

Q3 2018 Earnings Call

Company Participants

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

Other Participants

- Fabio Monteiro, Analyst
- Franco T. Abelardo, Analyst
- Joseph Giordano, Analyst
- Maria Paula Cantusio, Analyst
- Richard Cathcart, Analyst
- Robert E. Ford Aguilar, Analyst
- Thiago Macruz, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everyone to Lojas Renner's Third Quarter of 2018 Earnings Conference Call. We would like to inform you that today's live webcast, including the slide presentation, may be accessed at Lojas Renner's website, lojasrenner.com.br, in the Investor Relations section at the website platform and also the MZiQ platform.

As a reminder, questions will be taken by telephone and by the platform. We would like to mention that questions coming from journalists will be taken by our press office at the number 11-3165-9586 and the country code +55.

Before proceeding, we would like to mention that forward-looking statements that might be made during the call related to the company's business perspective, operating and financial projections and targets, are beliefs and assumptions of Lojas Renner's management as well as information currently available to the company. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions as they refer to future events and therefore depend on circumstances that may or may not occur.

Investors should understand that general economic conditions, industry conditions and other operating factors may affect the future results of the company and 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. Laurence Gomes, CFO and Investor Relations Officer. Please, Mr. Gomes, you may proceed.

Laurence Beltrão Gomes {BIO 15361799 <GO>}

Good afternoon, everyone. We are here in order to talk about the main highlights of the results of the third quarter of 2018. With me, we have Galló, our CEO; Paula Picinini, our Investor Relations and New Businesses General Manager; and Luciano Agliardi, our Controller.

The third quarter revenue (00:02:43) is marked by the return of the good pace of sales with an adequate commercial management of the collection projections in (00:02:51) the third quarter of 2018 reported a 6.9% growth in same-store sales. And this performance, when compared to the indices in the sector, shows that we are recurrently gaining market share.

Regarding the gross margin, I would like to mention the increase of 0.4 percentage points consequence of the mix (00:03:15) adjusted to the collection transition, the lower (00:03:18) volume of markdowns as well as the favorable exchange rate has contracted (00:03:26) for imported items.

Regarding the operating expenses in the third quarter of 2018, the dilution presented guaranteed the operating leverage that we (00:03:35) and this increase of 12.6% was due to the growth of the number of stores and the implementation of the digital initiatives in the new business cycle. As a consequence, the retail EBITDA grew by 29.3% in the third quarter of 2018. EBITDA margin went from 13.3% to 15.2% with an expansion of 1.9 percentage points, also positively impacted by other operating expenses.

And I would like to highlight the fact that, in spite or even if we exclude the non-recurrent effect of BRL 20 million in tax credit recoveries, the Retail (00:04:25) EBITDA margin would have expanded by 0.7 (00:04:26) percentage points. The results of Financial Products was BRL 86.6 million in the third quarter of 2018, going back 11.5% vis-à-vis the previous year, impacted by the reduction in the participation of private label in total sales as well as the growth - or more moderate growth in the co-branded portfolios revenue due to the stabilization and also the reduction of the spreads between this period.

The improvement in the concession credit assignment and recovery, the improvement in this process was supported by the digitalization of credit, initiatives percentage (00:05:15) guarantee the maintenance of the quality of our portfolios and lower levels of delinquency itself (00:05:20). Thus, the total adjusted EBITDA was BRL 347 million, an increase of 15.9% in the third quarter of 2018. And the margins went from 19.8% to 20.3%.

Another highlight was the net income that grew by 38.4% going from BRL 140 million to BRL 194 million. And this performance reflects the operating improvements that I have referred to and the reduction in the negative net financial result of lower growth in depreciation expenses and the effect of the lower income tax rate due to the recognition of BRL 24.7 million regarding the judicial decision related to the tax deduction of the PAT

program or the Workers' Food Program. And as a consequence of this performance, we had an increase of 1.4 percentage points in ROIC in the last 12 months from 21.3% to 22.7%.

These were our main highlights. And now, we will be available to answer any questions that you might have.

Q&A

Operator

Thank you very much. Now, we will start our Q&A session. Questions in Portuguese should be asked first. And afterwards, we will have time for questions in English. I would like to remind you that we will be answering questions from the platform as well.

Mr. Joseph Giordano from JPMorgan.

Q - Joseph Giordano {BIO 17751061 <GO>}

Good afternoon, everyone. Thank you for the questions. I have two questions, in fact. One, same-store sales, if we look at the normalized so to say pace (00:08:22) of the second quarter, I would like to better understand sales (00:08:29) acceleration, what was the reason for that and if you could separate the digital agenda that you presented in the Investor Day. And could you break this down or what already comes (00:08:44) from omni-channel or from e-commerce? And the second question has to do with the gross margin. I would like to understand the more promotional adjustments that happened in Camicado and Youcom that were overall very small.

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

This is Laurence. Thank you for the question. In relation to the same-store in the third quarter, what we can say is that it consistently improved and we saw a sequential improvement over the quarter and 50% was due to slower (00:09:28) traffic and the other one was ticket. And as we said before, I think we have a very good position in our collection as well as the good acceptance of the new collection. I would say that this is the main reason.

And about your second question in relation to the initiative that we presented in the Investor Day, I think it's a little bit too early because we already have some initiatives in initial stages, and the performance is going very well. However, I would say that it's a little bit too early for us to be able to measure any gains from these initiatives.

And regarding your third question, the promotional adjustment for Camicado, I think we see here a strategy of the end of one (00:10:32) collection and the new collection and the mix (00:10:37). We believe that this is just normal. This is our tactical move in terms of ending one collection and replacing it for another. So, we are well prepared for the fourth quarter.

Q - Joseph Giordano {BIO 17751061 <GO>}

Another question, please. So, talking about the gross margin, you had hedge gains. And for next year, have you already started to hedge your imports for the winter collection? And could you share with us at what exchange rate you're doing this?

A - Operator

Yes. So, during the third quarter, we see a contribution of this exchange rate, and it is practically offset in the fourth quarter or neutralized. So, we have a good expectation for our gross margin in the fourth quarter but not coming from the exchange rate or the hedge. It will come from the collection itself and for the preparation or the mix of our inventories.

Now, for 2019, we have made strides with the protection of our margin, yes, and we understand that there are two uncertainties not only in the local market because of the transition in our government but also uncertainties having to do with the international market into free (00:12:18) that are making some moves and with some risk involved. And we are trying to have a conservative stance in order to eliminate these uncertainties and protect our operating margins. The first half of next year is practically totally protected at an exchange rate close to BRL 3.9 (00:12:49).

Thank you very much, Joseph.

Mr. (00:12:58) from Santander, you may proceed.

Good morning, everyone. Talking about your inventory levels, we see that the level is higher than last year. In the second quarter, there were some deteriorations year-on-year for the reasons that we know. But we also see a deterioration in the number of days. So, we have to prepare ourselves for the fourth quarter. So, is there any other factor involved in this variation?

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

Okay. This is Laurence. Thank you for the question. We had higher volume of imports, and this was the preparation based on this higher volume of imports due to recognition of a favorable hedge that we had and we were very well prepared. And we believe that we are very well prepared not only for the fourth quarter, but also for the high summer. And we see also a higher inventory in Camicado and Youcom. Higher levels at Camicado had also an adjustment in the purchasing policy going more toward the imported items and also for the preparations for the yearend. However, we believe that we will be able to start the next year with an inventory very well aligned with the growth in our sales. So, we feel comfortable with the level of inventory that we have. Thank you.

Operator

Thiago Macruz from Itaú. Mr. Macruz?

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Q - Thiago Macruz {BIO 16404924 <GO>}

Good afternoon. I have two questions. I would like to understand if there was a pressure on the gross margin in the third quarter because of the leftovers of your collection in the second quarter. And in spite of that, you had a very good expansion in your margin delivery (00:15:18) and also, I see that there is a pressure in terms of the spread in your financial operations for different products. But you have -- but you can launch new products in order to offset this with creativity. Are you thinking about launching new products in Realize in the short run, let's say, in 2019 in order to offset this scenario that you talked about of a credit squeeze (00:15:46)?

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

Thank for the question. Well, the answer for this - to the first question is no. We had a lower markdown level than last year in the quarter. Of course, you know very well that our product have a markdown that is aligned to its life cycle. And it was better than last year, the strategy of leaving one collection and starting the other. So, there is nothing in the sense but (00:16:19) I would say the maintenance of our competitiveness and we pay keen attention to our positioning and we have to keep ourselves competitive and lots of attention to the market.

And regarding the spreads and the portfolio of product, the Financial Products, the initiatives in some that we have already presented, they are more in the sense of revitalizing the current products that we have and more in terms of focusing on the shopping experience and the attraction of the product, of course, aligned with vendors' positioning always (00:17:06) not really so many new product. Okay. So, there is a pipeline of initiatives in this regard, and I would rather not go into details about it right now.

Q - Thiago Macruz {BIO 16404924 <GO>}

Thank you very much, Laurence.

Operator

Robert Ford with Bank of America. You may proceed.

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

Thank you. Good afternoon. Congratulations on the results. Could you talk about e-commerce and what (00:17:48) about the trends in e-commerce your return (00:17:50)?

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

This is Laurence. Thank you for the question. Well, we continued with a good pace in terms of gaining market share in online and e-commerce. Our click and collect, we already have this in our stores and we already have 30% participation of click and collect, and we believe that it could still make strides where we already have same-day delivery in Rio and next day delivery in São Paulo and lead time - a very competitive lead time as well delivery time (00:18:53) in Renner.

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We are advancing in other e-commerce platforms of Camicado and Youcom and it is a (00:19:02) multi-channel initiative. And I'll take this opportunity to talk about the inauguration of the three brick-and-mortar stores of Ashua, and this was an exclusively online project. But we opened three brick-and-mortar stores already with a totally omni-channel format since their inception. And we haven't seen that the exchanges of products, 97% occur in brick-and-mortar stores. So, we have been seeing the synergy or additional sales and additional traffic – consumer traffic in the stores as well and we launched – and here, we have some initiatives that have to do with delivering more personalized campaigns.

And now, we have the (00:20:10) that has a very faster than – and it was a lot faster and lighter app (00:20:20) more segmented app as well (00:20:22). So, I think things are going very well, and this share gain or growth in market share comes from a fourfold higher increase than online.

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

And what about the growth of e-commerce and how is this affecting your plans in the medium run?

A - José Galló

Could you repeat the question? The (00:21:04) this is Galló speaking. I think you remember that in the renminbi we emphasized the fact that we believe in the omni-channel model and that creates the positive synergy where one sale (00:21:32) in e-commerce transforms or becomes an additional traffic into our stores – into our brick-and-mortar stores, as Laurence has just mentioned. And one thing that we see also is that in the stores – or in the markets where we have stores, the participation grows more quickly.

And now, with all these improvements that were mentioned during the (00:22:10) the new website and the better use of our communication budget, more productivity that we are obtaining from that, all this leads us to thought (00:22:25) to perceive that the omni-channel model is extremely positive, and a lot remains to be done in this regard. And as Laurence said, our growth is quite relevant, fourfold or four times more than the market growth overall. And most, probably this growth number (00:22:51) that we see in the market should be (00:22:58) online. And because of the fact that we use online and offline, we see a higher pace of growth than the market in general. So, this is our view about the growth in e-commerce (00:23:20).

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

If you're not able to grow in the shopping centers in Brazil, what about smaller cities with smaller population? I would like to know how you're looking at the growth of brick-and-mortar stores in Brazil.

A - Operator

Up to 2021, our objective is to have 450 stores. And what we see now is that we are growing to market nuclei (00:24:14), I would say, that are smaller and bringing us very interesting results. And when we made them (00:24:25) 20 years ago, we talked about

400,000 inhabitants per square meter in order to make one store feasible. Then, we went down to 200,000, 250,000. And now, we are doing some experiments around 100,000 and 110,000 inhabitants or even 60,000, 70,000. And creating this hub of 110,000 to 120,000 inhabitants in a radius that may be accessed in 30 minutes by car, and this has proven to be an interesting experience. And undoubtedly, with e-commerce, this could further grow (00:25:17).

You know very well that we have a very high degree of fragmentation in this market. We have the five biggest players in this market in fashion, us and four competitors, and we have 14% of the market. So where are the (00:25:44) other markets or the remainder of the markets? We have part of this market in smaller towns or cities in these nuclei that I have just described in terms of population. And I would like to remind you that we have the possibility of increasing our productivity per square meter and that we always (00:26:08) the fact that, before acquiring a share of market, you have to acquire share of mind and we have three different vendors so to speak here in São Paulo in the south. We have (00:26:24) and on average 12 in the remainder (00:26:34) years ago are present in the market. And when we evaluate the participation of cards in our target market - target population, we see that the number that we have here in the south, we could generate additional cards and that there's no operations in these markets. And I see that our growth is not only by means of organic growth by means of new stores. We may also grow by increasing more productivity or having more productivity per square meter. And together with e-commerce, this gives us a very interesting synergy for our next few days, I would say.

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

Thank you, Galló. Congratulations.

Operator

Fabio Monteiro, BTG Pactual.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Okay. Good afternoon. I would like to talk about products now. I heard from you about the evolution in the medium and the long term, not in the short term, the effect of the past fashion project (00:27:59). We have already made a considerable investment in the last few years. And what about push and pull. Could you tell us the status of the push and pull? Give us an update.

And connectivity, if you could tell us a little bit about your relationship with your suppliers. And do you already see an improvement in lead time? I would like you to give us an update, an overall update in this regard so that we may work on the improvement that these projects could bring about in the next few years.

A - José Galló

This is Galló, Fabio. So, we can - the consistent and constant evolution, we are very open to the market. We had some setbacks in our collection of women's fashion. And now,

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things have gone back to normal and we continue to invest a lot in terms of our suppliers. We have 9, 10 (00:29:22) engineers that focus on our suppliers all the time. They go to our suppliers in order to improve the processes and the reduction of water use, energy use, everything related to sustainability and everything that we described during the Renner Day.

And for the procurement area, for the whole chain or supply chain, this gives us many different alternatives. For instance a better construction of our collection, the use of artificial intelligence. And we're already starting to work with that in order to be more efficient in the amounts that we buy and also the distribution per market block chain starting to control where our (00:30:21) in each one of the suppliers. And everything means a better control over the chain. And we collect all the data regarding trends, and then we transform these trends into products with our suppliers and we then start having new KPIs and new information. And all that lead us to be even more rigid regarding all that. We could imagine an increase of productivity in this area and the reduction of lead times.

Now, about push-pull. We continue to develop push-pull. We have practically all our basics operating and we are advancing. We divide our collection in three parts: fashion, core and extension. This is a pyramid. At the top, we have fashion where we use less push-pull because they are practically pieces or parts that have smaller amounts that go straight to the stores usually. And when you go to the core then we have a relevant percentage in the core part of the pyramid, I would say, 40% 50% in push-pull. So, I think they are going well. And well in the future, we can see already improvements that we can make by means of a distribution center for instance.

We are still assessing the next step. And this next step will lead us to higher efficiencies and maybe adding new technologies and differentiated equipment. Many good things there may be added in order to improve our productivity, the flow of our merchandise as well and lead time as well.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Excellent color. But one thing you said drew my attention. You said that, in your core part of the pyramid, maybe half of the items are already inserted in the total (00:32:55) structure. If you take core (00:32:58) could you reach almost 100% in a few years' time?

A - José Galló

Well, certainly, while this is our target, I cannot - well, it's not going to take a long time. Everything that I have just described, I would rather not give you a ballpark figure. But I would say maybe one year, one year and a half (00:33:30) we would reach these figures.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Thank you very much.

Operator

Franco Abelardo from Morgan Stanley. Mr. Abelardo?

Q - Franco T. Abelardo {BIO 17416219 <GO>}

Good afternoon, everybody. Two questions. The first, looking at the (00:33:L53) expansion, we see some news that some stores planned for this year will be postponed for 2019. So, talking specifically about the Renner brand expansion in 2018 - and do you know the number of new stores to be opened in 2019? This is the first question.

And the second question has to do with Financial Services. We saw growth both in revenues and the EBITDA from Financial Services, totally expected because of the comparison base. My question is the following. In the third quarter, it was more difficult because of the comparison base. But starting on the fourth quarter, could we see an increase in your revenues and maybe also in the results from your financial services or is the base still very challenging as we expect the drop in these results in the fourth quarter? Thank you.

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

This is Laurence. Thank you for the question. The first one, about 2018, well, this is regarding calendar. This happens every year. Sometimes, you have some postponements and sometimes you have some that are open before schedule. And we are according to our schedule, I would say, 25 stores for this year and this would be very normal in terms of postponement.

Regarding Financial Products in the fourth quarter, the answer is, yes, we see a going back to normal, the results from Financial Products in the fourth quarter of 2018. And I think this was the biggest impact. The biggest impact on our revenues was in the third quarter. So, we estimate and we expect a healthy growth in the results from Financial Products in the fourth quarter.

Q - Franco T. Abelardo {BIO 17416219 <GO>}

Well, 25 stores - close to 25 stores in the total new stores, right, mixed. Because of the closings, it would be 20 stores, if I understood it correctly?

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

Yes, yes, that is correct. Thank you.

Operator

Maria Paula, BB Investments. You may proceed.

Q - Maria Paula Cantusio {BIO 18652439 <GO>}

Good afternoon, everybody, and congratulations for the results. Thank you for the question. I would like to know from you. About the payment conditions, cash sales - are you seeing sales (00:37:00) for third party cards and delinquency of Financial Products has dropped quite significantly from the third quarter of last year now consistently, are

you more conservative in credit assignments now credit approval (00:37:17) will you be more conservative from now on? Or will we see a higher participation of Renner cards in the total sales? And could you give us an update about your operation in Uruguay?

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

This is Laurence. Thank you for the question. There has been no change in our credit assignment policy. Our policy continues to be stable. And what we saw was a higher degree of efficiency in collection and credit recovery. For some time already, we have been implementing and investing in technologies and with our own teams and those are the processes that we have reformulated for collection. And because of all of these efforts, we are being able to have the more effectiveness in this area and also making available a higher number of channels in order to facilitate recoveries.

To-date, practically, we have 100% digital credit process. In the credit assignment and maintenance and the recovery of credit, this is 100% digital today and this makes us more agile and more efficient in recoveries. And also, the quality of our portfolio has improved. So, there's nothing to be adjusted in this operation because it's very consistent and very healthy in the credit. Initiatives - well, the participation of the card is a big challenge. This is a trend. It is very challenging because of cards with different functionalities (00:39:22) is the following. We believe that we can mitigate or even recover or even cope with this complication with initiatives in terms of (00:39:42) the shopping experience and the functionality of the credit instruments of Renner.

About our Uruguay operation, we are going well. We have a good operation. We have a good pace of sales with a good acceptance of our collections. We have already said before that the operation is performing better than we expected, a very positive performance. So, this has been a very important learning experience for us. And we are proving the success of Renner model in another country. And so, within 2018, we are going to open an additional two stores in Uruguay.

Q - Maria Paula Cantusio {BIO 18652439 <GO>}

Thank you, Laurence. And I would like to ask another question. Have you changed your strategy for Black Friday for this year?

A - Operator

Well, this is an important date for retail, and we will be participating as we have participated in the previous years in this calendar normally such as we do in other important retail dates. Thank you.

Richard Cathcart, Bradesco.

Q - Richard Cathcart {BIO 16457807 <GO>}

Good afternoon. I have two questions. One is a follow-up on Maria Paula's question about the portfolio. In the presentation on page 13, you have this information, the Renner Card. It dropped to less than 2% and less than 2% than the previous years between 2% and 3%.

So, could we expect something closer to 2% from now on or maybe between 3% and 4% such as it happened last year?

And the second question has to do with e-commerce again. Laurence, you said that you had a pilot of same-day delivery in Rio, next-day delivery in São Paulo. And I would like to know if you intend to have same-day delivery in São Paulo as well?

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

Richard, about your first question, yes, it is reasonable to estimate something close to 2%. I think this is feasible, which is reasonable. About your second question, we are adjusting our operation and we are streamlining the functionality of the service. And as we gain more traction in this functionality, this could occur in the next few months. However, this has not been defined yet. It is important to have consistency in the whole process and - then adding this functionality to e-commerce. Thank you very much.

Operator

This question comes from the webcast phone.

What about your expansion through e-commerce? Do you have a target? Do you intend to increase your investments in this means?

We have been making important investments in order to consolidate the platform and all the technologies, and we will continue to make investments. But I would say that the bulk of the investment in order to guarantee the addition of new functionalities, this has already been made. This investment has already been made. We will continue to invest. But our CapEx in this area is not as relevant as it was recently. Our whole marketing area is focused on the productivity of all the social media, and we will continue to invest in a normal range.

The Q&A session is closed. And I would like to give the floor back to Renner for the closing remarks.

A - José Galló

This is Galló. Quickly - very quickly, I would like to talk about 2019. Everybody is asking us, so what about 2019? And first of all I would like to say that, regardless of solution A or B, we will not have a recession. We will see a positive growth of the GNP of Brazil. And the solution seen as more favorable by the market will certainly drive a climate for - more conducive to investments. And everything that we said during this call will mean that we will take advantage of both the growth opportunities that we have described to you during this call and the solutions that might not be as favorably seen as - by the market will not be the end of the world because I believe that the major test is the value proposal by the company.

When you have a reduction in the businesses, of course, you have to show more competitiveness than your competitors because consumers are always consistently

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(00:47:04) or assessing our competitive advantages. And even in the situation of having with this B situation, we have to have a very good package to offer products and stores and e-commerce and omni-channel. We have to offer this kind of package. At this moment, they even gave us an opportunity to grow in relative terms vis-à-vis the markets exactly because of the value proposals that we believe is very competitive. So, regardless of the results, so we are very close to what is going happen, I would say that we are very well prepared for both scenarios A or B and we are very confident that we will be able to have a good year in 2019.

Thank you very much for your participation, and we hope to see you in our next call. Thank you very much.

Operator

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

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