Q1 2019 Earnings Call

Company Participants

- Felipe Coragem Negrao, CFO & Member of Board of Executive Officers
- Peter Estermann, CEO
- Unidentified Speaker

Other Participants

- Gustavo Piras Oliveira
- Irma Sgarz
- Julia Faga
- Tobias Stingelin

Presentation

Operator

Good afternoon, ladies and gentlemen, and thank you waiting. Welcome to Via Varejo's Conference Call to Discuss the Results for the First Quarter of 2019. This event is also being broadcasted by a webcast, which can be accessed at www.viavarejo.com.br/ir with the respective presentation.

The slide selection will be managed by you. There will be a replay facility for this call on the website. We would like to inform you that the company's press release is also available at its IR website. This event is being recorded and all participants in a listen-only mode during the company's presentation. After the Via Varejo's remarks are completed, we will initiate the Q&A session went further -- information further information will be provided. (Operator Instructions).

Before proceeding, we would like to let you know that forward-looking statements made during this conference call are based on the beliefs and assumptions of Via Varejo's management and on information currently available to the company. Forward-looking statements are not a guarantee of performance as they involve risks, uncertainties and assumptions because they are related to future events and therefore depend on circumstances that may or may not occur in the future.

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

Now, I would like to turn the floor to Mr.Peter Estermann, CEO of the company..

Ladies and gentlemen, please hold the Via Varejo's conference call. We will return momentarily.

Unidentified Speaker

Mr.Peter Estermann, you may proceed sir.

Peter Estermann {BIO 15380447 <GO>}

Thank you very much and we do apologize for the technical inconvenience. And I would like to start by welcoming you to our earnings release call. I would like to start by highlighting some of the most recent initiatives, we are deploying in the company, especially those related to these strategic pillars that we talked to you about earlier this year.

The first top -- topic refers to improvements in our top-line, based on a commercial strategy, also marketing and category management, which has been more efficient and I'll give you some highlights in a moment. The second pillar involves the improvement of our operating efficiency you may recall that last year and early this year. Our operating stability was quite improved both in brick-and-mortar and online operations. And the third pillar refers to cost adjustment, that would not have an impact on sales or even in the service level rendered to our customers.

Now looking at our commercial strategy. I would like to say that all of the actions that have been defined earlier this year are being implemented according to plan. And in our brick-and-mortar stores, we already engaged in a process of five -- fine tuning of the strategy and when I refer to fine tuning, I mean to say that in April, we are implementing a well-structured research -- regionalized plan that will help us to leverage our margins further.

We also have a better competitive position in the market. This month also we started operating with our category management focus in some categories, so that help us both in terms of customer traffic and margin improvements. Then I would like to emphasize our furniture management approached and that we do have material, which gives us a competitive edge.

Our position is such as being the most important retailer in that category in the country. I would also like to highlight that our planning to increase the share of this category in the company's total sales it's something that is been happening according to plan. And this month of April, we began having some participation in the sales of furniture, in the total sales of the Via Varejo and levels that were very similar to those that we had in 2017, when we experience a significant recovery. And this is a category that has an important impact on our margins.

Therefore, we will continue to expedite all those of the initiatives that are being deployed at the moment in our expectation is very positive in the second quarter vis-a-vis the activities that I just mentioned. As an example, also I would like to mention our more earmarked focus in terms of the management of our electronics and home appliance equipment, because they generate more traffic in the store and more attractive margins.

In April, we already experienced a very significant increase coming from that category. And we continue focusing on our white line category and telephony. Telephony is that category that will merit special attention still in the second quarter, because we are still going through the adjustment phase, which will allow us to get better adjusted to the fact that we do not have the Lei do Bem anymore. And this is an important category both online and in the brick-and-mortar stores.

Another aspect, that I would like to highlight in keeping with our commercial strategy is that as of now, we begin paying more attention to the fact that we want to add more categories to our base. Especially, those categories that not only will add more revenue, but will add revenue with a more positive margin.

In terms -- this is what we have for operating efficiency, we've been operating in brick-and-mortar stores is off March 15, with a better operating efficiency, which are at the same levels as in the -- at the end of 2017 and early 2018. Because at the time, we had to deal with the integration issues. But now, I can certainly tell you that, the brick-and-mortar operating efficiency is no longer a concern of ours in this quarter.

Another important point that is no longer a matter of concern is the stock out. I think, stock out means, that we always have further improvements to make both online and in brick-and-mortar stores, but, we reached a certain level today, that there's no longer effects on our sales performance. And so this quarter, our inventory is much better adjusted and much better balanced. And is more suitable to fit our operating strategy and commercial strategy.

As for the online operations as I mentioned earlier this year, we still have more room for improvement in this quarter. The first quarter had important developments, but we are not yet operating at an adequate stability level in our view. But I believe that the positive message is that in the last weeks, we were able to see that our operating levels are much better and very good are much better than what we had in the beginning of the year. For this quarter there is still other adjustments in progress and some are still in place but, we hope that by the end of May, we will be able to cover the aspects that are still pending.

In June, we still have some additions to make, I would like to remind you that on June 30th, we will then have the total integration of our online and brick-and-mortar platforms. And with that, a series of small adjustments that are still necessary will be in place.

So on the third quarter for the online business, we will certainly be operating at a different level when compared to the levels of the last quarter and the first quarter of this year. Therefore, we are very positive in terms of the performance of this operation we are well structure, we keep weekly tracks of all of the activities that are being implemented. And all-in-all, we were able to execute according to plan.

In regards to operating stability. I must say, that in the brick-and-mortar world things are well in place and adjusted. And in terms of the online business, as I said earlier this year on the third quarter, we should see different figures when compared to the levels of the past.

Another aspect I would like to mention, related to SG&A or general expenses. Our plan towards cost reductions I think, you may recall that we said that we will focus on cutting expenses, that would not impact our sales or would have no impact on customer experience. So all of the initiatives, that we had mapped out for the first half -- first quarter or

(technical difficulty)

Questions And Answers

Operator

(Question And Answer)

We change our marketplace platform or made several adjustments during the second half of the year and so today the platform operates at a much better level when compared to the old platform. Not only that, we review some of our processes and also, we change the way we hire sellers and therefore today, we have a better relationship with sellers, we can bring them onboard our platform, and the relationship with them improved substantially.

Therefore, I think, it's a combination of things involving improvements in the platform, improvements and processes and better management of sellers. In all of that combined can give us much better results. And as I said before, there in the 1P platform, there is still some necessary adjustments to be made in terms of the operating adjustments. And we will promote the integration of our online and brick-and-mortar systems until the end of June.

And with that, we will be able to eliminate the impact and be able to make further improvements in the online platform. The expectation is that 1P should also post a significant improvement in this quarter. Reinstating that, in Q2, in terms of operating instability, we will be operating at a much better level, when compared to what we had earlier this year.

We still have challenges to cope with online. We have the challenge to -- towards making adjustments in competitiveness in implies -- price competitiveness and we already started looking at that very very focus in April.

A - Unidentified Speaker

Mr.Gustavo Oliveira from UBS has the next question.

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

Hi, Peter. Thank you for taking my question. Few related to gross margin. I would like to understand your credit and service evaluation. These are products with higher margins and you also said that your sales were not so good in the first quarter. But I think that, credit and service is something that has been stagnated for over a year. So, what do you intent to do along these lines?

A - Unidentified Speaker

Thank you, Gustavo. Let us begin talking about the easiest part. Credit is evolving significantly. In Q1, in CDC, our share increased greatly vis-à-vis the previous quarter. And, we're also continuing our platform. You may recall that our credit platform by the end of last year, was very unstable and now is fully stable again. There is an impact not only of the stability of the platform, but also initiatives that were made in the operation.

In terms of bringing more proposals to the negotiation table for CDC and also the efficiency of the credit platform. So there was a very positive impact. In other words, CDC is improving.

As for financial services, there was a negative impact in Q1. And this impact is pretty much related not only to operating efficiency, but we have a very similar to what we had in the past. However, the category mix also had a significant impact on service efficiency in Q1. So it's nearly 100% related to the category mix. As you know, penetration on financial services in some categories is different from the rest. We don't get into this level of detail in this call, but rest assured that the drop we saw in financial services in Q1 is related to product mix.

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

So you related to extend that warranty basically?

A - Felipe Coragem Negrao {BIO 19434019 <GO>}

Felipe speaking. Like Peter said, and I confirm what he said, mobile, for instance, had a drop in share and also insurance of that and damage to mobile, which is also important to improve the share of services. And it has an impact on mobile as on a consolidated base as well. There is a reduction in the share of services portfolio into the mix.

Today, in the industry, when it comes to service penetration, we are the best in the industry. We are a benchmark in the industry. So this change in the share and the product makes may change. As for CDC it's started back in 2016, year-over-year, we are increasing our profitability last year we had a record income and we are improving a lot, compared to the record last year.

If we think about the bottom line of the company, think about the money in terms of profit and money to the company. It is true that there than impact on gross margin. One of the things we did last year, was the good down on credit. So, in terms of gross sales revenue, whatever I got in credit last year, now we have lower interest this year. And that's why there is an impact and gross sales revenue, but that's very positive to the company and once again, in the current quarter would have the best CDC result in the track record of the companies. This reduction in gross sales revenue what is more than offset in PDA and financial and collection.

As revenue, -- and if you think about a share of CDC it has increased. This higher share will bring results in the coming years. Based on previous experience, if we think about our current portfolio, we have models like no other bank, this is knowledge, our own expertise about these customers. As for new cases, it's right, we could improve our credit assignment operations and we've been working hard in recent years. And our after pilot studies, we managed to have a new credit model and we also have the approval rate, which increase to our customers and there's will bring positive results down the road. And that is why one of the reasons why we have a higher share of CDC.

In addition, to stores which also had an improvement in CDC So, we are better positioned in CDC, overall speaking and we are very optimistic about the future.

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

Thank you, Peter. Thank you, Felipe.

Operator

Julia Faga from Itau has a question..

Q - Julia Faga {BIO 20865300 <GO>}

Good afternoon, everyone. My first question is a follow on to Richard's question. I would like to better understand the integration online, offline Glenn to the end of June. Is it going to start at full speed, so by the end of June be able to run all the disease with these operations and everything that we mentioned before, in terms of gains, of synergy in both operations.

In addition, I would like to have more color about brick-and-mortar operations that are pretty more stable starting mid-march. So could you give us more color about to what extent it has improved? It would be really helpful. Thank you.

A - Unidentified Speaker

Thank you Julia. First point about integration of online and offline. Let me mention two core aspects. This integration that will perform by the end of June has two important parts. The first part is the capital integration and it's immediately after the integration of the platforms. Then we have the operation or integration. This integration will also happen immediately after June 30th, it will start on July 1st. But it will also take adjustments to our own operations, so we can really deliver a 100% of the fully integrated operation. It doesn't happen overnight. It's still take further adjustments. But it's important to say, that the capital integration should happen. This is the core point, it has to be a 100% operational, s4o the capital integration happens. Involved in inventories as well at a company level. Like I said, we have very much on schedule and as we speak, we don't see any red lights with regards to any initiative about this integration. But I repeat, integration of systems in a company as big as ours has to be followed that until the very last day. But up to now everything is very positive. So the answer is yes. Full integration of the 30. But in order to have all initiatives of Omni channel, potential operations, it will take a lot of lessons to learn and adjustments in the second half of the year. We started at a very different level with fewer manual interference compared to what we have now in the company.

With regards to your the second question. Brick-and-mortar stores when it comes to integration of brick-and-mortar stores and also their performance. And our expectations for the second and third quarters everything is pretty much in line with our expectations. We have already eliminated, so to speak important aspects, related to operational instability and we also brought to an end all the problems related to the stock out and we are fine tuning our commercial strategy. The whole sales force is fully aligned with our strategy. Therefore, we have to deliver better results coming forward.

Q - Julia Faga {BIO 20865300 <GO>}

Thank you. Perfect.

A - Unidentified Speaker

Tobias Stingelin, Citi Bank has a question.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Good afternoon, Peter and Philippe, with regards to integration online and offline. If we think about gains, -- potential gains, do you have anything to share with us or of these gains. You mentioned that is a capital aspect, tax aspect, maybe it's easier to reach as for operations, is only natural to expect a transition a challenging transition. Is there anything you might disclose about this?

Second point, now about SG&A more specifically, I think, we had a very great job here. Could you assume this is recurrent, not been one-off event that will never happen again, the 108 million for answers is off the accounts. I can't presume and assume it is one off. So, want to know about integration gains and then recurrent as SG&A or not. And finally if I met a last question. If, I think about a breakdown online and offline, when you think about net sales revenue there is a significant drop online more than 30% quarter-over-quarter, which is very different compared to grow sales revenue. Is it related to tax? Could you give us more color? Thank you.

A - Unidentified Speaker

Thank you Tobias. Let me begin by addressing SG&A. You're right in your assumption. Excluded is one-off event was we had in the first quarter. It is a recurrent result. Actions implemented and that will be recurring in the future, no risk of not capturing it, as SG&A is on the right track. As for integration, the main benefits and advantages, that will reap stemming from the total integration of the platforms is (Technical Difficulty) right the integration, but it will move faster, it is the possibility of customers by an online and returning a brick-and-mortar stores. It still take some processes and training, we are already working on this. At this will allow us to reach the results in a couple of months. Not immediately after the integration, so everything related to MOVVE channel, everything related now that we can deliver all inventories we can be more agile and also bring more visibility for brick-and-mortar stores in order to manage online in the time. Felipe is going to answer your line question.

A - Felipe Coragem Negrao {BIO 19434019 <GO>}

Good afternoon, Tobias. Let me just add two things about SG&A. Except for one-off events, the rest of the recurring. We might have other one-off events, further down the road and other initiatives as well. With still working on new initiative to lower SG&A We always have agreements with a fixed term with acquirers. We terminated in late March, and then we had a big -- and a bit and had a very good reduction. In Q1 there was a small impact, because it was only a couple of days, but starting the next quarter Q2, we began to see a positive impact on SG&A and a couple of other things as well. So we can improve the picture.

As for the integration. In addition, to what Peter mentioned what are the key aspects about the core of the business that are another two aspects. And financially speaking, they also have an impact, one of them is tax monetization. Once I integrate Cnova with the Via Varejo, if Via Varejo can have faster monetization, particularly these offerings because Via Varejo has higher payment of these offerings and our credit would come to an end fast, in a couple of months. And seek over takes all the credit we can use. As for personnel, expenses, administrative matters, we still have to include in the system.

And at the end of the day, there will be big gains. We're not only talking about managers, but also analyst people who make less money but, they also imply some gain.

There for invoicing. If you think about the integration for June 30, we are transferring more and more to the Via Varejo. If you think about TR [ph] we have account in methods. We have the origin and Cnova but using Via Varejo's inventory and invoicing eventually migrated into the Via Varejo. And that's why your lower a county invoicing had seen over and transferred to the Via Varejo as a result. So this is the main impact, we see in invoicing.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Great. Just a follow-up question. Peter, you mentioned that considering the magnitude and the size of the company. It is not easy at all to work on integration we saw that last year. If, I understood you correctly, online and offline, if we consider all the projects, you have now ,and whatever you are monitoring.

Do you think, they will be tough to see something or heart to see something that will impair the operation. So what is the risk? I assume to risk will be lower.

A - Unidentified Speaker

Tobias, every Monday we spend one hour and a half at least discussing all the possibilities of systems integration and operational stability. When it comes to monitoring out and level of detail about this product. We are really-really keen on this. What I can tell you right now, absolutely certain right now.

As we speak there is no risk mapped, which might affect any kind, any type of operations in the company. This morning, we had a special meeting specially to talked about integration and the performance of the systems platform. The system is very much focused. And I repeat, the confident level is very high in the sense, that we once faced any problems. And once again, we'll keep on monitoring. We keep on monitoring it very closely. And obviously, if any rest lights turns up, we will have to move our direction. But as you speak, as of see anything that could change our planning.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Wonderful, thank you. Just on last question. You already answered about sales that the trend would be better now. But at the same time, if you think about the macro view, that is not sustainable what about traffic? What is your feeling right now?

A - Unidentified Speaker

Tough question Tobias. Once again, we are bullish by nature. We always try to think about a positive aspect of everything that happens. Like I said in the beginning, we always discuss our planning for the year, we are says, every risk in terms of sales, margin expenses. And is come to the conclusion that -- now that we have additional initiatives we can stick to our guidance and the reason assumptions in this scenario macroeconomics in the country could be at least equivalent to what we see today. We are not working with a worsened macro-economic scenario right now, Tobias.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Great. Thank you again.

A - Unidentified Speaker

Irma Sgarz with Goldman Sachs has a question.

Q - Irma Sgarz {BIO 15190838 <GO>}

Good afternoon. Thank you for taking my question. My first question has to do with improved working capital for stockers. I believe, this is something you're considered to be recurrent, but I'd just like to confirm it. On the other hand we've accounts payable with a worst performance, to what extent is it related to specific deals and negotiations during the quarter or is there any other factor that we could, but we should keep an eye on. What is the outlook in the future? And secondly, can you bring down this pressure in gross sales margin and big lines, considering all the drivers that are mentioned in today's call and also in the release?

A - Felipe Coragem Negrao {BIO 19434019 <GO>}

Good afternoon, Felipe is speaking. Answering your first question about working capital. I just like to recall that it started to increase our inventory levels like we were just moving away from the crisis at that time and we began to see better sale was part of it that we were afraid of stock out any of the last quarter we had a huge inventory drop. We believe today at least in the middle long term, our inventory coverage is adequate. Once you have the integration of Cnova etcetera. We expect to have seasonal items. But maybe for the second half of the year or next year. Today, we consider it to be a recurring inventory level as for accounts payable, nothing has changed. The same term may be just as slide effect from agendas when you do the purchase that's why there was this, no recurring increase. But short-term we don't expect to see any change whatsoever, in terms of payment terms, we are sticking to the same terms with suppliers, the same that we had last year with no striking differences. The difference that was here is really owing to the procurement agenda. If you're buying in January or in March, there is a very significant impact, when we see the picture on March 31st. As for gross sales margin, if you think about the impact legal bay about 2.4% that's the impact on gross margin. Competitiveness is another one 2.6% and services 0.6%. So that's about it. These are the main numbers so we can do the math.

Operator

Thank you. (Operator Instructions) This concludes the question-and-answer session. We would like to give the floor back to the company's management for the final remarks.

A - Unidentified Speaker

I would just like to close by saying that we are very confident about the performance of our results in a sequential and consistent manner in future quarters, so can deliver the guidance that we disclosed to you. We are cognizant of the challenge ahead. And also our need to have impeccable performance particularly over the next 90 days. So we can start Q3 at a different level. And our trust, our confidence is based on action plans that are crystal clear and very concrete. And we are constantly following up every week at a company. Like I said in the beginning, when I answered Tobias question it's only natural that it all depends on the macro economic scenario. We are considering that the macro scenario will be stable. We are not considering a worse macroeconomic scenario in future plan. Would also to highlight that we have very issues team is fully engaged. With these initiatives and also all the challenges in the future and I personally very confident, that we will deliver the results that we promise to you. Thank you very much.

Operator

This concludes the Via Varejo's earnings conference call. Investor relations department is at your service for any additional questions. Thank you for joining us today. Have a good afternoon.