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Y 2018 Earnings Call

Company Participants

- Felipe Coragem Negrao, Chief Financial Officer
- Peter Estermann, CEO
- Unidentified Speaker

Other Participants

- Gustavo Oliveira, Analyst
- Joseph Giordano, Analyst
- Pedro Fagundes, Analyst
- Ruben Couto, Analyst
- Thiago Bortoluci, Analyst
- Tobias Stingelin, Analyst
- Unidentified Participant

Presentation

Operator

Good afternoon, ladies and gentlemen, and thank you for waiting. Welcome to Via Varejo Conference Call to discuss the Results for the Fourth Quarter and the Year of 2018.

The call is being broadcast via Internet at our website, www.viavarejo.com.br/ir, where you'll also find the Company's presentation. Slide selection will be managed by you. The replay will be available after the call is finished. The Company's press release is also available at its IR website. The call is being recorded and all participants will be in listen only mode during the Company's presentation. After the Via Varejo's remarks, there will be a question-and-answer session when further instructions will be given. (Operator Instructions)

Before proceeding, we should mention that forward-looking statements made during the conference call regarding business perspectives, projections and operating and financial goals are based on the beliefs and assumptions of Via Varejo's management, as well on information currently available to the Company. Forward-looking statements are not guarantee 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 could also affect the future results of Via Varejo, and cause results to differ materially from those expressed in such forward-looking statements.

Now I'd like to turn the floor to Mr Peter Estermann, CEO of the Company.

Peter Estermann {BIO 15380447 <GO>}

Good afternoon, everyone. Thank you very much for being with us in the earnings call for 2018, I have here our CFO with me, Felipe Negrao, and our call today is going to be separated into different moment. Felipe will talk about 2018 results and then, I will talk about what we are doing in the Company in order to deliver the results that we are estimating for this year, as well as, to talk about the continuity of our omni-channel strategy. So I will start by turning the floor to Felipe, so that he can comment on the results for 2018.

Felipe Coragem Negrao {BIO 19434019 <GO>}

Good afternoon, everyone. Thank you very much for being with us. So let's just start talking about the results for 2018 on slide number two, In 2018, we had a growth of our gross revenue, consolidated gross revenue of 5.2% reaching BRL30.6 billion. Brick and mortar stores, we had a growth of our gross revenue of 4.6%. In the online revenue, we also had a growth -- an increase in our gross revenue of 10.7%.

On slide number three, on the online we had a GMV growth of 10.2%. Invoiced GMV for 3P had an increase of 4.3%, and the performance of the invoiced GMV for 1P had a growth of 11.3%. Also, in 2018, there was a significant movement in our click & collect, a very important differential, and our brick and mortar stores are an important asset for Via Varejo.

Turning to slide number four, gross margin had a drop, as a result of a lower margin in products sold due to lower share of our direct consumer credit, because we are more selective in our credit policy, we are maximizing the cash margins of the Company and also a lower share for services. We had efficiency gains in SG&A, several lines, that went from 25.5% to 25.1% of our net revenue. We expect to have (Technical Difficulty) improvement in this result thanks to all of the measures that we have implemented and are rolling out in 2019. And because of all that, our adjusted EBITDA margin dropped to 4.6%.

Slide number five, our net financial result before restatement improved from 3% to 2.8% of our net revenue. We had a net loss of BRL267 million in 2018. Slide number six, the Company is maintaining a sound cash position with a net cash of BRL4.4 billion.

Now, I turn the floor to Peter, who will talk about the business perspectives of the Company.

Peter Estermann {BIO 15380447 <GO>}

Thank you, Felipe. Very well, the topics I would like to highlight today, they are directly related to our execution agenda, that is fully focused in the improvement of the purchasing experience of our customers, both in the brick and mortar stores, as well as

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the online stores and also in the delivering results. The results that we are committing ourselves is delivered to you today.

I will basically talk about four main pillars and we are already working on these pillars since the beginning of this year. The first one is to increase revenue in all channels, brick and mortar and online and to have the generation of cash margin. And the second one is related to the improvement of the operation, both for B&M and e-commerce. And the third one is implementation of all the initiatives to reduce expenses that are not effecting the level of service and not affecting the purchasing experience of our customers. And the fourth is the continuity of our omni-channel strategy that we have started at the end of 2016.

So, talking about the first pillar, which is the growth of revenue in both channels, with cash margin generation, I would like to say that, this pillar aimed at increasing revenue is fully supported by our commercial strategy. And main drivers here we have to work in the right offers with aggressive prices, in order to bring in traffic of customers to our stores, to increase the sales conversion rate. And this is -- and also with significant participation, a significant share of media here.

The second driver is focus in a sales mix that will favor the margins to try to offset that strategy of aggressive offers and there we focusing specifically in two categories that we understand that we will make a big difference in the results. The first one is furniture. In furniture category, that we have the largest furniture factory in Latin America and then we are the largest retailers of furniture selling in Brazil. So we have here an important competitive advantage because most of our products are manufactured in our own stores, in our own factories and here we have a significant margin differential. This category, we started accelerating since the beginning of the year and it's already showing an important and positive share contributing to improve our margin.

And the second category is a home appliances and electronics and this has an important margin as well. We have a team focused in order to have a greater penetration of that category in our sales mix. We are also reviewing our payment means strategy for all categories of products and price ranges. We want to adjust installments and credit assignment to each one of these price ranges and category of products.

We're also working in the very expedited fashion in order to optimize our relationship with suppliers. We always say that we cannot change the game without working with suppliers, so this is the joint work in our sales planning so that we can optimize the production cycle in the industry and a clear understanding of our strategy regarding categories and product mixes, and which one of them can bring a competitive advantage to our suppliers. Basically, the idea here is to be able to be more competitive.

And we have a very low level of stock out, especially in the high turnaround products. We are also realigning incentives for our sales force. And this is really a realignment, it's not a change. This is a realignment of incentives and this is focused on sales conversion now. And then the product mix that will accelerate our margin improvement and also financial services and credit operations that are crucial for the Company's margins.

About improvement in the operations, which is our a second pillar. We'll be concentrating our efforts in the operating stability of the system, in which, we have been working since the end of 2017. Those have been very strong in 2018. Integration of the platforms and then the development of the new systems. We did have a few problems, as you know, in the operating stability and the main focus that we have now for the short term is for the Company to recover that operating stability, both in our brick and mortar stores as well as in the online.

And here, we talk basically about our new system Via+, which is our brick-and-mortar stores operating system. I can tell you that it is already stabilized. The level of operation has improved a lot in the last 45 days. And we are already back fully operating in this system. You remember that we had to remove the long tail operation at beginning of the year because of systems instability, but we are back to the long tail again and the system is operating in a stable fashions with a very positive impact in brick-and-mortar store sales as well.

And we still have an important priorities to stabilize our app in also our e-commerce platform. I can tell you that in the last two weeks, it has already -- the stability has already improved a lot, but we still have an important work to do ahead. I also said that we put together some war rooms to define and to work on those instabilities. And I can already tell you the online stores are operating at a very satisfactory level of stability. And we already see that showing in the store environment as well as in terms of the (Technical Difficulty) sale force.

All the war rooms that we have created, we have deactivated and we are deactivating this week three of those war rooms. When we deactivate a war room, it means that we have reached the level of stability and we were able to address the main problems we had. So the war rooms that we have is stabilized are click & collect, fraud and marketplace. So by the end of this week, we will be leaving the war room for these three areas and we'll be back operating with these systems and the products of vertical and that means that they are stabilized.

The next ones in line that we have to go back to work and in terms -- they relate to orders development and freight. We have gone forward on those, but we still have some work to do and we understand that part of that war room, I believe, that in the next 30 days, we will be able to deactivate and the remaining we should take up to the end of May. And we still have three important war rooms ongoing fully, which one is related to mobile, and that is the stability of our app and the stability of the marketplace platform and also the marketplace in and out platforms. And these three war rooms will move on for a little longer, but we already have positive signs of important improvements.

The third pillar, which is expenses reduction, is fully ongoing, the implementation is expedited. We have done in January all needed adjustments to our back ops structure, so this is a stage that is done. We are reviewing IT contracts, the software and other agreements. Our legal area is working and our legal platform is working in a stable fashion. We have a lot of efficiency in the process management and there is a reduction in the new lawsuits. And you remember this is important in the revenue of Company and it starts to show important reductions there.

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And we have another crucial front working on the reduction of the cost of occupation, basically the leases of our B&M stores and some BCs as well. And we do have here also expenses to be reduced in consulting services.

And finally, I would like to talk about the continuity of our omni-channel strategy. We had concluded our first stage of the omni, so you were with us throughout last year. And we do have the opportunity to work and to grow a lot and using the information and now our data center is stabilized. And we are already having more assertiveness in terms of customized offers to our customers.

And also another front of continuous improvement, we have our MRI to improve our marketing efficiency. We have several learnings that are already bringing positive results to the Company. And also the use and the improvement of our platform for the apps to improve the shopping experience and also sales conversion in the online.

The marketplace platform, as I said, we have important steps there. Marketplace is growing significantly year-on-year. The platform is already operating in a more stable fashion. We have new products coming in, new sellers coming into the platform, that's already happening in a much better efficiency when compared to what we have in the past. And finally, in our omni-channel strategy, we will tackle the third wave of the credit platform and Felipe can give you additional details on that later on.

And to conclude, I would like to say that just today we have announced to the market a few guidance regarding the results we expect for 2019. I would like to say that our team is focused, very optimistic. And I can tell you that the team does believe that we can deliver the guidance that we provided today that is based on fact and data and the analysis of all opportunities that we have to implement and also in the execution capacity of our team.

So we do estimate a growth in brick and mortar stores of 2 percentage points above inflation, IPCA, this is an indicator that will accelerate, will increase over the year. We will have a continuous improvement quarter-on-quarter. And also here we expect to have an expansion of 20% to 25% of the invoiced GMV this year. We believe -- the whole team believes that we will be able to deliver this growth in adjusted EBITDA margin over 3%.

Based on the initiatives that I have already mentioned, we have already worked at these levels of EBITDA and I believe that we can just go back to delivering results that we have the delivered in the past -- 6% of EBITDA in the year. In order to do that, of course, we will have a period in the third and fourth quarter of better figures and in this one.

And to end our guidance we have an estimate to invest between BRL550 million to BRL600 million of investments this year .And this is still a attractive. The commitment of the Company to deliver long-term results for the Company. So once again, before we open the floor to the Q&A session, I would like to stress that we are very optimistic and constant. We believe we'll be able to deliver the guidance based on everything that we have analyzed and assessed so far and also in the delivery capacity that the team has. So now I'll turn the floor to the Q&A session.

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Questions And Answers

Operator

Now we would like to open for questions. (Operator Instructions) Thiago Macruz from Itau.

Q - Unidentified Participant

Good afternoon. This is (inaudible) in fact. Thank you for the questions. Please sort of with the gross margin of year-on-year, impacted by promotions and also financial products, so how much of the 450 bps was due to promotion, how much was the impact of the direct consumer loans and services? And I would like to know your view for 2019 about logistics, adaptation and legal claims, et cetera?

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

Good afternoon. This is Felipe Negrao. The first question, so there were three component in the reduction of the gross margin. The first one, as you said yourself, is the reduction of credit assignment. So maximizing the cash margin of the Company and because of that we had this high approval rate, that is to say higher than 50%. And when we talk about credit cards, it is lower than 20%, so I can reduce credit at the same time increase the credit margin -- cash margin. Credit plus financial services is very much linked to credit because it is much better than in the credit operations and in other products and you calculate about 70 basis points in gross margin. So this is the number.

So there are many other facts and we do not give a disclosure for that. So part was due to that. And there is another part, that is the inventory reduction. So from the third to the fourth quarter of 2017, you have the situation inventories and this year, there was a reduction in this inventory levels. And why do we have this result? As a first point we have the bonuses. So, when you buy it from suppliers, there is a part of the bonus that is the sellout. And this is allocated to the result. So, we had this situation regarding bonuses with the impact on the reduction of the bonus margin. This is a one-off expense, this is a one-off cost. Going back we started an increase inventory levels when we had the market already improving when we had a perspective of the Company, where we had a possibility of buying. So we wanted to have more inventory, we wanted to make sure we had enough inventory. So that was something that we needed to do. That was the best option for the Company at the time. And then the inventory levels went down, that happens in second fixed costs.

So, part of that is related to the season, and this is still have fixed costs and these fixed costs, i.e., a portion that I alluded to according to the volume of merchandise, the fixed cost allocated by product now is higher, because I have less product, less merchandise there. And for 2017 products went into inventory. And now, since I am destocking these costs turned and they are showing in the results, so therefore that also impact the stock reduction. So it was something needed for the Company. We needed to do that in the long-term and this is something positive.

Regarding SG&A expenses and other expenses here of BRL551 million, so what we (Technical Difficulty) part of that BRL74 million we believe that to a new one, so that's

BRL74 million coming from the write-off of assets, software development and the stores that we have closed and non-performing stores and so assets write-off and also the sale of one or another asset that we ended up selling, okay. So here we have an accounting write-off or so, okay. We have other line with related parties, there wasn't an agreement and we are more efficient in some criteria that we had here, we had a loss of BRL82 million. I believe this is going to be the last agreement we signed, we are reviewing all topics in the contract. And I don't think there's anything else to be a returned here to the client family and finally restructuring expenses, so up to the third quarter of 2018, we used to close a store or to have an expenses because of the company's restructuring in that expenses would go to other expenses, other operating expenses.

So even when people would, so the company revenue would have legal judicial expenses because of the lawsuit that would go into operating expenses in the company, whether these sales are administrative. And for us, since these expenses are related to restructuring, they have to go to other expenses and other operating expenses. That's why we did this reclassification in the third quarter and the year that has no impact and that's why we're now reclassifying that from the first to the third quarter and to the fourth quarter.

A - Unidentified Speaker

Okay. It's very clear. Thank you very much.

Operator

Mr. Ruben Couto from Santander has a question.

Q - Ruben Couto {BIO 20636571 <GO>}

Good afternoon or good afternoon. Thank you very much, a follow-up on this question. Regarding the expectation or what is that you estimate for expenses in '19, can you give us more color there? And also, I understand that 2018 is over, the focus is on 2019, but can you also give us more color, what really happened with the products, with our merchandise in the fourth quarter? Why didn't you bring sales of Black Friday and Christmas, the problems you had, have been addressed, do you believe you have a better reaction in the beginning of the year? Can you tell us what happened at the end of the year, should we expect to see something more normalized?

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

Okay, I will address the first part of your question and Peter will talk about the second part. So, first, we are not providing guidance neither of net income and nor of the other revenues. And these revenues are part of the EBITDA. On the other hand, if we compare that to the level of results and we go back to page seven, our adjusted EBITDA, we can see that in 2017, we had a BRL340 million that was the high in 2018, BRL551 million, also very high. It tends to be reduced for some reasons and the main one and I think that's first. In the two years we had a write-off and because of this agreement that we had with the client family, we believe this will no longer be there. Second, we had a restructuring expenses. 2015 and 2016, we had a reduction in the number of personnel in our

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headcount, and also we -- from then on we had expenses in the legal area. And those expenses have been reduced significantly.

And we did also have many lawsuits and we had opportunities to improve them in the Company so that these lawsuits won't happen anymore. We don't have any employee suing the Company. And therefore, we have a possibility of gains whether by the new law, by documentation or how we manage our headcount everyday. So if we look ahead, we expect to have a reduction there as well. It's very important to stress the whole management of the Company and also considering the compensation of the Company, all of us have an important KPI here, which is net income. So anything that changes in the Company that will affect the net income and also adjusted net income and so we are fully aligned to well-manage this line.

A - Peter Estermann {BIO 15380447 <GO>}

About the margin result of the last quarter, everybody knows that the last quarter has quite a big seasonable impact because of Black Friday and Christmas and in the brick and mortar stores we had a Black Friday in terms of sales that was as we expected. Nevertheless, the margin was lower. So there was a very good competitive situation in the market and this impacted our volume that is concentrated in brick and mortar stores. It was the same level that we expected. This is what I mean. And for 2019, you saw or you heard in my remarks that we radically changed our commercial strategy. That is to say, today, our commercial team has a target for sales and for cash margin as well. So we're working with a much more assertive offering policy and with a focus on products and mix that is quite different from the ones that we had before. So what I can tell you is that, the answer is, yes, we are being able to grow our top line with the re-composition of our margin and what we expect is that we will continue in this direction and of course with better results.

Q - Ruben Couto {BIO 20636571 <GO>}

Thank you very much.

Operator

Joseph Giordano from JPMorgan would like to ask a question.

Q - Joseph Giordano {BIO 17751061 <GO>}

Good afternoon, everyone, and thank you for the question. I have two questions. I would like to know the evolution of both growth and commercial margin over the first two months of the year. Can we see some positive change already? And Peter talked about the improvement in payment means and the composition of margin, product, so what about the strategy of Airfox, FinTech vis-a-vis credit? Thank you.

A - Peter Estermann {BIO 15380447 <GO>}

Thank you. I would like to let Felipe answer afterwards about payment made and FinTech, I think this is a very timely question because things are going on very well, they are evolving quite well and Felipe will give you details in relation to the outlook of sales and

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margin growth. What I can tell you is that in the brick and mortar stores, we have found the path for sales already with better margin results than we had before. So I would say that brick and mortar stores today we can tell you that we are on the right track. We have already found the right track and we are making the necessary adjustments so that we can have the margin according to what we expect.

And in online, we already seen more positive results in the last couple of weeks and we need a little bit more consistency in these results so that we make 100% sure that we are on the right track. But our feeling and what we are able to analyze in terms of the evolution already happening in the first few weeks of the year is quite positive. So we believe that this path is very promising and of course, you cannot change the game overnight so we need persistent deliveries quarter-after-quarter. So, this is our objective and this is on -- we are working on that and we have good expectations regarding this.

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

Good afternoon. Regarding installment and how we are working with that. Jorge Faical, the Commercial Director, Commercial Officer we are activating few things for credit cards in general. We had a more promotional policy and a lot of non-interest bearing installments and now for each product we have -- we are checking now how many installments and after a certain number of installments, then we start to charge interest, so this is first point. And how to do that without causing an impact on our sales? This is something, and in direct consumer loans, the interest rates we have always worked at the company in a way that my areas -- credit area we established the interest rate that we are going to charge and this interest rate that it is distributed, the average weighted interest rate you ultimately do this distribution.

And today the average rate that we have is around 7% per month and this is for all products end-to-end with only a little bit or slight variation between one and the other. And Faical is doing the distribution of the 7% with -- among products that have a higher rate and then the ones that have a lower rate. So we have a balance in our credit operations.

Regarding the strategy for direct consumer loans. What is important about that? Now we're getting into a phase which is very important because we already have automatic credit in a major part of that and how can we do that without raising the quality of credit. So what are we doing? This is a very important initiative at the stores. We have a different credit assignment process at the store. In the past, you got to the store and you had apply once for direct consumer loan and we analyzed the credit and most of the credit we said, well, okay, we're going to give you credit and a small part we did not assign the credit. And many people were standing in line there for quite a long time and when they go to their turn then they didn't have the credit approved. And today we have already changed because the sales people didn't stimulus in order to offer direct consumer loans. And now you just put your tax payer number and immediately, you have the result of your credit approval or not. So assertiveness in the credit assignment operations once the person applies is much bigger and this helps the salesperson to make a better offer for credit at the store. So this is very important this year.

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So we have better credit this way and we can increase the participation of direct consumer loan, not waving the quality of credit. And the second point that it's not going to give result as quickly as that, is the digital, online credit assignment. So we started with a website. And first, for our employees and we always streamlined the process and we correct this and that, but it is already on. And after our employees, we are going to open this opportunity for the pre-approved credit and then, afterwards, in a third stage, we are going to open for the public in general. So we can increase the participation of credit operations, which is profitable for the Company, not waving the quality. And lastly, we have pilot in two stores, we have good news about that. People who asked to download the app, for AirFox and this is very productive for the Company. So it is working quite well.

We already have the new brand for AirFox, we told you that we were going to change the brand and we will be launching this new brand around the second part of this year. Now, we are planning the launch of this new brand and we will have the prepaid card with AirFox and this week at the beginning of next week in March, then we will decide about the banner, the flag, and this will be very good business for us and this will help us a lot in terms of growing AirFox and with funds from Via Varejo for this growth.

Q - Joseph Giordano {BIO 17751061 <GO>}

Just a follow-up about AirFox. Do you intend to do a bigger integration with GPA, between Digital and FinTech, do you think they should be totally segregated or?

A - Unidentified Speaker

Well, this is a very difficult question. We are always evaluating opportunities so that we may leverage our businesses whenever we see an opportunity regarding synergies or any other opportunity that has to do with the expectations on the part of each one of the companies and we assess on an ongoing basis. We have not decided anything about that yet. Thank you.

Operator

Gustavo Oliveira from UBS would like to ask a question.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Good afternoon, everybody. Thank you. Felipe and Peter. The first question has to do with the two categories that you mentioned. You mentioned, furniture and home appliances, what is the installed capacity of Bartira? In one of our talks in the past, I jotted down that you had almost a 100% installed capacity already. So I don't know whether you're working with products that have a higher margin or whether you want to increase penetration of your sales and that would mean an increase in CapEx? And your CapEx for production is already at a considerable level. And Peter, what about mobile phones, smartphones? This category is quite profitable, and you did say anything about that. Was it because there is no big marginal gain or is there an impact of the Lei do Bem, the Law of Good as we call it? So what about the evolution of the Lei do Bem and the impact on your sales margins? So these are my questions.

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A - Peter Estermann {BIO 15380447 <GO>}

Thank you. Well the first one is a follow, at Bartira we are working in two shifts. And this means that we still have opportunities to increase our production. And the second point is the following, we have been working in order to have a better strength in the entry-level products and this is fundamental for you to have this build traffic into the stores. And -- but on the other hand we are also working with higher tickers. So you have the two strategies going in parallel and we have installed capacity to increase production further. So we do not need any additional CapEx in order to increase production capacity of Bartira. What we having at Bartira are some investments that are not significant in order to remove bottlenecks in production and improve operating efficiency and having better costs ultimately. But Bartira is very well operated and the plant has had an incredible improvement in the last couple of years. And this brings us an even bigger competitive advantage. So we are very bullish about Bartira.

Regarding the smartphones, as you said, this is a category that is already very pervasive both online and in brick-and-mortar stores. And now you will see the launch of the new product in the whole industry in the next three months. We'll be launching new products, we will be introducing new products to the market, and so we are bullish and we are still very strong in smartphones and we will continue to be so. This is an extremely important category, plus it gives us very good margins.

Regarding the Lei do Bem, that law. I want to be very clear to and transparent. I don't know what you have been hearing in the markets, but the Lei do Bem is not something that happens automatically. There is an endeavor that is needed in order to transfer it to the prices and we are making strides in that direction. And we are not transferring all of it yet. And I believe that this new moment that the industry is living, could favor the acceleration of the inclusion of Lei do Bem to the final price of our products, but this takes time. This is not going to be done overnight.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Well, this margin did not expand I understood because of the Lei do Bem. I don't know whether it is right to imagine that this margin would go down or it is already so down in the fourth quarter, that it became easier? So I would like to understand this because you said 6%, if you adjust based on the others if you take away the adjustments of the other ones, this is a rather modest guidance for your margins. So are you, considering an ongoing effect of gross margin with no recovery? Do you see an impact on your gross margin, beside the Lei do Bem impact and what do you see for this first quarter?

A - Peter Estermann {BIO 15380447 <GO>}

As I said, there are opportunities ahead of us. And the discussion about the change in prices and the transfer to the margins, you know how it works. If we wish to grow, if we want to increase our market share, there is a balance between what you transfer to the margin and what you transfer because of competitive reasons. So we are paying keen attention to that, and this is a challenge that we face. How can we grow sales and margin together with this growth in sales? So, it would depend on how the market behaves, how much margin, how much competitiveness. So this is a game that we have to play all the time.

Well, the base is quite challenging and our guidance of 6% EBITDA, consolidated EBITDA for the year is challenging because you know that as we said before, there is a broad trend of the EBITDA quarter-after-quarter. In order to get to this average of 6%, we have to accelerate in the third and the fourth quarter, but this is a challenge that we discussed a lot about internally and our team is very comfortable with the fact that we have so many initiatives in place and so many actions that it makes us comfortable in terms of delivering the 6%, but the base is not easy and the challenge is not easy. This is a big challenge, but we will deliver certainly.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

That's clear, Peter. Thank you very much.

Operator

Pedro Fagundes from Bradesco BBI has a question.

Q - Pedro Fagundes {BIO 20029197 <GO>}

Good afternoon everyone, and thank you for taking my question. I would like to have a follow-up regarding the online. Can you go into details there please? It's about the main bottlenecks that you find, and which are your priorities in this channel? I think we see a lot happening at the same time . And you have the stability of the system, the competitiveness, the changes regarding freight, the rollout of the full commerce. So if you can tell us, in your opinion, what was the main bottleneck for you at the end of the year and what are your priorities for 2019, that would make it much more clear for us.

And second, about a comment made by Peter in the beginning, the focus on media. Should we expect any changes in the marketing policies of the Company, any specific focus on any specific channel or commercial strategy, or something related to the app? So if you can tell us anything on that it would be great as well. Thanks.

A - Unidentified Speaker

Thank you, Pedro for your question. So first question, the main bottleneck, well, we had two important impacts at end of the year in the online and we started the year with these same two bottlenecks, having a significant impact on sales. The first one was the stock out. We ended the year and started the year with a high level of stock-out. And that has held back sales. We reduced the stock out by half than we had in the beginning of the year and we're still reducing it. This is an internal work of category management and focus on the commercial strategy, that is, which are the products that will have offers, which prices we adjust price -- which products that we adjust prices and so on. So this work is going forward. We expect that in the beginning of March we have that level of stock out addressed at the levels that we need to expedite sales. So this is the first bottleneck and by the beginning of next month it will be fully addressed. There are no risks of not solving it. And this has an important significant impact.

And the second, you also said operating stability, browsing and functionality of the app. You know that we launched the app in the second half of last year. This was a beta version

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launched, it did have many improvements to be applied. It was very difficult. You know your clients, you navigate in our app, you know some of the problems that we had. The app is not 100% at the level that we wished it to be, but it has improved a lot. So I would say that both the app, as well as stability of the platform of the e-commerce also have affected our performance in the online channel. And here in the second part we are going very well with something that we have implemented. The whole Company is focused on solving that, not only IT. It also involves business areas that are crucial so that we can accelerate the solution and the returns and any adjustments that we need in the system and we have a positive expectation thanks to the progress that we had in the past five weeks.

Therefore, I believe that as soon as we address stock out and we go forward in that shopping experience for our customers and we stabilize our platforms, I believe that the conversion rate will increase a lot. We do have a great expectation there, but there is a lot of work to be done, huge work to be done, but we have been able to move on, to move forward.

And second about marketing, The marketing strategy, well, we have our marketing strategy for B&M and for online, and of course, omni-channel strategy as well, and the mass media, and that affected directly the brick and mortar sales. But also it has a positive impact in the online sales. We have been more aggressive and more assertive. We have defined an agenda for our promotions that have a visibility of more in the long term, so that we can but the merchandise, supply to stores and put together communication plan that is more assertive than what we were doing, and a media that has more to do with (inaudible) by adjusted to each one of the channels. It has been very positive. We have an important hard sell every month and the first one we have done with a positive impact of both in sales as well as in cash margin. So we are changing, we are on the track to change.

In the online, we have learned a lot over last year. The team is much more structured this year, so that we can have that media directing in a more assertive fashion in different media that we have, and the search engines and also conversion. And we are learning a lot and we are learning fast. So we have no expectation to reduced marketing. We want to increase sales and we have to have the best use of our marketing budget to support to that sales growth. And now, so a better return or bringing back more our customers to stores and to the online channel.

Q - Pedro Fagundes {BIO 20029197 <GO>}

Okay, follow-up on the online, please. I would like to hear it from you, Peter. Do you believe that the lack of personnel or maybe lack of talent in the IT area is something that the Company is facing today, whether developers or product developers, that the type of professionals, do you -- what do you think?

A - Peter Estermann {BIO 15380447 <GO>}

Talent is never enough, right. We always have to improve the quality of the team. We are not lacking talent. I believe that we do have a great team, but what happened and we have already talked about this, we didn't have significant volume of system integration as well as development of new software and platforms integrating that to our legacy system.

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And we did have several interference in our legacy system and because of that, we did have problems. And the talent and people that know about it, they are in the house. So we have concentrated as I said, and some skilled people, -- technically skilled people, people that really have knowledge of our technology and product and we brought together our business team so that we could expedite all adjustments that need to be made, and the results are there. And this is focus, focus on the main problems that we have, on the main opportunities of development that we have. The result is very positive. The way that we are working has been is effective.

And as I said, I expect that we will -- believe that war room system of working and go to the product system of working and that will not take longer, it will become more productive, it will have been in the first half of the year, so that in the second half of the year, we are already in the vertical of the products and we will have our platforms stabilized bringing better result.

Q - Pedro Fagundes {BIO 20029197 <GO>}

Perfect, Peter. Thank you very much.

Operator

Tobias Stingelin from Citi has a question.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Good afternoon, Felipe and Peter. And this change that you have made, this accounting change of transferring these expenses regarding restructuring efforts, they are non-operating, so there is an impact of BRL400 something million for 2018. What was the impact of this line specifically? How much did you take away from the space and increased your margin in 2018 because of that difference, because of that change?

A - Peter Estermann {BIO 15380447 <GO>}

Good afternoon, Tobias. What we can see is nine months, looking at page number seven, I can see nine months of 2018, and we had BRL168 million and we do not break it down for the fourth quarter. And this is already something that's recurring in the Company. But I can tell you that nine months, the BRL168 million, but just to make it clear, this BRL168 million was just regarding reclassification of something that was before under SG&A and figure that you had to lay out and now you transfer that to another line. Is that it?

Q - Tobias Stingelin {BIO 18290133 <GO>}

Yes. So my question is, we are looking at a guidance of 6% for 2019, if the reference is 2017, you had a margin of 6%, but you had a gross margin of 32% and now you have a gross margin of 29%. So my question is, this 6%, let's say that we had in 2017, that cannot be compared to what we have now. Right? And also considering this reclassification that you had and if we had that in 2017, probably your margin would have been much higher, right. So it looks like the margin is improving. As you said, sales are improving, margin is improving as well, but believing and checking that reference in 2017, that you have a margin that is 300 bps lower and then your -- that difference will have to come from

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expenses, will you have to wait for or to expect a good performance on expenses. Is that right?

A - Peter Estermann {BIO 15380447 <GO>}

Well, it's partially, right. But yes, you're right to Tobias. You heard me saying that we have several fronts, several initiatives to bring down expenses. And yes, we do need to bring down expenses in the Company. You know that we believe that expenses have always to be analyzed to be assessed and optimized as much as possible. And as I said in my opening remarks, yes, we will be optimizing expenses, but it cannot affect sales, the level of service and the experience of our customers in the stores and in online. Other than that, yes, we will be concentrating in reducing expenses.

Q - Tobias Stingelin {BIO 18290133 <GO>}

And do you have the reclassification for 2017?

A - Peter Estermann {BIO 15380447 <GO>}

Yes, we do. But we can 't tell you right now, we don't know it right now. I can tell you later if you want.

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

I think, maybe we have that in the explanation note. Just one second.

Q - Tobias Stingelin {BIO 18290133 <GO>}

That's fine. I'll check it later. That's okay. No problem.

A - Peter Estermann {BIO 15380447 <GO>}

Okay. Tobias, Felipe can sent that information to you later on. Okay. Thank you.

Operator

Thiago Bortoluci from Goldman Sachs has a question.

Q - Thiago Bortoluci {BIO 20909105 <GO>}

Hello, Peter and Felipe. Good afternoon, everyone. We have two questions here. The first one, as Tobias mentioned, it has to do with the seasonality over 2019. You mentioned the guidance with a significant improvement in the margin throughout the year. Should we then expect a gradual improvement quarter-on-quarter or more concentrated in the second half of the year, benefiting from the comp that you will have ahead? And still talking about guidance, my second question is, if you will have a number regarding the impact of the IFRS 16? Thank you.

A - Peter Estermann {BIO 15380447 <GO>}

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Thiago, this is Peter. About the results improvement, yes, it was going to be quarter-on-quarter, gradual. But as you know, the last quarter for retail is a quarter where we have the greatest seasonality. It's a very important quarter and we have at least one-third of the results of the year concentrated in the last quarter. That's what we usually have. So, the fourth quarter is extremely important in our strategy, but you will also be able to see a gradual improvement quarter-on-quarter.

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

In the explanation Thiago we also have the impact of the IFRS 16. I'm looking for note here. It's page 17 of the quarterly report, 37, 38 of the quarterly return.

Q - Thiago Bortoluci {BIO 20909105 <GO>}

Just confirming, it's not in the guidance for 2019. Right?

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

No. Our guidance is revenue, EBITDA and for CapEx, that's all. EBITDA under the current criteria we are not considering IFRS 16. Okay.

Q - Thiago Bortoluci {BIO 20909105 <GO>}

Thank you.

Operator

And now the Q&A session, I would like to turn the floor back to the Company for their final remarks.

A - Peter Estermann {BIO 15380447 <GO>}

I would like to thank you all for being with us. Once again, thank you for the questions you asked, and I would like to stress that we are very optimistic about Brazil in 2019 in order also to deliver the results that we expect to deliver. I'm sure that an important part of it will be related to our execution capacity and also our capacity to look for all the opportunities that we have on our hands so that we really have these results, but we also expect that Brazil in 2019 is much better than it was in 2018. We are very bullish and we are very confident about delivering the guidance that we have just announced. Thank you very much.

Operator

Conference call for the results of Via Varejo has ended. The IR department is available to address any other questions you might have. Thank you very much for your participation. And have a nice afternoon.

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