

Q2 2017 Earnings Call

Company Participants

- Charles André Pierre Desmartis, Chief Executive Officer
- Sébastien Durchon, Chief Financial Officer & Director of Investor Relations

Other Participants

- Andrew Gwynn, Analyst
- Bruno Monteyne, Analyst
- Giovana Scottini, Analyst
- Irma Sgarz, Analyst
- Joseph Giordano, Analyst
- Richard Cathcart, Analyst
- Thiago Macruz, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. Welcome to Grupo Carrefour Brazil's Second Quarter and First Half 2017 Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. As a reminder, this conference is being recorded and broadcasted live on the Investor Relations website. The address is www.grupocarrefourbrasil.com.br/. A slide presentation is also available on this website. A replay of this conference call will be available until August 17 by phone on country code, 551131274999, access code, 61354102.

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Actual performance could differ materially from the anticipated in any forward-looking comments because of macroeconomic conditions, market risks and other factors. With us today in this conference call, we have Mr. Charles Desmartis, Chief Executive Officer; and Mr. Sébastien Durchon, Chief Financial Officer; and Daniela Bretthauer, IRO. First, Mr. Charles Desmartis and Sébastien Durchon will comment on the 2017 second quarter and first half results and provide concluding remarks. Afterwards, management will be available for a question-and-answer session.

I now turn the floor over to Mr. Charles Desmartis to start the conference call. Please Mr. Desmartis, you may proceed.

Charles André Pierre Desmartis {BIO 15118689 <GO>}

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Thank you. Good afternoon, ladies and gentlemen and welcome to Grupo Carrefour Brazil's second quarter earnings conference call. It is a pleasure and an honor for us to be with you on Grupo Carrefour Brazil's first ever presentation to the financial community of its quarterly earnings. I will start with a brief overview of the first half highlights of our performance. Sébastien will then provide greater detail on our financial performance in the second quarter and I will then make some concluding remarks before turning over the floor to your questions. Before commenting on our performance, let me begin on slide 3, with what brings us together today, the successful completion of our IPO on July 20. Grupo Carrefour Brazil became a publicly-traded company in its own right alongside Carrefour Group, which is listed in Paris.

This makes it the first directly-owned retail operation within the Group to have its own listing. The listing of Grupo Carrefour Brazil signals several commitments; first of all, a long-term commitment to Brazil. By listing on the São Paulo Stock Market, we are reaffirming that we are a Brazilian company; secondly, a commitment to the operational excellence, discipline, transparency and rigor that comes with being a publicly-traded company; and thirdly, a commitment to the highest standards of corporate governance as evidenced by our decision to list on the Novo Mercado segment of the B3 Stock Exchange. The successful completion of the IPO is a significant landmark, not just for us but for the Brazilian market. By raising up to BRL 5.1 billion including the exercise of the over allotment option, this was Brazil's biggest IPO since 2013, and Grupo Carrefour Brazil is already among the top 15 companies in terms of market capitalization.

Through the primary component of the IPO, Grupo Carrefour Brazil has raised BRL 3 billion, significantly strengthening its balance sheet. These proceeds will go to reinforcing our financial structure by paying down intercompany debt, thereby enhancing our financial flexibility. Upon completion of the IPO, the Carrefour Group remains Grupo Carrefour Brazil's controlling shareholder with a stake of 71.3% post full exercise of a greenshoe. Península Participações holds 11.5% and the free float is 17.3% conditional again to the full exercise of the greenshoe. Please move now to slide 4, the IPO marks a new milestone in Carrefour's 42-year history in Brazil. Since the opening in 1975 of the first hypermarket in Brazil, we had grown to become the leading Brazilian food retailer in terms of sales. Today, we are present in all 26 states of Brazil as well as the Distrito Federal, and we operated 588 points of sale in the country on June 30, 2017.

We will be reporting out the numbers through three distinct segments: Atacadão, which encompasses our Atacadão Cash & Carry stores and our wholesale delivery operations under the Atacadão brand; second, the Retail segment which groups our Carrefour hypermarkets, Carrefour (00:07:36) supermarkets, Carrefour Express convenience stores, our e-commerce operations, gas stations and pharmacies, as well as our shopping galleries and real estate activities operated by our Carrefour Property division; and thirdly, Financial Solutions, which encompasses our consumer credit activities operated by Carrefour Soluções Financeiras, CSF.

Let's now look at the highlights of our performance starting on slide number 5 with the financial highlights of the first half of the year. Sébastien will shortly talk about the second quarter. Overall, Grupo Carrefour Brasil posted a strong first half marked by continued growth in sales and profitability. Our gross sales stood at BRL 23.8 billion representing a

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9.3% increase over the same period of last year excluding petrol. This growth was achieved despite a strong drop in food inflation in the period as well as a lackluster overall demand against a backdrop of high unemployment and stagnating GDP. Our growth was achieved mainly thanks to our expansion, but also to a satisfactory same-store performance considering the challenging macroeconomic environment.

We posted growth in food and a double-digit growth in non-food sales. On a like-for-like basis, sales were up 5.6% at Atacadão and 3.8% at Carrefour Retail in the first half excluding petrol and calendar effects. Our adjusted EBITDA reached BRL 1.5 billion in the first half up 5% including Carrefour Soluções Financeiras, CSF and up 14.5% if we exclude CSF. We will highlight this repeatedly throughout today's presentation because the Brazilian Central Bank released a resolution at the end of last year implementing changes in consumer credit. This change effective as of April this year, translates into lower interest income from the existing and new credit portfolios. This regulation has a strong impact on our financial operations in 2017.

Moreover, the first half was marked by the initial investment linked to the launch and deployment of the Atacadão credit card, which also had a short-term impact in the first half and will progressively – the impact will progressively fade next year. Therefore, in several instances in the presentation, we isolate this impact to show the strong underlying performance of our Cash & Carry and Retail businesses.

Our bank will offset the impact of these changes through its cost savings initiatives, the transformation of its operating model through the digitalization of processes and the growth of the Carrefour and Atacadão credit cards. Taking into account those impacts at CSF, the EBITDA margin stood at 6.8%, down 20 basis points. Excluding CSF, the adjusted EBITDA margin of Atacadão and Carrefour Retail combined reached 5.8%, up by 36 basis points, demonstrating the strong underlying performance of our Cash & Carry and Retail operations.

Adjusted EBIT stood at BRL 1.2 billion, an increase of 2.7%, with margin of 5.3%. Excluding Financial Solutions, the adjusted EBIT in the first half of 2017 was up by 15.2%. Finally, net income group share amounted to BRL 440 million in the first half. This represented a strong growth of 12.8% (sic) [12.9%] (00:12:21), while margin was up 10 basis points to 1.9%. Excluding CSF, net income for Atacadão and Carrefour Retail combined was up 33.6%.

Let's now turn on to slide 6 to the key business highlights of the first half. The first half was marked by the continued roll-out of our omnichannel multiformat model. We expanded our physical store network with 23 openings of Atacadão and Express stores in the half, bringing the total number of openings over the past 12 months to 65, as traditionally we open more stores in the second half. Of those 65 openings, 12 were Atacadão stores.

We continued with the revitalization of our hypermarkets in the first half, converting another 26 stores to the New Generation model with the number of revitalized stores now standing at 80. The New Generation concept is a complete revamp encompassing not just refurbishment of the store, but also differentiated offers and services, as well as a

modernized customer experience. We also continued the roll-out of our non-food e-commerce activities and our marketplace offer, which now includes 22 vendors signed and already accessible by our customers or in the activation process.

E-commerce sales amounted to about 3% of our total Retail sales at the end of the first half and are gaining momentum. Another key highlight of the first half was the launch of our Atacadão credit card, which we view as a strong enabler of future sales growth at Atacadão and of the growth of our bank's credit portfolio. The card is already offered to our customers in 80 Atacadão stores. The effect of the roll-out of our expansion strategy already show in our performance.

Our total sales growth of 9.3% excluding petrol was mainly driven by expansion and was also supported by a solid performance in both food and non-food same-store sales. Again, considering the challenging environment, our food sales, which account to 82% of our total sales, posted growth in the half, and non-food sales grew in strong double-digits, attesting to the relevance of our non-food offering reformulation initiatives. This allowed us to post market share gains in Cash & Carry, hypermarkets and convenience formats according to Nielsen, demonstrating the strength of our multiformat model in Brazil's challenging consumption environment.

I will now hand over to Sébastien to comment on our Q2 operational and financial performance.

Sébastien Durchon

Thank you, Charles, and good afternoon. We will start on slide 8 with our consolidated Q2 sales. Total sales rose by 10.4% ex petrol, with high single-digit growth in food and strong double-digit growth in non-food. This is a very strong performance given that we are operating in an environment marked by sharply lower inflation. If you look at the graphic on the right-hand side of the slide, which shows the IPCA Food at Home index, you see that in the second quarter of last year food inflation stood at around 15%, while in the past quarter, it was close to zero with a declining trend month-on-month.

Looking at the different components of our sales growth, it was balanced between LFL growth and expansion. Like-for-like growth stood at 4.5% in the quarter, reflecting the inflation slowdown I mentioned. We benefited in the quarter from a positive calendar effect of 0.9% largely due to the fact that Easter was in April this year.

On the other hand, we had a negative impact this quarter of 0.4% linked to a fire that destroyed the Atacadão store in Rondonópolis. Work is underway on that store and we hope to reopen in the fourth quarter. Expansion was a strong contributor towards total sales growth at plus 5.4% in the quarter. This reflects the 65 openings of both Atacadão and Express stores over the past 12 months, but also the successful launch of our non-food e-commerce, which is gaining momentum.

On slide 9, we present a simplified P&L that shows that our underlying business has a strong performance, while CSF short-term profitability reflected the recent change in

regulation on consumer credit, as Charles mentioned previously. Net sales including petrol stood at BRL 11.7 billion in the second quarter, a gain of 8.8% or of almost BRL 1 billion versus the same quarter of last year. Our gross profit was up 9.2% to BRL 2.5 billion. And notwithstanding the CSF impact, gross margin rose 10 basis points to 21.4%.

Excluding CSF, gross margin is up by 90 basis points with both Atacadão and Carrefour Retail contributing equally to this gain. Adjusted EBITDA was up by 3.5% to BRL 827 million. This represents a margin of 7.1%, slightly down year-on-year as a consequence of the CSF impact. However, we saw very strong adjusted EBITDA growth at Atacadão and Carrefour Retail combined. Adjusted EBITDA was up by 20.8% and margin rose by 60 basis points. Net income group share was up 9.9% to BRL 279 million. Growth in net income group share excluding CSF was a strong 32.1% in Q2.

Let's now look in detail at the performance in the second quarter of each one of our three businesses starting on slide 10 with Atacadão. Gross sales were up by almost 10% to BRL 8.3 billion in the quarter. On a like-for-like basis, sales were up 4.9%. This reflects the sharp slowdown in inflation, especially commodities, which represent a significant share of Atacadão sales. For example, one liter of milk sold for BRL 3.10 in June 2016. In June 2017, that same liter of milk was sold for BRL 2.5, a 20% drop. Another example, one kilo of beans was worth BRL 7.5 in June 2016 and only BRL 5.2 in June 2017, more than 30% cheaper.

Sales growth at Atacadão benefited from expansion with 12 store openings over the last 12 months. We continue to see market share gains at Atacadão according to Nielsen. Gross profit rose by 16.9% and adjusted EBITDA grew by an even stronger 27.2% to BRL 497 million. Our gross margin and adjusted EBITDA margin both gained almost 1 point with gross margin at 14.8% and adjusted EBITDA margin at 6.6%. This improvement reflects operational gains such as lower shrinkage and better purchasing terms, but we also benefited from the recent Supreme Court decision on the PIS/COFINS taxes.

In March, the Supreme Court authorized companies to exclude the ICMS tax from the calculation base for the PIS/COFINS social contribution on sales. As a result, we booked in Q2 tax credits for BRL 45 million relating to sales in the first six months of the year, and this amounted to 60 basis points both in gross and EBITDA margins. This reduction in PIS/COFINS is permanent and will thus continue to have a positive impact in the coming months.

I would like to highlight that our Q2 results do not include any benefit from another recent Supreme Court decision that is favorable to corporate taxpayers relating to the ICMS-ST tax. We are currently analyzing and evaluating the impact of this decision on our 2017 results, as well as on results of previous years.

On slide 11, we turn to Carrefour Retail. Gross sales ex-petrol rose by a strong 12%. This gain was largely due to the result of expansion, and notably the impact of two new formats, Express and non-food e-commerce, which are growing rapidly and combined already account for 4.3% of our gross retail sales.

On a like-for-like basis, sales grew by 3.6% ex-petrol and ex-calendar. This is a solid performance given the year-on-year drop in food inflation. This performance was driven by the double-digit growth in non-food sales that demonstrates the relevance of our work on reformulating our offer, as Charles mentioned previously.

According to Nielsen, we gained market share both in hypermarkets and convenience stores, reflecting the relevance of our offer. Gross profit and adjusted EBITDA, both grew in double-digits, with gross profit at BRL 1.1 billion and adjusted EBITDA at BRL 258 million.

Gross margin was up by 100 basis points, reflecting operational improvements in our business. But, here too, the favorable impact of the PIS COFINS decision, which accounted for one-third of this gain. (00:23:43-00:23:48). Adjusted EBITDA margin was solid, growing by 20 basis points, to 6.3%.

On slide 12, we move to Carrefour Soluções Financeiras CSF, whose underlying business remains very strong. Activity of on-us and off-us sales, in other words, purchases made with the Carrefour and Atacadão credit cards in our stores or third-party stores, rose by a very strong 17.9% in the quarter to reach BRL 4.5 billion. In comparison, ABEX (00:24:24) forecast growth of 6.5% for the market as a whole.

The credit portfolio also recorded solid growth, increasing by 9% to reach almost BRL 5.5 billion. However, a new resolution by the National Monetary Council on consumer credit had a strong impact on CSF's profitability in the period. The new regulations limit the recourse to revolving credit to 30 days. For outstanding unpaid balances, banks must propose a solution in installments, which carry lower interest rates.

Net operating revenue reflected the impact of these new consumer credit regulations that came into force in April. As you can see on the chart on the bottom left-hand side of the slide, operating revenue was down 8.3% in the second quarter.

The chart on the bottom right-hand side shows that the EBITDA also reflects this impact. It dropped in the second quarter to BRL 107 million from BRL 198 million in Q2 one-year ago in spite of CSF's strong revenue growth. This reflects three main factors; first, a BRL 38 million impact resulting from the change in regulations on consumer credit; Second factor a BRL 25 million impact from CSF's investment to launch the Atacadão credit card; and third factor a conservative approach regarding provisions on credits, in line with IFRS methodology, which led CSF to maintain an additional provision of BRL 45 million, over and above the amount required under Central Bank regulations. Excluding these three effects, adjusted EBITDA would have reached BRL 215 million, an increase of 8.6%.

Looking forward, we believe that the short-term impact of the new regulation on consumer credit should be offset by the cost savings already under way, the portfolio's longer duration, as well as the continued portfolio growth linked in particular to the ramp-up of the Atacadão credit card.

Let me conclude with a quick look at our balance sheet, which as you can see on slide 13, has been significantly strengthened as a result of the IPO. At the end of the second

quarter, our financial gross debt stood at BRL 6.1 billion, of which BRL 4.6 billion was bank or intercompany debt and the remaining BRL 1.5 billion was discounted receivables from credit cards. But that debt has been almost cut in half to BRL 3.1 billion with the proceeds of BRL 3 billion from the primary component of the IPO. As a result, our financial gross debt-to-EBITDA ratio improved from 1.6 times pre-IPO to 0.9 times post-IPO.

We see the same effect on net debt, which falls post-IPO to BRL 1.6 billion on a pro forma basis at June 30, from BRL 4.6 billion at the end of Q2. Similarly, our shareholders' equity improved by BRL 3 billion post-IPO, and rises to BRL 11 billion on a pro forma basis from BRL 8 billion at the end of Q2.

The improved balance sheet considerably enhances Grupo Carrefour Brasil's financial flexibility to seize opportunities in the future.

Let me now hand over to Charles for his concluding remarks.

Charles André Pierre Desmartis {BIO 15118689 <GO>}

Thank you, Sébastien. I would like to conclude this presentation by sharing with you our view for the short-term and mid-term, and with a reminder of our key priorities for the second half. So, please turn to page 15.

We expect the macroeconomic and consumption environment to continue to be challenging and to be marked by low inflation in food, as well as continued lackluster demand. Already in the first half, we beefed up our productivity and cost saving initiatives in all our businesses in order to address these challenges, without reining in the deployment of our omnichannel strategy. This is because we believe that our omnichannel, multi-format approach is the right one and a key strength for the future.

So, we will continue rolling out this model in the second half. Openings will be mainly concentrated in our Atacadão banner, with the number of new stores for the year in line with previous years, and the Express banner, where openings will accelerate in the second half. We expect to reach our 100th Express store in the third quarter. We will also continue our remodeling program, implementing our New Generation concept in most of our hyper and supermarkets.

On the same slide, you also see an illustration of our expansion strategy with a photograph of the recently reopened Jardim Pamplona shopping mall in the Jardins neighborhood of São Paulo. The mall includes our flagship hypermarket, with a total sales area of 6,300 square meters, a differentiated offer of 34,000 SKUs and a number of technological innovations, including interactive screens and self-checkouts.

The shopping mall, with a gross leasing area of 18,000 square meters, will include 83 stores. We opened the hypermarket and part of the mall on July 27 and the full opening will likely take place by the end of the year. The Jardim Pamplona project is an excellent example of how we leverage our store-ownership model and our real estate expertise to benefit our retail operations.

As you know, Carrefour as a Group is increasingly omnichannel, and Brazil is no exception. Building on the successful launch of our non-food e-commerce activities, we will start rolling out a food offer this quarter, operating from a dark store in São Paulo at the outset.

We are also enhancing our customer knowledge, and we will be rolling out in the second half our Meu Carrefour CRM Program, which will offer our consumers exclusive offers and discounts as well as other benefits. Finally, we will complete the rollout of our Atacadão credit card in all Atacadão stores by the end of September.

We are aware that we will face, in the coming months, the effects of lackluster overall demand, declining food inflation in our retail and Cash & Carry business, as well as the impact of changes in regulation on consumer credit in our Financial Solutions business. However, Grupo Carrefour Brasil has strong medium-term growth drivers in place to consolidate its leading position in Brazilian retail. The results of our latest employee survey show the record-high levels of engagement, and this is our greatest strength.

Thank you very much for your attention. Sébastien and I are now available to take your questions.

Q&A

Operator

Thank you. We will now open the questions-and-answer session. Our first question is from Mr. Thiago Macruz from Itaú BBA. Please, you may go ahead.

Q - Thiago Macruz {BIO 16404924 <GO>}

Good afternoon. My question is about Atacadão. We saw in this half a combination of strong profitability and slightly lower growth. I would like to understand in your mind how is the tradeoff between investing more in competitiveness at a point like this or maybe start operating at slightly higher margins. That's my first question, specifically about Atacadão. And my second point, second question is I didn't understand very well, does it make sense to imagine that you are not benefiting from this tax exemption of the ICMS and that's an additional benefits that may appear in coming quarters? That's my two questions, thank you.

A - Charles André Pierre Desmartis {BIO 15118689 <GO>}

Thank you, Thiago. It's Charles, and Sébastien will answer your second question.

We don't expect significantly in a growth strategy versus profitability, I mean, the improvement in profitability has different factors, operational and tax factors, was not done to the detriment of price competitiveness, so there was no significant change and we do not consider for coming months changing this balance between competitiveness and profitability. Sébastien?

A - Sébastien Durchon

About ICMS/ST, we will recognize it until the end of the year as a result of the Supreme Court's decision. We are working to measure the impact. We need to remind the complex mechanism of ICMS/ST, the tax replacement, in this system, the supplier will charge from the retailer the ICMS tax on the end sale to consumer. So, this is done based on a table state-by-state. We need to look the sales per state, per store, because the final margins can be considered looking at the final margin and calculating the difference with the entry margin given by the tax.

And this calculation is being done, it's being developed and we are doing this very cautiously, of course, all the quality assurance required for us to get to a completely assertive number with the right recommendation to sustain this recognition. So, we will make the best of this, and this will occur from now to the end of the year.

Q - Thiago Macruz {BIO 16404924 <GO>}

Excellent. Thank you very much for your answers.

Operator

Our next question is from Ms. Sgarz from Goldman Sachs. Please, Irma, you may go ahead.

Q - Irma Sgarz {BIO 15190838 <GO>}

Good afternoon. My first question is in line with the comment that you already made during your opening remarks, but I wanted to go back to the consumer point. If you can talk a little bit more about the behavior that you see, from what I heard, you still feel that consumers are susceptible to the price. Do you have an expectation, for the inflation being lower, is going to help in the volumes as you had talked about, volumes that were positive in the first and second quarters. I wanted to hear a little bit more about how you see this considering the inflation outlook and what we should keep in mind for the future and whatever additional comments you may have on the consumer behavior and how they are - if it's still continuing on the down trade, if you could get into the details?

And another question, maybe more for Sébastien about the timing of the repayments for the Carrefour Group in France. If you have a timeline, if this is to be expected for this quarter or the next quarter?

A - Charles André Pierre Desmartis {BIO 15118689 <GO>}

Irma, we don't see elasticity, and we haven't seen in the past three quarters, elasticity in the volume demand to prices. As the reality both for Carrefour and Atacadão, is quite the opposite. Brazilian consumers' behavior with their experience of inflation more than deflation is that they are waiting, they don't buy more today because they are waiting for the prices to lower further. So, our performance in the first quarter was not helped by an increase in volume, an exceptional increase in volume.

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But lower price sensitivity, we expect that this behavior will change. Consumers are buying only what they need and don't replace, because they believe that inflation might grow again. We are not banking on it for the volume growth on the second half, again, our short-term strategy is for that the cost base and competitiveness, the differentiation initiatives in the Atacadão and supermarkets as we described.

The changes and transfers from different volumes of basic supply from Cash & Carry continue, as we have been seeing, and we (00:39:40) strongly in this quarter. But as a group, we managed our two models with the work that we do in the food and hypermarket and reiterate during the presentation, and my introduction and Sébastien's as well about the very positive impact on the hypermarket sales, which also increase the attractiveness, the assertiveness in the hypermarket format for the consumer segments with a low stamina. Thank you.

A - Sébastien Durchon

Going back to the question about the debt, we had the result of the IPO in the 24th of July and we already paid, so this payment has already occurred.

Q - Irma Sgarz {BIO 15190838 <GO>}

Very helpful. Thank you.

Operator

Our next question is from Mr. George Bob (00:40:40) from Merrill Lynch. Please, you may go ahead.

Congratulations on your results. Good afternoon, Charles, Sébastien and Daniela. I apologize for repeating, just when you eliminate some ambiguity. It's incredible how the gross margin, historically, you've been very disciplined in 14% gross margin. How should be consider the gross margin from now on for Atacadão, especially with the increasing competition, with the presence of your competitor?

A - Charles André Pierre Desmartis {BIO 15118689 <GO>}

About the impact of this second quarter, again, we registered BRL 45 million credits of PIS/COFINS at Atacadão, so that reflected an increase of 0.6 percentage points in margins. And the remainder came from sales and improvements in the purchase area.

In particular, we worked in the purchase of commodities. And part of the guidance describes one-third of margin gains are linked to tax advantages and the remainder 70% come from operating improvements, improvements in purchasing condition, lower shrinkage, and a more sophisticated commodities.

Q - Operator

Yes. And congratulations on the advances, they're impressive. But my question is from now on, is this discipline of 14% which will be followed as an inversion of the value

proposition and becoming more competitive?

A - Charles André Pierre Desmartis {BIO 15118689 <GO>}

No, we won't provide guidance about Atacadão's margin for the quarter, third quarter and fourth quarter, but it's an adaptation. When we have an opportunity to maintain our competitiveness and level of profitability, we will do so.

We have the regional opportunities and national depending on the competition conditions regionally or city by city, not only for Atacadão, but the national trade that make way for opportunities, as well as the ability to compete whenever necessary.

Q - Operator

And will you have anything specific and the general credit card operations, if you can talk about specifically the Atacadão cards in terms of penetration, improvement of shopping attendance?

A - Charles André Pierre Desmartis {BIO 15118689 <GO>}

There's two very clear lessons, the acceptance of the cards by our customer. So each store that we open, the ramp up of card sales exceeds by far our business plan. And second, the average basket overall was significantly higher, the share increases in-store sales. But to give you an idea of the share, we need to have some months of roll-out at the store and with the client base holding the cards already, it's significant (00:44:27) to understand what it will mean. But so far, all indicators compared to our business plan are above our expectations.

Q - Operator

Thank you, Charles, and again congratulations.

Our next question is from Mr. Joseph Giordano from JPMorgan. Please, you may go ahead.

Q - Joseph Giordano {BIO 17751061 <GO>}

Good afternoon. Good afternoon, Charles and Sébastien. My question may be on the macro view. I'd like to understand a little bit of how you see the economic scenario per region of the country. I'd like to understand how that compares to a Cash & Carry and Retail. And based on that, if you can talk a little bit about the competitive environment per region to understand, for example, especially in São Paulo with a competitor with a lot of promotions on retail. Thank you.

A - Charles André Pierre Desmartis {BIO 15118689 <GO>}

Joseph (00:45:32), on the macroeconomic level, what we see from the base of purchases and sales region by region, we can't really see a difference, a notable difference in performance. We have a differentiated performance that will depend on the competition scenario or the formats of Retail or Cash & Carry. Of course, some regions

have stronger competition, but what comes from the presence and density of the many formats of the multiple players.

But again, in particular for Atacadão, we have been able to offset harder competition in some regions with opportunities in areas where Atacadão was the leader, which is a strength. And we can't be more specific about the regions. But of course looking at São Paulo, it's a region with strong competition, with strong density of large national players, but also regional players in the Greater São Paulo area in Cash & Carry and Retail that's very strong. But again, we have the strength of Atacadão hypermarkets in the region of São Paulo. That attraction is very good.

Q - Joseph Giordano {BIO 17751061 <GO>}

Excellent. Thank you, Charles.

Operator

Our next question is from Mr. Richard Cathcart from Bradesco. Please, you may proceed.

Q - Richard Cathcart {BIO 16457807 <GO>}

Good afternoon. I have two questions. The first about inflation at Atacadão. You show a chart on slide 8 where the IPCA index for food was 0.6% negative in the second quarter. I'd like to ask if the internal inflation of Atacadão, the growth of average ticket in Atacadão was somewhat in line with IPCA or maybe slightly lower because you have many commodities categories. And my second question about the Atacadão card, at the more mature stores, I'd like to ask you if the customers are replacing their cards with the Atacadão cards or is the Atacadão card is helping bring new customers to these mature stores? Thank you.

A - Charles André Pierre Desmartis {BIO 15118689 <GO>}

I'll answer your first question about the evolution of food inflation at Atacadão. That was the purpose of the two examples that Sébastien gave, the price of milk and price of beans. We said commodities represent a significant share of Atacadão sales, and it was in the commodities, the inflation differential is more marked. So, the differential inflation in Atacadão is more marked than in the other distribution formats or the food IPCA tax (00:49:25).

A - Sébastien Durchon

Now, Richard, it's hard to answer your question because, again, we started the roll-out of the credit card a few months ago - three months ago. For many consumers, Atacadão consumers, the Atacadão card is the first card that they have access to. Many of them didn't have the luxury of replacing another card with the Atacadão card. So, that's why the acceptance rate is high among our customers. The bank applies the same rigor in the approval of accounts as it has been with Carrefour. It's even more cautious in the new regions where the Carrefour cards and the bank don't know as well as the regions where the card already has a performance and history over the last two years. But within three, four months, we will be able to give you a more precise answer.

Q - Richard Cathcart {BIO 16457807 <GO>}

Excellent. Thank you, Charles.

Operator

Our next question is from Giovana Scottini from Eleven Financial. Please, Ms. Giovana, you may proceed.

Q - Giovana Scottini {BIO 20134064 <GO>}

Hello. Thank you for taking my question. I wanted to know about the card division and to what point you see that the credit portfolio can get to, how high, and how should this revenue mix be distributed in on-you and off-you - on your stores and off your stores base?

A - Operator

I'll take the second half of your question. Today, for the Carrefour card, which is the only significant space, we have 70% of sales paid where the cards are on-us, so on Carrefour stores, and 30% (00:51:36). And the off-us sales increased over the last few years. But it's hard to predict the percentage or level of sales, total sales or the total card activity the off-us sales can get to, but it's 70%-30%. Knowing that with the new non-food sales performance at hypermarkets, the growth of the e-commerce, the Carrefour card has new growth opportunities for on-us sales.

So, that means that if the hypermarkets do a good job, as I mentioned, the Carrefour card follows the sales and the dynamics of food sales. Even if the off-us sales continue to grow, this balance 30%-70% on-us/off-us sales shouldn't differ in the short-term significantly. About the total portfolio growth, it's very difficult considering that we are in the first few months of implementing the new regulation from the Central Bank. So, it will depend on the behavior of our new customers. To give you a number, in the past, in the old system of rotating credit, the average financing of the customers of around five months. Now, we divide in 12 installments. So, we believe that this will lead to robust growth for the portfolio in the next few months.

Q - Giovana Scottini {BIO 20134064 <GO>}

Excellent. Thank you.

Operator

Our next question comes from Mr. Andrew Gwynn of Exane. Please, Mr. Andrew, you may proceed.

Q - Andrew Gwynn {BIO 15089439 <GO>}

Thank you. Sorry, my Portuguese is terrible.

(00:54:02)

A - Operator

No problem, no problem.

It's all right. We can read English. Go ahead.

Q - Andrew Gwynn {BIO 15089439 <GO>}

Thank you. When I look at your statements, you have a pretty good increase in - well, very good increase in gross margin, but you also have a very significant increase in SG&A expenses as a percentage of sales. So, I'm just wondering where you expect that to evolve over the coming quarters. And then, the second question is that - I suppose there's a lot of noise around the Financial Services division. It's Q2, what we should expect maybe in Q3 and Q4, sort of similar level of profitability to that or is there an effect (00:54:43) that maybe some of those Atacadão marketing charges affecting them either way (00:54:58)?

A - Charles André Pierre Desmartis {BIO 15118689 <GO>}

We'll answer in Portuguese and you'll receive the simultaneous translation. I'll answer the first question and Sébastien the second. Of course, the expenses increased. There's two factors; operating expenses and more markedly in the Carrefour segment than in Atacadão because of the specificities of the format. As we said, we invest in Carrefour and Atacadão and growth - new initiatives. So there's an initial investment in competencies and fees to launch and roll out these initiatives. Of course, one of the challenges that this environment with a lower food inflation with the expectation of expenses, and people carry the impact of the negotiations from last year that were done based on last year's inflation. So of course there's inflation. In fact, not only personnel expenses, but many services and outsource services and fees.

And one of the challenges for us (00:56:19) on the additional initiatives for productivity, cost savings because those who know our case understand then on - over the last four years the result improvement came from cost savings, productivity much more than any (00:56:42) this discipline, this culture, increases and add to the initiatives. And that applies to the three businesses including banks. So of course, this SG&A increase translates again last year's inflation and the challenges that retailers and wholesalers today had been facing as I said. We are completely aware of this. I won't detail all the initiatives for productivity at the stores but also in the headquarters and the bank.

Atacadão and Carrefour should mitigate the impact of our operating margins of a blended (00:57:31) benefit a strong inflation anymore and the costs that again carry the impacts from last year. About the bank's profitability in the second half, what impacted the profitability were two effects. First, the (00:57:48) impact, new regulation became effective in April, and immediately the interest rate went from 15.99% down to 9.99%. So looking at this regulation, the second quarter reflects the lowest point. And looking forward, we believe that portfolio will recompose with the installments getting to a higher level.

And it will offset in the mid-term the initial impact of this regulation. That's why we talked about the short-term impact in profitability. The secondary impact investments that we're making in the Atacadão cards to offer the card to our customers at stores. We need to have (00:58:43) stores and hire employees to sell the cards. And for that, we need to do all that and the revenue will come later. So again, the heart of the rollout operation was on the second quarter and now there's a little bit more expenses to finalize the rollout for the revenue will start increasing quite quickly.

Q - Andrew Gwynn {BIO 15089439 <GO>}

Thank you.

Operator

Our next question comes from Mr. Bruno Monteyne of Bernstein. Please, Mr. Bruno, please proceed.

Q - Bruno Monteyne {BIO 18250387 <GO>}

Hello. Two questions for me, please. The first one is, are you considering acquisitions to accelerate the growth within Brazil? And the second question is your competitor, (00:59:36), seems to have a much higher like-for-like growth, about 9 percentage points higher. Can you comment on why there's such a huge difference between your Atacadão like-for-like and your main competitors' like-for-like? Thank you.

A - Operator

I will answer the second question first and then the first one. I will not talk about the numbers released by our competitors. There are many effects that may cause smaller competitor with a stronger expansion in particular with the expansion of store conversion to another model. So, the like-for-like is naturally included with this movement. Atacadão, until the end of last year, was double the size of its second largest competitor with a base - much higher base, so each new store maturing and getting into the like-for-like and the impacts of the like-for-like is lower than a smaller player. That being said, of course we are watching very closely.

The move not only of the competitor you mentioned, but all the regional competitors that we've had in the past two years with a strategy of diversifying and implement - investing in this format. Those who were already present accelerated their conversion and others - other retailers also launched the Cash & Carry format and the competitive environment for those formats became much more dense in recent years. Again, we are happy with the Atacadão's performance considering Atacadão's size, but of course also at Atacadão, we have initiatives for competitive differentiation.

To further improve the model for retail clients and professional clients and at the end according to Nielsen as we said, Atacadão over the first six periods of the year gained market share significantly considering the dominating market share that it already holds. Your first question about acquisitions, M&A, of course we look at opportunities in this area in different formats and both models Cash & Carry and retail. Our experience of 42 years

makes us consider all opportunities with vigor and discipline. Disciplined in all areas; discipline in the assessment of strategic fitness; discipline in evaluating prices and values and discipline in the risk assessment for the risks associated to acquisitions in Brazil in an industry where there are many risks and may reach high values.

Last question. Our next question is from (01:03:48) from Banco Santander. (01:03:55) removed his question from the list.

A - Charles André Pierre Desmartis {BIO 15118689 <GO>}

So again, I'll repeat as I did in the introduction. It's been a pleasure and an honor to have the opportunity to present our quarterly result of Carrefour Brazil's results for the first time to our analysts and investors. Our next meeting will be for the third quarter results to be held in the month of November. Our Investor Relations department will give you the dates and details of this next call. So once again, thank you and have a great weekend.

Operator

Grupo Carrefour Brazil's conference call is now concluded. We thank you all for your participation and wish you a good day.

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