

Q2 2021 Earnings Call

Company Participants

- Fabio Adegas Faccio, Chief Executive Officer
- Unidentified Speaker

Other Participants

- Analyst
- Andrew Ruben
- Daniella Eiger
- Felipe Cassimiro
- Irma Sgarz
- Joseph Giordano

Presentation

Operator

(Call starts abruptly) (Foreign Language) and winter collections as well as the optimization of integrated inventories have been contributed to very healthy markdown levels, partially offsetting the challenges of exchange rate and the prices of raw material freight. This favors the gross margin, higher level than expected for the period, an evolution of 10 percentage points vis-a-vis the second quarter of '20.

Regarding -- Slide 4, we'll represent our performance in financial services, in which, we reached a low level of delinquency in quarter, reflecting the consistent credit quality. The result was slightly inferior, mainly because of the lower volumes of the financed portfolio due to the lower sales in the previous period.

And lastly, on Slide 7, we bring the adjusted total EBITDA, which was 2.2 times higher on a comparison basis and the same period last year due to the higher volumes sold. It's important to mention that in the second quarter of '20, we had the recognition of BRL735 million, impacting the EBITDA in referring to the exclusion of the ICMS from the PIS and Cofins calculation basis that benefited result in the period. I would like to remind you that this performance also reflected investment related to the development of the fashion and lifestyle ecosystem, the acceleration of digital sales and initiatives related to digital transformation underway.

These were my remarks. And now, I would like to give the floor to Fabio, who'll get into details about these initiatives.

Fabio Adegas Faccio {BIO 19664887 <GO>}

Thank you, Carla and Alvaro. I would like to thank you all for participating and picking up where Alvaro left. I would like to reiterate that at the same time that we work very hard to guarantee the short-term performance that Alvaro mentioned. We do not waive interest rate for the future. In this sense, we continue to advance in the consolidation of our fashion and lifestyle ecosystem, on Slide 8, to offer a more and more complete journey, not only to our current clients, but also to the ones that we intend to acquire industrially. We have been investing very strongly in this construction. One example is that the CapEx -- IT CapEx participation in the third [ph] quarter reached 47% of total, a nine percentage point increase vis-a-vis the same period in 2019. Logistics receiving relevant investments with disbursements increasing threefold the participation from 2019 to this year.

Having said that, I would like to go a little bit more in depth about how we are advancing each one of the avenues of our ecosystem. In the omni front, on Slide number 9, from the viewpoint of digital sales, as Alvaro said, we continue with an important performance, and the online GMV represented 14.1% of the total. This performance reflected investments made in omni-channel, such as UX improvement, increase in sales channels and mainly integration of inventories. All these improvements resulted into more and more qualified and engaged clients. Our active base evolved 89% and retention increased nine percentage point vis-a-vis 2Q '20. Likewise, Renner app approximately maintained the total leadership in MAU among all the national players.

Now, going to the next Slide, number 10. We show the main initiatives in omni. Currently, (Technical Difficulty) the assortment and the depth of the products available to our clients, giving about productivity with our inventory besides LOE, [ph] the higher use of the stores for the last mile in the last few months, about half the online orders contained exclusive store products and this would not have happened if it were not for the implementation of the Infinite Aisle. Likewise, we continue to invest in the expansion of our stores with an even more relevant role in the omni journey.

We opened 27 units in the quarter. And in April, we opened the Guide Shop pilot to offer a fully omni-channel experience, putting together the best in the retail -- in the physical retail with the facilities of digital. And we advanced digital structure of our new omni-DC, which evolved in a relevant fashion in digital -- Pague Digital, the checkout by the client by means of his own mobile phone, accessing our digital portfolio in the Renner app. This modality already represented 7% of sales of the physical stores. And besides reducing the checkout lines, it gives a better shopping experience and help the digitization of clients by means of the store and which helps to reduce the CAC.

As a result of all these investments, the omni client base more than doubled vis-a-vis 2019, driving the potential of our ecosystem once these clients have average frequency and expenses higher than the ones that only buy from one of the channels. And the ongoing investment in the omni journey with a higher scope of integrated platforms and channels brings a higher digitization flexibility to journey, convenience enchantment and, as a consequence, an increase in sales and better productivity and profitability.

Slide 11, regarding the extension of the assortment. We started the lab of the Renner marketplace and its first stage still has quite a few sellers. We started with two, then we went to five and now we have about 50 sellers on this platform, which allows us to learn quite a lot regarding the profile of our partners, optimization of processes and complementarity of our assortment. We have already developed the new interface platform with our partners. And in the second half, we should at least double the current number by the end of this year. In Camicado, we have about 120 sellers and GMV represents 17% of the total and should reach something around 200 partners in marketplace by the end of this year.

On the next slide. In content and branding, we made important strides in the construction of image of digital brand. We increased the partnership with brands, content channels and influencers. We also intensified the lives with more than one event per week, bringing about a higher engagement frequency and agility in communication. And we launched the Ta Online, ta na Renner campaign, reaching 13 million people. We introduced Rennata, our digital persona and the spokesperson of all the release of the Renner brand. And we were the first fashion retailer to be at Fortnite in physical store in the gaining virtual environment. In the quarter, the revenue generated by these actions increased by 41% year-on-year when the -- quarter-on-quarter when strategy was implemented and resulted in a 96% increase in accesses, 98% for online users.

Now, CRM. We see our client base increased a significant (inaudible) investments made. Currently, the ecosystem has 15.6 million active clients, an increase of 22.5% vis-a-vis the same period in 2020. Likewise, another important point is retention with a reduction of 60% in the churn rate on a year-on-year comparison, which shows that we are on the right track, engaging and enchanting [ph] increasingly our clients. We advanced not only in the size of our base, but also the identification of our base with 85% of our sales we identified, which helps us more and more personalized communication with them.

Additionally, our clients are becoming more integrated both in shopping channels as well as in brands of the ecosystem, besides the increase in omni-client participation that I referred to. We see an important potential in the synergy among the businesses once the client who buy in more one of our brands in our ecosystem, we seek to seven times amount higher than the others. One of our objectives is to encourage this behavior in one of the initiatives of loyalty program, which is being structured in an advanced phase and it will be cross brand, serving the whole ecosystem. We will be offering benefits, not only we want to take the benefits but mainly differentiated experiences. Now, we pass to the integration phase with a points of contact with our client in the different businesses, including our Realize fintech, which will be an important accelerator of the program.

On Page 14, financial solutions. Realize also delivered significant evolution in last few months, exploring in a broader manner the entities of ecosystem participating more actively on the life -- in the life of our clients. In this sense, extending offer of products at Renner and also capturing the other businesses, retail businesses, and starting the first operations of financing for sellers and suppliers and testing new lending modalities for clients. The increase of the financial solutions portfolio, it started the pilot of the digital account with a limited number of clients and launched new options for insurance and assistance. As a consequence, the total payment volume, TPV, in the quarter was 32%

higher than the same period in 2019 with a robust base of about 6 million active clients. Our estimates point to this Realize client base has a TPV potential of about BRL200 billion.

On Slide 15, regarding the offer of adjacent services to the core. In July, we announced the acquisition of Repassa, which has operations in the fashion resale. This strategy is aligned to the strategy of the company and is the first inorganic movement in direction, representing another step among other relevant ones that we have ahead of us, and totally adherent with our pillars of digitization, innovation, and sustainability.

Slide 16 talks about some advances in important enablers of our ecosystem. In technology, we continue to reinforce teams and currently we have over 860 people dedicated to our businesses. From March on, we set up nine tribes and we launched 60 squads focused on key initiatives of our ecosystem. In total, we are talking about 600 people, dedicated people, and 19,000 hours of training with agile method that should generate in the next two months over 1,700 evolutions and deliveries to our ecosystem.

In data, we reached new levels. We have over 90 people dedicated to the development of data news to improve decision-making. We evolved the sales forecast model for forecast for the short and the medium run in items, as well as artificial intelligence model for the sale and opening of new stores. A 100% of allocation of basic items is guided to data from Renner. 70% allocated with the use of artificial intelligence with no human intervention. In Youcom and Camicado, we also follow this expansion. We are also piloting the use of artificial intelligence in the process of purchase of products from resale that uses information for sales forecast and level of coverage of -- lead time of the suppliers.

We advanced also ad prices and promotion. This quarter, we expanded the markdown engine pilot, representing 13% of the sales. The engine makes suggestions for the right moment for a markdown and the depth of the discount. And in the second quarter, we started the Camicado pilot. The engine uses public market information and suggest prices to increase the competitiveness of the business. And we're using data to identify with assortment opportunities in 3P and having a better direction and decision about our marketplace partners.

And lastly, on the slide now, I would like to talk about Encantech, which is in-house community of diverse people who cooperate towards using data technology and methodology to create solutions that might generate enchantment and bring forward the attraction of talents to our system. And all that align with the constructions of lasting and sustainable ecosystem.

On Slide 17, we have the main ESG actions in the quarter. Regarding less impacting products, we launched new collections with the RE seal, besides the collection -- a sustainable collection in partnerships in sector with reused or recycled product and we also adhere to Corporate Fiber & Material Benchmark realized by Textile Exchange Organization, of which we are members. And we are the only company in Brazil and one of the two Latin America to obtain this certification. And as of June, we started to support

the Task Force on Climate-related Financial Disclosures, a global initiative that guides the dissemination of companies about climate change.

In the social aspect, for more than one decade, Renner has been -- having the campaign that calls -- that is called Todos Avanzamos Juntos, with funds collected for project for women's empowerment in government. We published an information about the Brazilian Code of Corporate Governance for 2021 with 98.1% adherence, higher than the average of the Brazilian companies. And as a recognition of our action and sustainability, for the seventh consecutive year, we've become members of the FTSE4Good, one of the most important global indices about this theme.

And now let's go to Slide number 18. Then -- now, we go toward the third quarter '21, we are positive regarding the short-term. In July, we had a group of over 20% over 2019 and August is also good with a robust Father's Day. In the warmer regions where we already have items of the spring/summer collection in the stores, we see a very good acceptance of the collection, which reinforces our bullish perception. We are seeing a gradual flexibilization in restriction and the advance of vaccination also contribute. And -- but we continue to pay keen attention to the consequences of COVID-19 and prepared to react very rapidly, should this be necessary. And we are convinced about our future.

We continue to invest in the strengthening of our value proposition to be more and more relevant to our consumers and, as a consequence, continue to gain market share and consolidating ourselves more and more as a leading ecosystem in our segment. We are already the biggest omni player in apparel in Brazil as you can see in the presentation and this chart was based on the information of public players and with a lot of relevant in -- relevance in online. And we continue to be committed to our project based on the ESG Act and by means of sound relations with our stakeholders.

Now going to the last slide, we already have important evolutions in the increase in our client base synergy among the businesses and increase in engagement, stickiness and lifetime value, which shows that we are on the right track. And there is more to come. Our ecosystem has a very big potential that can be explored and we will continue to align organic and inorganic investments and partnerships to accelerate this construction, evolving your business model to enchant our clients more and more, and so that we may continue in the leadership in our segments. So these were our remarks. Thank you very much for your attention.

And now, we would like to open our Q&A.

Questions And Answers

Operator

(Question And Answer)

(Operator Instructions). So I would like to start the first questions, came by audio. So the first one is from Andrew Ruben from Morgan Stanley.

Q - Andrew Ruben {BIO 20391468 <GO>}

Hi my question is around ecosystems. So from the marketplace filing, what services are you seeing have the most demand or how would you determine how to charge them once you roll them out. Thank you very much.

A - Unidentified Speaker

I will translate to Portuguese. (Foreign Language)

He is asking about the marketplace and which are the sale of services that are more demanded. And we see demand for some services and also regarding data to help the sellers in their sales. And very soon, we tend to have many services extended to them, in digital marketing and others, these are services that are being requested by the sellers. And they have been developing a very good work with us. And we are not delivering services to them yet, but we are getting structured in order to do this in the short run.

Operator

Joseph Giordano from JP Morgan. (Foreign Language)

Q - Joseph Giordano {BIO 17751061 <GO>}

Good afternoon, everybody. Thank you for the question. I would like to talk about the expansion model of the company. How do you see the evolution of this model over the last few months? And what is the contribution of this model to your multi-channel operation? And another question, how do you see the evolution of sales over the last few months? Thank you very much.

A - Unidentified Speaker

Thank you, Joseph for your question. In fact, two questions. The current model (Inaudible) allows us in ongoing expansion for the next few years, so that we may go back to the level that we have, and even slightly higher than the level that we had in the last few years, maintaining our expansion target for all the businesses of Lojas Renner S.A. And besides Guide Shop, is a new model which is still a pilot, it's very recent we all -- we opened one store and we will have another pilot very soon. But this is a model that we believe will bring us more penetration than it was in our initial plan. And this allows us to get into market that are smaller bringing a better footprint and bringing a stronger omni proposal. And in your question, I believe that -- well, we have been able to advance both in physical and digital sales or omni, because it's very convenient for a customer to exchange a product in another store and it brings more digital and more store sales. So it's very important to keep and expand this capillary to so to say, this penetration of omni. And it's very early to say anything in terms of figures for Guide Shop, but what I can say is that it's going beyond our plans. --

Operator

Felipe Cassimiro from HSBC. (Inaudible)

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Q - Felipe Cassimiro {BIO 20321618 <GO>}

Good afternoon. Thank you for the question. The first I would like to ask a question about loyalty program, about the rollout for clients. And more details about the types of benefits and how the communication will be? And the second has to do with the lives, Fabio, you were talking about it. What about the development of social commerce? I believe that the lives are more focused on the content, but you have a project to foster specialized discounts or some kind of assortment that is dedicated to these lives.

A - Unidentified Speaker

(Inaudible) Felipe, thank you for the questions. Regarding the first part, I will not be able to answer because very soon, we will be announcing our loyalty program, and how it's going to work and the date et cetera. So in the meantime, we are finishing the structuring part of that. So very soon, we will have more information. What I can say is that, it's a problem for the whole ecosystem to further incentivize cross sell among companies of the ecosystem, which is something very important, and that we see that brings the best clients with better productivity for our ecosystem. Now, in relation to the lives and social selling, we have content lives but also bring about conversion. Some of them are more focused on conversion, but some lives -- they have to be in the interest of our clients' subject and topics that are of interest to our client, and that ultimately, bring about the conversion that is almost a leisure journey, and that becomes a shopping journey. Sometimes at the same moment and sometimes afterwards.

So we bring clients more and more by means of content. And if we think about some time ago, we were the first ones to do live shopping, and then we had the launch of collections once a month and now we are having more than once a week. And very soon, we will intensify this even further. And the conversion of this kind of contact it helps very much. But also it reinforces the brand, it brings more traffic to the website to the platform, it brings conversion, because it is convenient and the clients like it. And this is something that we should intensify more and more. This is what we have been doing. Content with conversion. Thank you.

Operator

Irma Sgarz from Goldman Sachs.

Q - Irma Sgarz {BIO 15190838 <GO>}

(Inaudible)

A - Unidentified Speaker

Good afternoon. Thank you for the question. I would like to know your expectations for your gross margin and for 2022 as well, because we still see some pressures on the side of materials and shipping, international shipping freight. And on the other hand, there are pressures on the gross margin, but on the other hand, there are other initiatives such as services and marketplace that might add not maybe in the very short run but in the long run. It will add to your gross margin. So for the remainder of the year, I would like to know

about the gross margin that you expect, whether they are going to bounce back to historical levels and your estimate for 2022.

Thank you Irma for your question. You mentioned the point that really impacted our margin up to now, and that should still have some effect as you mentioned. Although, the gross margin has recovered vis-a-vis 2019 taking 2019 as a better period for comparison with the current moment, there has been a major recovery already, but we still have a way to go. And the impacts were exactly the one that you mentioned, exchange rate, growth of online, putting pressure on the gross margin so far, but as we said few times already in different moments in our relationships with our investors, we have all our major projects already underway regarding the measures that will strengthen our ecosystem, and we see a very good performance of sales, vaccination continues to grow in the country, which gives us a very good outlook regarding the expectation, and the continuing movement by the end of the year.

And that will have a favorable impact on our sales and as Fabio mentioned, we have a very good acceptance of the new collections, very positive over the last few weeks and the beginning of the third quarter. So besides vaccinations, we have a very good perspective regarding sales in general. And this means that, from now up to the end of the year, we believe that we will be keeping the level of recovery of the gross margin. Now talking a little bit about investments. Investments, as we mentioned in our recent road show, they are being developed very intensively both organically and inorganically as we have been publishing as Fabio said during the opening remarks of this call. And with the development, that should happen in the next 12 to 15 months starting now.

We expect most of these initiatives to be concluded or to be close to conclusion. And this will help us in different points regarding our pipeline and operating efficiency management. And all this, as you said yourself, should bring about good results, good impact. It would be reasonable to believe that, as of 2022, we will see levels of gross margin in a gradual increase in the delivery of initiatives as well as the expected maintenance of a positive scenario in vaccination. And therefore, the movement of people for being able to move about.

Operator

-- from Itau BBA.

Q - Analyst

I have two questions. (Inaudible) We saw a high penetration regarding the digital sales. What were the main factors for that PD[ph] only? This was the first question. And the second question has to do with the marketplace. You are at the beginning of the project, but we would like to understand your experience and the opportunities. What you have been finding in terms of marketplace and sellers?

A - Fabio Adegas Faccio {BIO 19664887 <GO>}

This is Fabio. Thank you for the questions. Regarding omni, this is our strategy and it has been for many years since the end of '17, '18. We have been talking about our belief in the

model, and it has become more and more evident as time goes by, and the clients -- have a much higher level than the others. And the pandemic itself accelerated the transformation of clients that were only offline into omni. And this is a trend and it will continue. Very soon, we expect the restrictions to be even lower, but people liked omni, and they feel safe by online and they like the experience of the omni model which is not exclusively online because they have a physical contact whenever necessary, and they have been online convenience when necessary.

And this makes sense to client and they'd explain -- it increases their expenditures, they buy more. And we see this growth as natural in the participation of omni clients and growing in physical and digital, and this is our belief in our model, and we expect this to continue, because we still have many improvements to carry out and this tends to -- continue to grow. Regarding marketplace, it's very early because we started in May. -- We already have more experience but in --, it's too early. It started in May with a test with only a handful of sellers in order for us to start operating and developing platform and develop connections. And now, we already see some parts that are already developed and prepared by team in order to make bigger strides. We are not accelerating very fast, because want to do this with very good quality, and we want to have our sellers sell our clients, and bringing to the sellers the use of data, understanding what kind of assortment and what kind of seller make sense to our clients, and placing this -- onboarding this to our platform.

And this brings not only sales to sellers and to clients, but also bring a better flow, a bigger flow which also has a positive impact on all of our products. So it's a win-win situation and that allows us to advance such as well as the beginning, it was -- as Andrew asked, delivering other services to these sellers to bring more services to them and increasing their revenues, and thereby increasing our revenues and increasing convenience for our clients. We still have a long way to go. We are not doing this rashly. We want to do this with quality. We want to be agile, but never waving quality. We have about 50 sellers now. And we are ready to get to 100 by the end of the year and then we start to scale up.

Operator

Daniella Eiger from XP.

Q - Daniella Eiger

Good afternoon. Thank you for the question. It has to do with Irma's question about profitability. But talking about operating expenses, the level that we saw in this quarter, do you believe it already reflects the investment -- the recurrent investments in the ecosystem? Or do you still have additional investment to be made in that line? I would like to understand the dynamics of the level that we could expect as normal? Or do you still have some initiatives that could have an impact on that?

A - Fabio Adegas Faccio {BIO 19664887 <GO>}

Daniela, thank you for the question. Regarding the expenses, we can say that the second quarter already reflects -- maybe when we talk about OpEx, a wide range of the

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endeavors that we have made since last year, or mainly since last year but they started before in the construction of these teams related to our project in ecosystem, the construction of the data team, and the reinforcement of the data team and the IT team as well. They have been growing quite extensively in order to meet our demands and all the developments that are underway. And the structure of our new businesses team that grew as well, and they have been working very hard, mapping for our strategy.

So we have a major part of that already reflected in the second quarter of this year. This does not mean that there will be nothing more. We continue to reinforce some teams and they are still processes of development with OpEx, but I would say that, the bulk of that has already been seen during this quarter. There should be additional impact and I would like to remind you as I mentioned in Irma's answer that all the projects associated to our ecosystem project start to reflect on our top line. We should see a balance -- a higher balance as of now and over 2022 reaching the end of '22 at the normal level. That is to say, comparable to the previous margins. Thank you.

(Foreign Language)

Operator

I have a question from the chat. And then, we see there is a communication problem with both. I have a question which is very well aligned with the previous one, --. Given the vaccination, how are the negotiations with the stores and expenses from now on? this is the first one. And the other one is the construction of the new DC, more details about the execution.

A - Unidentified Speaker

Thank you -- for your questions. Over the second quarter, since the '19 as Fabio mentioned in his presentation, when we had almost a 100% of our stores open and the opening hours almost reaching a 100%. Because of all that, people started to go back to shopping centers, and naturally, the process of renegotiations tends to have less flexibility because, of course, it has the impact of the sales variable and the flow of the traffic is becoming normal or going back to normal. So negotiations are different now, different from the pandemic from the -- it doesn't mean that, we are not making our best endeavors, and this is one of the points of attention.

Our agents have been working very intensively in the negotiation processes, and we have been able to obtain different gains in relation to the indexing factors and the percentage of adjustment that should be applied or should not be applied and the negotiations are still going on. And as traffic becomes more and more normal in shopping centers, you can see that, of course this affects our negotiation. But our efforts continue, and this is one of the points of attention, and one of the points of intensive negotiation for us. About the new DC, it is on schedule. We are getting into in almost final phase of the civil construction and the setting up of the net -- and beginning of the automation assembly. This is a very important part. So that, at the beginning of the year, we start the -- and placing the first operational phases of DC.

Operator

Another question --

Q - Analyst

At the beginning of the pandemic, you were identifying -- could you discuss this when you get -- does this affect the capacity to --

A - Unidentified Speaker

I'm apologizing for, it was not very easy to understand the question here. Yes, we were able to improve our model and we have speed of development for production, and the production of each item until it gets to the stores, and we can reduce this lead time more and more in order to be more and more assertive and mitigating this and becoming more assertive. So we are making investments in the -- and in the algorithms and data, artificial intelligence so that we may become more and more assertive regarding the collections and distribution, and what is the best point of (Inaudible) study the technology in order to put together the work of our teams, with the work of our partners with their plants and manufacturing plants so that we can have faster and faster development. And one of the investments that we are making has to do with the development of connection platforms, so that this may become faster and faster and more and more assertive been generating more efficiency in our inventories. The new DC, there is another question here.

Operator

So with that, we have no more questions. So I would like to give the floor back to you for your closing remarks.

A - Fabio Adegas Faccio {BIO 19664887 <GO>}

I would like to thank everybody for the participation. It was a very important quarter looking back. We had a more challenging year with the COVID. So this quarter encourages us very much. And in this quarter, the 18 first days of this quarter, we only had 72% of the stores open. And it gradually improved, and today the reality is quite different. Of course, all the time we pay attention to all the possibilities of the pandemic intensifying, but the scenario is better now than we had for the operation than the beginning of the quarter. And we were able to despite of that to deliver of these figures. Our expectation is good. We believe in our plans, we are sure that we are on the right track and the figures show us that and the data as well. So I thank very much for your attention. On behalf of the whole team, thank you very much. And we will remain available should you need any additional clarification with our IR team and we hope to see you soon in our next meetings.

Operator

Thank you very much for your presence for your participation. And now, let's observe the next month with optimism and always pay attention to the general scenario. But this is the moment of good growth and we continue to be bullish regarding (Call ends abruptly).

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