

Q2 2017 Earnings Call

Company Participants

- Felipe Corage Negrão, Chief Financial & Investor Relations Officer
- Flavio Dias Fonseca da Silva, Online Business Unit Officer
- Peter Paul Lourenço Estermann, Chief Executive Officer

Other Participants

- Fabio Monteiro, Analyst
- Guilherme Assis, Analyst
- Gustavo Piras Oliveira, Analyst
- Irma Sgarz, Analyst
- Joseph Giordano, Analyst
- João Mamede, Analyst
- Paola Mello, Analyst
- Richard Cathcart, Analyst
- Robert E. Ford Aguilar, Analyst
- Thiago Macruz, Analyst
- Tobias Stingelin, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Via Varejo's conference call to discuss the results of the second quarter of 2017. This event is being broadcast simultaneously by the Internet via webcast, and you may access it at www.viavarejo.com.br/investorrelations, where you will find the presentation as well. The slide selection will be managed by you. The replay of this event will be available soon after it ends.

We would like to inform you that the press release about the company's results is also available at the Investor Relations website. This event is being recorded and all participants will be in listen-only mode during the company's presentation. Afterwards, we will have a question-and-answer session when more information will be given.

Before proceeding, we would like to clarify that forward-looking statements that might be made during this call related to the business perspectives of Via Varejo, operating and financial projections and targets are beliefs and assumptions of the company's management as well as information currently available.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions as they refer to future events, and therefore they depend on circumstances that may or may not occur. Investors should understand that general economic conditions, the industry condition and other operating factors may affect the future performance of Via Varejo, and may lead to results that differ materially from those expressed in such forward-looking statements.

Now, we would like to give the floor to Mr. Peter Estermann, CEO of the company.

Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

Good morning, everyone. It is with great pleasure that we announce the Via Varejo's results for the second quarter of 2017, which will show you a significant evolution of the operating indicators and financial indicators as well. And this is driven by many initiatives and projects put in place and started in the last few months, and that you have already learned about. I would like to highlight a few of them that we have already talked about in previous calls but that start to have a positive impact on our results now.

The first one is in Móveis, which is fully implemented already 100% of our stores since the end of last year and already reaches its maturity stage and starts to be part of our routine of area management for our stores. I would like to highlight about Móveis, an important improvement in the performance indicators of the brick and mortar stores.

These indicators, as you can see, have a significant improvement in sale conversion of the stores and an important reduction in the dispersion of performance within the stores, when we compare the stores to each other. And a reduction of the dispersion of the performance of the salespeople with a positive impact on sales. And we also see an important improvement or significant improvement in our credit operations and also in the sale of financial services, which is extremely important as well, mainly regarding the final result, the bottom line of the company.

And finally we see also an improvement - a rather big improvement in the NPS indicators that reflects the client satisfaction, so Móveis is already in operational routine. We are working already in the second version of Móveis and we will be carrying out some improvements as of the second quarter and this initiative now is part of the company's routine and we expect it to bring even more significant results during the next quarter.

I would also like to highlight the logistics integration and the improvement in the service levels regarding the delivery of merchandise to our clients with the cost reduction and improvement also in the level of satisfaction. And I would like to say that as of now this is part of our import (00:05:12) operational routine and our daily operations, because the implementation has already been concluded and the evolution of our Click&Collect as well by means of the fast withdrawal which are the [Technical Difficulty] (00:05:28) when you have the store pick-up and today the store pick-up modality already represents 25% of the over 10,000 products that are eligible in this modality of sale. And we have been focusing a lot on sales growth, especially in the store pick-up and this is where we have a major cost reduction and a very good repercussion in terms of treating our clients. And

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today, there is modality that is to say, the store pick-up already represents over 50% of our Click&Collect, and we have doubled our sales in this modality from the first of the second quarter, which is extremely positive. And we are absolutely sure that the acceleration of the multi-channel strategy will be an important competitive difference for Via Varejo in the short run.

And I would like to highlight also the positive impact of our strategy for our premium stores. As of July 1, we went from 36 stores that we had implemented in January, and now we have 51 as of July 1, and the performance of the premium stores compared to last year, the like-for-like comparison, the growth was 32% in the second quarter, in the first half.

And now, we are adding two more stores to this category. And up to - by the end of the year, we expect to practically double the number of stores in the premium model, so our expectation is very bullish. And July has already shown that the implementation capacity of all the initiatives that we have been taken in the 36 stores goes very well, and now we have 51 stores, premium stores, and a gradual improvement also in the penetration of sales participation in our furniture category.

You know that the furniture category has been suffering a lot with the downturn in the market in the last couple of years and as of the moment we implemented our event in furniture (00:08:06) in January. We have been able to implement these initiatives and we closed the second quarter, that is to say mid-June, with a positive growth in a market that continues to be down in July is already showing a positive performance vis-à-vis last year and this shows that we were able to recover this category, which is very important for Via Varejo.

You know that the furniture category represents the sales volume, a very important sales volume for the company and we are going back to 17% participation of furniture in our overall business in a situation in which we have technology and cellular phones or smartphones growing a lot as well. So, we are very happy with the strategy that we put in place for the furniture category and we have a bullish expectation for the second half of the year.

We continue to be very focused on the initiatives aiming at the future of the company and I would like to mention three of them. The first one is the acceleration of the multi-channel strategy, focusing on the Click&Collect store pickup that we believe will be a big difference for the company and we see a consistent growth month on month. And we see that all the work that we've been doing is very prudent, consolidation and the implementation of the initiatives that we've designed and that we've already talked about during the last call. We have a very positive expectation regarding this project and we are sure that we will be accelerating very strong the transformation of the company aiming at driving all our competitive advantages, improving our technological platform, our innovation platform, always focusing on the shopping experience of our clients in this multi-channel environment.

Now, I would like to give the floor to Flavio, who is going to highlight a few points of the project that is a major transformation project that we have in the company and for the second half of the year.

Flavio Dias Fonseca da Silva {BIO 18281132 <GO>}

Good morning everyone. In practice, this project with Accenture CLM, CRM, customer experience technology translated into a higher efficiency of our marketing in order for us to make the necessary decisions and the reduction in the development cycle by means of applying this methodology and strengthening user experience, leveraging our assets. As the main drivers are the conversion rate, the frequency of shopping and the items per ticket.

And as Peter said, we are in a very advanced phase of planning and the teams are in place and the business case is finalized and next week, we intend to start execution and also reap the fruit of that in 2017. The expectations are very high and very soon we will be able to give you more details about this thing.

Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

Thank you Flavio. Continuing here about our initiatives aiming at the future of the company and marketplace our focus as I said during the last call, we are focusing on the sellers that have products that supplement our portfolio and that have a work philosophy aligned with our strategy in terms of certain level of service. And I can highlight that the service level of our marketplace has improved a lot and we are very pleased with the work that is being developed to achieve this improvement, then the sales at marketplace are really giving a very major contribution to our GMV and we have been growing consistently in marketplace and we understand that this is an initiative that we have to continue and with very sharp focus on that.

And lastly, we started the rollout of our pricing system. As I said before, this system will allow us to focus on micro regions on stores and we will be able to have a more assertive management of the commercial strategy for each one of the categories. Today we already have 40% of our sales volume running on this platform and as I said before our expectation is that during the last quarter, we will have 100% of our products running on this platform and we will start 2018 at another level of pricing and our expectation is very good regarding the result that we have already seen in the first stage, the 40% of products already running and a positive impact on our margin for 2018.

Now Felipe Negrão will take the floor and he will be talking in detail about our financial performance.

Felipe Corage Negrão {BIO 20496721 <GO>}

Good morning, everyone and thank you for the preference. Let us start by discussing the results and our business perspectives as well. Slide number 3, where we show growth and market share gains in the online and brick-and-mortar channels. The physical one, same-

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store sales going up by 10.8%, double-digit in - since the third quarter of 2013, we have not seen that. And on online gross GMV, growing by 22.5%. Click&Collect already represents 25% of all the eligible products online and it is important to have a loyal and satisfied client with a lower logistic cost and service efficiency which is much higher, and the transaction becomes much more profitable as well.

The increase in gross margin, together with the evolution of the integration of our online activities and the impact of the operating leverage reducing SG&A as a percentage of net revenue, gave us an expressive increase in our EBITDA margin, 5.8%. Adjusted net income pre term of agreement was BRL 19 million compared to pro forma net loss of BRL 488 million in the same period last year.

On slide number 4, we closed the second quarter of 2017 with a high market share gain with a growth of same-store sales of 10.8% and gross GMV, 22.5%. In the brick-and-mortar stores, we continue with our strategy of looking for balance between profitability and sales growth, besides continuing to teach our clients about how to use this kind of channel. Mother's Day and Valentine's Day had a very good performance as well.

And online, we continue with our strategy of optimizing the marketplace platform, trying to reinforce our partnership with the main seller that are aligned with the strategy of our brands, as well as the shopping experience that we want to promote on our website and we still have many opportunities to improve our online operations. And we closed the quarter with 966 stores and 9 stores were closed in the quarter.

Management maintained the focus on the necessary corrections in terms of stores that do not give the adequate profitability and closing these stores.

On slide number 5. We closed the second quarter of 2017 with a gross margin of 31.2%, 270 basis points improvement vis-à-vis the same period last year. And this growth comes from the commercial strategy of both channels and the successful implementation of the multichannel strategy and the increase in the participation of services and financial products in our net revenue.

Adjusted SG&A was reduced by 240 basis points, reaching 25.9% of net revenues. Deduction of SG&A shows that we have a full control of the company's expenses that's relevant impact of the operating leverage with the dilution of expenses. We continue with our initiatives to control expenses and with the multichannel strategy, we expect to optimize more and more our expenses line. As a consequence, we had a growth of 520 basis points in the adjusted EBITDA margin that reached 5.8%.

On slide number 6, the company maintains its sound financial structure. Driven by high cash generation, excellent management of our working capital, the adjusted net cash BRL 742 million increased, BRL 2 million (sic) [BRL 2 billion] (18:38) total. The cash and cash equivalents adjusted by receivables, reduction BRL 272 million and the gross debt decreasing by more than BRL 1 billion.

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And the net income, on the next page, before monetary adjustments, improved resulting from the better net cash, the better average term and receivables. The net income net of the impact of the agreement of the company was positive BRL 19 million vis-à-vis a loss of BRL 488 million in the same period of 2016. Considering the impact of the terms of the agreement, we had for BRL 45 million.

And the acceleration of this agreement was an important landmark for Via Varejo, because it eliminated the divergences between Casas Bahia, Via Varejo, GPA, in terms of contingencies that occurred as well as the implementation of mechanism (19:56) in order to avoid the contingencies these divergences from happening in the future.

The term of agreement still has to be approved by an independent party and the board. And as a result of this agreement, over the second half, the company will be receiving about BRL 70 million from Casas Bahia due to the losses incurred. Also because of the signing of this agreement, we wrote up BRL 96.9 million. And lastly, we maintain the guarantees of Casas Bahia and the Klein Family, Mr. Michel Klein, Mrs. Klein. And also some million reais in real estate that are covered.

And now, we would like to open for your questions, also the mortgage of real estate.

Q&A

Operator

And now, we will now start the Q&A session, so could you please ask all the questions at once. Mr. Robert Ford from Bank of America would like to ask a question.

Q - Robert E. Ford Aguilar {BIO 1499021 <GO>}

Thank you and congratulations for the results. Peter, could you talk about the TV category and if you had any benefits coming from?

A - Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

Thank you for the question, Robert. Robert, we will not able to quantify exactly the amount of the impact of the change from analog to digital. And what we saw was that this category of TV sets, accelerated sales in the second quarter. Therefore, there is a positive impact coming from this change from analog to digital, especially in the metropolitan region of the greater São Paulo where this change was implemented.

So there is a positive impact and we cannot really measure the size of this impact, but the TV category had a good performance in the second quarter and we continue to see a positive performance at the beginning of the third quarter.

Q - Robert E. Ford Aguilar {BIO 1499021 <GO>}

Can you estimate the penetration of digital TV sets in Brazil?

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A - Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

Robert, we do not have this information now or yet, because this is really an issue with penetration. So it's not possible for us to see the size or the extent of this participation, but what happened is greater São Paulo area where this was implemented shows that there is a very big potential for penetration and we are preparing ourselves in order to tap into a major part of this volume.

Q - Robert E. Ford Aguilar {BIO 1499021 <GO>}

Thank you very much and congratulations again.

A - Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

Thank you, Robert.

Operator

Mr. Richard Cathcart from Bradesco would like to ask a question.

Q - Richard Cathcart {BIO 16457807 <GO>}

Good morning. I would like to ask a question about the online platform. Because I was looking at the Reclame Aqui score for client satisfaction. Casas Bahia is improving in the last few months, but still a little bit weak. So could you please tell me how you're solving this problem, what are the major bottlenecks and how soon do you expect to have a score that reaches your competitors that have a better score?

A - Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

Richard, thank you very much for the question. We have a very strong team working on the improvement of the service level of the company as a whole and especially online operations. You are correct. When we look at the Reclame Aqui website, which is the website for complaints and we see an improvement in our score.

But I would like to mention one important highlight here, one important detail. The score that you see when you go to this website, Reclame Aqui, this is the effect of six months, consecutive months of improvement, gradual improvement. And therefore, what you can see is just one initial step of the improvement that would have been implemented.

If you look at our score of last month on the Reclame Aqui website, we see that the performance is totally different from the one that we had before. So our performance is already good in practically all our websites, all our brands, our banners. And in order to answer your question, we do have an in-house target that we're going after. And all the initiatives that we're putting in place have been bringing the expected results. And our expectation or our target is to end this year with all our scores in Reclame Aqui at a good level.

Reclame Aqui means complain here, and that is a little blue face on the website. And when we started this work because of the many difficulties that Cnova had in the past and

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the change in the system all operating problems, we closed that year, last year, in a very bad situation, and we are aware of the fact that we really have to turn this game, and we are working on that, and our expectation is very positive.

And I did not want to go to get into detail about that, because I like to talk about things, when we start to have very consistent results vis-à-vis the changes that we carry out at the company. So I can tell you that we are on the right track and we are sure that things will be different by the end of this year.

Q - Richard Cathcart {BIO 16457807 <GO>}

Thank you very much, Peter.

Operator

Mr. Joseph Giordano from JPMorgan also wishes to ask a question.

Q - Joseph Giordano {BIO 17751061 <GO>}

Good morning, everyone. Good morning, Peter and Felipe. I have a few questions. First, in the brick-and-mortar stores, where you had a significant improvement and you mentioned conversion points and also financial products, and what is your mindset about the return of the stores expansion? What can we expect, if we can expect more areas? And what will be the profile of these new stores? Are they going to be as large as the store inventories or they would be smaller stores?

And second question about e-commerce. You mentioned that the e-commerce is already contributing with margin nowadays. And what is the level of profitability that you are operating with the e-commerce, how much you expect to improve there? Thank you.

A - Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

Thank you, Joseph, for your two questions. First, about the expansion, I mentioned in the prior call that we are piloting two new source models. One that we have called the smart store and another one that we have called digital stores. We have a project of having six stores this year in the smart model. Now, we went up to eight stores there. These projects are ongoing in the implementation stage. We expect to operate all these stores in November this year.

So digital store will be ready for December probably and just one digital store with that digital concept. And I believe that the main short-term expansion potential is there and we believe that the smart stores, which are smaller than the traditional stores of 300 square meters, 400 square meters at the most 500 square meters in area, those will have lower inventory levels and more technology. And we expect that these stores will have a positive performance. And they represent an important potential growth for the company, especially to grow in regions where we do not have a footprint right now and where we have competitive advantage. Because of our infrastructure and all our logistics networks, we can reach these stores then with a lower delivery cost than what we have today.

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And also, we believe these will be main drivers for our multichannel strategy. The store pickup in the national level, so we have a bullish expectation, but we have to have these stores operating, that should happen in November. Let's see how it goes.

About the expansion for this year, that's what we have right now in the pipeline. We are reviewing all our footprint of stores. We are in our third analysis of that footprint and we should conclude that work during the month of August I believe. And if we identify another opportunity something that we are not seeing today, we'll check what can be done. But right now, what we have in our expansion plan as those six smart stores or eight smart stores and one digital and online store.

Now, turning to your second question. We've been talking and discussing internally about that online margin topic and we understand that it is making less sense to discuss the results of these businesses in a separate manner. We are working to have a single and unique company with a multichannel strategy. And we just mentioned the online results for the first quarter because of the great expectation that we all had in terms of that ability of changing the game and having the positive result as we have announced in the first quarter.

What I can tell you is that we're still working consistently. The results are going up, are improving consistently as well, and they have been contributing significantly to our margins. So our multichannel strategy is correct. All our commercial strategy and category management in both channels is going very well. The pricing strategy, obviously, taken into consideration the characteristics of each channel, but already working with the pricing strategy that is jointly that has been bringing important opportunities to improve results.

And you will see that in the second half of the year that is already result of that multichannel strategy. So we'll no longer disclose or talk about margin results of businesses, because it doesn't make sense. What we are going to discuss is the top-line. For the top-line, we'll go into the details. But the contribution is positive and we are very happy about that.

Q - Joseph Giordano {BIO 17751061 <GO>}

Thank you very much, Peter.

Operator

Ms. Paola Mello from Citibank also would like to ask a question.

Q - Paola Mello {BIO 17712227 <GO>}

Good morning, Peter. I would like to know more about the improvements in the working capital. Is that is still reflecting the online operations normalization? We know that when you delivered Cnova, you had a problem in the working capital. Are you just bringing those levels back to normal? Do you have any expectation that current level is sustainable from now on? Thank you.

A - Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

I will turn the floor to Felipe so that he can address your question.

A - Felipe Corage Negrão {BIO 20496721 <GO>}

Good morning, Paola. The adjustment that we have made in working capital for Cnova was at the end of last year. We had the level of supplier that was much higher than what is the evaluation (33:03) practice. So at the end of last year, we were already applying the same practices as we have in the evaluation. We understand that these are the best practices that we have and we should keep that with the same terms for suppliers the inventory levels as well.

Obviously, we might have a few fluctuations because of opportunities. Sometimes, we have an opportunity to buy more or to buy less, that could change a little. But we still have inventory at the same level.

And for receivables, also, today, we see an improvement that is a little bit higher for cash payments. So there was an increase since last year we have seen that, because consumer is more concerned about credit and about loans and financing. So we don't see major changes ahead in neither of these accounts.

Q - Paola Mello {BIO 17712227 <GO>}

And if I can ask you about a follow-up once you mentioned receivables. You have securitized a little bit less than what you were used to do in this half of year. What has motivated that decision?

A - Felipe Corage Negrão {BIO 20496721 <GO>}

Since last quarter, we are aiming the minimum discount possible and the minimum that we need to operate the company. So the expenses we have dropped and also because we had lower CDI, we mentioned in the past that for - every point of the CDI in terms of financial expenses represent BRL 80 million to BRL 100 million a year, and we have an average term for receivables, discounted receivables that was less than what we had last year. In the past we had a policy of higher discount, we end up discounting in all terms, now we have lower portfolio, so we are focusing on the shorter term receivables to discount.

Q - Operator

Okay, clear. Thank you very much.

Ms. Irma Sgarz from Goldman Sachs would like to ask a question.

Q - Irma Sgarz {BIO 15190838 <GO>}

Good morning Peter and Felipe. Two quick questions. First, can you tell us more about the technology used, where you are at? Where do you want to be? What are the next steps

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to use more technology, not only in this new store models, smarter digital but also in all existing stores?

I don't know if you're thinking about mobile checkouts and to give the sales reps with digital tools as well? And another question about housekeeping. About GMV - online GMV, what has been reported last year and what we see in other models is very different from what you have reported now, the growth rate that we would come up to would be very different. So can you clarify that please? Thank you.

A - Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

Thank you, Irma, for your questions, and now turn those two topics to Flavio, he's going to go on to the details.

A - Flavio Dias Fonseca da Silva {BIO 18281132 <GO>}

Irma, about technological advancements, for store experience, everything that we mentioned in the beginning and now also that project with Accenture and the use of artificial intelligence that we commented on in the first quarter using Watson from IBM, they will benefit the experience in all the channels and they will be applied into store improvement.

We also are working hard to relaunch our front-end platforms in the stores. This is a major project that is going at an accelerated pace. This new storefront will be totally web-based and will bring information that will allow the customer a faster selling process and for our employee, for our sales reps an ability to render better services, a quality selling process with products and functionalities that will help them to have a smooth and healthy selling process, meeting the needs of our customers. So that platform will soon be launched and it's really being developed at an accelerated pace.

About GMV question, the way that we have disclosed in the past considered Cnova's criteria that would complement the GMV with several other activities; for instance, a major activity that is not in the current criteria of the Via Varejo, is the wholesale which is very expressive, very significant it was at the Cnova base at last year and because we understood that this is not an activity fully related to the online channel, we do not include that in today's figures. And we do have other activities not as important, but if we sum that up, they were part of the prior criteria, but they are not part of the current criteria. And that's why we have that difference and that has been posted in the brick-and-mortar (00:39:23).

A - Felipe Corage Negrão {BIO 20496721 <GO>}

Irma, this is Felipe. In terms of revenues for both existing online is as GMV as we're not considering and we understand that this is not the best criteria to measure GMV to consider wholesale, okay. The revenue is the online, it's under the online revenue, okay.

Q - Irma Sgarz {BIO 15190838 <GO>}

Thank you.

Operator

Mr. Thiago Macruz from Itaú would like to ask a question.

Q - Thiago Macruz {BIO 16404924 <GO>}

Hello. I have two questions. We see that cash payment is gaining share lately. I would like to understand, if you have a theory that would explain that trend. And about SG&A, you were able to grow it below inflation. And I understand you wish to continue to do so and do you think this is – you can keep on growing the SG&A below inflation or that's going to change? Thank you.

A - Operator

Hello, Thiago. Good morning. About SG&A, we have two important topics there, actually three. We have efficiency projects for SG&A, this is the first one. We are always working on that, this is a routine in retail. We always analyze SG&A every month, we have meetings to discuss SG&A.

Second, is the operating leverage and I believe that in this quarter, because we had that growth that was significant and I believe that tends to maintain, we should be having gains in our SG&A just to give an idea. I am considering the SG&A cost of one-third of total costs and these are fixed costs. So we have a great leverage gain. And third the multi-channel strategy. And also online share in the SG&A, that also allows us to bring down our SG&A.

Now about credit operations. We understand that consumers lately are more aware about credit operations and payment growth (00:42:05), and they are trying to decrease the number of installments in loans for the future. This is happening since last year, this is not something that started this year. We have researched on that. We have seen that happening for a little while and it should continue to – we should continue to see this behavior for a while. Thank you very much.

Mr. Tobias Stingelin from Credit Suisse would like to ask a question.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Good morning, congratulations, Peter and Felipe. You have BRL 167 million of operating turnover because of the agreement, BRL 70 million are expenses related to store closings. So the number of store closings in this quarter was very low, is this from the past quarter, so how this line will progress from now on?

And about PIS and Cofins (00:43:07) has posted the gain, in the first quarter although they have a discussion there in the quarter. You mentioned, but you have not posted that. So what is the difference, how do you see that matter specifically? And if you can tell us and I don't know if Peter would like to address that, and I think he did not address that question. But about the gross margin, how much of that came from e-commerce, how much came from brick-and-mortar? Thank you.

A - Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

Tobias, I'll turn the floor to Filipe, so that he can address the first question and also answer for the second.

A - Felipe Corage Negrão {BIO 20496721 <GO>}

Okay, the first question, we have an amount of BRL 96.9 million for the agreement. I don't have here with me the breakdown of other expenses, but I can send you and we'll get that figure and we will let you know. About the decision of the Supreme Court, what is the issue here, we have a few topics to mention. We have a contingent asset and that is an audit request. This is an important asset, then we depend on the Supreme Court in order to post it. So once this is concluded, we should post that. So it really depends on that, so that we post that in the results and we will discuss how that's going to be posted in the future results. And we have to talk about that with our auditing team.

We are talking about the BRL 160 million as well. We should be able to monetize that amount in around a year. So that would be a credit of PIS and Cofins. And if we maintain our current rates for PIS and Cofins we will have a monetization that, it can be done rather fast. And so we are monetizing the evaluation.

Q - Tobias Stingelin {BIO 18290133 <GO>}

If I can follow up on that so if you monetize in a year you should have a credit of BRL 50 million, BRL 60 million a year, or a month. So you have a first impact of monetizing (00:45:26) so is that a name, is there a name factor in the gross margin? Is that it, so we also have to imagine that your gross margin will increase once the decision is final?

A - Felipe Corage Negrão {BIO 20496721 <GO>}

Just a moment please. The gross margin is already impacted starting this quarter - actually let me (00:45:50) but we already have the impact and the gross margin is positive and when we also have back credit.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Okay, so you're not provisioning any more, you're having a discussion on the past credit.

A - Felipe Corage Negrão {BIO 20496721 <GO>}

Yes. Now I turn the floor to Peter for the other questions.

A - Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

About the margin, in this second quarter, the major contribution - we had margin improvement in both channels but the larger contribution came from the online margin increase.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Thank you. Thank you very much.

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Operator

Mr. João Mamede, from Santander would like to ask a question.

Q - João Mamede

Good morning. I would like to talk about the sales in brick and mortar stores which was one of the main highlights in the quarter, and as you mentioned, you had FGTS money coming in and over the quarter what was the behavior if - have you seen a significant improvement the week or very close to the 11th where we had that FGTS money coming into the economy.

And I know that there is little over a month, the first half of the year, but do you see a trend of a strong improvement till over this beginning of July? That's the first part of my question. And second, I'd like to follow-up on some topics related to the e-commerce and because of Peter's comments on also saying that you no longer want to discuss the business separately. I understand that the synergy capturing of that combination has already been done and if I am right, that has been done in a much faster pace and intense manner than what was expected. And the fact when you gave us the guidelines and the amount of synergies in the peso, I would like to understand that.

Peter, can give us an idea, how much more synergy you were able to tap into with the integration of e-commerce vis-à-vis, what you had, imagine (00:48:15) had estimated in the past that you had inventory optimizations, expenses reduction and so on? Thank you.

A - Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

Thank you for both questions. First about brick-and-mortar sales - brick-and-mortar store sales growth. It was consistent over the second quarter. It's important to highlight that we have two seasonal events that we have seized into significantly, which were Mother's Day and Valentine's Day.

If we compare last year to last year we did - we have a significant share of gains in the weeks after Mother's Day and also in the week of Valentine's Day and our sales went very well, both online and brick-and-mortar stores with a positive share. So, we did have these still impact, so we also had the impact in this quarter of the furniture festival, that was our second furniture festival of the year. We should have a few more in the future.

We worked in a very special manner, we launched new products there. And also we have our the activation of our sales top sellers. And all of that drive significant results in the quarter. And so, once again we have the FGTS release as you mentioned, I'm sure there is an impact in our sales but we today have a clear perception that the impact was not as strong as we would expect in the beginning. And I could tell you that July started well, we are within our expectations, we are growing significantly in both channels and the most important information is that we have growth with margin we are doing well.

Now, turning to your second question, that synergy among companies, you are right. They were faster, they happened faster than what we expected and that was - those synergies

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work much higher than what we expect and that what we mentioned, when we started both business and we're doing additional possibilities and we still have some synergies to talk into after the end of year.

So yes, we have concluded our first stage of synergy capturing, we delivered more than what we expected and we have initiatives to bringing more positive contribution there. The major challenge that we still have ahead is to integrate all the systems, platform both companies, that is the focus that we have right now for the second half of the year. So that we in fact expect to start next year at an operating level that is fully integrated. But the project is going well, we are working on schedule and we have several intermediate deliveries to happen up to the end of the year. I would say that we still have some synergies to tap into they are already mapped and some are in the implementation stage.

Q - João Mamede

Thank you, Peter.

Operator

Mr. Fabio Monteiro from BTG Pactual would like to ask a question.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Good morning everyone. I have two questions about integration, about the unification of the tax ID number, the CNPJ and possible fiscal matters, tax exemptions, what can impact there? And what will be the strategy? And how we should see that integrated in terms of the tax ID number for both companies?

And about freight; your freight revenue is increasing at a very stable steady, a little bit lower than general revenue but expenses increased a lot, the freight expenses went from BRL 110 million to BRL 181 million. I would like to understand. Apparently, this was more in the consolidated results than in the controlling, I don't know, it came more from online and how and how can we think about freight accounts from now on? Thank you.

A - Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

Well. Let me address your first question about the consolidation of businesses and also about the system platform and about a single tax ID number. We already mentioned that we have a tax incentive in Rio de Janeiro State where we have our online business. There their initial expectation was to integrate the tax benefit in the new Via Varejo with the online business already consolidated because of specific aspects related to the State of Rio de Janeiro, but that possibility actually is more complicated. We have an integrated tax ID number and the company is seeing as a new request for that incentive and there is an additional difficulty there.

So, we have reviewed our IT project and today we are already working with the project that we call a multicompany platform; that is, we are going to integrate the systems so that we can work on that platform in an integrated fashion with more than one tax ID

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number. That - because of that we have to extend the term. You remember we said that after the end of the year, we wanted to have the company fully integrated in its systems. And now we are going to have to extend that up to April, but also as I said we have several intimated deliveries happening and the main deliveries about leverage, especially, the shopping experience of our customers in the multi-channel company and the improvement of service level and then integration of the logistics platform.

All of that have intermediate deliveries that will help us up to end of the year, but the full integration of the company should happen by the end of the April, considering this new perspective that I mentioned. So, this is what we have right now. We have changed our strategy to a multi-company platform, because before we had a single platform for the company.

Q - Fabio Monteiro {BIO 3711690 <GO>}

(00:55:43) release. And this where we put the pro forma results including Cnova and Via Varejo and probably you're looking at the expenses in the release and the variation from 2016 to the other is not Cnova, so you have a higher expense. And this year it's without Cnova. So, could you please tell me what the pro forma would be from the operations viewpoint?

A - Felipe Corage Negrão {BIO 20496721 <GO>}

A major part of the synergy gains that we had came from the reduction of the freight costs. Although, we are increasing the leverages from freight, we have been able to have a growing freight revenue with the reduction in the delivery time and also a reduction in the delivery costs. So, this component is very important for us in terms of profitability of the online business that we are implementing.

A - Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

Great. Fabio, thank you very much. Thank you, Felipe.

Operator

Gustavo Oliveira from UBS.

Q - Gustavo Piras Oliveira {BIO 15129435 <GO>}

Good morning everyone. I have two questions, one about the working capital. Your inventory levels are still quite high. Can you foresee a drop in that figure as you integrate your online and brick and mortar businesses or do you think this level will be sustained from now on? This is one question.

A - Operator

Gustavo, let me answer the first question. We still see opportunities to improvement in the inventory levels and we have some initiatives in place, but it's important to stress that we have a very strong view regarding improving the availability of products to our clients. So this is very important information that is having a very positive impact on our sales

online and offline. (00:58:17) reduction in our stock-out, online already works with the stock-out levels very similar to the ones that we had in the old Via Varejo and the drop is very steep.

When we look at the stock sellers, we already have a level of excellence in the company and you know that you need to have a balance there. So we are very much focused on working capital and we still see opportunities for improvement and we have been working with a significant decrease in the level of stock out. So I would say that all-in-all it is positive.

Just to add something that is important. We must always seek efficiency in the working capital. So you have the supplier that has a positive contribution to the cash flow, because you have the inventory working capital ratio. So there is a very positive impact coming from that as well.

Q - Gustavo Piras Oliveira {BIO 15129435 <GO>}

And the last question regarding receivables, regarding that change to cash payments that was everybody's attention?

A - Operator

We could imagine that there - well, I understand that there is not a big impact of the FGTS and you probably had a steep drop in the average ticket.

Q - Gustavo Piras Oliveira {BIO 15129435 <GO>}

If it's true, because I understand that the FGTS has had some impact on a quarterly basis, so it was not very clear for me.

[Technical Difficulty] (01:02:29)

A - Operator

Once again, if we look back - well, we were tracking this since last year, the situation of cash payment, but we checked again and there is a consistent movement in this regard. It is not an impact of the FGTS, because since last year it's not - this is not the reason, because since last year we see a very big trend towards cash payment.

Q - Gustavo Piras Oliveira {BIO 15129435 <GO>}

And what about the average ticket?

A - Operator

No impact.

Q - Gustavo Piras Oliveira {BIO 15129435 <GO>}

Thank you very much.

Operator

Mr. Guilherme Assis from Brasil Plural would like to ask a question.

Q - Guilherme Assis {BIO 16143141 <GO>}

Good afternoon, thank you for taking my question. Could we talk about margin, I think it's very clear that e-commerce is giving a good contribution to the increase in your margin, and the operating leverage of the company. However, I would just like to understand one detail. We see that sales has improved, but the market continues to be a little bit complicated. So how can we get this margin increased per channel?

For each channel with the competitive environment, I understand that there are many competitors that give better conditions and the small players suffer even more. So I would like to know if you have been growing your sales with margin vis-à-vis your competitors and something else to help us understand this margin gain that you obtained. Can you measure the impact of financial services and other services on the margin gain that you had vis-à-vis last year? That would help a lot, so this is my first question. Thank you.

A - Felipe Corage Negrão {BIO 20496721 <GO>}

Good morning, Guilherme. This is Felipe. In financial products and services, we can get the participation of revenue coming from payment book and financial services such as the extended warranty. And the total net revenue would be 19%, basically what comes from this revenue turns into EBITDA because you have commission to sellers et cetera. So all this becomes a gross margin and the EBITDA margin has some variation, but they are not very relevant, in terms of gross margin as a whole for the company. There was an evolution in the brick-and-mortar stores part was very good and the gross margin from online grew very much, or steeply.

The management of the company did a lot of work, and there is integration, so we worked a lot in order to achieve this margin. For many reasons we have more availability of products and we are being able to have a better margin and also Click&Collect, which is a big competitive advantage and we differ from competitors because we are multichannel.

Because the client is more satisfied and he can go and collect the product - pick up the product very quickly at the store and logistics go down, the expenses go down, because it's much easier for you to have the client picking up the products at the store. This is much easier in online, because we want to focus on online, because of all these advantages and when the client comes to the store, we can sell services in a more incentive manner. So, it improves the company's margin as well, because of that.

A - Operator

Just adding to what Felipe said, and your initial remark of the competitive market and many major competitors, many big players, of course, this has a positive impact on our growth, both of sales and margin, because I can assure to you that most of this

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contribution comes from online and you can see that we had an improvement in our prices. So, we did a lot of work in the last quarter to reposition our online prices.

And the second point is that we have a very well-tuned category management between the two channels and we have placed our bids on categories that gives us a better margin of contribution. And you know that growth in sales of smartphones in both channels is extremely positive and in a very satisfactory manner. We are able to grow in both channels without having a very big competition. Thanks to the commercial strategy that we adopted and the category management that we have been adopting.

And to another point, as we said before, is the fact that we have been able accelerate our multi-channel strategy. So, there are many factors that have a positive impact on margin improvement.

Q - Guilherme Assis {BIO 16143141 <GO>}

Thank you very much. What about our portfolio in direct consumer credit, because we can see that it is more concentrated at the over 90 days compared to 10% that was the figure that you had last year? Is it due to the fact that you are selling more cash or have you identified some increase in delinquency levels in your order portfolio? So, I would like to understand this about your portfolio.

A - Operator

What is happening, is the effects of some actions with (01:08:17) assignment we have been more assertive in credit assignment. So this gives us a better portfolio quality vis-à-vis the past, and focusing more on the collections of - once we have a delinquency then what we do is collect in the first few months, and as a result of that, if you look at more than 180 days, because of these two points it is more difficult for you to collect if you got to 180 days. But overall it's very good and we still see opportunities to improve the results from our credit operations. With fee that we charge from the client, we can maximize in reals and even working with a slightly higher delinquency level. So we try to maximize in reals.

Q - Guilherme Assis {BIO 16143141 <GO>}

Okay. Very clear. So we should see a decrease in over 90 days past due, is this what you mean?

A - Operator

No, percentage-wise it increases. And we believe it will continue to be high percentage-wise, but the result will be improving.

Q - Guilherme Assis {BIO 16143141 <GO>}

Thank you.

Operator

Right now, we close our Q&A session. I would like to turn the floor back to the company's management for your final remarks.

A - Peter Paul Lourenço Estermann {BIO 15380447 <GO>}

So, just to conclude I would like to say that the first half of the year has results that reflect our initiatives and projects that we have implemented with a lot of discipline, I should say. And I would like to take this opportunity to thank the team for the work they have been doing, and also to stress that we are fully aware that we have a lot of room to grow. And our main challenge is to accelerate the focus on the activities that will stress our competitive advantages.

We are confident that we are on the right track, and we believe that we are not going to lose focus in implementing what will take the company to a new multichannel integration level. We know that the challenges are many and we are confident that we are going to be able to deliver what we have committed to do so.

Thank you very much.

Operator

The conference call for the result of Via Varejo is concluded. The IR department is available to address possible future questions. Thank you all for your participation, and have a nice day.

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