Q1 2012 Earnings Call

Company Participants

- Adalberto Santos, CFO
- Jose Gallo, CEO
- Unidentified Speaker, Unknown

Other Participants

- Fabio Monteiro, Analyst
- Felipe Oliveira, Analyst
- Gustavo Oliveira, Analyst
- Irma Sgarz, Analyst
- Tobias Stingelin, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. And thank you for waiting. Welcome to Lojas Renner's First Quarter of 2012 Earnings Conference Call. We would like to inform you that today's live webcast including both audio and slide show may be accessed through Lojas Renner's website at www.lojasrenner.com.br at the investor relations section webcast platform.

As a reminder, I would like to tell you that questions will only be taken by telephone. We would like to inform you that all participants will be in listen-only mode during the Company's presentation. After the Company's remarks, there will be a question-and-answer session when further instructions will be given. (Operator Instructions).

Before proceeding let me mention that forward-looking statements that might be made during this call are based on the beliefs and assumptions of Lojas Renner's management on information currently available to the Company.

They involve risks, uncertainties. And assumptions because they relate to future events and, therefore, depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions. And other operating factors could also affect the future results of Lojas Renner and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I would like to turn the conference over to Mr. Adalberto Santos, CFO. Mr. Santos, you may begin.

Adalberto Santos {BIO 16803045 <GO>}

Good afternoon, everyone. With me besides Gallo, our CEO, we also have (inaudible), our General Manager for Corporate Finance, Luciano Viatte [ph], our General Manager for Controller Office and Paula Picinini, our IR Manager.

We can see that the First Quarter of the year was positive for our sales. Really, if we consider the slight economic slowdown that we saw in the second half of last year and also the more competitive apparel (technical difficulty) retail in the First Quarter of the year.

And the sales performance, particularly in January and February, was rather positive. And only in March, with higher than expected temperatures for the period, we saw a slight reduction in the pace of our business. And I would like to remind you that in some important states such as Sao Paulo we had up to five degrees warmer temperatures than last year. Nevertheless, with the return of lower temperatures in the last days of the month, we can say that there was an upswing in the level of sales.

In terms of results, the First Quarter of 2012 was aligned with our expectations which we had already been sharing with you, with marginal gains in gross margin and a certain compression in the EBITDA margin, totally explained by the current [ph] expenses with the new stores opened at the end of 2011. And the remodeling underway of other stores and some additional logistics cost and the consolidation of Camicado, which was acquired in May 2011.

In financial services, the highlights were the all time lows in delinquency, even before our forecast for the stabilization of losses as a percentage of our portfolios which were expected more towards the end of the year.

Regarding the net income in the period, the reduction that we saw refers basically to a higher depreciation driven by the acquisition of the Camicado assets and also the high number of stores recently opened, as well as costs related to our new capital structure.

For the remainder of the year we trust we should maintain profitability of our business, similar to 2011. And here we are talking specifically about the EBITDA margin, notwithstanding the high number of opening of new stores and also the remodeling of stores under way and still (technical difficulty) contribution by Camicado to the results. And of course, the expenses having to do with the new distribution center to be opened in July.

Now, slide number three. The evolution of the consolidated net revenues that in the First Quarter was BRL619.2 million, growing by 19.6% in total. And 4.8% in same store sales. And this growth in a challenging competitive scenario is driven by the assertiveness of the recently inaugurated stores and the growing capacity of rede [ph] and response from our style area to the different fashion preferences in the different regions of the country. And the contributions already presented by Camicado.

And I would like to remind you that all the data presented here refer to Renner and Camicado consolidated for 2012. However, they were not presented pro forma for 2011 or 2010.

Now, going to slide number four. On the left, we see the footprint of the Renner and Camicado stores in cities as well as the three pilots of Blue Steel. We can see on the chart on the right, the evolution of the selling area, 337.2 thousand square meters, corresponding to the 200 stores of the combined operated. Of the total we have 169 units of Renner, including Blue Steel. And 31 Camicado with areas of 321.2 thousand square meters and 16,000 square meters, respectively.

On side number five, we present gross income and gross margin from the retailing operations. As you can all see, in Q1, gross income was BRL328.6 million, growing by 19.8%. And gross margin reaching 53.1% growing 0.1 percentage point year-on-year.

And here, if we isolate only the Lojas Renner operation, the margin would have been 53.6% with an important gain of 60 bps. The improvement comes majorly by the combination of a good assertiveness of the collections with the adequate inventory management, which ultimately implies lower stock-outs and lower mark down needs.

And I would like to mention the effect of the reduction in the price of cotton for these products that are made domestically.

On slide number six, we can see our selling expenses amounting BRL208.2 million in Q1, representing a 33.6% increase, 33.6% of the net revenue from merchandise sales, versus 32.3% in Q1 2011. And this is due to the expenses with the opening and preparation of new stores and also the preparation of the stores and fixed expenses with stores in refurbishing. And the consolidation of Camicado.

On page number seven, we have the general and administrative expenses which in Q1 increased by 24.6% year-on-year, representing 10.4% of net revenue 40 bps, higher than the 10% in the First Quarter of last year. And this increase is also a consequence of the refurbishments underway, which make it more difficult to dilute fixed expenses due to the lower performance of the stores and some additional logistics costs and consolidation of Camicado also impacted the result.

On slide number eight, the table with the breakdown of results from financial services, BRL40.9 million in Q1, vis-a-vis BRL38.5 million in the same period last year. I would like to stress the initiatives adopted to improve the recovery in the level of past due receivables, which, in a way, collaborated for delinquency in Q1 to have an all time low as a result of losses with Renner card net of recoveries in the quarter we had 2.1% over the portfolio, vis-a-vis 2.3% in Q1 2011. And 3.8% in Q1 2010.

On this table, I would like to mention the operating expenses amounting to BRL24.8 million, a 40.3% growth in the period. And this increase is due to the higher expenses with the co-branded cards, the increase in the number of stores with their here are these [ph] the Renner credit areas, a consequence of our more aggressive expansion as well as expenses related to the actions of collections and recovery of past due receivables.

Now, going to slide number nine, we have the losses on the private label portfolio showing graphically the lower percentages that I mentioned before. And another important item in the column, the percentage of past dues reaching an all time low with a very positive evolution for our portfolio. And this indicates a very good outlook for the next few quarters in terms of losses.

On slide number 10, we have the same indicators related to the personal loan portfolio. The portfolio is considered as having a higher credit risk. But also with a good evolution, vis-a-vis its history.

Now, going to slide number 11, we have the consolidated EBITDA for the Company. In Q1 2012, BRL83.6 million with an EBITDA margin of 13.1% with a 2.9 percentage point reduction year-on-year. And this reduction is aligned with our expectations and reflects the impacts related to the expansion of stores. And the refurbishments underway. And logistics expenses. And the Camicado consolidation, as I have already mentioned.

In the upper part of slide number 12, we have the net financial results, which in Q1 was an expense of BRL4 million, in fact, vis-a-vis a net financial revenue of BRL5.8 million in the same period last year. I would like to remind you that the change occurred is related to the cost of our new capital structure adopted and the lower remuneration of the cash and cash equivalent due to the drop in the Selic rate.

Now, going to the cash and cash equivalent in the lower part of the slide, we have cash and cash equivalent amounting to BRL499.4 million in March 2012. And discounting the BRL373.9 million debt, leads us to BRL125.5 million net cash position. In breaking down. So we have BRL311 million referring to the issue of debentures carried out in July last year, BRL33.5 million related to funds raised with the Banco do Nordeste and BRL29.3 million related to short term operations of Camicado.

On slide number 13 we see the net income from the combined operation amounting to BRL35.7 million, with a 5.8% margin in Q1 2012, vis-a-vis 9.2% in Q1 2011. And this drop is due basically to the higher depreciation level. And the level of fixed assets in the Company practically doubled in this period. And also the reduction in the financial results that was mentioned previously. And on the same slide, on the right we have the consolidated ROIC, 2.8% in Q1, vis-a-vis 4.5% in Q1 2011, a reduction that was majorly caused by a combination of the lower percentage of EBITDA and operating revenue, resulting from the investments recently made.

And now, going to slide number 14, we have the balance sheet of the Company. And I would like to draw your attention to the evolution in our inventories growing by 24%, vis-a-vis March 2011. And this is related to the new operations and also to the strategy of bringing forward the results obtained. And in the other line items, no relevant highlights.

And I would like to draw your attention to the current liabilities. With the new import financing instrument, which in March 2012, was BRL80.1 million and will continue to finance a major part of the imported volumes. And this mechanism extends the maturity of payments for purchases made abroad by 180 days and which should benefit our working capital and our free cash flow.

In liabilities, no significant changes. And we have the higher lines which are the FIDC laws of Renner, BRL344.5 million. And debentures amounted to BRL298.2 million.

On slide number 15, we have information about investments made by the Company, which in the quarter amounted to BRL69.8 million, of which BRL23.7 million refers to the opening and preparation of new stores, besides an additional BRL22 million referring to remodeling.

On the distribution center line, we have BRL13.7 million for the new distribution centers scheduled to be opened in July. And here on the right we have the opening of stores that are forecast for the first half of the year. We will have eight Renner and four Camicado.

And now to slide 16. We present the card issued, 19.4 million plastic, 11% growth. And the lower part, the evolution of the average ticket for the Renner card increasing by 8.2%, amounting to BRL138.72.

On slide number 17 to the left we have the evolution of the total average ticket for the Company, which in Q1 had a 6.4% increase, reaching BRL99.21. And to the right, we see the distribution of the forms of payment on the total result of the Company. Renner Card represented 51.2% of sales, vis-a-vis 53.9% in Q1 2011. And during the period, the form of payment in five installments represented 39.6% of sales. And in eight installments, interest bearing, 11.8%.

These were our remarks. And now we will be available to answer any questions that you might have. Thank you, very much.

Questions And Answers

Operator

Thank you, very much. Now we would like to open the question and answer period. Questions in Portuguese will be asked first. Afterwards, we will be receiving questions in English. (Operator Instructions). This is Mr. Joao Pimentel from BTG Pactual. You may proceed.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Good morning, everyone. This is Fabio Monteiro speaking. I have a question regarding sales. Could you give us an idea about January and February, because you mentioned the temperatures in March? So, I would like to know what was the base of business, the base of sales before? And the second question would be recovery of demand over the year. What about April as the temperature has dropped slightly already? So, I would like to know about the recovery of your sales for April so far?

Q - Unidentified Participant

This is Robert Philando [ph]. Good morning. Sales in Q1, in January the level was close to 7% and in February and March, they were slightly higher, around 4.5%. And what is interesting about this Fabio, is the following.

When you normalize the sales we closed with 4.8% and if we discount the stores that are being refurbished, we believe that same store sales would have been higher than 6%, around 6.2% or 6.3%. And when you compare the First Quarter to the Fourth Quarter, you compare 6.3% to 5.3% in the last quarter. And 3.8% in the Third Quarter, which is rather positive as far as we are concerned.

So, our reading; I don't know if you remember. But at the beginning of our call we talked about the First Quarter that would have a lot of promotions and what really happened. And our reading is that our sales have a relatively good performance in this scenario. In the beginning of April, in fact, we had the effect of the higher temperature. But now by the end, we are seeing a recovery already. So, this is our reading of the situation.

Q - Fabio Monteiro {BIO 3711690 <GO>}

What about the effect of remodeling of stores over the year, because you talked about the impact and in the release you mentioned the remodeling of the stores. And do you believe that this will still be felt over the year?

A - Adalberto Santos {BIO 16803045 <GO>}

In the Second Quarter, Fabio, we have four and we will have five large ones. And then three smaller ones -- medium size. So, in the Second Quarter, we do see still the impact of the remodelings. Over the year, you already start reaping the benefit from these remodeled stores.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Thank you, very much, Adalberto.

Operator

Mr. Gustavo Oliveira from UBS. You may proceed.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Good afternoon, Adalberto and Gallo, everyone. My question has to do with the operating leverage of your model. The opening of stores, of course, we understand that sales are not as high as they could be yet. But I would like to know what is going on in the model that in the short run could lead to a pressure, especially on selling expenses, not focused especially on the First Quarter because you talked about the remodeling of the stores and the impact of the same.

But I understand you will have to invest a little bit more in advertising or marketing. Or does it have to do with the change to the fixed cost model that was done in 2007. And that may need some adjustments and fine tuning. So, could you explain what is going on in this regard? And how do you intend to bring back your operating leverage?

A - Unidentified Speaker

Gustavo. Good morning. When we open a new store, of course, there are operating expenses that are very relevant regarding the opening of the new stores. Just to give to give you an idea, in the last quarter of 2011, we opened 23 new stores. And nine in December alone.

So, the first moment is a moment in which the sales start at that level. And depending on the region, the sales start at the level of 65%, 70% of the possibility for the store. So, this is when you have sales starting, ramping up. And you have significant opening expenses. And we are not making any additional effort in communication. Just regular routine efforts.

And with the number of stores, we have a higher concentration of expenses. And, mainly last year, due to the concentration in the second half, this has a heavier bearing on our expenses than sales starting to happen in Q1 and going towards the Second Quarter. And starting to really pick up in the third and the Fourth Quarter. And even with the pressure that we have in the first and the Second Quarter, the expectation, Gustavo, is that we will be closing the year at the same level of percentages as last year.

So, there is no need to revise our model because, in fact, the pressure was higher last year because we had 30 [ph] plus three, that is to say 33 [ph]. So, the biggest pressure was last year. And this year we are almost reaching our cruising speed and we offset this pressure in other ways in such a way that our EBITDA percentage should be kept at the same level as last year. And, of course, as these stores mature, we start reaping the fruit of our operating leverage, which should occur in the next few years.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Great. So, could we expect some level of improvement in Q2 already? Or would that happen later this year?

A - Jose Gallo {BIO 1822764 <GO>}

In the second half, Gustavo. As Adalberto said, we have four major remodelings in the First Quarter. And these remodelings started in the Third Quarter. But they have not been finished yet. And they will be finished in the Second Quarter. There was a need in Baja. And another one. And this would be extended until May. So, the five new stores in the Second Quarter. And I would say that in the second half of the year is when we will be seeing the result of all that.

And talking about the second half of the year, we see -- well, besides the remodeled stores, we will see a recovery in the economic environment as well when we will have elections and lower interest rate. And inflation under control. And income going up consistently. So, I believe the second half of the year will be stronger than the first half.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Thank you. Thank you, very much.

Operator

Our next question comes from Felipe Oliveira from JPMorgan. You may proceed, Mr. Oliveira.

Q - Felipe Oliveira {BIO 16557799 <GO>}

Good afternoon. Two questions. What about the price increase for this year? Maybe considering the lower cost of cotton than last year. So could you please link this to your outlook in terms of gross margin for your retailing operations?

Q - Unidentified Participant

Felipe. Good morning. Let's talk about the First Quarter and then we can get into more detail. The average price of cotton was around 3%, 3.5% higher than last year. If we talk about price increases for the future, this is complicated because now we are going to start reaping the benefits from the imported cotton. But at the same time, we have the issue of the exchange rate that started to go up in this last quarter. And prices depend on the dynamics of this segment.

In Q1, we had quite a high inventory. But now recently it shows that we are having the situation for the beginning of the Second Quarter and it makes it more difficult to forecast what your price will be and whether you will be able to increase your margin or not. Our expectation is that we will continue to gradually increase with the 60 bps that we were able to achieve and that in the next two quarters we will be able to continue achieving that and having an average closer, maybe, to 100 BPS towards the end of the year.

Q - Felipe Oliveira {BIO 16557799 <GO>}

Thank you.

Operator

Irma Sgarz from Goldman Sachs. You may proceed.

Q - Irma Sgarz {BIO 15190838 <GO>}

You talked about the gross margin. And as the gross margin should deliver this kind of increase, don't you see some space for the EBITDA margin to increase slightly year-on-year? As far as I understand, based on your previous remarks, the EBITDA margin should remain more or less stable this year, with a certain pressure on it until the first half. And a dilution toward the third and the Fourth Quarters. And just to clarify, when you said that, were you referring to the retailing margin or the total margin for the Company? Could you clarify this point?

A - Unidentified Speaker

Irma, well. Good afternoon, first. I was referring to the Company's margin as a whole. And the difficulty for us in terms of having gains is that fact that in the second half of the year we will start operating our other DC. And that should bring about the second, an additional expense between BRL8 million and BRL10 million related to the new distribution center. So, it's a little bit difficult for us to consider the possibility of gain. So, the maintenance of the same margin would already be a rather interesting feat on our part.

Q - Irma Sgarz {BIO 15190838 <GO>}

Thank you. And the second question is a following. Could you give us an update about Camicado, how you see the evolution of the gross margin and the EBITDA margin for Camicado. And also expenses from now on that have an impact on the result of the First Quarter.

A - Unidentified Speaker

Irma. Good afternoon. Regarding Camicado, last year was the year of consolidation and adjustments in the controls. And in the First Quarter now we started to work with the product mix and new possibilities. And we implemented the concept of lifestyle in Camicado and we reached the conclusion that in the same physical space we could have 20% to 24% more SKUs, which would ultimately become more sales per square meter.

So, we have made great strides already in negotiations with our suppliers and also looking for new suppliers and more long term negotiations with suppliers, as well. And, certainly, in the second half of the year, we will be tapping into the results of all these efforts.

We also have a new store model that is rather attractive with visual merchandising and that we will be showing you on May 9 here in Porto Alegre. So, we have (technical difficulty) seen an evolution. We have already shown you from 40 to 43.7 [ph]. And surely, there is even more room for additional progress and this will be materializing in the second half of this year.

Q - Irma Sgarz {BIO 15190838 <GO>}

Thank you. One last question. Inventory levels a little bit high year-on-year at the end of Q1. And I imagine that part of that is due to the sales in the beginning of winter that were slightly weaker because -- and, it show how do you see your inventory level for the Second Quarter? Are you sure you will not need a more intensive promotion to reduce your inventory levels?

A - Unidentified Speaker

Irma, the higher inventory level in Q1 was due to the fact that we brought forward our imports and we reached our target of sales in Q1, our budget. And now our inventories are under control. And we are expecting the cooler temperatures now. But what happened was that our imports came before, that is to say, our schedule. So, this is the reason why.

Operator

Mr. Tobias Stingelin from Santander, you may proceed.

Q - Tobias Stingelin {BIO 1557190 <GO>}

Good afternoon. What about the co-branded card? We see that sales 0.5 and 0.8 [ph] have been losing space. When will we see higher revenue coming in from the co-branded cards?

A - Unidentified Speaker

Good afternoon. We published this material in which you already have a contribution to the revenues of about BRL5 million. You have this in the report and the portfolio is being formed consistently -- BRL28 million last year -- at the end of last year. And BRL37 million in Q1.

So, this product is maturing. There's nothing different about it. It's about 305 [ph] utilizations per month. And I believe that during the Renner Day we will be able to talk about this more in detail. But what we see for the people who started co-branded operations before we did it is that co-branded by itself cannot revert the participation of the private label, cannot offset by itself. And we are very much focused on initiatives in order to increase the profitability of our private label. And we will be sharing this with you during the Renner Day. So, I hope you come to the Renner Day.

Q - Tobias Stingelin {BIO 1557190 <GO>}

And what about the reduction of the spread and interest rate by banks? Do you intend to cut your interest rates as well?

A - Unidentified Speaker

In fact, since last year, Tobias, we started this in our loan operation to get some lower ranges, even lower than 5% for loans. And then we started to test other products for financial sales. And in our case, we have better taxation. So, the loss is lower. The funding cost is lower. So, these are the three major components. And so you can practice, lower prices, exactly as we have in the retailing operations. Not only us. But other retailers should be reducing the ranges in the next few months.

And, on the other hand, we always try to develop new products. Products that match our proposal of in retailing and that really can drive sales. So, besides lowering the rate, you can lower the range and we want to develop new products as well. Not only lower the range.

Q - Tobias Stingelin {BIO 1557190 <GO>}

Imports. How do you see imports as a percentage of your sales on the average for this year and next year, vis-a-vis last year?

A - Unidentified Speaker

It will continue to represent about 18% of our overall sales, up to 20%, tops, which is exactly what we have been having up to now.

Q - Tobias Stingelin {BIO 1557190 <GO>}

Thank you, very much, Gallo and Adalberto.

A - Unidentified Speaker

And, Tobias, I forgot to mention, a major part of the imports, a product that do not exist in Brazil, especially the winter items, because in the past, for instance, the leather apparel industry and also wool products were very active. But they gave up because half of the time they supplied the domestic market. And half of the year they exported. And as exports are not really feasible today, the export started to cool down. And so the industry almost disappeared. So, about 40% of what we import are products that are no longer manufactured in Brazil.

Q - Tobias Stingelin {BIO 1557190 <GO>}

Thank you, again.

Operator

(Operator Instructions). Thank you, very much. Now, we would like to close the Q&A session and I would like to give the floor back to Mr. Adalberto Santos for his final remarks.

A - Adalberto Santos {BIO 16803045 <GO>}

Once again, I would like to thank you very much for participating in our call and invite you, once again, to join us during the Renner Day on May 9 in Porto Alegre. Thank you, very much and see you there.

Operator

Lojas Renner conference call is closed. We thank you for your participation and wish you all a very good afternoon.