

## Q4 2018 Earnings Call

### Company Participants

- José Galló, Chief Executive Officer & Executive Director
- Laurence Beltrão Gomes, Chief Financial & Investor Relations Officer

### Other Participants

- Joseph Giordano, Analyst
- Robert E. Ford Aguilar, Analyst
- Ruben Couto, Analyst
- Thiago Macruz, Analyst
- Tobias Stingelin, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good afternoon, ladies and gentlemen, and thank you for waiting. Welcome to Lojas Renner's Conference Call in order to discuss the results referring to the fourth quarter and the full year of 2018. We would like to inform you that this conference is being recorded and simultaneously translated. The slides of the presentation are available at [www.lojasrenner.com.br](http://www.lojasrenner.com.br), Investor Relations section, also at the webcast and the MZiQ platform.

I would like to remind you that we will be taking questions by telephone and by the platform. We would like to inform you that participants will be in listen-only mode during the company's presentation and afterwards we will have a question-and-answer session when further instructions will be given.

I would like to remind you that questions from journalists may be addressed through our press office and the phone number is 55 (11) 3165-9586.

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

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Investors should understand that general economic conditions, industry conditions and other operating factors may affect the future results of the company and may lead to results that differ materially from those expressed in such forward-looking statements.

Now, we would like to turn the floor over to Mr. José Galló, CEO of the company. Mr. Galló, you may proceed.

## **José Galló**

Good afternoon, everyone. First, I would like to thank and welcome on the web 300 (00:02:45) participants in this call. We are here today in order to talk about the results of the full year of 2018, and before giving the floor to Laurence, I would like to say a few words about this last year, the opportunity that we will be having ahead. Today with me, we have Fabio Faccio, Paula Picinini, and Luciano Agliardi, our Controller.

In 2018, we had a year with major external impact, but also many opportunities. And in spite of the challenges of the first quarter, such as - of the first half, such as the truck drivers' strike and the lower store traffic during the World Cup, combined with the uncertainties in the political scenario, we were able to recover the sales pace, especially in the second part of the year.

We see a major change, a major improvement as of August and that has been consistent now in 2019. In this last year, we inaugurated 55 stores in the Renner, Camicado, Youcom and Ashua formats, and we continue to open stores in Uruguay.

During the process of monitoring the profitability of our stores, such as we do on a quarterly basis, we identified some stores that had - that were underperforming and we chose to close these operations. By that we mean five stores of Renner and six Youcom, but it is important to say that part of the sales of these stores were absorbed by other units nearby and bigger and are better catering to our clients in the same way, however, with a higher profitability for the Renner businesses.

Besides, in 2018, we finished to form the teams that will be taking ahead the three large structuring projects for digital transformation that we described in detail during our Renner Day. We have already started to operate many initiatives such as mobile sales, and at the stores, the use of smart devices for our store operations, bringing mobility and agility to our processes of markdowns and replenishment of products and also inventory and sales management.

With the online control of the sales of each one of the stores, on the products' side, we have already started to pilot the quantification in terms of trend and also sales forecast, as well as the use of algorithms for the definition of mix store-by-store and also model for the more efficient distribution of our products.

Regarding the corporate areas, we use data technology in order to allocate people to stores, and we also launched a totally automated treasury, and we also already piloted the

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use of Blockchain in our supply chain in order to guarantee a better quality and compliance with our suppliers.

We also launched all the new e-commerce platforms for Renner, for Camicado, for Youcom. We implemented click and collect with the collection of orders in all stores in Brazil - all the Renner stores in Brazil, and we are still testing the same-day delivery in the view this enable stores (00:06:59), and we are also bringing lockers (00:07:02) in order to fully automate click and collect and still in 2018 with the (00:07:08) RFID project, which will cause extremely important changes in the efficiency and the productivity of our operations.

And we're already preparing the rollout of that still within 2019 and this will allow us to speed up inventory process, the replenishment of items in the sales area process and also leading to increase in sales. In our Realize, we implemented facial biometry for reduction of fraud, and the self-issue of Renner cards by means of an app, and also a portal dedicated to debt negotiations, totally automated robots with 30% of deals, an increase of 30% in all agreements achieved.

Now looking at 2019, I would like to say a few aspects about this year that has resulted. We will continue to invest wisely in structuring digital projects, focused on our unique view of the client and also improvement with product life cycle seen from the capture of trend to the execution and the last step at the client level. And we will continue also to unify our online and offline channels in order to guarantee an omni-channel experience to all our clients.

And according to the capital budget that we presented, we'll be investing BRL 700 million this year, included the inauguration of 25 Renner stores, included the Argentina and Uruguay units. For Camicado and Youcom, we intend to open 10 stores in each one of the formats, besides 5 Ashua units.

We will be investing in a new distribution center as well and we will be improving our technology systems wherever necessary. Regarding external factors, this year showed a rebound in consumption. All the macroeconomic variables are favorable inflation, lower unemployment, increase in income, and also the reduction of household indebtedness. So, our consumers have a low level of indebtedness and financial credit (00:10:03).

We can imagine an incentive to an increase in consumption. So, we believe it is possible for us to keep our good sales growth pace. Regarding our gross margin, we expect stability as the exchange rate, especially in our winter collection, is not as favorable as it was in 2018.

Now regarding SG&A, we will have the opportunity to have a small dilution in relation to the net revenue. Nevertheless, with the challenge of mitigating the gap between the retail EBITDA margin of 2018, that benefited from non-comparable items and that will not be repeated in 2019.

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In relation to financial products, after a period of fluctuations, our structuring of Realize (00:10:59) and technologically updates and regulatory changes in the card fee, we should see a solid growth this year. And keeping our tradition of low delinquency and a stable gross margin scenario and non-comparable items that played for 2018 - in favor of 2018, we will see a major challenge to mitigate the gap of the total EBITDA margin. And I can guarantee to you that we are and we will continue to be very much focused on internal opportunity on our market position and our value proposals, and also a very strict control of our expenses, which is a characteristic that is to say to austerity (00:11:53) that we have in this company, we will seek the best way possible to neutralize, to offset these impacts in order to maintain our profitability.

Now, I would like to give the floor to Laurence and he will be getting into details about the results that yesterday we disclosed to all of you.

### **Laurence Beltrão Gomes** {BIO 15361799 <GO>}

Good afternoon, everybody. This is Laurence and I would like to say a few words about our performance in the fourth quarter and the full year of 2018. The fourth quarter was marked by the continuity of the good pace of sales that we had in the third quarter of 2018, with the correct execution of our operations and the good acceptance of the high summer collection. In this context, we achieved a growth in our revenue of 17% and same store sales growing by 12%. For the full year, the revenue growth was more moderate in the first half of 2018 and then it accelerated as of August. And the same store sales indicators reached 7.4% in the fiscal year of 2018.

Now talking about the gross margin. In the fourth quarter of 2018, we saw an expansion of 0.4 percentage points. It does reflect our commercial management and the adequate product mix. And for the year, we reached 56.5% gross margin and the growth was up 80 bps, also benefiting from the exchange rate hedge that we contracted for the product (00:13:47) mainly in the first half of the year.

In relation to operating expenses, as expected we had an important dilution of expenses in the quarter and this benefited our operating leverage for the year in spite of the challenges of lower sales in the first half of 2018. Thus, the retailer data of the fourth quarter of 2018 grew by 26% with an expansion of 1.9 percentage points in the margin. For the year, the increase in the retail margin was 1.7 percentage points and this reflects also the recognition of tax credits during the period.

The performance of financial products was a consequence, most of it of the increase in the use of new customer (00:14:44), there was a good quality of the loan portfolio with low levels of losses in the quarter, those results was BRL 79 million and in the year it was BRL 349 million.

Thus, the total adjusted EBITDA was higher by 22%, reaching BRL 743 million in the fourth quarter of 2018, advancing 140 bps of margin. For the year, the total EBITDA grew by 20%, retail margins 23.7% (00:15:20).

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Another highlight was our net income that reached BRL 440 million in the quarter, growing by 33%. For the full year, net income exceeded for the first time BRL 1 billion, with an increase of 39%, which allowed the annual ROIC to go from 21% to 23%.

These were my remarks. And now we are going to open for questions from you. Thank you very much. Now, we will start the question-and-answer session.

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## Q&A

### Operator

Please ask your questions in Portuguese first and afterwards we will be opening some space for questions in English. Our first question comes from Mr. Thiago Macruz from Itaú BBA.

#### Q - Thiago Macruz {BIO 16404924 <GO>}

Good afternoon. This is my Macruz. My question has to do with the strong same store sales that we saw in the quarter - the last quarter. So, could you please clarify and break this down between traffic and assertiveness of the collection? So, are you - would you be able to break this down? And do you have a repetition of this? This was a trend, have you been seeing this either first quarter of 2019, do you expect this to continue at the level that we saw in the fourth quarter?

#### A - Laurence Beltrão Gomes {BIO 15361799 <GO>}

In relation to same store sales we grew 75%, in ticket 45% - 65% and 45%. And it's the good acceptance of the high summer collection, and the change in collections is very important which impacts on the flow as well. Yes.

#### Q - Thiago Macruz {BIO 16404924 <GO>}

What about January?

#### A - Laurence Beltrão Gomes {BIO 15361799 <GO>}

Yes, I'm sorry. I apologize. I missed the second part of your question. Yes, we started January with a good pace and I would say that the breakdown is quite similar to the one that I had already mentioned, maybe 50:50, 50% traffic and 50% ticket.

#### Q - Thiago Macruz {BIO 16404924 <GO>}

Thank you.

### Operator

Ruben Couto, Santander.

#### Q - Ruben Couto {BIO 20636571 <GO>}

Good morning, everybody. You mentioned in the annual report that you had some - many benefits from push and pull, you continue (00:18:46) in the collections. What is the current situation and what is your expectation in order to finish the push and pull initiative? And about Galló's presentation, Galló mentioned, the maintenance of profitability in 2019. What could we expect in terms of EBITDA margin, retail EBITDA margin? Would it be flat or do you expect to have a slight increase in the retail EBITDA margins?

**A - Laurence Beltrão Gomes** {BIO 15361799 <GO>}

Okay. Thank you for the questions. In relation to push and pull, I think it was as planned according to schedule, implementing first day, they can then (00:19:33) roll out to the core products, so everything is according to what was planned in 2018. In relation to the EBITDA margin, I believe that we have positioned (00:19:51), as Galló mentioned. We have some non-recurrent results that were important and that helped the margin this year, and that we will not be seeing again next year. But we will be making our best endeavors to get there and we are very much focused in order to mitigate as much as we can in order to get very, very close to the stability in our profitability in 2019.

**Q - Ruben Couto** {BIO 20636571 <GO>}

And push and pull, when do you intend to finish this in the collection items?

**A - Laurence Beltrão Gomes** {BIO 15361799 <GO>}

Well, we have already made strides, and we will be getting close to the conclusion during 2019, and part of that, the final, final conclusion will be with the start-up of the new distribution center with this new methodology or the full system already in place for distribution.

**Q - Ruben Couto** {BIO 20636571 <GO>}

Thank you.

**Q - Joseph Giordano** {BIO 17751061 <GO>}

Joseph Giordano, JPMorgan. Good afternoon. Could we talk about your digital transformation? I would like to understand e-commerce multi-channel, the evolution of the company, and the contribution to same store sales. And when I look at same store sales at the 55% traffic, how much of that comes from e-commerce?

And I would like to understand the potential for cross-selling in click and collect and the lockers in place in the stores? Are you already identifying cross-selling?

And lastly, when we look at big data and algorithms in the mix of per store and the mix of the collection itself, I would like to understand if this is very preliminary still or is this already part of your day-to-day activities?

**A - Laurence Beltrão Gomes** {BIO 15361799 <GO>}

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In relation to e-commerce, we continue to see an expressive growth in the operations. This year was very important and we implemented the new e-commerce platforms with Renner, Camicado, and Youcom. And our app (00:22:49) with a very positive impact in conversion - on conversion, and it was a major gain as well.

As we said before, we concluded the click and collect in our stores and we have been seeing major synergies of approximately - we could say 30% of sales are collected in our stores. And I would say that 10% is reflected in new purchases with the ticket above 20% higher in these additional purchases. So, we reach the conclusion that so far we can conclude that our omni-channel clients spend more; they are having an experience that has been generating a higher degree of loyalty and additional sales, as just Galló said.

We continue to focus on same-day delivery and lockers. So, this is a very important year in terms of strides. We may get (00:24:18), we have been seeing e-commerce growing more, where we have a physical presence, where we have a brick-and-mortar store mainly in the interior of (00:24:35) and we see high level of synergy deriving from that. I think these are the main points. Have I answered your question or do you need additional information?

**Q - Joseph Giordano** {BIO 17751061 <GO>}

Can you quantify the contribution of same store?

**A - Laurence Beltrão Gomes** {BIO 15361799 <GO>}

As I said at the beginning, we had a very structured growth and today we are growing six times more than the growth rate of the online market for fashion portal. And as you know, we do not disclose a share.

**Q - Joseph Giordano** {BIO 17751061 <GO>}

At the beginning of the call, Galló was telling us about algorithm window to help with the mix and the connection. So, do you already see an impact of that on your figures?

**A - Laurence Beltrão Gomes** {BIO 15361799 <GO>}

Well, in 2018, we said already that it was very important for the reorganization of the structuring project that we had and the definition of the three structuring projects and it was the theme of our Investor Day. But in order for them to start to kick off, we had to organize teams and processes. And in an indirect fashion, we believe that with organization (00:26:24) to kick off the projects has already brought benefits. But we expect the bulk of the benefits to happen as of 2019 or start in 2019 and beyond.

**Q - Joseph Giordano** {BIO 17751061 <GO>}

Thank you, Laurence.

**Operator**

Tobias Stingelin from Citi.

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**Q - Tobias Stingelin** {BIO 20764287 <GO>}

Good afternoon, everyone. During Galló's opening, he talked about guidance for financial operations, because I think I missed something, you are bullish with the growth of credit, but regarding the guidance I have some doubts, whether I understood it or not.

**A - Laurence Beltrão Gomes** {BIO 15361799 <GO>}

Tobias, thank you for the question. This is Laurence and I'm going to answer, although Galló mentioned this. We expect to see more normal situation in terms of financial products. We saw a growth that was a little bit low this year and the comparison base was 2017, but we see this going back to normal. We do not estimate or factor in any change in our methodology to approve our credit models. You know that quite well, you know that we are consistent in terms of credit approval, we have limits.

So, what we see it operations that captured benefits of the digital transformation of a 100% of the credit operations since the credit origination and going to the granting of the credit, the credit assignment and then the maintenance and the recovery, a 100% digital and this brought more efficiency both in origination and in recovery.

So, we believe that with that we will be able to achieve a healthy or quite healthy result, much higher than we had before in terms of financial products, and an ongoing operation with no change in policy mainly as far as credit is concerned.

**Q - Tobias Stingelin** {BIO 20764287 <GO>}

Thank you. In that direction, you're going to accelerate top line again, but from the margin viewpoint, should we see potentially better margins than we saw last year?

**A - Laurence Beltrão Gomes** {BIO 15361799 <GO>}

Tobias, I don't understand. Are you talking about the total operations?

**Q - Tobias Stingelin** {BIO 20764287 <GO>}

No, credit.

**A - Laurence Beltrão Gomes** {BIO 15361799 <GO>}

Okay, only credit. Okay. Okay. Now I understand. In 2019, due to the project that's happened in Realize and the implementation and stabilization of the structures and the setting up of the structures and the project themselves that we had in this digital transformation, we had the expenses that were growing more than our revenue, and this will be reversed next year - next year, we see an operating - we expect an operating leverage in the financial products of Renner area in 2019.

**Q - Tobias Stingelin** {BIO 20764287 <GO>}

You mentioned in the note (00:30:32) the IFRS 16, how do you tend to report this as of the first quarter. Do you have the old financials, the new financials in order for us to know how to think about that?

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**A - Laurence Beltrão Gomes** {BIO 15361799 <GO>}

Thank you for your question. This is a very important question, so that we may already align your expectations. The idea is that in the first quarter we're already working on that heads on and you can even help us over (00:31:08) frequent talks and our interactions, but the idea is to show very clearly a comparable result. It is important for this change not to have a cash effect or fiscal effect, in fact (00:31:24) the impact on the balance sheet only. So, I believe that we will be adding or integrating these lines with the adjusted EBITDA in order to make the comparison of the results better. So, the ultimate objective is to preserve comparability in a very transparent fashion. And we will be showing this as best as we can and showing all the differences.

**Q - Tobias Stingelin** {BIO 20764287 <GO>}

Thank you very much.

**Operator**

Robert, Bank of America.

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

Thank you and congratulations for the quarter. Let's talk about Argentina. Could you say a few words about Argentina, how many stores and why Argentina?

**A - Laurence Beltrão Gomes** {BIO 15361799 <GO>}

We decided to test our model and we chose Uruguay because of the advantages that we mentioned, the local GDP, proximity to traffic, proximity with our headquarters, and the ease of going there back and forth and our distribution center, low inflation. And it was quite successful because we saw that our position was very correct, and when I say position, I mean fashion, quality, price, so much so that we had the results that was 40% to (00:33:26) 50% higher than we estimated at first.

And when we went to Uruguay, we made an important investment in systems, BRL 20 million. And, of course, this would be a preparation for us to operate in other countries, in other currencies in order to tap into all these investments made then return on to Argentina.

And many markets (00:34:02) why not Argentina? So, we looked around and we have been evaluating and looking at the market for quite some time, large consumer market, 44 million inhabitants, the Greater Buenos Aires has 13 million inhabitants, and many cities, 25, 26 cities with over 200,000 inhabitants. And the average age of the target is close to ours and we have (00:34:45) tool of bringing our products there and our brands are very well known because many tourists from there come to Brazil to Santa Catarina and other states of Brazil, and we saw the acceptance of our products in the stores that we have with the borders with Argentina. We went there. We talked with government officials. We talked with economists. We talked with retailers and local industrialists to learn about how to operate in Argentina.

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Of course, we are not going to hide from anybody that there is a high volatility in Argentina. However, the major message that we got from Argentina is that if you want to go Argentina, if you want to stay in Argentina, you can have very interesting results. And even - we've talked even to some Brazilian companies that are established in Argentina. So, we decided to choose Argentina. So, we have two stores in Buenos Aires, one in Córdoba (00:36:11) that we are opening in Argentina to start. And the experience is going to be quite interesting.

And we believe that there is a very good potential there and that we actually would be continuing there, because we were able to achieve good deals regarding the locations. The risk is not big and on the other hand the opportunity is big. So, this is why Argentina.

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

Thank you very much. Very clear.

**Q - Operator**

Could you talk about the perspective for - I think you said e-commerce result (00:37:00) is very bad, (00:37:01)?

**A - Laurence Beltrão Gomes** {BIO 15361799 <GO>}

(00:37:16) ask him to ask again. We had an extraordinary result in same store sales. I think the gentleman mentioned Youcom, but it's very difficult to understand. Well, this is Laurence. I think you're asking about Youcom. If you're talking about Youcom, the second half was different for Youcom as well. We've had some adjustments that we decided to carry out and have more promotional activities to have a very quick change in our collections.

And as a new business, we are still looking for the - the second half was already different than the fourth quarter and the outlook for 2019 is okay, we made adjustments to the operations and we made some changes also in processes and management. And we are confident that Youcom will bring good news in 2019.

**Q - Operator**

Thank you and congratulations.

(00:38:57) from Goldman Sachs.

Good afternoon. Thank you for the questions. We have two questions here. Your fixation for gross margins for Camicado, because you have seen your margins under pressure and the average days - inventory days, what about the impact of that on working capital in the first quarter of 2019. So, these are my two questions.

**A - Laurence Beltrão Gomes** {BIO 15361799 <GO>}

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In relation to the Camicado gross margin, we saw the year - mainly in the second half of the year, we saw competition was higher, was stronger, so more commissions (00:39:48) because of that. So, we made a decision here to adjust our competitiveness because of this situation. So, we adjusted our position vis-à-vis competitors in terms of prices in this period. I think in Camicado we still have the opportunity of product mix and the participation of imported items in the mix, and we see some recovery and some stability in the Camicado margin for 2019.

Regarding your second question, the inventory and the inventory days, as we have been saying during the year and the same in the first half of last year, we said that we would end the year with a growth in inventories, very similar to the fourth quarter and the growth is aligned with the growth in sales in the fourth quarter. However, we made a decision to bring forward some imports. So, we increased our imports with a growth of 39% in imported items. So, we continue to focus on a normal situation, although inventories grew more than our sales, the age and the quality are very good, they're very young. So, there is nothing different from what is normal in terms of margins. So, we are very comfortable with that. And part of our strategy was for the first quarter to - for us to have an inventory well prepared for the end of the year and the turn of the year registering to (00:41:59) 2018, 2019.

## Operator

The Q&A session is closed now. We would like to get the floor back to Gomes for your closing remarks.

## A - Laurence Beltrão Gomes {BIO 15361799 <GO>}

Once again, we would like to thank you very much for your attention. And as always, we continue to be available to you if you need any more specific clarification if you wish to contact us. And I think it's important to remind you that on April 18th we will have our general shareholders' meeting. And we will be available by means of our Investor Relations area, and it is very important to have your participation in this meeting. And as this is the last call of last year, the first one of this year, we are very much motivated by everything that we have already referred to.

We see that the company recently go in major in-depth transformation in technology using all the digital tools and very much advanced in these efforts. And there is no doubt whatsoever that the results of all these endeavors will happen as we develop digital. And as a synergy, that is already happening between online and the brick-and-mortar stores.

I personally - I was extremely impressed when I learned that in a very short time, we were able to get to 30% of our sales online and being collected in the stores and those leading to cross-selling. And we are very comfortable today in relation to the usability of our website about our brands and further improving them in terms of content. This is an ongoing thing and there are so many things happening here at Renner and that will ultimately bring about very interesting results in 2019. So, thank you very much to all of you for participating.

## Operator

Lojas Renner's conference call is closed. We thank you for participating and wish you a good day.

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