Q2 2015 Earnings Call

Company Participants

- Felipe Negrao, Financial Services Executive Officer and Chief Financial Officer
- Libano Miranda Barroso, Chief Executive Officer
- Marcelo Rizzi de Oliveira, Investor Relations and Strategic Planning Officer

Other Participants

- Andrea Teixeira, Analyst
- Gustavo Oliveira, Analyst
- Joao Mamede, Analyst
- Tobias Stingelin, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Via Varejo Conference Call to discuss the results for the Second Quarter of 2015. This event is also being broadcast via webcast, which can be accessed at www.viavarejo.com.br/ir, where you can find the respective presentation. Slide selection will be managed by you. There will be a replay facility for this call on the website.

We inform you that the company's press release is also available at its IR website. This event is being recorded and all participants will be in listen-only mode during the company's presentation. After Via Varejo's remarks are completed, there will be a question-and-answer session, when further instructions will be given. (Operator Instructions).

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of Via Varejo management, and on information currently available to the company. They involve risks, uncertainties and assumptions, because they relate 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 could cause results to differ materially from those expressed in such forward-looking statements.

And now I'd like to turn the floor over to Mr. Marcelo Rizzi de Oliveira, Investor Relations Officer of the company.

Marcelo Rizzi de Oliveira {BIO 19111391 <GO>}

Good morning. Welcome to our conference call for the second quarter 2015 results. We will have about one hour presentation and then we'll have a Q&A. We have Libano Barroso with us, CEO of the company and Felipe Negrao, Financial Director, that is also temporarily the CFO of the company. Mr. Barroso, you have the floor.

Libano Miranda Barroso {BIO 4670536 <GO>}

Good morning. Welcome everyone to our second quarter '15 conference call. Before moving to slide two, let me tell you what we saw in the first and the second quarter was a fairly quick change in the macroeconomic scenario. This was a fast and unpredictable change to us. One example, is the Monthly Trade Survey, published by IBGE were in March it was minus 4.4; in April, minus 13.3; May, minus 16.8, showing a reduction from March to April, more than three-fold in the numbers presented.

In this environment of quick changes, we made adjustments, we have to implement some corrections to deal with this short-term scenario, but we maintained our long-term vision to capture market opportunities. We maintained our long-term structural plan which we will explain momentarily.

So let's just now move to the presentation. Please go to slide two. Our net revenue was BRL4.3 billion, down 21.7% in the second quarter. And looking at the first six months, this reduction was minus 11.5, which is exactly what I mentioned before, this very abrupt change in the second quarter. In the second quarter and we will explain this in more detail, has a comparative with the second quarter of last year where we had the FIFA World Cup. Well, the World Cup was offered a push in the technology category, which was now repeated. With this regression, we still had a market share gain of about 0.7 percentage point year-to-date, January to May 2015. Like I said, we are maintaining our strategic plans. We have to roll-out all of the Crescer Mais project and here we see the main figures. Until June 30th, we had the revamp of 45 cell phone store-in-store format; 30 stores with the new furniture category concept; 36 banner conversions; and 21 stores, conventional stores opened in the first half of '15. 36 conversions, 6 that we have done before in the rest -- in this quarter.

The EBITDA margin of the company was 5.5% impacted by the lower dilution of fixed expenses, given the adjustments with this change in the whole scenario. Corrections in our expenses are being implemented -- were implemented in the second quarter will continue to be implemented in the third quarter. By year-end, we expect our expenses to go back to the previous levels of the company.

Implementation of cost reduction initiatives to mitigate the decline in consumption across the sector in the second quarter of '15. We implemented a number of measures and initiatives to reduce costs and we're going to be speaking about that. We maintained a strong discipline in terms of a -- expense matrix management using the zero budget strategy, trying to reduce our expenses and improve our productivity. In the scenario, we are confirming our solid capital structure with a cash balance of BRL2.97 billion reducing our net debt by BRL173 million.

Please go to slide three. Talking about our strategic initiatives. Let's concentrate on the Crescer Mais project. As I mentioned before, we have 45 stores that were revamped with the new Telephone approach -- the telephone store-in-store, or mobile store-in-store concept. We changed the display of products in these stores. Clients are invited to try the products, all of the products are displayed with WiFi, they are connected, they are on and clients are invited to try them out. So we have 45 revamped stores already and we estimate for 2015 to have 100 revamped stores by year-end. We were quite encouraged by our pilot plan in this period. We had a significant results where pilots converted stores grew on average 45 percentage points above Via Varejo's stores average in the cellphone category. And I'd like to remind you that this is not just a new way of displaying products, we offer a complete solution to clients, because they have an option to buy a cellphone and activate their line. So we have telephony operators, telephony mobile carriers, so clients will buy the hardware and they can leave the store already using their cellphones.

Please go to slide four talking about revitalization of the furniture concept. The Crescer Mais project includes telephone, furniture and strengthening the Ponto Frio banner. I'll talk about that later. So talking about furniture, again a new furniture concept, likewise, we have 30 revamped stores with a new concept. We changed from a simple display of furniture to the creation of environments, where the clients can enjoy and experience to see how the room in their homes would look like. So we sell a complete solution. We finance their purchase and we estimate to have a 100 revamped stores by year-end, again such stores have already been revamped.

Pilots converted stores grew quite a lot. The result was quite encouraging. We saw an average 15 percentage points growth above Via Varejo's stores average in the furniture category. Furniture has been gaining share in our categories. And I'd like to remind you, we talk about two categories: telephones, cellphones and furniture with the best sales margin.

Finally, talking about the third pillar of the Crescer Mais project which is the strengthening of the Ponto Frio banner. In this year, we opened two premium stores. We have a premium store in Sao Paulo, one in Rio de Janeiro, where clients have differentiated experience. In addition to having a better display of products of our top product line, we also offer clients an opportunity to have a new sensory experience, they can touch our products, they can experiment with our products. In addition, we saw that Ponto Frio have a brand, recall, brand strength in very defined regions. We are studying at last, each and every region and identifying in that macro region what the vocation of the banner is. In some regions, we saw an opportunity to comfort Ponto Frio stores to the Casas Bahia banner. We had an appointment with six stores and on July 2, we completed 30 stores converted. These stores are located in regions where we combine demographics, income distribution and consumer behavior, not just income distribution, but also customer behavior. And in these regions, what fits the best is Casas Bahia.

In our experience, with these converted stores, we saw growth in the 6 converted stores in the pilot project, showing an average growth of 39 percentage points more than Via Varejo stores average. We will continue to analyze each one of the micro regions to verify whether we have -- we can identify new opportunities for conversion along the year.

I will give the floor now to Marcelo Rizzi to present the numbers.

Marcelo Rizzi de Oliveira {BIO 19111391 <GO>}

On page six talking about revenue. As Libano mentioned in the second quarter of '15, we saw a strong retraction in the market of durable goods in Brazil. As of April, this decline was more marked and continued until June. Later from the Monthly Trade Survey proved this trend, with that we had a revenue reduction of 21.7% in the quarter, in the same-store concept minus 23.5%. In the first half of 2015, the decline was 11.5%, in the same-store sales minus 13.1%.

Highlight goes to the TV category, that accounted for approximately 1,000 basis points of the total sales decline in the second quarter. And we have the strong comparative basis with the first half of 2014 with the FIFA World Cup. Even with this kind of decline, we maintained our market share gain of 0.7 percentage points in this specialized market. Year-to-date, we're gaining market share and even in this more challenging macro scenario environment, the company maintained our confidence in the long-term strategy which is reflected in our expansion plan.

In the second quarter, we opened 18 stores. 21 were opened in the first quarter of 2015. Our plan started in January of 2015 expecting to open 210 stores in three years. We completed a year and a half, and we have opened more than half of that 210. We opened 109 stores from January -- since January 2014 to date. It's important to highlight that in this store opening plan, we increased by 50% our installed base in the Northeast. The midway of the North and the Northeast accounted for 60% of all of the new openings. At the installed base in the Midwest and South and Northeast is a lot more homogeneous, very close to 100 stores to date.

Please go to slide seven. Starting with gross profit. We had an improvement in our gross profit also as a result of the efficiency gains of the company improvement gains in services, logistics, assembly, new sources of revenue and synergies with the Group. And also given the sales mix, we had an improvement of 110 basis point, about 31.4% increasing to 32.5%.

In SG&A expenses, the declined -- rapid decline in sales and high inflation pressured our fixed expenses. Our expenses as a percentage of net revenue increased from 22.4% to 27.4%, plus 500 basis points. As Libano mentioned, it is important to highlight that the company is implementing a number of measures to bring down our costs to fit this new short term reality, and we'll talk more about that later. This increase in sales expenses as a percentage of net revenue had an impact on our EBITDA. Quarter-on-quarter it dropped from 8.9% to 5.5%, 240 million of EBITDA compared to 493 million in the second quarter of 2014.

In the first half of 2015, our EBITDA margin is 7.8% compared to 8.9% in the first half of 2014, delivering BRL755 million in EBITDA in the first half of 2015, compared to 979 million in the first half of 2014, and even in a more challenging macro scenario. Our partnership with our suppliers helped us having more successful inventory management which enables the company to deliver another quarter with an increase in the gap between inventories and suppliers as we can see in the chart.

On slide nine, we see that the company presented solid financial structure and cash generation, almost 3 billion. Net cash of almost 1.8 million for the company which brings us an indicator of net cash over EBITDA. And we can see here an improvement in our net debt of BRL173 million. As for the net financial result, in the second half we had a reduction in our net financial result which was minus % to minus 4.3%. This strategy -- this was due to the strategy to postpone the securitization of credit card receivables from the first quarter to the second quarter, which impacted negatively in the second quarter of '15, but allowed gains in the first half of 2015.

On slide 10, we give you the net income showing that a decline in sales, costs, net income reduced from 187 million in the second quarter of '14 and down to 13 million negative in the second quarter of 2015. Net income margin dropping from 3.4% to minus 0.3% year-to-date, net income margin was 2.3% compared to 3.3% in the first half of 2014. 226 million in net income compared to 365 million in the first half of '14. It's important to highlight that we are adjusting our cost base to this new short term scenario.

We follow zero-base budgeting and a matrix management of expenses. We are accounting out adjustments in all of our expense lines, but particularly, we are going through headcount optimization, reducing marketing expenses. We are revising our rental and utility costs. We are reviewing our logistics, routing and freight, outsourcing our distribution and we're closing unprofitable stores.

I will now turn the floor back to Libano for his final remarks.

Libano Miranda Barroso {BIO 4670536 <GO>}

Our vision is to continue gaining market share through a qualified expansion in regions that provide a better response to the current long-term scenario. In addition to organic growth, we're also paying keen attention to inorganic opportunities. We are very diligent considering our solid financial position which allow us to exercise these options. We also consider the possibility of implementing more efficient assets, pursuing more efficiency, more sales, and more return per installed square meter. And that's why we want to keep on improving an expediting Crescer Mais project, strengthening Ponto Frio. Like we've said before, we implemented a reference stores, we have two premium stores. We also work on banner conversion. We created a new visual identity. We brought the penguin of the digital world into conventional stores. We're also working on specific campaigns. And we also see the need to recover the sales gap that Ponto Frio has vis-a-via Casas Bahia.

In addition, we also have the loan operation in nearly all Ponto Frio stores. We will be boosting our revamp for furniture with at least 100 stores in 2015. And also the roll out of the store-in-store format in telephone with at least 100 stores in 2015. We maintained our investment plan. Naturally, we are being very mindful, considering the higher capital costs. We have to be far more accurate whenever we allocate our capital needs. But luckily, out of our strong financial structure, we maintain our options.

In terms of pursuing more efficiency of assets and financial assets, we'll keep on being very diligent optimizing costs and improving our efficiency. Like Marcelo said, in all the items of expenses and costs at the company level, we will consider internal and external benchmark to adapt the company's cost structure to the new reality in the market. We want to improve our capture of benefits and therefore, we are accelerating our synergies with the GPA Group.

One example is the implementation which started last year of joint accounts. We are accelerating logistics synergy by sharing distribution centers with Nova and also Extra. And we already have rolled logistics jointly with Cnova and joint deliveries in the Northeast.

Financial services. They are a strategic benefit to us, an important source of revenue. We implemented processes and IT tools and they have delivered good results and we managed to assign more credit to the best payers or lower risk customers. And as a result, we see improvement in loan and credit recovery.

We're opening now the question-and-answer session.

Questions And Answers

Operator

We're opening now the question-and-answer session. (Operator Instructions) The first question is from Tobias Stingelin from Credit Suisse.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Thank you. Good morning, Libano, Rizzi. I want to know the following. Could you give us an indication for sales more specifically for July? What about July? I don't know if you still see the world -- individual World Cup effect or negative impact as a result. I would also like to understand more specifically considering all the measures to lower expenses that you mentioned. Libano mentioned in the beginning of that, by year-end he expected to have the same level of expenses that you achieved last year. I'd like to have a better understanding, is my assumption correct? What about opportunities, what about the mapping of opportunities to lower expenses according to different initiatives that you take?

And lastly, what about renegotiations with malls? I would like to have a better understanding of this area, so you can really lower the operating costs.

A - Libano Miranda Barroso {BIO 4670536 <GO>}

Tobias, Libano is speaking. How are you?

Q - Tobias Stingelin {BIO 18290133 <GO>}

Good.

A - Libano Miranda Barroso {BIO 4670536 <GO>}

Thank you for your question. Let us break down your question in two parts. July first. We do have the residual effect from the World Cup. It was until mid July last year. So it does have an impact on our figures. The scenario for July remains quite challenging. It is too early to work on any trends for the quarter. In August, we expect to have a seasonal date, which is Father's Day. It is not as significant as others that we had in the first half of the year, but let's wait and see until we can come to any trends. But what I can tell you right off is that July remains very challenging.

Q - Tobias Stingelin {BIO 18290133 <GO>}

I'm sorry to interrupt you, but the accounts that you said except for TVs, it would have been '14. So if you think about the future, do you think the impact or double-digit same-store sales until mid-year, to what extent is this possible or not, you don't have to give any guidance, but what is the scenario that you expect to face?

A - Libano Miranda Barroso {BIO 4670536 <GO>}

It's too early to work on any trends, because the scenario changed very quickly. Like I said, if you consider data from the PMC or the Trade Survey, particularly after April, well at May, these are the public figures. So it's too early to mention any trends.

And by the way, speaking about the breakdown. We are working on several actions at the company and cost reduction. If you consider the fast change unforeseen in sales, cost actions take awhile to be implemented.

By year-end, well I cannot give you any projections, I cannot assure you that we'll come to the same levels, but they come back to something more consistent to this sales area that we usually have. Please remember, we have cost events that we did not have last year due to the economy. We have the electricity impact in our sector. We also have inflation adjustments. Not to mention other issues related to the payout and to the payroll. And this will happen or not by year-end depending on some decisions to be made.

So I cannot give you any forecast, but we are preparing the company. So that in a short timeframe, maybe not in one quarter, but as soon as possible, we want our expenses to be consistent with the sales levels. And this applies to all lines in terms of cost reduction.

In our release, we stated that in an active management of our turnover, we reduced our head count about 4,000 positions -- 4,500. So this reduction is not necessarily a layoff, it is just related to an average turnover 25% per year, which is about 15,000 coming in and out. And we work reducing this 4,500 staff and we also have utilities and rentals and as to malls and not only about malls, but we can show in the new scenario and in several other scenarios, we have positive results. I do want to adapt rental and utilities to the current scenario. This goes just for freestanding stores and mall stores and that's the reality in our market. Did I answer your full question?

Q - Tobias Stingelin {BIO 18290133 <GO>}

Just another question. I think you closed 8 stores this quarter and I know Negrao is also here with us, and he's very much familiar with the loan operation. Negrao, could you give us an overview? What are your thoughts about the loan policy to you? Are you raising the bar, are you increasing provisions, allowances? So he's mainly in charge of this business. So I would like to hear from you too. Thank you.

A - Libano Miranda Barroso {BIO 4670536 <GO>}

Tobias, we close eight stores. Four stores due to CADE's decision and four because we consider that they were underperforming during the quarter. In July, we closed 15 stores, 19 stores in total. Considering the scenario because they were unprofitable. And now I give the floor to Felipe, so he can answer your question. Thank you.

A - Felipe Negrao {BIO 19434019 <GO>}

Tobias, about the loan operation in the third quarter of 2015, there was a reduction in the credit operation. We were really cautious this year. We implemented several measures to optimize processes implementing new policies at credit, granting our credit assignment. So this quarter, we managed to maintain the same stake as last year but the quality of the portfolio is much better. In the current economic scenario, we believe that on a long-term basis considering the better quality, it tends to go down. We made adjustments in interest rates for credit and we also had a reduction considering automated processes. We reduced our staff.

So once again the scenario depends on the economy but we have a positive outlook for the loan operation going forward.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Don't you believe there will be a worst base, allowance will remain the same, what about the recovery of the operations. Don't you see any warning signs yet?

A - Libano Miranda Barroso {BIO 4670536 <GO>}

It's worse than last year, because we have historical portfolio. We have a legacy to work on, but it is below what you expected from our shareholders. I think all corrective measures that we had in credit assignment already happened in the first quarter and we are comfortable to maintain our loan share for the credit operation for sales in the second quarter.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Perfect, thank you again.

A - Libano Miranda Barroso {BIO 4670536 <GO>}

You're welcome.

Operator

The next question is from Joao Mamede, Santander.

Q - Joao Mamede {BIO 15265292 <GO>}

Good morning. I have three questions too. The first question is about suppliers. I imagine there are lives -- supplier's lives is also very tough, not only for retailers. So my question, I would like to have a better understanding of your relationship with suppliers. It was always very close. In hard times, do they resort to any joint strategy related to big sales for instance. In other words, right now, how can you benefit, maybe from a weakness from your suppliers, that's my first question.

The second question is about receivables discount. This quarter it was different from the previous quarter, you used more cash in order not to have so much receivable discount and not to have a great impact in financials. So what about going forward, what is normal about receivables discount for the second half of the year, maybe more similar to the second or the third quarter or on average. Cost is going up, even though it is a relatively cheap financing method. You can always fund from part of your cash which is also quite high. So I'd like to have a better understanding up dynamics going forward. Considering, there was a mismatch between the first and the second quarter.

Third point, just out of curiosity. Libano mentioned in the presentation data on a monthly basis, PMC, the Trade Survey. In your case, more specifically, is there any strike in difference on a monthly basis or do you follow the behavior according to IBGE data? These are my questions. Thank you.

A - Libano Miranda Barroso {BIO 4670536 <GO>}

Joao good morning and thank you for your questions. First, I will answer about suppliers and then Marcello will answer the other two questions. We have a long-term relationship with the industry and our suppliers. We have a partnership which includes jointly design and develop products. We analyze the market together and we work on a vision to improve and lead to a win-win solution.

If you consider the current market scenario, we have to strengthen our bonds and that's what we're doing. We have to see what we can do in order to encourage our product sales and it involves joint actions in volumes, logistics to lower our supplier costs and we are trying to work together. So suppliers can shorten their delivery times than less time in our darken [ph] areas and we also address categories, categories strengthening. So we are very close. And at the end of the day, due to this balance, we managed to move forward with -- or negative networking capital requirement with the suppliers term financing our inventory days. So this is in good balance. And we maintain a vision focused on a better upturn in the market as soon as possible.

A - Marcelo Rizzi de Oliveira {BIO 19111391 <GO>}

Rizzi speaking now.

Q - Joao Mamede {BIO 15265292 <GO>}

Hi, how are you Marcelo?

A - Marcelo Rizzi de Oliveira {BIO 19111391 <GO>}

Great. Let me talk briefly about receivables discount. Just to give you some context. In 2013, we were discount nearly all receivables days. In 2014, we started to discount once per quarter, and in 2015 this year, we decided to go beyond and discount only once half-yearly, using our cash balance to honor short-term commitments. And as a result, discount costs or the financial result improved from 3% to 2.8% in the second quarter considering CDI. At first, we expect to maintain the same strategy over 2015, but it will largely depend on the select scenario whether we will change the strategy or not and you keep you posted.

The last question is about the PMC, the trade survey. The drop was similar to PMC. What we see in our sales. In April, there was a decrease, worse compared to March. May was worse than April and June was worse than May, which was very similar to what happened with PMC. But our strategy is to be very focus on big sales, particularly when customers visit our stores, so we can gain market share when you have more economic activity and this strategy allowed us to gain share as you can see in our presentation.

Okay, great. Thank you, Marcelo.

Q - Joao Mamede {BIO 15265292 <GO>}

Okay, great. Thank you, Marcelo. Thank you, Libano.

Operator

Our next question comes from Ms. Andrea Teixeira at JP Morgan.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Good morning. Thank you for the opportunity. I only have two main questions if I may. Starting with the margin. Gross margin was strong. Now I'd like to understand, regarding the optimization of headcount for 1,800 people, what should we expect in terms of the margin? Should we expect a margin recovery and what would be the impact of the termination of employees? So that's my first question about the margin.

Second question, it has to do with the cash flow and CapEx and store openings. Given this movement to postpone the securitization of receivables. And given this more challenging macroeconomic environment, do you maintain the expectation of opening so many stores this year, will this be feasible? Will this be reviewed, where we have more historic compressions? I think you had about 30 store conversions for this quarter, so what would be the year-to-date and what could we expect looking forward?

A - Libano Miranda Barroso {BIO 4670536 <GO>}

Andrea, good morning, this is Libano. I will try with the second question about expansion and Rizzi will speak about the margin (Technical difficulty). I'd like to remind you that we have a guidance of 210 stores in three years. We are at one year and a half of that guidance, and we have opened more than 50% of what we have promised. We were able to rebalance the regions, as Rizzi showed, today we have a number of stores in the northeast, which is very similar to what we have in the Midwest and the south. It used [ph] to be very concentrated in the southeast, but we were able to rebalance the stores, and this is quite interesting. In the northeast, we have for example, a 50% growth. Well this shows our focus to expand, but in a qualified fashion across the regions.

In addition to a qualified expansion, we are having this expansion effect through a better and higher efficiency of existing assets. The conversion of Ponto Frio stores to Casas Bahia, the acceleration of the furniture concept to roll-out and the telephone store-in-store format, while these are having effects which are quite similar to the expansion effect. And we also have a real option of considering inorganic growth perhaps a market acquisition opportunity, given our financial structure. Again, we will always be working very diligently and very carefully. So that, if an acquisition opportunity is enjoyed, it will be good for our shareholders.

I will turn the floor to Marcelo.

A - Marcelo Rizzi de Oliveira {BIO 19111391 <GO>}

Andrea, starting with the gross margin as we showed in our presentation, we had an improvement efficiency gains and gains in services, logistics, assembly, et cetera, and also our sales on the payment book. But particularly in sales, general and administrative expenses, decline in sales happens a lot faster than our capacity to restructure our cost base. So, we went through a first way of restructuring the first half of the year, but there are some initiatives also planned for the third quarter. We should expect improvements in the fourth quarter of this year, but it is still too early to anticipate improvements in the third quarter. We should expect these improvements seen in the fourth quarter, indicated as a percentage of net revenue.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Thank you very much, Libano. So, if I understood, we should not have -- should not expect a lot of high returns in the furniture in cellphone store-in-store formats. Okay, so how could we expect store openings and store conversions of this change?

A - Marcelo Rizzi de Oliveira {BIO 19111391 <GO>}

No, Andrea, we maintain our vision for store openings as well, we will continue to open new stores and we will accelerate the roll-out of the furniture and telephone concepts. We'll continue with our three-year guidance, considering 210 stores. But we will be more (inaudible), particularly in the short term scenario. So it's a balance between the two, and we will be updating you every quarter in terms of our actions in the store openings and increase in efficiency of our sales area.

Q - Andrea Teixeira {BIO 1941397 <GO>}

If possible, could you comment on the succession of the CFO?

A - Libano Miranda Barroso {BIO 4670536 <GO>}

Yes, of course. Well, Emmanuel Lemaitre chose to leave the position, and so we thought that at this point, it would be best to have Felipe Negrao taking over, he is already one of the officers of the company. He's experienced, he's been handling our financial services and payment book department. So temporarily, in addition to his current position, he is also the CFO. Until, we decide to hire a new Chief Financial Officer.

Q - Andrea Teixeira {BIO 1941397 <GO>}

I see. And finally, one last question regarding accounts. This reversal of 100 million, is it a tax liability in Bartira? Is there a risk that this will be charged? Any other expectations of reversal in the coming quarters that could come from this process?

A - Libano Miranda Barroso {BIO 4670536 <GO>}

It is exactly what you said. This is a provision that we made during the acquisition, but it's no longer applicable.

So we've reversed, given the statute of limitations and there is nothing else to be reversed.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Perfect. Thank you very much, Libano.

Operator

Our next question comes from Nicole Noel [ph] Bank of America Merrill Lynch.

Q - Unidentified Participant

Hello, good morning everyone. Thank you for the opportunity. I'd like to go back to suppliers. Many suppliers are saying that they are increasing their prices to offset the foreign exchange variation. Are you feeling that? Where are you going to be able to transfer this to the end consumers?

And another question on inventories. I understand that with a decline in sales, your level of inventories have increased. So I'd like you to speak a little bit about the quality of the inventory. Is these are older products, newer products? And with a decline in sales going back to the suppliers, will they be helping you a little way in case you need to return products or are they giving you a longer-term of payment? Thank you.

A - Libano Miranda Barroso {BIO 4670536 <GO>}

Nicole, hello, good morning. This is Libano. And I will answer your first question and then I'll turn the floor over to Marcelo. Your question about suppliers. Nearly a 100% of what we sell is manufactured in Brazil or assembled in Brazil. Therefore, suppliers do have an agreement. They do feel an impact of the foreign exchange variation and the real depreciation, but it just not an impact that will affect a 100% of their cost base, just a part of their cost base.

Having said that, we tried to reach a balance, because with our suppliers there is also the sell-out aspect. I mean it's no use, we making an adjustment in the cost of acquisition of the goods that we'll make it impossible for us to sell these goods in the stores. So we share with our suppliers. Our vision in terms of price levels, demand, elasticity of prices. And once we do that, we negotiate with them to trying to reach the best level to adequately remunerate our suppliers, to adequately remunerate Via Varejo and so that we'll have attractive prices to the end consumers. Now there is an FX impact of course, and we are trying to mitigate and reduce this impact, so it will not have an impact on the demand at the store level.

A - Marcelo Rizzi de Oliveira {BIO 19111391 <GO>}

This is Marcelo Rizzi. Nicole regarding inventory, it is important to highlight that in the second quarter of this year, a decline in sales was quite sharp. It was actually unexpected where we probably didn't expect it to be this sharp. So that impacts our inventory level. We can adapt the inventories, but just like we can't adapt expenses very quickly to sales decline, the same goes for the inventory. We are making some adaptations now. We also had some strategic procurement with a more favorable dollar real ratio.

But this increase in inventory was followed by an increase in the purchases from the suppliers, we have better payment terms. And also our gap between inventories and suppliers improved.

Q - Unidentified Participant

Thank you very much.

Operator

(Operator Instructions) Next question from Gustavo Oliveira, UBS.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Good morning, everyone. My first question is a follow-up question about relation with suppliers. But more specifically, I want to know not only the impact of the suppliers in COGS, but what about the future? What about the gross margin estimate, think about benefits considering many factors, including mix, these leads to an expansion of the gross margin. But what about the dynamics? What about the behavior of the gross margin in future quarters?

And just to confirm Libano, I think you said that 100% today of what you sell is assembled and manufactured in Brazil, but as far as I understand, several suppliers, particularly for an important category, smartphones that are shutting down their operations in Brazil and we work with imported products. So what about the dynamics of the suppliers industry, your internal dynamics in terms of changes and mix and what about the impact on gross margin going forward? That's my first question.

A - Libano Miranda Barroso {BIO 4670536 <GO>}

Would you like to ask the second question, too? I think it would be easier.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Sure. The second question is about stores. I want to understand if when you revamp the furniture section, for instance, and when you remodel telephony, I assume you are doing this separately. 45 stores for telephony, 30 stores for furniture, what about the future, do you going to expedite this process for both categories simultaneously? And what about the expected impact if you do the full base? So if you're working on 100 stores now with both, are there same 100 stores or will it be a greater effect?

And also about conversions, I think you have converted 30 stores in one week, if I'm not mistaken, based on your presentation. Could you do more conversions? And the 15 stores that you closed in July, are they only Ponto Frio stores?

A - Libano Miranda Barroso {BIO 4670536 <GO>}

Thank you for your question. Let me start with a question about suppliers. When I said that we sold 100% in Brazil, you're right. Some suppliers have more imported components or fewer imported components. Some suppliers do assembly operations in Brazil, others manufacture components to see a trend to change these levels. So I cannot confirm precisely, like you said, a strategic change to shift down plants, manufacturing plants moving into imports. So as far as we know, we maintain the same scenario. Naturally, it does have an impact. This change and like I said before, we work together in order to have the lowest impact possible, in order not to have a negative impact on pricing demand as the store conversion.

At the same time, we analyze all the stores that we are opening, we analyze the expansion. And they are ready open with a store and store format for telephone and also with a new furniture concept. And we crossed stores that we expect to use preventive maintenance. So they can do that on a scheduled basis and at the same time, we also roll-out these categories. So that's a combination of actions and we also select specific locations for these actions, 30 stores in one week. This is the end of a project in reality, prior to that you'll have less than 90 days, you have planning, you also have the Phase II work on the furniture, train your personnel and in this case you have a different approach for sales in Casas Bahia compared to Ponto Frio. So you have to train your staff and we also have legal matters.

Even though they're all Via Varejo, you always have the fantasy brand. So you have to change this brand in that specific branch considering the corporate tax number. You do have tax/legal issues. So conversion involves many other things and we also have to define the micro region. This definition of the micro region stands from a whole action that we carried out over the year and also over last year with strategic points and measurement of pilot phase. So it does have a lot of prep and the stores that we closed.

We have Casas Bahia and Ponto Frio and the vast majority is Ponto Frio stores, but we also closed Casas Bahia stores among all the underperforming stores. Now I turn it over to Marcelo to talk about the margin.

A - Marcelo Rizzi de Oliveira {BIO 19111391 <GO>}

About the gross margin for upcoming quarters. We don't consider any positive effect to throw the margin upwards or downwards. We don't anticipate any change in the current levels. So probably stable.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay. I have just one last question. You mentioned two or three times maybe involuntarily of this quarter. The possibility of inorganic growth. What are the main metrics that you would be analyzing or what is the level of leverage that you would be comfortable with the company for an acquisition?

A - Libano Miranda Barroso {BIO 4670536 <GO>}

It is a case by case analysis. First of all, based on our experience. We are analyzing -- if you analyze the potential acquisition, it has to make all the sense in the world in the region. And also in terms of the capacity to improve our footprint in key regions. And at the same time, minimum overlapping with our existing store base. So at the end of the day, it becomes quite complex, because it does, if it generate economic concentrations sometimes you don't have a target to benefit from your total store base.

Having said that, it has to make sense in economic terms and also for assessment purposes. But our differentiator is that today is free cash, free debt positive, so have more cash than that, we are in favorable conditions and we have very low net debt over EBITDA ratio. So it does give us the chance to search for potential targets, but always a very capital diligent.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Clear, thank you.

Operator

The next question is from Fabio Monteiro.

Q - Unidentified Participant

I have two questions. First, I'd like to go back to sales. Obviously, you mentioned the television effect, but still net of the television effect, which would be about 14% that's quite a negative effect. I wonder if you could elaborate more about your opinion about this number, obviously, we have to take into account, macroeconomics, consumer trust, but could we just move away from TV and World Cup and hear your opinion and perception about the importance of other effects to explain this residual drop, so to speak.

And also along the same lines, I would like to learn more about television sales more specifically at Via Varejo, we had a drop of 57% at Cnova, it was very strong. There was a big discrepancy, so I would like to know if this is fully explained by price strategy, obviously, combined with the fact that e-commerce grows more than conventional stores in Brazil. So I'd like to have a better understanding and even go beyond this discussion and try to better understand how you coordinate the commercial strategy and the pricing strategy at Via Varejo with Cnova? Thank you.

A - Libano Miranda Barroso {BIO 4670536 <GO>}

Fabio, good morning. Thank you for your questions. Let me start by addressing the scenarios. In the current scenario, the macro scenario affects all sectors. PMC is an indicator, an external indicator, and at the end of the day, it is an important evidence of what happens to the consumer segment. Even though that are indicators for productivity and some comparative differences, we are also affected by the economic scenario. We are very much focused in the micro scenario. Naturally, we have to take that macro environment into account, but we are very much focused on the micro environment.

We believe there is a lot of opportunities in micro economics, if we think about regions, categories, customer behavior, we learning more and more that segmentation and clusterization by income alone and demographics is a limited field. Customers do change behavior and we have items that changed in the periphery of the big city and also in upscale malls. Customers have different desires and aspirations, and that's something we see and that's why we're focused on different credit possibilities.

So we want to focus on regions, categories in which we're strong, accelerating the roll-out of our key projects, like, furniture, mobile phone, strengthening Ponto Frio. This does not offset the macroeconomic effect, but it does lower the effect and therefore maintains our competitive hedge, and in particularly the company's capital structure.

Q - Unidentified Participant

You mentioned TV a specific category when you mentioned e-commerce for Nova.

A - Libano Miranda Barroso {BIO 4670536 <GO>}

First of all, we have a strategy, both in conventional stores and also in e-commerce. Our strategy is to gain market share in its corresponding markets. Our competitors are from conventional stores, and as Cnova has e-commerce competitor. So each one has a different strategy to remain competitive and to pursue profitability in the market. We also have a strategy amongst ourselves for the items we advertise for the same price in both channels, and channels are increasingly trying to be more specialized in their categories/SKUs. The strategy lies in doing everything we can to ensure market share gains in corresponding markets and strengthen the brands. We want our customers to relentlessly search for Ponto Frio and Casas Bahia in conventional stores and at e-commerce.

Q - Unidentified Participant

Okay, cool. Thank you very much, Libano.

A - Libano Miranda Barroso {BIO 4670536 <GO>}

You're welcome.

Operator

We're now closing the Q&A session. I would like to turn the floor back to Via Varejo for their final remarks.

A - Libano Miranda Barroso {BIO 4670536 <GO>}

I would like to thank everyone for joining us. We and the Investor Relations department remain available for further clarification.

Operator

Thank you. This conference call on Via Varejo's results is closed. The Investor Relations team is available to answer any further questions you might have. Thank you all for participating in this call and have a nice day.