Q3 2016 Earnings Call

Company Participants

- Jose Gallo, Chief Executive Officer
- Laurence Beltrao Gomes, Chief Financial Officer and Investor Relations Officer

Other Participants

- Fabio Monteiro, Analyst
- Franco Abelardo, Analyst
- Guilherme Assis, Analyst
- Gustavo Oliveira, Analyst
- Irma Sgarz, Analyst
- Joao Mamede, Analyst
- Joseph Giordano, Analyst
- Paola Mello, Analyst
- Richard Cathcart, Analyst
- Robert Ford, Analyst
- Thiago Macruz, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen, and thank you for waiting. Welcome to Lojas Renner Conference Call to discuss the results of the third quarter of 2016. We would like to inform you that this call is being recorded and translated simultaneously into English.

The slides are being shown at www.lojasrenner.com.br at the Investor Relations section at the webcast platform. And I would like to mention that questions will be taken by telephone and through the platform as well. We would like to inform you that participants will be in listen-only mode during the company's presentation. Afterwards, there will be a question-and-answer session when further instructions will be given for you to participate. (Operator Instructions)

I would like to remind you that questions from journalists might be taken by our press office at 55, country code, 11-3165-9586.

Before proceeding, we would like to clarify that forward-looking statements that might be made during this call related to the (inaudible) company projections and targets, both financial and operational, our 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, as they refer to future events, and therefore they depend on circumstances that may or may not occur. Investors should understand that general economic conditions and industry conditions, and other operating factors may affect the future results of the company and may lead to results that differ materially from those expressed in such forward-looking statements.

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

Laurence Beltrao Gomes {BIO 15361799 <GO>}

Good afternoon, everyone. This is Laurence, and we are gathered here today in order to talk about the results of the third quarter of this year. With me today we have Jose Gallo, our CEO; Paula Picinini, IR General Manager; and Luciano Agliardi, Controller. The combination of different factors, both internal and external, led us to an atypical quarter in sales, the period between July and September was under the strong influence of the economic environment with lower traffic in the shopping centers, mainly during the Olympics.

Besides, we also had lower temperatures and for longer period, and this lasted throughout September and part of October as well. Looking at our internal issues, as we said before, in August, we concluded the ERPs update. And by that I mean, all the back office management systems and also the commercial part.

And this implementation brought about some imbalances in our inventories between a number of stores, which is normal in this kind of implementation. And this was a process of great magnitude in which all the back office activities such as orders and the issue of invoices and also shipping in certain cities and sending and receiving goods were paralyzed for 15 days as planned. And this time was necessary to migrate all the data from the low -- from the old system to the new system.

Likewise, the resumption of activities occurred gradually over other 15 days, as we didn't have any great setbacks. This implementation, due to its sizes, also to the ease with which it was carried out, became a benchmark with our partners in this project. And I would like to mention that this new IT platform brought about a whole array of benefits for its better commercial and store management, besides allowing us to use additional functionality that will bring about a higher efficiency and also a better shopping experience, and this is a fundamental step towards our growth and competitiveness strategy.

This new system will allow us, among other things, to have a higher number of stores and as well as operating abroad and having new services with a higher flexibility for e-commerce, besides enabling us for the use of new technologies like multi-channel and more precise inventory management still above the quarter.

We continue with our work to streamline two brands of women's apparel, which have a lower performance than the other one. And here it's important to mention that some decisions regarding imports and fabrics and prints, they are defined long before. And when they need to be changed, it takes some time to adjust. We are already in the final phase of this process and we see gradual improvement since July. The maintenance of our gross margin and inventory is under control to show an adequate commercial management, in spite of this moment that was extremely challenging.

Now, talking about the expenses, I would like to mention our endeavor to adapt, in an agile fashion, the operating expenses to the slower sales pace. You may be sure that we are paying keen attention to the economic cycle and the sensitivity of the market and the impacts on the business in order to guarantee our profitability. I would like to highlight regarding this quarter, the result from financial products that delivered an expressive growth, due to higher level of revenues and mainly to an improvement in the credit quality stemming from all the initiatives that we have been implementing in the credit granting and the maintenance of limits and also the collection strategy.

And in order to conclude this initial part, I would like to mention that we continue to be focused on the long run and investing on an ongoing basis in order to make Renner more and more competitive and more and more prepared to rise up to these market challenges continuing with our store expansion plan as planned.

Now going into the presentation, on slide number two, on the upper part of the slide, we show you the sales in the quarter and I have already mentioned that at the beginning, in the nine months of this year, net revenue 3.8 billion, 5.2% increase. And on the lower part, we have the gross margin that was kept at the same level of 2015 as the return of the payroll charges were about 60 bps benefits. Year-to-date, gross margin 55.6%, a 130 bps higher than 2015.

On slide number three, on the upper part of the slide, we have the operating expenses over net revenue, which were 40.4% and this higher percentage reflect the impact of the payroll charges, as well as the higher number of stores inaugurated in the new Santa Catarina DC. You can see that the lower level of sales ultimately impacted our leverage as well. Nevertheless, we should mention that net of the payroll charges effect, the SG&A, and same-store sales dropped by 1.2% concerning these fixed expense control that we have adopted.

Now talking about the lower part of the slide, as a result of the points already mentioned, here you can see the retail EBITDA, which was 164 million with a 13% margin.

On slide four, we have some remarks for business in the different formats. At Renner, we had a slightly lower revenue and a retail gross margin of 53.7 in Camicado and Youcom. They are more resilient during this period with revenue increases of 15.7% and 90.7%, respectively. Besides these two operations already delivered improvements in gross margin, which reflects the measures that we have been adopting in the development of collection, mix, product mix, and store layout.

On slide number five, we show the results from financial products that grew by 36.5% on a year-on-year basis. This performance reflects the important improvements in credit that stems from the initiatives that we implemented in the granting and maintenance of caps, and also the strategy of collection in this area, as we said before, and revenues from financial products in this quarter grew by 8%, driven especially by the co-branded cards, the private label card and in turn recovered revenues due to the comparison between the taxes and the actions implemented at the beginning of the year.

Credit losses showed an important reduction due to the better levels of recovery, as well as the lower provision due to the slower sales in the quarter. And when we look at the delinquency charts on the lower part, we see that private label continues to show improvements in the loss ratio over the portfolio, which went from 4.2 to 3.3. And besides the Saque Rapido, fast withdrawal also had a reduction of 2.1 percentage points. On the other hand, Meu Cartao, due to the nature of the product, still shows a higher delinquency rate.

Now going to slide number six, we see that the consolidated EBITDA was kept in line with the previous quarter, margin was 18.2% and net of the effect of the payroll charges it would have been 19.4% with a 0.9 percentage point increase.

Now let's talk about the net income reduction of 11.5% in the quarter, mainly due to the non-recurring effect of the write-offs of assets related to IT and equipment, IT systems and equipment, from the old Santa Catarina CD. If we did not consider this effect, our net margin would have been similar to last year. In the quarter, we invested a 107 million and most of that were for new stores and remodeling. And continuing with our expansion plan, we inaugurated 10 stores, 6 Renner and 4 Camicado. Besides, this year, we have already remodeled 11 stores, 7 Renner and 4 Camicado.

On the next slide, we have the CapEx and ROIC. And our ROIC reached 3.4%. On the next slide, we have our indebtedness and also the free cash flow that grew by 134% or BRL53.6 million, due mainly to lower investments in fixed assets.

Very well, these were my remarks about the quarter. And before opening for your questions, I would like to mention that August was the most challenging month in this quarter. It was an abnormal period in our view, because we have already seen a gradual improvement both in September and October. And therefore, we believe that the fourth quarter will be better than the third quarter of '16.

And we would like to remind you that in half year consumers tend to buy a little bit more by the end of the year, and they look for strong brands such as Renner. You may be sure that we will continue to pay keen attention to the current situation, always looking for efficiency improvements in our operation and protection to our profitability.

I believe, that now, we could open for questions.

Questions And Answers

Operator

Thank you very much. And now, we would like to start our Q&A session. (Operator Instructions) Mr. Guilherme Assis from Brasil Plural. Mr. Assis, you may proceed.

Q - Guilherme Assis {BIO 16143141 <GO>}

Good afternoon, everyone. Thank you, Laurence, for the questions. I would like to go more in-depth in your performance over the quarter, in your retail operation. I think you mentioned quite a lot of factors from the macro factors going into the changes in the ERPs and the Olympics and something more specific in relation to collections at Renner. So, could you get into more details about what happened?

Laurence, during the call, you said that you are taking some measures already in order to try to improve or correct the performance of the collection itself. However, that it takes some time to correct, because you have the whole supply chain involved and you've mentioned that, and you said that you will plan this well beforehand. So, looking ahead, it seems to me that you are more bullish regarding the performance in the fourth quarter or maybe towards 2017. So, could you give us more color regarding these problems, regarding the collection and the timing, that is to say, in how long can you correct that?

And in the same-store sales, that was minus 3.9, we would like to know how much of that was due to the impact of these problems with the collection. I know that sometimes it's not so we need to measure this or identify this, but looking ahead and with the improvement that you expect, what kind of situation could we expect to see?

And another question regarding the tax credits. In the three quarters of this year, you've had a reversal of the tax credits in other operating revenues, and this was quite high. Could we expect these amounts to be recurring? I think it was 14.7 million this quarter, so could we expect this to continue from now on? And what is generating these higher credit this year vis-a-vis your history? Thank you. These are my questions.

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

Guilherme, thank you for the questions. This was really some isolated issue, that is to say, two brands in our women's collection, and we identified during the year that these brands are having a lower performance than the other brands of the company. We have already identified some opportunities to adjust these brands and we have already started these adjustments in Q2.

So, we adjusted processes and we've strengthened the management, and it's important to stress that these processes regarding collections, our decisions that are made few months beforehand and they involve important products that have a longer cycle, they involve fabrics and prints so on and so forth.

So in order to adjust the process, of course, you need some time and this is what has been going on since July. We had been adjusting this, and besides the internal adjustments that we have carried out, both in processes and management. And we are also making adjustments with a markdown for these brands. So, I believe, that we have already reached the final stages of these adjustments and from now on we expect a gradual improvements in these two brands. So -- and it is important to stress that this is limited to two brands of our women's collection.

Before we talk about the tax creditors, we mentioned that changes take some time because they involve imports and et cetera, but you had internal changes in the company as well. So, first of all, we brought an executive with a lot of experience, international experience in order to manage this area. We also did some changes in the team and we also tried to improve our process of tapping into trends with a higher specialization in the team. So, these are the main points.

A - Jose Gallo {BIO 1822764 <GO>}

Guilherme, just to add to what Laurence has said. Regarding the ERP, I would like to make it clear that for two weeks we came to a halt. This is a normal process, because during these two weeks and this is part of the project itself. This is the only way you can migrate. For two weeks, you stop and you bring all the data from the old system to the new system.

Just to give you an idea, during these two weeks, you have to test approximately 1,000 system integrations, because if you migrate wrong data to the new system then it's going to be a very bad start. So this is absolutely normal. And after that, of course, you cannot start completely, because it takes about -- you start with 5%, 10%, 15% and it takes about an additional 15 days to go back to normal. All this happened as planned, and we are extremely pleased, both ourselves and Oracle, we are very pleased with the way it was carried out.

Now regarding the quarter, agreed [ph] this difficulty was in August because of the Olympic Games. And this happened with the whole economy and you see that even industrial production was impacted and the level of services was impacted by the Olympic Games as well.

In August, we had a two-digit drop in same-store sales, because people just, you know, they left and they went home and they watched the games, and now we see already an improvement in September. And also the weather had an impact, as Laurence said. We had an abnormal situation in September and October regarding the weather and we saw that in the last week when weather went back to normal then sales were more favorable.

So it's impossible to say, well, X percent was because of the Olympics, X percent because of the collection, you cannot really quantify that. I don't know whether I have answered your question or not. But it's --

Q - Guilherme Assis {BIO 16143141 <GO>}

Yes, Gallo, I know that sometimes you cannot really quantify the way journalists would like. But I think it helped. But looking ahead, you said that the worst month was August and you mentioned all divisions, this was made very clear, and you said that September was better and it seems that October things are coming back on track. Could you clarify what normal would be? And do you expect the fourth quarter to be positive again?

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

Well, undoubtedly, it will be better than the third quarter. However, we have to wait for Christmas, November, but we are sure that it is going to be better than the third quarter, yes. Now, what is important as well, we are talking about the ERP, for instance, and it's important to mention the improvements that this will bring about with this ERP. For instance, we had a limitation before regarding opening new stores. It will take -- and this ERP, we can -- with this we can open a 1,000, 1,500, and with the previous one only 450. And this ERP has subsystems that allow us to operate abroad, for instance. In the old one, we didn't have this possibility. And we have a whole series of improvements in inventory control, in the operation of our stores, and by means of collecting information that is allowed by this new technology. So, we will have a higher degree of efficiency, and we can learn about our inventory in one store and in the nearby stores as well.

And so, this led us to many new technologies like omnichannel and other technologies, and this was not possible with the previous systems. Of course, it was a huge investment, it took us two years to do that. It was done very carefully, very prudently, and with total success in the implementation.

Q - Guilherme Assis {BIO 16143141 <GO>}

However, you can say well, but did you take any measures regarding inventories?

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

Of course, we did, but it's very difficult for you to have a right forecast of the inventories that will be needed if you have two weeks doing this migration and another two weeks starting up or rolling this out. So I think we had an excellent performance, if you consider, the magnitude of this process.

Q - Guilherme Assis {BIO 16143141 <GO>}

And what about the tax credit?

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

Guilherme, this is something recurrent that we put in practice here at Renner. We review our tax situation on an ongoing basis. But from now on, I would say that it will be up to this level or lower levels, because we have already recovered most of that. So, I would say from this level down.

Q - Guilherme Assis {BIO 16143141 <GO>}

However, this is a recurring process?

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

Yes, it's never ending and you know the complexity of the Brazilian tax system, you are familiar with that, so they will always exist.

Q - Guilherme Assis {BIO 16143141 <GO>}

Okay. Thank you.

Operator

Joseph Giordano from JPMorgan. Mr. Giordano, you may proceed.

Q - Joseph Giordano {BIO 17751061 <GO>}

Good afternoon, everybody, Laurence, Gallo. Thank you for the question. I have two questions. On the positive side, the goods expense control and the improvement in your credit operations. On the expense side, I would like to understand if we should still see additional gains, especially looking at the next few quarters. I believe that you still have some ramp up of the shared services center that will bring about additional gains too.

And my second question, when we look at the Meu Cartao portfolio, this was a negative point, because the level of losses was quite high compared to the other portfolios that showed an improvement. And this is the line that has the fastest growth in the division.

So, how do you see the market as a whole? We see that interest-bearing sales has lost momentum and I believe that people are paying more attention to the limit that you give in order to buy outside the company. So, could you mention the rule of this game and what can you say about that?

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

So then, I will start by the second question, and then Gallo will answer your first question. What we have been seeing is a more disciplined consumer vis-a-vis credit. They are more cautious regarding credit and they are avoiding interest-bearing plans. And also cash payment or non-interest-bearing payment is being the preference, and the consumers are more cautious. So this is the reason why we see this drop in this participation.

A - Jose Gallo {BIO 1822764 <GO>}

Regarding Meu Cartao, we made an important change in the private label and the fast withdrawal. We were able to bring this to a very interesting level regarding net losses and Meu Cartao has a different nature, it has a different dynamic. The clients uses it more often outside Renner for supermarkets, drug store, fuel stations, so they take longer to control this kind of expense.

But, having said that, we are not concerned, because it is under control and we analyze this -- all these ration as a slight deterioration, a small deterioration. And this is according to the nature of this product. So, we have a good outlook there as well for the fourth quarter. We continue to believe in stability of losses for the fourth quarter and also the result that with a good contribution to the bottom line of the company.

There is a point that I would like to mention and that I have not mentioned. As the Meu Cartao portfolio is slowing down in its growth, the representation of this loss become higher, and this is an important point, which is a relative increase of this loss because there is a deceleration of this portfolio as planned. I would like to remind you that this portfolio was relaunched in 2013. We saw strong growth in the last three years and as of next year it will be at cruise speed getting to one digit increases.

About our expenses, Renner has always been very careful regarding expenses. We are a very strict company and we have to have beautiful stores, okay. But we saw that something was about to happen around the end of 2013, beginning of 2014, we started expense reduction program and we have an internal team for that, and we acquired a lot of experience, even a process of expense reduction that is being applied, and because of this experience we can carry out very efficient adjustments, according to the behavior of our sales.

You may be sure that our initial budget, it was close but it did not contemplate this reduction in sales that we saw in the last few months. And the most important thing there is the following. The whole team gets together and coordinated by this team and we adjust our expenses and we check every single area, and this is what's happened. We have a routine, we have a process in place.

Besides the meeting of this group with the whole executive committee once a month, when we closed the month, we have the matrix budget, and I get together with all the officers of the company to talk about expenses and we have a process of packages as we call them. Officers at Renner, they are not only accountable for their areas, each one of them has a package of expenses that are under their responsibility and they manage them, regardless of these expenses being in their area or another area. So it's not something improvised, it is very well structured and it can be very quickly adjusted to any change in the environment.

Q - Joseph Giordano {BIO 17751061 <GO>}

Thank you very much.

Operator

Thiago Macruz from Itau. Mr. Macruz, you may proceed.

Q - Thiago Macruz {BIO 16404924 <GO>}

Good afternoon. We saw the average ticket of the company going up very little year-on-year. Does it reflect your strategy regarding pricing or does it have to do with the change of mix on the consumer side? And you talked about some pressure on the gross margin because of a less favorable hedge position in Q2. Have you offset this quarter or are you going to take this or carry this over to the fourth quarter?

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

In relation to the average ticket, what we see is more the behavior of consumers. Consumers are more disciplined, there is no strategy in this regard. And all payment means, they had a lower digit in terms of growth. So, it is not due to any changes on our part. What we see is, a growth in debit card and cash payments as well. So we see this kind of displacement, the shift towards the other payment means, as I mentioned.

Regarding our gross margin, due to these adjustments that we mentioned in this quarter, we believe that we have a good inventory control, a good commercial management during this quarter. And for the next quarter, we believe that we will be able to deliver and to maintain this level of gross margin, that is to say, stability vis-a-vis last year.

Q - Thiago Macruz {BIO 16404924 <GO>}

Thank you very much, Laurence.

Operator

Joao Mamede with Santander. Mr. Mamede, you may proceed.

Q - Joao Mamede {BIO 15265292 <GO>}

Good afternoon, Gallo, Laurence. Two points that have not been raised yet. The first one about CapEx, we see a strong reduction vis-a-vis the previous quarter, and you have a medium and long-term plan that is varying regarding your stores. So, could we expect a more normal level of CapEx going back to previous levels or is this a new reality and you will be working with less remodeling of stores or the remodelings were already carried out or do you still have a lot of remodeling to go, to do?

And going to financial services, the result was excellent, but you should remember that last year in the same quarter, there was a slight problem with the deterioration in delinquency. And also the PIS and COFINS on financial revenue, so there was a loss of financial results that was very strong and the base was easier. So most of this growth is due to going back to normal, because now you have a fair comparison because of the PIS and COFINS taxes. So what could we expect regarding this line item for the future?

You mentioned during the call that consumers are spending less with credit cards and revenues are not increasing as much as in the past. So, could we expect a lower growth than you had in the previous year? Thank you very much.

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

There is an impact on revenues from financial products and the comparison, because the PIS and COFINS taxes plays a role and also an attempt to adjust the interest rates, which is something that we did in Q2. But as we said, due to the behavior of the consumer, they no longer want interest-bearing payment, they are more disciplined in this regard, and there is a challenge there regarding revenue growth.

You have a lower participation of 0+8 and also the behavior that we see on the part of consumers we are avoiding interest-bearing payments. So, this has been an impacting factor on our revenues. For the fourth quarter, we are expecting a certain stability in our revenues as well as in our losses.

So regarding the CapEx for 2017, we are doing our budget now and we are going to have a CapEx that will be submitted to the Board, our plans will be submitted to the Board. But last year we said that we were going to open 60 stores and we will be opening 64; 25 Renner, as promised; Camicado, we said 15, we are going to open 17; and Youcom, we promised 20 and we will be delivering 22. We are finding good opportunities of negotiation in the specialized stores and we are taking this opportunity in order to accelerate our expansion plans. I cannot say anything about 2017, because it has to be submitted to our Board first.

Q - Joao Mamede {BIO 15265292 <GO>}

Thank you, Gallo, and thank you, Laurence.

Operator

Franco Abelardo from Morgan Stanley. You may proceed.

Q - Franco Abelardo {BIO 17416219 <GO>}

Good afternoon, everyone. My first question has to do with the recovery of same-store sales. In the fourth quarter of last year the comparison base was easier, so I would like to understand if this recovery in same-store sales will be at the same magnitude as you see a reduction in the base, that is to say, from the third to the fourth quarter was 8 percentage points, the differential. Could we expect a recovery of the same magnitude or do you think the macro scenario is still very challenging?

And the second has to do with the consolidated EBITDA margin. The expectation was for a stable margin for this year, but in the year to-date it dropped about 60 basis points or 90 bps in retail. So the expectation of a stable margin is maintained for the year or do you expect an expansion in margin in Q4 or not?

And the third question about recovery of credits in financial services. We saw a reduction in your non-performing loans. I would like to know if you have any specific action regarding recovery or could we expect a more normal level for the fourth quarter?

A - Jose Gallo {BIO 1822764 <GO>}

Thank you. This is Gallo. When we make a projection of sales, in fact, we make a projection, let's say, well, we will be selling as much as we can based on the current economic situation. What I can tell you is that, we see an improvement in our sales vis-a-vis our budget. And if we compare with last year, mainly in this last week, which leads us to say that we will have a better same-store sales is, of course, a lower comparison base, but what is very important for us is that we are getting closer and closer to our corporate budget.

The consequence of that will be having better same-store sales. We already see an improvement in our women's collections, we see a good performance of the other brands as well and, as you said yourself, the fourth quarter has a lower comparison base. So all this leads us to say that we will even be closer to a positive result and we are working based on this hypothesis.

About the recovery of credits written-off, Franco, this is already a result of all the initiatives that we have been putting in place in the last 12 to 18 months. You remember that we made an investment in our collection infrastructure adding technology to the process and we also have a better capacity in terms of treating our data, as well as collection that shows strategies and tactics for collection of new models.

And also, because of better (inaudible), so to say, so I would say that we have this improvement because of our processing that are better, our collection is more efficient.

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

You also asked a question about our expectation regarding EBITDA margin for the year, so adding to what Gallo has just said and looking at the other analysis like the details of our process and discipline and accuracy and agility in our expense control, we have been implementing all that over the year and because of all of that, we believe that, yes, it will be possible to keep the same consolidated margins that we delivered last year.

Q - Franco Abelardo {BIO 17416219 <GO>}

Thank you. And still about credit recovery, it is done internally by Renner or do you have an outsourced company doing this? And do you consider as a recovery when the client pays that credit or when you have a negotiation and it get into your balance sheet as another debt, but not a delinquent debt, so it's not a past due. It is when -- so which is why they settle their debt.

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

Depending on the moment, it's internal after 90 days. And this also has to do with the strategy and the whole agenda that is given by ourselves to our third-party, contracted third-party.

Q - Franco Abelardo {BIO 17416219 <GO>}

Thank you.

Operator

Irma Sgarz from Goldman Sachs.

Q - Irma Sgarz {BIO 15190838 <GO>}

Good afternoon. I have three questions. Could you talk about the new capital rates and the 0+8 in a scenario in which the interest rates will potentially go down over 2017. So the idea is to transfer this to consumers and go back to the rate that you had during these last

18 months. Or do you believe it will not be necessary to transfer this to consumers, because the consumer does not react so much to that as much as to other initiatives and 0+5 had a higher penetration year-on-year.

Are you carrying out any specific initiatives in your stores or any action in order to incentivize your sales team to issue new cards, to motivate interest-bearing sales, or was it because of decision made by consumers themselves, and also about the asset write-off. This is related to your ERP system or any other thing?

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

Irma, thank you very much for your question. About the interest rates, things are a little bit more complex. We are not only talking about the nominal rates, but it has to do with the risk itself with the current delinquency levels in the market and also the macro indicators, and we will probably see even higher in employment rate. So, there is a risk in the market. Although we have things under control, we are improving this, but we started this 18 months ago and we believe that we should still be cautious until we have a higher visibility of the macroeconomic scenario. So, we will be discussing our budget, but we should be cautious, because the visibility is not so good yet.

Regarding 0+5, this comes from the behavior on the part of consumers. They are avoiding interest-bearing payment, they are more conscious about this kind of expense. And, of course, 0+5 is an entry gate, it's very important for the Renner Card and it's very important for loyalty reasons, but everything starts by the card and by 0+5. There was nothing very specific, it's just business as usual, it's the routine operation that we have regarding 0+5.

And about asset write-offs, the asset write-off is related to the old systems that were updated and replaced by the new ERP, and also the equipment that was written-off of the old Santa Catarina DC that was discontinued due to the new DC in Santa Catarina.

Q - Irma Sgarz {BIO 15190838 <GO>}

Thank you.

Operator

Mr. Fabio Monteiro from BTG Pactual. Mr. Monteiro, you have the floor.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Good afternoon, everyone. Could we go more in-depth into next year and think about the positive impact regarding the push and pull projects and activities, how much improvements are you expecting in stock up reduction and lower volume of markdowns, lower discounts in markdowns, so could you talk about that?

And more specifically in the third quarter, I know it's difficult to keep things apart, but I would like to understand if you see any impact from push and pull and reactivity in the third quarter, and where you have felt the positive impact of the initiative?

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

Fabio, you know that we do not give visibility of push and pull. And I think, if I'm not mistaken, you have already asked me the same question in the last quarter, if I'm not mistaken. In fact, we are evolving our push and pull, and we believe that -- so going back, it is not 100% of the products that will be included in push and pull, because you have fashion products that you don't put there; but on the other hand, you have fashion products that you believe a lot in them and then it goes to push and pull. But the control factor is really like the basic products.

Next year, we will have practically 100% of the basic products in the push and pull system, which represents an important part and basics are more predictable. Now, what is really fashion, it really varies, but we are evolving. We have to go step-by-step. You cannot say, well, I have the equipment in place and let's go. It's very difficult, because you have to put your suppliers in the system and we are working on that, and there will be a relief this year.

I think you remember that last year, that is to say, this year, in the first quarter of this year and the beginning of the second, we had difficulty by -- because of the dollar exchange rate and things have already gone back to normal now. So it facilitates our life regarding the agility of having a fast return, because it uses to have the push and pull alone. We have to have the reactivity on the path of suppliers. And this supply, it has already back on track.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Thank you. And in the fourth quarter or even in the third quarter, have you seen any positive impact of these projects or will you be feeling this next year?

A - Jose Gallo {BIO 1822764 <GO>}

Yes. We already have a reasonable percentage of the impact, but most of that will be felt in 2017.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Thank you, Gallo.

Operator

Paola Mello from Citibank. Mrs. Mello, you may proceed.

Q - Paola Mello {BIO 17712227 <GO>}

Good afternoon. I would like to go back to the migration of your ERP, and talk about the transition. We know about the experience of other retailers and sometimes there are problems regarding inventory that gets lost between systems and we're ceasing 15 days that had to stop. I believe, you, of course, -- you anticipated that as you spend more inventory to the stores. I would like to know, if things have gone back to normal or do you have surplus inventory in the certain store and that need some markdown. So, could you please go a little bit more in-depth?

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

Paola, I think, I described this, but going back we stop operations for 15 days in order to transfer all the data from the old system to the new system over a thousand integrations of the different ecosystem, and then we start operating. And the big problem that companies face is when you're not careful enough in this free-period, because you went up transferring incorrect data and they get into the new system, in the new ERP, and they are distorted or they're wrong and this is where you have problems.

This is the crucial part of the migration and the one that really provokes problems, and this is what we controlled very well. And you can ask, well, how can you say that everything went smoothly. Because on August 14th, we closed our accounting figures of July with no problem whatsoever. So this means that our inventories were, okay. We didn't lose any inventories, the taxes were, okay, accounts payable, okay, everything working smoothly. And we were invited to present our case in a world example -- worldwide example of Oracle. And people have problems when they transfer this -- store to the wrong data from the old system to the new system. So you lose control and it's not easy to recover control. And our team was extremely efficient, they worked very hard, and congratulations to all of them.

Q - Paola Mello {BIO 17712227 <GO>}

Thank you.

Operator

Mr. Robert Ford from Merril Lynch.

Q - Robert Ford {BIO 1499021 <GO>}

Thank you. Good afternoon. Thank you for the question. You talked about the efficiency and the array of products that you intend to have.

A - Jose Gallo {BIO 1822764 <GO>}

Thank you, Robert, for your question. The project for the financial institution is going as planned according to our schedule. So, we continue to believe that in the first half of 2017, it will be possible to have the kick-off. But, we do not expect to have an increase in our product portfolio. The financial institution will be a platform that will be better prepared to support all these products and to support the -- in a retail operation. We believe that Meu Cartao, the co-branded -- well, we will start with Meu Cartao during the first half.

And the second one will be the Saque Rapido or fast withdrawal versus [ph] credit and Saque Rapido in the second half of the year, so this is the time schedule. And the other one only in 2019, the private label, only 2019. So, this is our timeline.

Q - Robert Ford {BIO 1499021 <GO>}

What kind of benefits do you expect from this initiative?

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

We expect to have a higher degree of flexibility in this operation, a higher degree of independence and flexibility, mainly in terms of obtaining funding. This will be important, and we believe that we will also become more agile in our tactical changes in this operation. And it is also important to stress that from the P&L viewpoint, it's practically neutral. We believe that this will be neutral. There are some benefits regarding the funding, some benefits regarding new revenues, but on the other hand we have a higher cost because of the new structure and it is important to say that the benefits, also a reinforcement to the governance of this area will be another benefit. So, we will be able to better struck to this area with the financial institution. So, it's another benefit. Thank you.

Operator

Gustavo Oliveira from UBS. You may proceed.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Good afternoon, everyone. I would like to understand the gross margin dynamics in this quarter. Over the year, you have been saying quite a lot about the discounts in shopping centers, lots of promotions by stores, and in spite of weaker sales, weaker than expected, you were able to keep a stable gross margin. So, you have 5 to 10 bps contraction [ph] by other sectors and a good adjustments in your inventory levels in spite of challenges. Is this a right reading or do you have any imbalances in your inventories, not in amount but in the quality of the product to be sold in the fourth quarter?

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

Gustavo, your reading is very correct. It was not easy, because we saw these markdowns in these two brands and we have one guideline here. We do not just hide the problems in this regard and we have to face our problems, we have to tackle them in order to avoid any further surprises. And it's a matter of management. It's very hard to explain things to you, but our people managed this situation very well. So we have no markdowns hidden under the work, for instance.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay. Thank you very much. Congratulations.

Operator

Richard Cathcart from Bradesco.

Q - Richard Cathcart {BIO 16457807 <GO>}

Good afternoon. Two questions. The first one has to do with the volume in same-store sales. Was this drop caused by a drop in traffic in the stores because of the Olympics or was this because of the collection?

And the second question, going back to the same-store sales, I understand what Gallo has said, that he cannot quantify impact from Y or Z, but if we -- but maybe you could give us an idea of the negative impact of the collection. Was it more in the third quarter? Could you, at least, pinpoint that?

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

Well, it's probably affected more the third quarter, because what happens with the situation of these two brands is the following; you have markdowns, we end up producing a lower volume of sales. So, of course, the impact was higher on the third quarter than on the second quarter in same-store sales vis-a-vis these rent. The other question?

Q - Richard Cathcart {BIO 16457807 <GO>}

Well, the other question was about the drop in volume in same-store sales.

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

Yes, the main reason for that was the lower traffic, 7% lower than last year.

Q - Richard Cathcart {BIO 16457807 <GO>}

Thank you.

Operator

Please stand by while we wait for questions. The Q&A session is closed. And I would like to give the floor back to (inaudible) for the closing remarks.

A - Jose Gallo {BIO 1822764 <GO>}

I would like to thank you all very much for your attention. And if we were to recap in a nutshell this quarter, maybe we did not reach the sales that we wanted to reach. But on the other hand, we were able to preserve our cash and we even saw an improvement in this and our expenses were quite under control as well.

And we concluded our ERP with no problem whatsoever very smoothly. And our credit area also delivered a very good result, and we continue with very conservative call policy in place regarding credit granting, and in November we will have a promotion, the first payment in 60 days, so this is not abnormal. So, we are already warning you, because for 14 years we have been doing this kind of promotion, okay. And finally, we believe that in the first half of 2017, we will see a slight acceleration in the consolidation of retail and it might be an opportunity for us. So, thank you very much for your patience. Laurence?

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

Thank you all very much for your attention. We will continue to give you additional clarification whenever needed, and thank you very much, and see you next quarter.

Operator

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