Q1 2016 Earnings Call

Company Participants

- Fabricio Bittar Garcia, Vice President of Sales and Operations
- Frederico Trajano Inacio, Chief Executive Officer
- Roberto Bellissimo Rodrigues, Chief Financial Officer and Investor Relations Officer

Other Participants

- Guilherme Assis, Analyst
- Leonardo Cavalcanti, Analyst
- Luiz Cesta, Analyst
- Marcel Moraes, Analyst
- Tobias Stingelin, Analyst

Presentation

Operator

Good morning and thank you for waiting. Welcome to Magazine Luiza's Conference Call to discuss the First Quarter of 2016 Results. We would like to inform you that this event is being recorded, and all participants will be in listen-only mode during the company's presentation. Afterwards, we will have a question-and-answer session when further instructions for you to participate will be given. (Operator Instructions) The replay of this event will be available soon after it ends for a week.

We would like to remind you that forward-looking statements that might be made during this call related to Magazine Luiza's business perspectives, operating and financial projections and targets, our beliefs and assumptions of the company's management, as well as information currently available.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions 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, industry conditions and other operating factors may affect the future performance of Magazine Luiza and may lead to results that differ materially from those expressed in these forward-looking statements.

In order to open this call, we would like to give the floor to Mr. Frederico Trajano, CEO, who will make the presentation. Mr. Trajano, you may proceed.

Frederico Trajano Inacio {BIO 17269235 <GO>}

Good morning, everyone. Thank you for participating in our call. I'm here with all the members of the Executive Board in order to talk about the results of the first quarter of 2016. I would like to start by saying that, in spite of all the difficulties due to the difficult political economic scenario of our country, Magazine Luiza -- because of the lot of focus on -- on the part of our team was able to deliver good results practically in all key indicators in the first quarter.

I will start with sales. We were able to have a positive growth in sales in spite of the drop in durables. For the market, we don't have the data from March yet, and we were able in spite of this scenario to gain market in this quarter. Thanks to a very detailed work that we did since last year, identify regional opportunities in regions and for each one of the categories of Magazine Luiza, and of course an effort made by our commercial people in order to tap into these opportunities.

And the major -- the highlight is e-commerce, we grew 27.8% and the market was stagnant during this period, according to the data published. And the result had already been very great in the last quarter and this shows how right our multi-channel strategy is to transform our company into a digital company. And as a -- the final result of the company improved with participation in this gain of e-commerce, we have good results both in the top line and the -- top line and bottom line of the company. Our e-commerce is the only one that is profitable in the market and we were able to evidence this in the quarter.

As I said in the last call that we held about the last quarter of 2015, I said that we were going to gain market share without hindering our profitability. So we thought there was a possibility to do that and this is exactly what we delivered, the gross margin growth of 2.1 vis-a-vis the same period last year. But the base of last year if we look, at all the quarters, the best margin was in the first quarter in 2015.

So we had a reasonably good basis in the first quarter of 2015, and in spite of that we show that we are able to increase sales and gain share without necessarily have any rational pricing policy that happens mainly in the e-commerce companies, but also in brick and mortar chain. So you don't have to wait for profitability to gain share.

In expenses, we were able to reap the fruit and we are still reaping from two major projects that we had with the Galeazzi Consultancy, ZBB, GNB [ph] and we made the big effort especially in all the packages of the company, administrative and when -- and also expenses with credit cards and freight and a whole series of expenses that we're working on. Very much focused on optimizing our processes and our contract and in spite of an inflation here like we had last year that impacts contracts. We had an expense dilution; SG&A dropped 3.2% vis-a-vis last year in nominal terms.

And Luizacred after two quarter of more difficulties in terms of results because of some adjustments in products and also credit assignment, we bounced back and we are balanced for a year like this one. We had a good result of Luizacred in the first quarter, still lower than the first quarter last year.

This scenario continues to be challenging and we were able to decrease our debt by 191 million this year vis-a-vis the first quarter of last year. And have a net debt adjusted EBITDA ratio of 1.5 times which is recently profitable to face the turbulences that we might have in the future.

And to finalize, I would like to give the floor to Roberto Bellissimo, and say that our view of the political and economic scenario continues to be the same for the consumer market, but we believe that operating in a market that is a market of over R$100 billion with less than 10% share. We believe that there is a lot of room for us to consolidate this market and with a balanced management in all retail fundamentals and continuing our successful implementation of business strategy, we have room to gain share preserving our profitability.

With that, I end my introduction and give the floor to Roberto Bellissimo.

Roberto Bellissimo Rodrigues {BIO 17269312 <GO>}

Good morning, everyone. Okay, let's go to our presentation on page two, our highlights. Frederico has already talked about our growth and sales about 3% to 2.7 billion improvement in relation to the last few quarters. Growth of e-commerce, 22% share which is a relevant share in the total. Our gross margin that increased by 2 percentage points highlighting here the better sales mix.

And this quarter we sold more Smartphones and less of the category that have a lower margin such as air conditioning that in January was not so warm and the sales of air conditioning were not as high as last year. Freight and assembly that we started in April last year, we started to charge for that we had already told you that. So this is where we were able to increase our margin by charging for assembly and freight for instance, and so on and so forth. And improvements in the whole sales scenario both online and offline and e-commerce as well, an increase in margin with a more rational price scenario as well.

Talking about the EBITDA line we grew to 144 million, adjusted EBITDA 7.2%, one of our best margins. And non-recurring expenses of 19 million, they were just one-off expenses, non-recurring and they were basically in January and February only. Net income of 5 million and adjusted net income of 18 million.

Talking about working capital, we had an improvement in our inventory and it was positive even regarding our gross margin. And we were able to increase our suppliers account. So, with a positive impact on working capital, we reduced our net debt compared -- well practically R$200 million, reducing our net debt, and we increased our cash. And Luizacred grew inside Luiza stores 5% and outside as well, and this shows the quality of our client base and the activation of our clients.

On the next page, page three, we show you the evolution of the number of stores. 27 new stores more than in the first quarter of 2015. We invested 23 million lower than the first quarter of 2015, but it was mostly on technology, which is our major focus currently and 25% of our stores are maturing still.

On the next page, page four, we show the quarterly evolution of gross revenue. It is clear that last year we saw a drop in sales in all quarter, so this was the first quarter of growth in sales, 10.7 billion; in e-commerce a higher growth of all the last quarters. 19% -- 28% now from 600 -- over 600 million. And same-store sales growth stabled with the growth of e-commerce, and better than we had in the last few quarters as well.

On the next page, we show the evolution of gross profit. One important detail here, with the end of the tax benefit, we had a reclassification from last year when we posted higher net sales as a line of taxes than now for comparison effect. This is under operating expenses. The gross margin of last year goes up a bit and in the same proportion expenses. And here we show in the gross profit, 30.2% of gross margin, better than the first quarter last year more or less in line with the margin that we had around the middle of last year. And growth of gross profit of about 7%.

On the operating expenses side, expenses which selling went down, G&A also dropped. In spite of the growth in sales, we were able to reduce our SG&A. And with the increase in the INSS tax, and the end, therefore of the tax benefit. In the others line here, we have minus non-recurrent expenses, and at the end we saw a dilution of SG&A. Here we show the evolution quarter-on-quarter also about the equity income. The first quarter was better than the last quarter of last year recurring the result of Luizacred.

On the next page, we show EBITDA net of non-recurrent expenses, you can see an evolution to 163 million in the first quarter this year which is 7.2% of EBITDA margin and is explained by gross margin and as the reduction of SG&A. On the lower part, we have the EBITDA performance vis-a-vis last year, 2.1%ingross margins; 0.4% in selling expenses; 0.2% in G&A. Equity income slightly lower than last year, loan loss provision, other expenses.

And we have on the next page, the financial result -- financial results, a slight increase, but lower than the variation of the CDI in the period. Also impacted a little by the growth in sale as the interest went up with the card anticipation. And in the other expenses more related to the debt service they dropped because our net debt is lower than last year. Net debt and our leverage of 1.6, as you can see here, on the lower part, the working capital improving as well. I had already mentioned the suppliers account, but we also improved the receivables account.

And going back to the net income quarter-on-quarter, 5 million this quarter and net of the non-recurrent expenses, 18 million.

On page nine, Luizacred revenue is going up 2% and Luiza Card inside and outside the stores, but we reduced the DCC revenues and also personal loans as part of our strategy of Luizacred to be more conservative and focus on the Luiza Card.

We see here an increase in EBITDA margin last year, but dropping vis-a-vis December very much because of the reduction of credit and the better quality of the portfolio, more concentrated on Luiza Card and also reflected here -- you can see that Luizacred had a performance better than the second quarter last year.

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

Frederico Trajano Inacio {BIO 17269235 <GO>}

I will go straight to the last slide. Before seeing our expectations for 2016,the main focus of our work for this year, accelerating the implementation of all of the digital project. We have over 20 digital projects with the objective of transforming our company from traditional retail to a digital company with human warmth in store picking and many other projects that we are about to launch, we already have a pilot continuing to participate in the market in a sustainable way increasing profitability, focused on reducing operating expenses, implementing the projects, being conservative in credit assignment and with the product mix of Luizacred.

As Roberto mentioned, continuing our efforts to improve cash generation or protecting our cash in a euro crisis something that we implement into the first quarter and we will continue. And lastly maintaining the company among the best companies to work for in Brazil.

Now I would like to open for questions from analysts.

Questions And Answers

Operator

Thank you very much. Now, we'll start the Q&A session for investors and analysts only. Questions asked over the Internet will be answered later by email. And we will be available to clarify any doubts that you still have. Our first question comes from Mr. Marcel Moraes from Deutsche Bank.

Q - Marcel Moraes {BIO 20057766 <GO>}

Good morning, everyone. Congratulations for the results. My first question has to do with sales performance both in brick and mortar stores and e-commerce. It seems to me that you're gaining additional market share now and the sales performance is very clear vis-a-vis your competition. Is it because of some specific region, is there a region where you are getting more market share because of other stores being closed? And what is your expectation for e-commerce more specifically because your performance is very much a dot outside the curve vis-a-vis your competitors in this quarter?

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

Thank you for the question. Good morning, Marcel. The first quarter of this year as I said during the presentation, the results were due to the work done by our two teams in brick and mortar stores and e-commerce, we found very good potential in different regions. I would say, every region in all categories. And we work very strongly in order to tap into these local opportunities that we identified by our project that is called focus on sales.

So, Magazine Luiza gain share consistently for more than four years. Ever since our IPO, we have been growing practically every year, even last year when we saw some reduction in our sales vis-a-vis the previous year. And in 2014, there was the World Cup and we had an extraordinary gain of share. So the comparison between 2015 and 2014 was very difficult because the bar was very high and now comparing to 2015, it is more normal, let's say. But ever since the beginning of this year since -- or since the IPO we have been gaining share since the first quarter that we published our results.

And this year we are gaining share in brick and mortar stores, and practically all regions highlighting the South and the Northeast. We have been gaining more share in these two regions because of consolidation of the stores and also because of competition, specifically in each one of these regions and also in the interior of Sao Paulo and other regions as well.

More specifically regarding e-commerce, this is the second quarter that we have growth higher than the market, and the base is from 2014 to 2015 just to remind you it was very difficult. And it has to do with what I have been saying in the last few calls. We feel that there is a move of rationalization of prices in e-commerce in Brazil because many players sold at prices that were below the cost price which is not sustainable in the long run.

And this -- we believe that, of course, investors want to have return on their capital invested. And we see now that there is a trend in the market of more rational behavior vis-a-vis prices. And our cost base is shared and we have multi-channel operations. And it is also of course due to a lot of hard work done by our e-commerce people in pricing, management, et cetera.

Q - Marcel Moraes {BIO 20057766 <GO>}

Fred, when you look to the next quarters, and you think about your sales mix that you will have, could we imagine different categories evolving in a different fashion? What category do you believe will be the one delivering the best performance and which categories will not have a very good performance? Categories in general, which ones will have a better performance and the opposite as well?

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

Well, a category that shows an interesting growth in spite of the economy is mobile telephony. It gained a higher participation in the overall sales both in e-commerce, and brick and mortar stores. This is a product that everybody wants to have. You saw all the revolution that the blocking out of Whatsapp have caused. So, you have all the different age bracket very interested in having a mobile phone or a cellular phone. And this product has a short life span differently a refrigerator for instance. Many people trade up their mobile phones every year, and Fabricio will add also. Fabricio is our VP.

A - Fabricio Bittar Garcia {BIO 17269261 <GO>}

Good morning. This is Fabricio. As Fred said, we identified in general the categories we started and smartphones are the category white line, very stable and we have been working on that and it was practically zero to the regarding growth. TV is another category. Last year, it sold quite a lot. So TV is our image. And another category is furniture. Furniture grew in this first quarter and we will continue the work to increase growth, but I would say smartphones, white line, image and furniture.

Q - Marcel Moraes {BIO 20057766 <GO>}

In this order Fabricio?

A - Fabricio Bittar Garcia {BIO 17269261 <GO>}

Yes, in this order.

Operator

Luiz Cesta from Votorantim Brokerage House.

Q - Luiz Cesta {BIO 15223262 <GO>}

Good morning. Thank you for the questions. Regarding your gross margin, you mentioned three regions that led to this increase, better sales mix, charging for freight, better operating efficiency. And could you give us more details about these three factors, was it more due to one of the factors or was it the same participation of the three factors in this improvement?

And regarding e-commerce, I would like to go back to the growth phase. Could you please tell us in detail, what is the reason for this growth? Are you being able to convert more sales? What is the specific channel? Is it the mobile phone, is it traditional sales via desktop? So maybe you could give us more details about how are you converting? Thank you very much.

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

Good morning. Thank you for the question. About margins, as Roberto said during his explanation, we operated with a level of profitability in the first quarter of 2016. That was similar to the one, in the two last quarters -- the second and the third quarters of last year. So the level of margins and profitability that we had last year in the second and the third quarter.

And there isn't one single factor. We did a lot of work in all the categories and all of the stores and e-commerce also improving, our margins also because of the fact that the market is more rational. But I can tell you, the increase in telephony and the mix is the main reason.

We had a very big heat wave last year and this year it was not the case, and the drop in white line and the increase in smartphones was very big. And it was the factor that contributed the most to this increase in margin. But we have the same level of last year in the second and the third quarters.

Now regarding e-commerce, I'm going to give the floor to Fabricio.

A - Fabricio Bittar Garcia {BIO 17269261 <GO>}

Regarding e-commerce, our expectation is to continue to grow higher than the market and gaining market share in a sustainable fashion such as the policy of the company and getting into more details about sales at the first quarter. Our sales are based on a sum of factors, ticket conversions and calls, and we had gains in all three variables, increase in calls, conversion and average ticket. Regarding the devices, the app has been contributing to the growth.

In hit [ph] and conversion, we had already identified that the migration of hit was -- into conversion was becoming very fast and we had to offer it in app that could have a conversion equal or similar to the desktop. So we launched the app at the end of last year with personalization and low friction, with a higher conversion which is what we expected. So, this migration from desktop to mobile devices is giving a contribution to our sales in general.

Q - Luiz Cesta {BIO 15223262 <GO>}

Thank you.

Operator

Mr. Guilherme Assis from Brazil Plural.

Q - Guilherme Assis {BIO 16143141 <GO>}

Good morning, everyone. Thank you for the question. I would like to go back to gross margin, Fred. You made it clear that the main factor that has been driving your margin, and we know that there is the impact of your charging for collection, you're charging for assembly and freight.

Could you quantify, because year-on-year we saw an increase of 210 bips [ph]. Of these 210 bips, what came from freight and assembly, how much came from your different mix? And still talking about margin, we know that your main competitor is more aggressive in brick and mortar stores. How do you see that, because looking at the result, it seems to me that you were not -- you didn't have to be aggressive in prices because of your competitor -- your main competitor. So have you noticed a higher degree of aggressiveness on the part of the other competitors or maybe more specifically your main competitor. And how are you reacting to this, maintaining such a strong growth with a major margin gain. So how can you achieve that?

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

Guilherme, good morning. Thank you for the question. I would divide the answer into two. The first one, regarding the composition of the margin gain. And in fact, there is nothing new to be added here. All the factors have contributed and I'm not going to talk about all of them. But I will reinforce that last year, the lowest margin last year was in the first quarter because of high participation of white line driven by the heat wave that we had last year. So many air conditioning devices and fans, et cetera. But all the others freight and assembly, rationalization of the e-commerce market that as a consequence improved our margin. All of them gave a major contribution, not as big as the mix, but a major contribution to this growth in margin.

And the second part of your question, when we established the purpose of gaining share without losing profitability, you see that the market has not concentrated yet. You have many small and medium sized players, 70% in the main categories and we feel that these companies felt the crisis more than the companies that are more capitalized and that are structured and they suffered with shortage of products and many companies are closing stores.

We have been reading quite a lot of news about companies that are closing stores and we are increasing our number of stores. We opened 27, 28 new stores vis-a-vis the first quarter of last year, which means that we are being able to deal very well with this competitive scenario. The crisis is rather big and it affect everybody of course, but it affects more those who are not so well prepared. So I don't see any need to reduce margin to gain market share or to protect ourselves because of the scenario that I have just described.

Q - Guilherme Assis {BIO 16143141 <GO>}

Very clear. Thank you. Regarding the cost reduction that you achieved in spite of the increase in the tax burden over your payroll. I would like to understand your process of ZBB with the Galeazzi Consultancy. Do you think there is more fact to be trimmed with this zero base budget process? We still see weak sales and inflation is still high. So, what could we expect regarding your operating leverage that you showed for the first quarter?

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

Roberto will answer your question.

A - Roberto Bellissimo Rodrigues {BIO 17269312 <GO>}

Good morning, Guilherme. Over last year, we showed a very consistent work done in expenses. In this quarter, we were able to once again reduce expenses. We reduced our marketing expenses even. So, it was a lot of work that we did to reduce our expenses without jeopardizing our sales. So, you have to plan all this very carefully.

And we started last year -- ZBB we started last year, we started in September, October. So our whole budget was raftered with this new methodology with zero base budget. And we have to adjust every single month in order to comply with the budget that we have proposed. We have the potential of further reducing the company's expenses. We are also dealing without the contract, and freight, and rentals, et cetera. So we are on the right track in order to continue to deliver growth in our sales and a very strict control on our expenses, focus on all the opportunities, marketing, rental and freight, and all the expense lines of the company. We are addressing all of them consistently.

Q - Guilherme Assis {BIO 16143141 <GO>}

Thank you, Roberto.

Operator

So, Tobias Stingelin from Credit Suisse.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Good morning. Thank you for the question. But my question has already been answered. Congratulations.

Operator

(Operator Instructions) Our next question is from Mr. Leonardo Cavalcanti from Nordestao.

Q - Leonardo Cavalcanti {BIO 19140877 <GO>}

Good morning, everyone. Congratulations for the excellent results. I have two questions. About your short-term debt, are you comfortable with your debt level? As you have a multi-channel strategy, your margins are different between e-commerce and brick and mortar stores, of course. Could you describe this in detail, please?

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

Well, the call was very bad and we were not able to understand your questions. The quality of the call was very bad. So we ask you to please repeat your question.

Q - Leonardo Cavalcanti {BIO 19140877 <GO>}

The debt profile, there was an increase in your debt in the short run. How do you see that for the next few quarters. Are you going to the market to raise funds? You have synergies between e-commerce and brick and mortar stores. The improvement in your margin, was it because of the e-commerce or was it because of your brick and mortar stores?

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

I will answer the first part of your question regarding the debt. Ever since the end of 2014 and beginning of 2015, we worked very hard to extend our debt profile. And last year, we were able to reduce our net debt in nominal terms. This year, we continue with this reduction in the first quarter and net debt was much lower than the first quarter of last year, and our cash position is better. On the other hand, in this quarter, we had just a few maturities and we -- this year, we do not have a major concentration of maturities because we have rolled over our debt. We have some maturities more towards the end of the year.

Our cash position is very comfortable and we have enough time to negotiate and continuing to roll over our debt. Of course, the cost in the market are higher now and this is very clear based on the recent issuances of debentures, et cetera, and the cost of money went up for everybody.

And thus we have a small part that should be refinanced this year. This will not be relevant in the short and medium-term of our debt because this quarter was even lower than the cost of the same -- of the debt than the same quarter last year with the anticipation of credit cards coming from higher sales -- on credit cards.

So this is the way we will continue to deal with our debt. We will continue to generate cash and working to improve our working capital to generate cash, and refinancing debt in the best way possible having a comfortable position of cash and net debt to EBITDA ratio. So we are comfortable when working to maintain this level of comfort for the company.

Regarding margins, well, the answer is the same that I have already given to other questions. Once again, the main factor was the mix, but all the other components were important, they played an important role to allow us to deliver this result. So, there is nothing to add.

Q - Leonardo Cavalcanti {BIO 19140877 <GO>}

Thank you.

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

Thank you, everybody. We thank all of you who have participated in our conference call.

Operator

Thank you very much. Magazine Luiza's conference call about the results of the first quarter of 2016 is closed. You may disconnect your lines now. And we wish you all a very good day.