Y 2015 Earnings Call

Company Participants

- Eduardo Galanternick, E-commerce Manager
- Frederico Trajano Inacio Rodrigues, Chief Executive Officer
- Marcelo Jose Ferreira e Silva, Ex-CEO and Vice Chairman of the Board
- Roberto Bellissimo Rodrigues, Chief Financial Officer

Other Participants

- Fabio Monteiro, Analyst
- Guilherme Assis, Analyst
- Luiz Cesta, Analyst

Presentation

Operator

Good morning and thank you for waiting. Welcome to Magazine Luiza's Conference Call to discuss the results of the Fourth Quarter of 2015. We would like to inform you that this conference call is being recorded and all participants will be in listen-only mode during the Company's presentation. Afterwards, we will have a question-and-answer session, when further instructions for you to participate will be given. (Operator Instructions) The replay of this event will be available for one week after the end of the conference.

We would like to mention that forward-looking statement that might be made during this call relating to the business perspectives of Magazine Luiza, operating and financial projections and targets are beliefs and assumptions on the part of the company's management, as well as information currently available. Forward-looking statements are not guarantees of performance, they involve risks, uncertainties and assumptions because they refer to future events and therefore, they 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 performance of Magazine Luiza and may lead to results that differ materially from those expressed in such forward-looking statements.

We would like to give the floor to Mr. Marcelo Silva, who will make the presentation. Mr. Silva, you may begin.

Marcelo Jose Ferreira e Silva {BIO 20220206 <GO>}

Good morning, everyone. It's a great pleasure for me to make my last presentation as the company's CEO, up to December 31, 2015. When I completed my cycle in the Executive Board of Magazine Luiza, I would like to thank you all who have been with me in all the last quarters and take the opportunity to mention, when I was invited by Luiza Helena in order to set up a more professional Executive Committee; when Luiza Helena invited me in 2009, we published relevant or material fact which was a joint venture with the Bank and renewed for an additional 20 years. This was an important fact showing the partnership and how healthy this partnership between Itau, Luizacred and Magazine Luiza is.

In 2010, we established a strategic plan for the next five years and the main strategy was sustainable growth. We needed to have a much higher share of the Brazilian market and we decided that we should go after that, but with sustainable growth and for that we needed to consolidate our business in the regions, where we already operate in the Southeast and the South of Brazil and we also had to penetrate other regions, mainly the Brazilian Northeast, which has a lot of -- a lot to do with Magazine Luiza, because of the predominance of the C class. Then we brought our Headquarter from Franca to Sao Paulo because of our big footprint in the Greater Sao Paulo area and also because of the fact that Sao Paulo is the economic capital of Brazil and we acquired on the same year the Maia stores, 140 and in 2011 continue with our strategic plan.

We did our IPO and afterwards we acquired the Bau stores in order to consolidate our presence in the South and the Southeast. In the two subsequent years 2012 and 2013, we integrated these chains and in two years, which was something really incredible big success because you all know how difficult it is to integrate stores and history shows this in many different situations. But we were very successful in our endeavors and in 2014, we had the highest growth in the market, the best result in our whole history, very important for us.

We saw the evolution of our e-commerce more and more sustainable and growing more than the market and higher than the market. And we started our multi-channel strategy and we will be talking about that during the presentation in 2015; that we will comment in detail because it's the object of our conference today. We renewed our contract with Cardif, and once again, evidencing our joint governance with Cardif and BNBand we evolved even more in e-commerce and Frederico will be talking about this in detail in a few minutes.

And the last subject that I would like to mention in this cycle of seven years is our corporate governance, besides the successful joint ventures and the Itau Unibanco, BNP Paribas. For many years, we have already had a Board with independent board members and up to 2015 we had the presence Mr. Castro Neto, as the Chairman of the Board. And we thought -- we should review our corporate governance and this is what we did with a specialized consultancy company and we decided to have two additional committees, in Finance, audit and risk; and now we have a compliance one with experts from the market.

And in this review, Luiza Helena became the Chairman of the Board. I was invited and I accepted, of course, the position of Vice President or Vice Chairman of the Board. We have two independent Board members. And Frederico Trajano is now the CEO, he was already our COO. So he was appointed CEO in the succession process and we think it was very good and very well done. So he took this position now in 2016 together with Fabricio, Executive VP; but we have Isabel and other friends that came on Board and joined this team in order to reinforce our position and to maintain consistency, which is a major driver of our business. This is a big characteristic of Magazine Luiza not only in the operation, but also in terms of the culture and values of the company.

So people, both individuals and corporations have cycles. So I have just ended my cycle in this executive position, and I am very confident and this is why I continue to participate in the life of Magazine Luiza, because now the CEO is currently somebody who knows retail in-depth and ever since we started our first steps in e-commerce and multi-channel as well, he has been ahead of these initiatives. So we are totally confident that we are on the right track preserving the future of the company, which is the most important thing for our shareholders, for us.

So I would like to end my opening remarks. Thanking you very much for all your participation, all your interest in the company and now I would like to give the floor to Frederico Trajano, who is the CEO of the company.

Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Good morning, everyone. Thank you for participating in our conference call. Before talking about 2015, I would like to make a tribute to Marcelo Silva, not only because of the great cooperation that he gave us, but because his personal legacy, his examples in terms of ethics, consistency and he has always been a guiding light to all of us who work for the company.

Now, going to the results of 2015, I would like to summarize the year. I think, it's necessary to say that we had very challenging macroeconomic conditions. And as our sector is cyclical such as the durables, this is why we feel more or less these economic movements and the whole sector felt the effects of the deceleration that we had in 2015.

And as Marcelo said, the comparison base is very high, because in 2014 we grew by 18.7% and the best year of growth in the history of Magazine Luiza and we were able in spite of all that preserve our margins. We have the drop of 8.7, but the drop was offset by an additional percentage point in our gross margin. And I would like to mention that we had the best gross margin in the last four years. I would like to mention that we do not believe it's necessary to waive margin to gain share online or offline.

We have a lot of discipline in this sense and we will continue in 2016. Our focus this year will continue to be market share gain with preservation of our profitability and I believe that probably we will have better conditions for this market and I can go in details afterwards during the Q&A.

I would like to mention the performance of e-commerce mainly in the second half of the year. For a long time, we have been saying that at some point in time economic rationality would go back to e-commerce and when this happened, we would benefit from that because of our multi-channel strategy. And finally, this has been happening, we grew 19.1% in e-commerce. Even with a higher participation of e-commerce, we had an increase in gross margin and this shows that we have a rational operation there.

In an economy of index cost such as ours and the scenario of high inflation and higher interest rate in spite of all our efforts in reduction of expenses, we had a drop. In September last year, we hired a company to further focus our expense reduction, and we are already implementing many projects that were the focus of that. Cash is king, as American [ph] say, and in a moment of economic difficulty, companies have to focus on cash generation, and this is what we did last year. We had a sound cash generation and we reported a significant improvement in our cash in the last quarter of 2015.

Our net debt dropped from 1.2 billion in September of 2015 to 489 million at the end of the year. At the close of the year net debt-EBITDA ratio dropped from 2.3 to 1.1 in the same period and with that we believe that we are prepared to face any challenges that we might face in 2016. All these figures will be detailed during the presentation and I will come back to talk about our strategy not only for 2016, but also for the next few years.

Roberto has the floor now.

Roberto Bellissimo Rodrigues {BIO 17269312 <GO>}

Good morning, everyone. Let's start our presentation on slide number two. Once again, we highlight the sales performance, 3 billion, a reduction of 8.6% on a basis of 10% increase year-on-year. The fourth quarter of 2014 was very high. e-commerce once again growing by 19% representing already 21% of our sales, increase in the gross margin and expansion in this quarter, due to the improvement in the mix and the collection of freight and their charging for shipping and assembly, et cetera.

EBITDA with a higher gross margin but a lower dilution of expenses due to the sales performance and the market performance, but reaching BRL100 million with a 4% margin on net revenues. We had a reduction of over 700 million in our net debt 1.2 billion to less than 500 million and from 2.3 times net debt-to-EBITDA to 1.1 net debt-to-EBITDA and then operating cash generation, the quarter of BRL614 million impacted by the improvement in working capital that we have been working on during the whole year.

For the year as a whole, 10.5 billion decrease of 8.7% and the basis, the comparison basis was 18.7% in 2014, e-commerce growing practically 10% with 20% of our sales, an increase of more than three points or 340 bps higher than 2014 gross margin; 120 bps due to the same factors. And EBITDA dropping by 100 bps year-on-year, from 6.2% to 5.2% of net revenue reaching BRL465 million. For the year as a whole, net debt going from 651 million to 489 million dropped in the quarter and in the year as well. Net debt-to-EBITDA, adjusted net debt-EBITDA of 1.1 times. Cash position, quarterly BRL300 million going up from 863 to 1,160 million, which is far superior than its short-term debt, so we increased liquidity in the company.

And on the next slide we show the number of stores we opened in the year as a whole, 30 new stores. We still have one-fourth of the stores still maturing of the up-curve and in the year we invested a 158 million, highlighting a higher investment in new stores and technology. We invested 54 million in IT to support the whole company and the whole e-commerce and our stores and we invested less in remodeling, because we remodeled practically all stores in the previous years.

On the next slide, we show the quarterly evolution of the gross revenue first. As you can see the performance was better than the second and the third quarters with the evolution of e-commerce growing 19% based on 20% growth on a year-on-year comparison and exceeding BRL2 billion, the total sales of e-commerce.

On the next slide, we show you the evolution of our gross profit. Gross margin better in all the quarters than the previous year. In general, gross profit had a reduction of only 4%. On the operating expenses line, we can see that selling expenses in this quarter, for instance, were lower than in the previous year, administrative as well. So overall, these expenses dropped in nominal terms, in spite of the expenses in marketing that were higher because of our sponsorship of Soccer.

But you can see the sales performance and nominally dropping due to -- in the equity income line, we see that in the year as a whole, we have 76 [ph] million, a little bit less than the previous year, that was 100 and now 76, the result of Luizacred was impacted by higher provisions for delinquency for our non-performing loans, of course, and in the quarter, 8 million, and the year 123. Luizaseg, 5 million in the quarter, 28 million in the year, growing more than 50% the net income or the gross profit of the Insurance Company.

Here on the next slide, the quarterly evolution of the EBITDA once again impacted by the increase in gross margin and lower dilution of operating expenses and a slightly lower result from Luizacred for the year as a whole, we had a variation of 6.2% to 5.2% in EBITDA margin.

On page number eight, we show the financial result. We have a payment of receivables, prepayment of receivables impacted by the increase in the CDI of over 20% considering the quarter and the full year. And it does not reflect yet the improvement of the cash situation of the company and the renewal of Cardif happened at the end of December. So we increased quite a lot our cash position at the end of the year.

We show the reduction of our net debt here, in the last quarter you can see a reduction of over BRL700 million and based on the improvement of our operating cash flow, cash generation and also the renewal of the insurance contract. The improvements in working capital happened in all sides over accounts. You can see receivables, discounted receivables, inventories and you can see that the main accounts of working capital were addressed over the year.

And on the next slide, we show details of the cash flow of the operations. For the year as a whole, the cash flow of the operations was 428 million and we received from Cardif and

Luizacred 288 million. We invested 158 million and with a total 299 million cash generation, 300 million practically that increased our cash position and cash availability to 1.160 billion.

In the next slide we show the evolution of our net income. In 2014, we have earned 29 million and this year we closed with 66 of negative result. Net margin of minus 0.7% impacted by the sales performance, higher marketing expenses that I mentioned and the higher CDI in the period that also impacted this side of the account.

On the next slide we show the Luizacred revenues. Here we can see lower in the DCC. In the quarter, DCC dropped 52%, DCC of Luizacred plus the card, but the card grew by 3% showing how important our Luiza card base is and for the year as a whole the same. DCC for instance, dropped from 1,200 to 700, So our reduction over 500 million come from this conservative position in terms of our DCC operations that has been partially offset in the last couple of months about the Losango project, by the Losango project for the year as a whole. We show you the highlight; payers with Luiza card increased inside Magazine Luiza and so the participation of this card in our mix increased.

Now, we show you the portfolio of Luizacred, its lower sales in DCC, going from 1 billion to 600 million, and card 3.6 billion to 3.8 billion, so an increase because of the change in our sales mix and the profile of the Luizacred portfolio and the performance over the last few years.

And finally, we show you the overdue payments. We see an increase in past dues higher than 90 days in line with the indicators of the market and a reduction in the short -term delinquency, mainly in the last quarter dropping to 3.4%. The coverage ratio has maintained 118% and 120%, increasing our provisions, of course, and maintaining a conservative position in the approval rate for DCC and cards, credit as a whole.

Now I would like to give the floor back to Frederico.

Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Now talking about our strategy for 2016. I have a very clear mandate from my position vis-a-vis the Board, which is to accelerate the digital transformation of our business. We are a traditional retail company with an important digital operation, but we want to be a digital company with physical or point-of-sales any human want. Many projects are going to be followed in the digital transformation.

The first pillar is digital inclusion. The purpose of the companies to bring the access of many to what is the privilege of a few. This is the objective of the company and all of us and the reason that of the company. The current focus of the proposal is to make products and services more democratic so that people can not only own, but really master the technology. We have a big -- 70% of Brazilians do not have a Smartphone; 90% do not have a smart TV, many business opportunities exist in these areas and we want to be the top in these categories.

The second pillar is the digitalization of stores, of the brick and mortar stores. We want to revolutionize and bring digital technology to all our point of sale. The best example of this pillar is our mobile sales initiative. We have already trained 2,000 people. We want to reduce from 45 minutes to two minutes, improving the shopping experience for our client. By the end of the year, we want to roll out -- roll this out to all our brick and mortar stores.

The third pillar is multichannel. Today, we are the only retailers that are really multichannel and we want to bring this integration to the next level in 2015. More than half of the online sales in the south and southeast were catered to by this logistics network. And we reduced the time and the cost by over 70% for these regions and we trained all the sales people of Magazine Luiza about the over 40,000 items of our website. So they have a commission, this is all fully integrated and so the stores have to be distribution centers of our e-commerce.

The fourth is transforming the site into a digital platform. We already have our first test to sell via marketplace and we will be launching our marketplace initiative also to other online stores still within the first half of this year we want to increase the categories and the items for over 15 million consumers that hit on our website. And we acquired a subsidiary three years ago and you have this information, and this is a new category for us, in fact, which is health and beauty growing 70% last year with net income of BRL8 million, another sales operation that can get into e-commerce and evidence of being able to do this with a profit.

And the fifth is digital culture. It's not enough to want to be digital, you have to have the technical capabilities and we created Luizalab for our transformation and we innovated and we will have all the projects that are described in our pillars and this is fundamental for the digital transformation.

And I would like to say that we have many challenges that have to be tackled very seriously. But I believe that these challenges are much, much smaller than the opportunities that we have in the future.

I finish my presentation now, and I open for questions from you. Thank you very much.

Questions And Answers

Operator

Now, we will start our Q&A session for investors and analysts. Questions asked on the Internet will be answered afterwards, by email. And of course we will stay at your disposal if you still have any doubts. Mr. Fabio Monteiro from BTG Pactual.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Good morning, everyone. I would like to hear from you, your projections about market growth for 2016 in your segment both in e-commerce and in brick and mortar stores, whether you gained share or not this year, I would like to know what are your projections for this sector as a whole?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Good morning, Fabio. Thank you very much for your questions. This is Frederico. I have already given an interview about this, our view is that the market will present the same figures in terms of a downward curve as 2015.

I believe that macroeconomic scenario in 2016 will be very similar to 2015. I think the opportunities will be microeconomic in terms of gaining market share et cetera. So our focus is gaining share online and offline, but not to the detriment of our margins. We believe that there is the opportunity and the possibility of gaining share this year. Once again, and you know our history, we can gain share still in a profitable fashion, generating value to our shareholders.

In e-commerce, last month, it was like one digit, but the top of one digit and with an increase in the average ticket. So I think we can grow more than this for the year with the increase of our online operation.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Thank you, Fred. Another question about Luizacred. This year you have the effect of the increase of the PIS/COFINS taxes and probably higher provisions are part of this scenario. I would like to understand, what kind of scenario should we consider for Luizacred considering all that? Do you believe there will be a relevant drop in your net income or what level of ROE do you expect would be reasonable for Luizacred for us?

A - Marcelo Jose Ferreira e Silva {BIO 20220206 <GO>}

This is Marcelo Ferreira. For Luizacred, we don't give a guidance, as you know, we cannot give a guidance, but what I can tell you is that the scenario, the same way we have for retail is very challenging for credit as well and at Luizacred we are focusing on lower risk assets. If you look at the balance sheet of this year, you will see that we are focusing on lower-risk assets this year, and you see that revenues didn't go down. We were able to increase our revenues, because of our focus on Luiza card. There is a lot of loyalty on the part of our client for this card and we can sell credit based on this card. And what I see for 2016 is a continuation of the strategy. But in a deteriorated environment vis-a-vis credit as we saw in the last year, so it's more towards the fourth quarter than the first quarters of the year, because we still had a slightly better scenario for credit in the three first quarters of 2015.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Thank you very much, Marcelo and Fred.

Operator

Luiz Cesta from Votorantim Brokers.

Q - Luiz Cesta {BIO 15223262 <GO>}

Good morning. Thank you for the question. I would like to ask a question about e-commerce. This growth of 19% is really flabbergasting. So could you describe how you were able to achieve this growth rate. Was it via organic road or did you buy any clicks or was it the app that is improving the performance for mobile access. So could you explain how you were able to get this growth? And what about the marketplace project? Is there anything new that you could share with us?

A - Marcelo Jose Ferreira e Silva {BIO 20220206 <GO>}

Luis, thank you for your question. And I will answer, and if Eduardo wants to add, then please feel at ease [ph]. If you look at the last four years, we grow more than the market every year in e-commerce, you can see that we achieved very consistent results regarding growth in e-commerce always very rationally, as you know, this is one of our characteristics in the first quarter.

We had a comparison basis of over 40% growth in 2014 and you can see that the economic slowdown reached [ph] e-commerce in 2015 and some moves of rationality in the first quarter of last year. But in the second quarter, we had normal growth rates again. We resumed our growth, which is our history in the last few years. And if you have an operation with a rational management and a good competence regarding client acquisition, this gives you then an advantage and also due to the fact that we have multi-channel operations and very good logistics delivery, South, Southeast and Northeast, which have different needs in fact, and there is no silver bullet there, it's just a whole array of competences, rationalization of the e-commerce at some point in time, the cash and for those who sell below their cost. And I think all this movement towards rationality is very healthy for the whole market and we already benefited from that last year, and we will continue to benefit this year. And I now give the floor to Eduardo.

A - Eduardo Galanternick {BIO 20410320 <GO>}

Just adding to what was said in terms of conversion, we made a bet in October in terms of platform and what we saw was a higher conversion and this contributed to this result that we achieved at the end of the year in relation to market here --marketplace. We are already having attached with Epoca doing our operational and production test. And in the second quarter, we expect to expand and preserving our whole operations and our relationship with our clients.

Q - Luiz Cesta {BIO 15223262 <GO>}

Thank you.

Operator

Guilherme Assis, Brasil Plural.

Q - Guilherme Assis {BIO 16143141 <GO>}

Good morning, everyone. Thank you for taking my question. I would like to understand, how you see the competitive environment? In your message, I understood that you recognize that this will be or this is a challenging year and that you intend to gain market share. And I would like to know, how do you see the competitive environment in the strategy and how can you really preserve your margin with such a drop, an environment of a drop in sales, which is the estimate for this year, how can you preserve your margin? And are there any players who either regional or national that will allow you to gain more market share because of their poor performance?

A - Marcelo Jose Ferreira e Silva {BIO 20220206 <GO>}

Thank you very much Guilherme for your question. Good morning. Yes, we believe there is room both online and offline to gain share preserving our profitability. We do not believe it's necessary to waive your margin in order to gain market share. You have to have a performance that is better than the market and I believe that for two reasons.

We believed in e-commerce that there will be a trend, there is a trend, there is a higher rationality of prices, and this is necessary for the financial balance of the companies and we benefit from that such as already happened in the third quarter.

And in the brick and mortar stores, I think the same economy, of course, impacts companies as a whole. So all players in the market, you know that we are a BRL140 billion market, even if drops 10%, 130 billion we still have a lot of share to gain. This is not a monopoly. This is a market that has many players and I believe that the better structured and better capitalized structures, and our company is one of them, well structured and, well capitalized. These companies have the opportunity to gain market share, because some suppliers may have a problem regarding shrinkage or reduction in the number of stores. And we intend to continue to expand our base and we have to tap into this opportunity.

In this macroeconomic scenario that we mentioned during the presentation opportunities do exist. However, you have to be careful, you have to do this cautiously and doing this very well and with the very good execution of all the processes. There is no silver bullet, gaining share is difficult, so you have to be very focused in order to do well, what you have to do.

And if you look at our history, we have been achieving this over the years, we have grown more than the market and we have been preserving our gross margin. Fred?

Q - Guilherme Assis {BIO 16143141 <GO>}

Looking at the promotions of the year-end and January, have you noticed any change in the strategy of your competitors in terms of pricing, be it because they are more aggressive or because problems regarding cash flow of some players that is changing their strategy. So how do you see the beginning? In the beginning of the year, the pricing strategy on the part of competitors, do you believe -- you said that the market is going back to a more rational approach, but you've talked about that in e-commerce. But what about the brick and mortar stores, looking at January and your radar regarding competitor prices. What can you say about that?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Guilherme, I would like to talk about January and February. But till -- be about the market, what I have been saying here regarding what I believe will happen in the market, I think will materialize this year. Nothing in January or February, goes in the opposite direction. So I believe there is room for us to execute our plan for the year and with a lot of discipline regardless of what one or other competitor might do. The competitive environment is being like you know I described to you.

Q - Guilherme Assis {BIO 16143141 <GO>}

Thank you.

Operator

(Operator Instructions). As there are no more questions, I would like to give the floor back to Frederico Trajano for his closing remarks.

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

I would like to thank everybody for participating in this call and summarizing our message. We will have challenging year ahead of us but we are very confident in our company, in our team, and in our plans regarding costs and long term -- and just to tap into the opportunities that we have ahead of us. Good afternoon. Thank you.

Operator

Thank you very much. Magazine Luiza's conference call is closed. You may disconnect your lines now. Have a very good afternoon.