Q1 2014 Earnings Call

Company Participants

- Laurence Gomes, CFO

Other Participants

- Fabio Monteiro, Analyst
- Guilherme Assis, Analyst
- Gustavo Oliveira, Head of Latin American Research
- Irma Sgarz, Equity Research Analyst
- Tobias Stingelin, Analyst

Presentation

Operator

Welcome to Lojas Renner's Conference Call to discuss results for the First Quarter of 2014. We would like to inform you that today's live broadcast is being recorded and simultaneously translated into English. And the slide presentation is being presented at the website, www.lojasrenner.com.br at the investor relations section at the webcast icon.

We would like to remind that questions will be taken by telephone and by the platform. (Operator Instructions) We would like to remind you that questions coming from members of the press might be taken by (inaudible) office, 55 11 31659682.

Before proceeding, let me mention that forward-looking statements that might be made during this call related to the business (aspects) of the company operating and financial projections and targets are beliefs and assumptions of Lojas Renner management, as well as information currently available to the company. Forward looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions, because they relate 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 also affect the future results of the company and may cause results to differ materially from those expressed in such forward-looking statements.

Now, I would like to turn the conference over to Mr. Laurence Gomes, CFO. Mr. Gomes, you may proceed.

Laurence Gomes {BIO 15361799 <GO>}

Good afternoon, everyone. This is Laurence Gomes. And with me today I have Luciano Agliardi, Controller of the company. And Paula Picinini, Senior Investor Relations Manager.

Very well. The year, as you know all know, brings some important challenges to us and we have been working in a very well organized and planned fashion in order to guarantee the profitability of our businesses and at the same time maintaining our expansion plan.

I would like to suggest that we go straight to page number four, where we have the highlights for the period between January and March. Here, I would like to stress that the growth in same store sales of 5.4% is important and if we exclude the effects of the social security contribution on our revenue, this indicator would have been 6.8% and all this on top of an already high growth of 9.4% in Q1 2013. That is to say a very high comparison (pace) already. And I would like to highlight our operating expenses that were diluted by 2.4percentage points. We have met revenue and as a consequence, the retail EBITDA grew by 73.7%.

Financial products result were 29% higher and the total EBITDA reached BRL135 million, with a 50% gross and a margin increasing by over 4percentage points. Thus, the consolidated net income grew by 135.6%, reaching BRL51 million.

Now, going to a more in-depth analysis, I would like to ask you to go to slide number six. Our net revenue from sales were BRL814.5 million, representing a 12.1% growth. And this percentage follows the same growth pace that we achieved in 2013, especially the second half. And this is due basically to ongoing work of collection development and introduction of products to our stores, as well as the improvements of the implemented by Camicado. I would like to add that, as was the case last year, we continue to talk the monthly retail service, the PMC of the IBGE. And in two months we already have the data available, which means January and February.

Now, going to slide number seven, where we show you the gross profits of the company. Back in Q1 '14, reached BRL422.3 million, 13.5% higher on a year on year basis. And the gross margin from the retailing operation was 51.8%. The good inventory management (inaudible) and the better margin delivered by Camicado contributed to this.

Inventory losses posted in the quarter were lower than in Q1 2013. But still higher than the historical average for the company. After concluding the inventory in March, we adjusted our position levels and we will start to provision approximately 10% more than the levels that we had last year. Our losses are equivalent to about 70% of the average level in the market. I would like to stress that regardless of this factor, our gross margin for the year should be stable vis a vis 2013. Besides, I would like to remind you that the new security system has brought us many benefits from the seat of operations and increasing productivity and up to savings generated by the elimination of the referred logistics of the labor resolution that we had in our SGA, due to the new alarm system, more than offset the losses that were higher than historical levels.

Now going to operating expenses on slide number eight. You can see that our SG&A amounted BRL337.8 million. In Q1 '14, selling expenses were diluted by 1.5%, whereas general and administrative expenses went down by 0.8percentage points, vis a vis the net revenue. These dilutions are related to some (phase ins) to the initial benefits from the implementation of the Shared Services Center, as well as our strict expenses control and the preparation of our corporate structure for the Second Quarter of 2014 that has many uncertainties because of the number of holidays and the impact of the World Cup on the inflow of clients into our stores. We are prepared to take a slower pace of sales and in case this narrative does not materialize, we expect to keep the profitability of our operations.

Now, going to slide number nine, where we have the EBITDA of our retailing operations growing by 74%, reaching BRL73.6 million. This growth is related to the good margin practices by Renner and Camicado, as well as the strong expense control. You may notice that part of this margin gain should be neutralized in the Second Quarter of 2014. And that we maintain our expectation of stable margins for this year as a whole.

Now, please turn to slide number 10. I would like to say a few words about the financial operations -- financial services operations with a 29.1% growth. And we continue to grow our revenue, aligned and even (requitely) higher than the growth of retail. The losses continue at low levels. And operating expenses were only 7% higher.

In this part of the operation, I would like to highlight three additional points. First, the (Cartao Renner), the Renner card operation that continues to drop participation. But less than in the previous years, the reduction was 0.9percentage points which should be (receptivist) of our (Portuguese) project. Secondly, I would like to comment on the Meu Cartao operation, which is our co-branded card with Visa and MasterCard. We already have a portfolio of BRL208 million, with 147% growth on a year on year basis. And the operation is going as planned. And we are currently working to increase our client base. And lastly, I would like to highlight the delinquency level that were still lower than the First Quarter private label Renner card, producing losses of 2.1 to 1.7% in the First Quarter of 2014. Personal loans from 4.1% to 3.7%. And co-branded fell from 8.9% to 4%.

On slide 11, we show you the evolution of the indicators that we have already mentioned, as well as the past due levels in our portfolio that have been dropping due to the good behavior and the better extension of credit. Due to the points on slide number 12, we show you the total adjusted EBITDA BRL135 million, 50% higher than in the First Quarter of 2013. And the total EBITDA margin went from 12.4% to 16.6%.

On slide 13, we have the financial results and the net debt of the company. On the upper part, we show you the net financial expenses of BRL15 million, 14% lower than the BRL17.7 million in the previous year. On the second table on the same slide, we have the net debt that reached BRL303 million, made up by cash, BRL753 million in gross debt, BRL1.56 billion, considering the ventures and the (banco).

Closing our financial statement, I would like to show you on slide number 14 our net income for the period that grew by 135.6%, growing from BRL21.6 million to BRL51 million. And margin -- net margins from 3% to 6.2%. And lastly, still on slide number 15, we have the CapEx breakdown in the quarter, amount to BRL77 million in this quarter. And invested more than BRL37 million in new stores, BRL16 million in store remodeling and I would like to highlight the distribution center that received BRL21.5 million, allocated mainly to the new (Santa Caterina DC).

So these were my main remarks. And now I will be available to answer any questions that you might have. Thank you. Thank you.

Questions And Answers

Operator

Now we will start the question and answer session. First we will be answering the questions in Portuguese. And afterwards, we will be answering the question in English. In case you have a question, (Operator Instructions)

Our first question comes from Mr. Guilherme Assis from Plural. You may proceed.

Q - Guilherme Assis {BIO 16143141 <GO>}

Good afternoon, I have two questions. The first one had to be -- had to do with cash flow. And the inventory line accounts receivable that is to say we saw an increase with (inaudible) last year. Could we expect this to go back to the historical levels? And we could expect the longer cash cycle and we saw an evolution of the great margin vis a vis the First Quarter of last year. Is this is a change in your pricing and mixed strategy in (inaudible)? Or was it because you are beginning to mature in (UCOM)? Thank you very much.

A - Laurence Gomes {BIO 15361799 <GO>}

The first question is about the receivables. The main impact here was the growth in our account receivables from Meu Cartao. The Meu Cartao portfolio with 147% growth and it's interesting to observe that in our accounts receivable, we have accounts receivable that come partly from the operation of financial products. So if you isolate these accounts receivables from our financial operation, our accounts receivable from retailing operations would have been 14%, very well aligned with the growth in our retailing operations and sales operations. So here we have personal loans. But also it was the Meu Cartao portfolio that caused this impact, or this higher growth in our accounts receivable total.

Regarding (UCOM), it's important to remind you that (UCOM) is a rather new business and we are building a brand, with a new format and it was the first collection ever. So the markdown was bigger in this quarter. But this is just a natural adjustment in a business that is (salty). We continue with the same growth guidance as planned up to 2021. This has not changed and the opening of stores for 2014 continues to be 15 stores. So this is just natural, this is just business as usual. And it takes some time for cooperation to mature.

Q - Guilherme Assis {BIO 16143141 <GO>}

Regarding accounts receivable. So we should expect Meu Cartao receivables to continue have the same impact in the future, is that correct?

A - Laurence Gomes {BIO 15361799 <GO>}

No. But this was totally financed by the operation itself. The financial services operation itself funded. So you can see that accounts receivable from our retailing operation are aligned with our sales -- our retail sales, Okay? Thank you.

Operator

This is Irma Sgarz from Goldman Sachs.

Q - Irma Sgarz {BIO 15190838 <GO>}

Good afternoon. About Camicado, you had already relevant gains in your gross margin from Camicado and I would like to know the profitability in the EBITDA for the First Quarter? And what are your strategies from now on regarding this format and the additional mergers that you could be taking regarding product mix or profitability and further expense reductions?

A - Laurence Gomes {BIO 15361799 <GO>}

In the First Quarter the gross margin was higher year on year. And it stems from the adjustments at the level of products and the comparison paid was low. So Q1 last year we had an adjustment in our inventories and an aggressive markdown in order to be able to turn the Camicado inventory. So this penalized our margins in Q1 2013. But over the year, many adjustments were made and in the First Quarter of 2014, we already delivered positive results from this operation in the product mix. So this is a plus.

A gentle improvement or gain well it has to do with the mix of imported products. I think we still have room to increase the participation of imports in our mix. And this could help us with the Camicado operation and productivity or shore up productivity is something that is already underway. In line with our (inaudible) opinion. And we are always seeking improvements in the operation and this is an ongoing work. And we continue with our plan for Camicado, which is from six to 10 new stores to be opened before the end of the year.

And Camicado is good in terms of mix of stores in shopping malls, which has a national footprint today, already. And our expectation is very bullish about this business and our plan for 2021 is to reach 125 stores -- Camicado stores. And the second part of your question regarding the break even. We expect to reach the breakeven point this year for Camicado's EBITDA level. Thank you.

Q - Irma Sgarz {BIO 15190838 <GO>}

And your (inaudible) interest bearing sales? We saw a significant drop, quarter on quarter. Are you changing your strategy? Are you giving preference to clients that chose a different financial product? Meu Cartao maybe?

A - Laurence Gomes {BIO 15361799 <GO>}

There are two points. The drop in the participation of the Zero Plus Eight, shows a lower appetite on the part of clients for interest bearing plans. But the net loss that (inaudible) the reduction in provisions, due to the debt rollover of these product. And this is was explains the reduction in net losses in Zero Plus Eight. The drop in participation, our revenues were lower in terms of (CGQ). And (CGQ) was discontinued when the cost of funding went up. And this also had an impact on revenues from this product. And also we see a lower willingness on the part of clients to buy in the interest bearing system.

Q - Irma Sgarz {BIO 15190838 <GO>}

Have you been (tressling) the increases due to the (Feliki) rates to your consumers? What about their reactions? Very often the consumers are not very much aware of how much they are paying in terms of their overall debts. But maybe you could talk a little bit about this?

A - Laurence Gomes {BIO 15361799 <GO>}

In the operation of financial products, this is this reports the retailing operations and the Renner Card go back 40 years and our credit policy, we are very cautious about that and we have a lot of discipline in our credit assignments. And this operation will always be subordinated to our retailing operations. And always subordinated to Renner's value proposal regarding the purchases that are made by our clients.

Q - Irma Sgarz {BIO 15190838 <GO>}

So this transfer?

A - Laurence Gomes {BIO 15361799 <GO>}

Well we have not transferred these up to now. We have not saw the need to transfer this to our clients. And we believe that we can. So to say, absorb this impact of the increase in our funding conditions. And we can give this back to our clients in terms of improving our productivity and improving the efficiency of our collection. And we're now in negotiation with suppliers, et cetera. And we're trying not to transfer debt to the clients so far, up to now. Of course, depending on the scenario this could change. But so far, we do not deem it necessary to transfer this additional cost to our client. Thank you.

Operator

Fabio Monteiro from BTG Pactual.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Good morning, everyone. Now, about logistics. My question has to do with logistics. You talked about BRL21 million invested in this area this year, mainly in the (Santa Caterina DC). Maybe you could give us an update about the situation of this project and the push for models and for next year? Could you tell us please about the current benefits derived from the new model that you will be achieving for the company? And still talking about logistics, you said that part of the gains in your gross margins, I would like to know how much appreciable, which was not fully implemented yet, if it had any bearing on these results?

A - Laurence Gomes {BIO 15361799 <GO>}

Well first, talking about investments. As I said before, (leaving) in this quarter, we made investments that were very much focused on the (Santa Caterina DC), the 2,000 square meters in the DC and that will operate in the First Quarter. And we expect it to be ready by the end of 2014. So that it may start up in the second half of 2015, moving according to our schedule and in Rio de Janeiro the First Quarter is operation between 20 and 25% of the overall pieces that are distributed and we will only start to reap the results of 2016. And our visibility is, as of 2016, the impact of the changes and the new logistics infrastructure. This is when you will be seeing this on the back of the overall revenues. But the distribution center was (inaudible) working in the adjustments are being done. And everything is going according to plan.

Q - Fabio Monteiro {BIO 3711690 <GO>}

For 2015, do you know how much you will be investing in this project?

A - Laurence Gomes {BIO 15361799 <GO>}

(audio gap)

Q - Fabio Monteiro {BIO 3711690 <GO>}

..in your format and what will your strategy be in regarding third party brands also in apparel?

A - Laurence Gomes {BIO 15361799 <GO>}

Fabio, there is no relevant change. Everything is according to budget. There is no change whatsoever in these divisions. Nothing's relevant that I could tell you. Thank you.

Operator

Tobias Stingelin from Credit Suisse.

Q - Tobias Stingelin {BIO 18290133 <GO>}

This year there was benefit of the INSF on the payroll. Could you quantify that?

A - Laurence Gomes {BIO 15361799 <GO>}

When you talk about the benefit, are you talking about the gross margin?

Q - Tobias Stingelin {BIO 18290133 <GO>}

No, on the G&A?

A - Laurence Gomes {BIO 15361799 <GO>}

1.8%.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Of your G&A? You've had this year. And you didn't have this last year, because it was only enforced as of Third Quarter. Now, looking at the gross margins, last year, you had an adjustment in your inventories, BRL12.9 million and 53 in a margin from retailing operations. And this year, it would have been 52.5, normalized. If I make a comparison, there would have been a drop in your margin. Am I missing something in my calculations?

A - Laurence Gomes {BIO 15361799 <GO>}

You are considering the social security contribution, right?

Q - Tobias Stingelin {BIO 18290133 <GO>}

Yes, I'm adding it back. I'm adding it back. That's right.

A - Laurence Gomes {BIO 15361799 <GO>}

This quarter, we had a supplement of BRL7 million in our provisions. So if you go back we reach something very similar in terms of gross margins.

Q - Tobias Stingelin {BIO 18290133 <GO>}

And one last question, you said that this would be a tough year. But looking at the Second Quarter I know that there are many uncertainties regarding the number of holidays. But are you more concerned than you were before? Do you fear a higher number of holidays?

A - Laurence Gomes {BIO 15361799 <GO>}

No, as we have been saying since last year. And also in the last call, we expect to have a year that is very similar to the previous one, in terms of operation margins. And also in terms of growth. So there is nothing different in this regard.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Thank you.

Operator

Mr. Gustavo Oliveira from UBS.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Good afternoon. I have a question about your financial operations. Zero Plus Eight losing share being offset by the profits in the co-branded products. How do you see the behavior of the co-branded consumers? Is it the same consumer that is no longer buying Zero Plus Eight and using the card, the co-branded card, more often or replacing the Zero Plus Eight? What kind of products are the buying outside your stores with the co-branded cards?

A - Laurence Gomes {BIO 15361799 <GO>}

No, you shouldn't draw a correlation there. Of course, there is a loss. And the co-branded is like an upgrade on our private label cards. It is a way for us to put a stop to the drop in participation of the private label cards. So this is a private label, with additional features, with different features and special features. In fact, the clients continue to have a cap, a limit inside the stores. And, of course, the clients can buy outside our stores as well. But what we see is a higher participation of these clients in the purchases made within the branded stores.

So this correlation does not exist. It is not true. And it's important to say that we have a discontinuity in the co-branded in 2012. And we re-launched co-branded in 2013. And we started to offer and to activate our clients inside our stores. This as important. So this year, we have already reached break even, that is to say, in September 2013. And they're very good results already. So co-branded is going very well. And we have a good expectation regarding the co-branded card. There is no cannibalization and the drop in participation in Zero Plus Eight has to do with a change in the behavior of clients. And all of the clients, all the banks are saying that consumers are having a high degree of difficulty regarding credit. So this probably had an impact on the drop, on the Zero Plus Eight interest bearing operations. Clients are more cautious regarding taking credit.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay, thank you. Very clear.

Operator

I would like to remind you that in order to ask a question, (Operator Instructions) Please stand by while we wait for questions. The question and answer session is closed. We would like to give the floor back Mr. Laurence Gomes for his closing remarks.

A - Laurence Gomes {BIO 15361799 <GO>}

I would like to thank everybody for participating in our call. And we will expect to see you next quarter. I wish you all a very good afternoon.

Operator

Lojas Renner conference call is closed. We thank you for participating and wish you a very good afternoon.