquency scenario. So I guess we anticipated some of the effects the market will face going forward, and that's why we had such a low sales increase.

But this is due to we had a -- just for you to have an idea, we had a 70% approval rate in credit solicitations and we lowered that to 40%. The good news is, as Leonardo said, is that on September as well as on October we've been observing a healthy increase rate in our sales, which -- even with these more strict credit conditions. So I guess this gives you a good scenario on where we're standing right now on our sales.

Q - Irma Sqarz

Okay. Thank you, very much.

A - Arnaldo Faissol {BIO 17305748 <GO>}

You're welcome.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I would like to invite Mr. Rocha to proceed with his closing statements.

A - Leonardo Rocha {BIO 16071703 <GO>}

Yes. I'd like to thank you all for joining us in our conference call regarding the third Q '08 results and hope to see you in the next call. Thank you, very much.

Operator

This concludes Globex's conference call. Thank you, very much for your participation and have a nice day.

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