Q3 2011 Earnings Call

Company Participants

- Adalberto Pereira dos Santos, CFO and IR Officer
- Jose Gallo, CEO
- Unidentified Speaker, Company Representative

Other Participants

- Andrea Teixeira, Analyst
- Fabio Monteiro, Analyst
- Gandier Madero, Analyst
- Gustavo Oliveira, Analyst
- Irma Sgarz, Analyst
- Lore Serra, Analyst
- Ricardo Boiati, Analyst
- Tobias Stingelin, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

(interpreted) Good afternoon, ladies and gentlemen, and thank you for standing by. At this time, I would like to welcome everyone to Lojas Renner Third Quarter 2011 earnings conference call. I would like to inform you that today's live webast, including both audio and slide show, may be accessed through Lojas Renner's website at www.lojasrenner.com.br in the Investors Relations section at the webcast platform. (Operator Instructions)

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Lojas Renner's management and on information currently available to the Company. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstance that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Lojas Renner and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'd now like to turn the conference over to Mr. Adalberto Pereira dos Santos, CFO and IR Officer. Mr. Adalberto, you may begin your conference.

Adalberto Pereira dos Santos {BIO 16803045 <GO>}

(interpreted) Good afternoon, everyone. We're here today to discuss the results of the Third Quarter of 2011. We have here with us, Jose Gallo, our CEO; Lucia Andrade, Controller Senior Manager; and Paula Picinini, our IR manager.

Before starting the presentation, I'd like to make a few comments on some of the aspects that had an impact on our activities this quarter. The first aspect has to do with season transition. As you all know, it was very challenging since we virtually had a longer winter this year until late August in the south and southeast. And these are important markets for the Company.

In this scenario, we have a large share of the demand still looking for winter items but all stores are ready to display our new spring and summer collection. Secondly, the whole issue related to the macroeconomic scenario, although the main drivers of the retailing sector remain positive, more specifically lower and lower unemployment rates, abundant credit supply. We have found that the population is becoming increasingly concerned with the daily news on inflation, high dollar rates and the crisis in Europe and the US, therefore, Brazilians are less willing to go shopping.

As we see it, aid[ph] and trust is definitely beginning to be affected. At first classes A and B, usually better informed. But once you have a leap in the dollar rate prices from BRL1.65 to BRL1.90 in one week, this message ends up by reaching all social brackets, no exceptions.

A third. And not less important aspect, has to do with inflation in cotton quotations. Even though it's not a recurring topic, it was exactly in the Third Quarter that we had higher impact in the cost of goods sold due to the delay between acquisition and availability of products in the store.

We could also mention higher funding costs due to higher interest rates, a more competitive labor market, higher cost in civil construction affecting the preparation of new stores and remodeling of existing ones. And finally, adjustment made by the Company in late 2010, particularly in back office and logistics to support the new level of growth. In short, we could say that the competitive environment has become not only more challenging but also more uncertain.

Just by this scenario, the consolidated sales of the Company increased 15.5% in the quarter and 17.4% in the first nine months of the year. In both periods, Camicado is showing its contribution, BRL33.7 million in the quarter and BRL55.4 million year-to-date, about 3% of total sales.

Gross margins, both for the quarter and also year-to-date were virtually in the same levels of these periods in the previous year, even if we consider the cotton issue that I mentioned before. And the slight dilution brought by Camicado's operation. Actually, if you consider our main operation, Renner Retail, our gain would have been 20 bps in both periods.

The same effect is seen in the EBITDA or retail EBITDA margin of Renner's operation, our main operation, in the quarter, moving from 11.4% to 11.6%, despite pressure in the structure to support the new level of growth and also pre-operating expenses of stores to be opened in the second half of the year.

We continue our expansion plan by introducing two additional units. One traditional Renner store and another Blue Steel pilot store, followed by five additional units opened in the first days of October.

We're also maintaining our integration process of Camicado operation implementing a good share of the action plan forcing -- including those that allow the acceptance of Renner Card in the stores of that operation.

Now, starting our presentation, slide three shows the performance of the consolidated net revenue. In the Third Quarter, it added to BRL657.1 million, growing 15.5% vis-a-vis the Third Quarter of last year. In the first nine months of the year, BRL1.9 billion or growing 17.4% vis-a-vis the same period of the previous year.

Notice that all these data refer Renner and Camicado combined for 2011. However, we don't have the pro forma for 2010.

Same store sales, which in this case consider Renner operations alone, were 3.8% in the quarter vis-a-vis 10.5% in the Third Quarter of '10 and 8.1% between January and September vis-a-vis 10.5% in the same period of 2010.

Slide four shows on the left amount for the breakdown of Renner and Camicado's stores and DCs. We can see on the chart on the right the performance of the selling area, 304.8 thousand square meters, corresponding to 174 stores of the combined operation. Out of this total, there are 146 Renner units and 28 Camicado units, areas of 290.5 thousand square meters and 14.3 thousand square meters respectively.

Slide five shows the gross income in absolute value, growing 15.1% in the Third Quarter of 2011 and 17.2% in the first nine months of this year. The gross margin of the consolidated retail operation was 50.2% in the Third Quarter of 2011, virtually in the same level presented by the Renner operation only in 2010.

In the first nine months the consolidated gross margin was 52.4%, also in line with the level achieved in the first nine months of the previous year. Please note once again that the gross margin of Renner's retail operation alone, our main operation, had a positive performance of 20 bps in both periods. This improvement achieved at the peak of the impact of cotton inflation was associated to the higher volume of imported items and also low temperatures in July and August.

They slightly impaired the arrival of the new collection. But there were no needs to mark down renaming items from the winter collection.

On slide 6, selling expenses. They increased 18.4% in the Third Quarter of 2011 and as a percentage of net revenues accounted for 28.8% vis-a-vis 28.1% in the Third Quarter of last year. In the first nine months of 2011, these expenses grew by 21.5%, accounting for 28.1% vis-a-vis 27.2% last year.

These increases are related to pre-operating expenses of the new stores inaugurated this quarter and part of the stores that will be opened in the Fourth Quarter of this year, in addition obviously to a slight impact brought by Camicado's consolidation.

On page 7, general and administrative expenses, which increased 12.5% vis-a-vis the Third Quarter of last year and 0.3percentage point lower compared to the percentage of net sales in the previous year, which was 10%. In the first nine months, this percentage was 9.1% or 0.1percentage points higher compared to the previous year due to higher expenses incurred in the first half of this year.

On slide 8, we show a table with a break down of financial services results, achieving BRL34 million, a reduction of 6.9% vis-a-vis BRL36.5million in the Third Quarter of 2010. The reduction is basically due to the non-recurring reversal of BRL6 million in the Third Quarter of last year, which, to some extent, changes the comparative base. But it's also related to roll out expenses of the co-branded card, which at first don't generate relevant revenues.

Delinquency was slightly higher compared to the same period of the previous year, generating the need to adjust the percentage provision at 0.5percentage point to interest-bearing zero plus eight sales. But these levels are historically low and comfortable.

In the first nine months, the result generated by the financial product area was BRL104.6 million, growing 19.5%. And this improved mainly on the initiative implemented in recent periods and also gains from FDIC, around BRL9.9 million.

Now moving to slide 9, we have a chart showing the performance of the consolidated EBITDA, which added to BRL105.3 million in the Third Quarter or growing 3.9% in absolute value, an EBITDA margin of 16% or 1.8percentage points lower than 17.8% presented in the Third Quarter of 2010. This reduction stems mainly from the temporary difference in reversal of the financial product area and to a lesser extent the dilution presented by Camicado.

In the first nine months, EBITDA was BRL370.1 million, growing 13.2% vis-a-vis 2010 and the consolidated EBITDA margin was 19.2% vis-a-vis 19.9% in the first nine months of last year. If we focus on Lojas Renner operations only, this margin would have been in line with the figures for the first nine months of 2010 -- in other words, 19.9percentage points.

Slide 10 shows the net financial results, shown on the top table. In the Third Quarter of this year our net financial revenue was BRL1.7 million, lower than the result in the first or in the same period of the previous year due to changes in the Company's capital structure. On September 30 of this year, cash and cash equivalents totaled BRL659.1 million. And if we deduct indebtness of BRL354.4 million, our net cash position is very comfortable at 304.7 million in late September and this increase is basically related to our recent issue of debentures.

On slide 11, we show the net income of the combined operations, totaling BRL56.7 million, a margin of 8.6% in the Third Quarter of this year vis-a-vis 10% in the Third Quarter of last year. In the first nine months, net income was BRL217.8 million, growing 17.8% and with a consolidated net margin of 11.3%, the same percentage in 2010. In the same slide, on the right, we show the ROIC of the combined operation, which was 5.3% in the Third Quarter of '11 vis-a-vis 6.3% in the Third Quarter of last year.

For nine months, ROIC was 19.6% or 0.8percentage points lower than the rate of figure for the first nine months of 2010. In those cases, the reduction was primarily caused by a higher total cash position of the Company stemming from the issue of debentures.

Slide 12 shows the Company's balance sheet. First, I draw your attention to the performance of our inventory. They grew 26% year-to-date, therefore higher than our sales growth. This fact, in addition to the product mix of our new store, we flagged a higher share of imported items in these collections, absolutely in line with a strategy to gradually increase these items.

Still in assets, we highlight intangible assets, assets totaling BRL247.4 million at the end of the period, reflecting the posting of the Camicado's operation. For non-current liabilities we highlight the line of financing of financial services operations, amounting to BRL342.9 million related to FIDCs in the quarter and debenture lines, BRL298 million related to the issue in August.

In slide 13, we share information on the Company's investment, which totaled BRL55.7 million this quarter, out of which BRL29.6 million referred to the opening and preparation of new stores. Year-to-date these investments totaled BRL144 million.

Now moving to slide 14; on the left we have a list of the 12 stores opened in the first nine months of the year. And we highlight two Blue Steel pilot stores, one in San Paulo and the other in Belo Horizonte.

In the beginning of the Fourth Quarter, we've already opened four additional Renner stores and the third Blue Steel store in Porto Alegre. On the right of the slide we show a full list of the inaugurations of the Fourth Quarter of '11. And we closed the year with 30 Renner stores between compact and traditional stores, three Blue Steel stores and four Camicado stores, as previously expected by the Company.

On slide 15 we show the card issue, reaching a record of BRL18.4 million as well as the performance of the average ticket of our private card, increasing 8.5% moving to

BRL136.34. In the first nine months, average ticket was BRL140.90, therefore growing 10.6%.

On slide 16, on the charts to the left we show the performance of Renner's total average ticket. In the Third Quarter the increase was 7%, reaching BRL100.07. And year-to-date increasing 8% with an average value of BRL102.49.

On the right we have the performance of the payment methods in the total sales of the Company. This quarter private accounted for 55.3% of total sales vis-a-vis 56.9% in the previous year. This loss in share, which seemed to be irreversible in the past, is becoming increasingly lower in recent quarters and luckily they have remained stable since last December, probably thanks to the measures we've been implementing to revamp and make this product more appealing.

The Company is keeping an eye open on the international crisis and any potential impact on domestic market. We maintain absolute control in our cost structure and regardless of our sales levels, we'll try to protect our margins so we can keep on delivering at the best levels of the market.

Please don't forget that 2011 as a whole will still show very good results or maybe exceptional results for the Company. We have a new level of growth. We've been growing with 10 or 15 stores and now we have 30 stores per year.

We had the integration of Camicado, the beginning of our co-branded roll-out card, the compact operation, Blue Steel pilot phase. They are all important initiatives that will support the Company's growth in years to come.

As we said in our last call, both Renner and Camicado operation plans have been maintained as well as initiatives related to adjustment in our distribution structure and it will bring important operating gains. And they are also important to make the Company grow in years to come. Particularly, more focused on Camicado, our management is very confident in the opportunities brought by this operation to the Company.

As we said before, we are moving fast and this integration, improving systems, logistics, product development and several other fronts. Since early October, all Camicado stores have already Renner cards and the first results are very encouraging. Some stores in the South already have share higher than 30% on the cards, despite our little publicity.

Finally, we'd like to share with you our excitement, our happiness related to some of the acknowledgement achieved by the Company in recent months. Just to give you some examples, we were awarded with the Valor 1000 award 2011 for retailers awarded by Valor Economico newspaper. We were among the best companies to work for in 2011 by Exame Magazine and were ranked second for people management with companies with more than 10,000 employees according to Valor Economico newspaper. These were our remarks. And we'll be happy to take your questions. Thank you, very much.

Questions And Answers

Operator

(interpreted) (Operator Instructions) Fabio Monteiro, BTG Pactual.

Q - Fabio Monteiro {BIO 3711690 <GO>}

(interpreted) My question has to do with the compact stores. Actually, I'm curious to hear your opinion. What is the experience with your smaller store when it comes to management and inventory management and product mix assortment?

And what about growth? I know we are just beginning but could you make some comments on this experience? And the same goes to Camicado. Adalberto, you made some comments on Camicado already. But maybe we could focus more on the outlook for the synergy capture growth at Camicado considering the acquisition and everything you've been through? Thank you.

A - Adalberto Pereira dos Santos {BIO 16803045 <GO>}

(interpreted) Fabio, this is Adalberto. The compact stores are doing fine. I would even say we're not only at the beginning, now we're closing with 16 compact stores out of the 30 total stores. We have 16 compact stores open. Numbers have been confirmed, particularly when it comes to the gross margin. We have a better, a slightly better gross margin at 1.5 bps 1.5percentage points. As to the cost structure, we are working on it, making some adjustments. But the total EBITDA seems to be slightly higher compared to the total operation, as we said before or as we expected.

Now, something we don't know yet because it's based on logistics and we hope we can enjoy it from next year on, has to do with more frequent supply. And this should account or should bring some turnover gains and chances are we have higher margin gains as well.

Another important aspect has to do with CapEx. We used to have a proportion of CapEx and now it's slightly higher than we expected. If the store has 50%, for instance, we will consider 50% of present[ph] CapEx now. It has proved to be 60% or 70% of traditional stores. It's slightly high. But when we use the discount rate, for instance, the ROIC of the operation proves to be very interesting.

As to Camicado, I don't know if I mentioned, well, the number of action plans that we've been working on for the integration. It's really surprising -- about 460 action plans related to integration. And we expected to close with 80 of these plans already implemented -- I mean, 80%, already implemented. And by April, we expect to complete 100%.

As for back office, we're in the final phase of integration. Systems are also moving fast and we highlight the inventory control system or SAP. They didn't use it in their distribution center. But those will allow to better control the inventory, better monitor our margins and better understand the operation as a whole. And several other fronts, including personnel, remodeling, et cetera.

Our reading is that by mid next year, we'll be completing our operating phase, the integration and improvement of our operation as a whole. I mean, the operational aspect per se. We've already begun some activities, some initiatives related to product improvement, lifestyle. But we'll benefit better in late last year. And I think Gallo can also provide you with more information.

A - Jose Gallo {BIO 1822764 <GO>}

(interpreted) When it comes to products, we'll be focusing more specifically on two lifestyles. We had a whole assessment, survey of existing products and we're aware of opportunities for the future. We're still in the early phase but we expect to increase the number of SKUs supplied so we can better explore these two lifestyle, something around 30% to 40%.

We're still working on the design. And by the way, we've already started to check other supply sources. Right now we have some people in China with initial contacts, choosing agents. So -- before we get into any kind of expansion. But we're about to open some 5 to 10 stores next year. But we want to have a stable process, all the processes as described by Adalberto. It used to be a very light family company when it comes to control. And now there are many things that we have to explore better when it comes to sales. Our idea is that we can have more sales from the same square meters. And we are trying to imagine how to work on that.

We don't think we will need additional area. We want to grow vertically. Our structure is very flat. So that's what we've been working on and we're very excited and things are doing fine.

Q - Fabio Monteiro {BIO 3711690 <GO>}

(interpreted) Just one last question, also related to the plan to open new stores. I'd like to have a better understanding of this experience for you. This experience of having this pace or this rhythm that is faster than usual. Adalberto mentioned you feel comfortable with about 30 stores next year. So what about this experience for you. And what about the risks involved?

A - Unidentified Speaker

(interpreted) Fabio, in 1999 we had 21 stores and in one-and-half years we inaugurated 28 stores. So the Company did not fail at that time and it never happened. And we could always deliver. So I can say that in-house we are handling this well. Obviously, we are doubling our size. We have three Camicado stores and another Blue Steel store. But these are lighter stores and we're doing fine.

Our challenge is still the shopping malls. We have delays in delivery. But we'll be delivering the 30 stores. But the rationale would be 15 stores in the first half of the year, 15 in the second half of the year and we still have 16 stores. So today is October 28, we have 16 stores to be inaugurated. And we'll be opening one or two stores in December, which is absolutely impossible from the commercial viewpoint. So this is our problem. It has to do with civic construction delays. But from our part, everything is running smoothly. The problem is delivery basically.

And obviously, just adding to what you said, there are repercussions. Just imagine we have teams, we have to recruit people and usually we have 30 day delays. So our expenses increase a little bit. But our challenge is having everything delivered to work on the stores.

Q - Fabio Monteiro {BIO 3711690 <GO>}

(interpreted) Thank you.

Operator

(interpreted) Ricardo Boiati, Bradesco.

Q - Ricardo Boiati {BIO 16528742 <GO>}

(interpreted) Adalberto, I wonder if you could make some comments on delinquency. How do you see it in-house? Do you think there'll be a worse scenario for the future, despite -- I know the level of loss is very low. But do you think there is a trend of stability or a worse scenario for the future?

And I wonder if you could update us when it comes to Blue Steel? Or what happened to the compact stores, maybe some economics? Could you make some comments on performance or the tests performed so far? Do you already have an idea of the potential number of stores to open in future years? Any update for Blue Steel would be really helpful? Thank you.

A - Unidentified Speaker

(interpreted) Okay. Delinquency, we always keep our eyes open. We focus on whatever might happen but we feel comfortable with what we see. The approval of new credit is still at very good levels, greater than 60%, which is high compared to the market as a whole.

That doesn't mean our policy is not very stringent. We have our credit committee. They have monthly meetings. They assess the market conditions, the health of the portfolio and make potential adjustments.

Now, when we consider the current portfolio, what you have is a slightly older portfolio and there are several factors that led to it, including the postal service strike that hurt and affected collection. But we have amplified or -- installments past due five months ago that have not been paid yet. And this is likely higher compared to last year, which was exceptional, about 1percentage point higher but lower compared to previous year. And this is for personal loan and also for loans in general.

We are comfortable. Our coverage rates, our coverage index, as I talk to Paula, are slightly lower when it comes to coverage. But we'll keep an eye on provisions, on past yield portfolios. Last year we had 35% and now we are working with something around 32%, 3% lower. It is lower but it's higher than the 23% we had in previous years.

So new loans, new credits are doing fine, they are healthy. And the portfolio is slightly old. But we don't see any signs of deterioration. So overall speaking, I think things are running smoothly. And an important driver or a factor that might be concerning when it comes to delinquency, not only at Renner but in Brazil has to do with employment.

If people have a job they tend to pay the payments. And in our case our average ticket and our average installments range from BRL20 to BRL25. People usually -- well, they don't want to run the risk of being in the blacklist or Siraza[ph] just for BRL25. So they may lose a job. But in our case, the impact will not be so strong.

People usually pay their tickets and they don't pay higher accounts. So that's usually consumer's reaction.

(interpreted) Ricardo, about Blue Steel, well, we're doing fine. In the beginning we have three stores; Boulevard Tatuape in Sao Paulo, Shopping Cidade in Belo Horizonte. And 2 weeks ago we opened a store in Porto Alegre.

We cannot give you any data, any -- we don't have a final conclusion because first, we need to wait three or four months to give any results. But at first what we see is that our sales per square meter are very interesting compared to specialized stores. And please bear in mind that our brand is just beginning to be built.

We're not a consolidated brand yet. We already see some trends in some products and a couple of things that could be added to the store. And we realize our public is different. And even when -- sometimes you have a very initial move. But we don't see a cannibalization when it comes to Blue Steel and Renner.

What we begin to see is that there is a slight chance of having a more differentiated product at a freestanding store. But these are only early signs. We have to wait a couple of months. But at first I can say things are very interesting up to now.

Q - Ricardo Boiati {BIO 16528742 <GO>}

(interpreted) Great. Thank you.

Operator

(interpreted) Gustavo Oliveira, UBS.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

(interpreted) My question has to do to same-store sales trends. Now that you are given more information about the Company's average ticket, I wonder if we could assume that you have a good balance over the last two years between ticket and traffic?

Now in this quarter, more specifically, your traffic trend was negative. Any special event related to that? Maybe the climate, the weather, anything about the collection that might be affecting traffic? Or maybe not so much advertising? I don't know exactly the reason why you have this traffic trend for the quarter. And do you believe you can have a better balance for the Fourth Quarter and onwards?

A - Adalberto Pereira dos Santos {BIO 16803045 <GO>}

(interpreted) Gustavo, your rating is correct -- same-store sales 3.8%. And we have a negative flow of about 3%. I think these are -- this is the math you use, right?

Q - Gustavo Oliveira {BIO 15129435 <GO>}

(interpreted) Correct.

A - Adalberto Pereira dos Santos {BIO 16803045 <GO>}

(interpreted) At a macro level you have a transition. You have consumer trust, seasons. But there are other details of operation that could always be improved. There are some very peculiar facts like central store. We lost some important room in Shopping Bahia in Belo Horizonte.

I'm sorry, St. Arnachio[ph], the mall in Sao Paulo. We lost important space in Bahia Mall in Belo Horizonte. And some cannibalization of new stores. And we believe they could come close to 1% when we open stores where we already have other store, Santa Catarina. And other things that could have been done differently; for instance, we were late with our spring collection.

So in our reading, I think this might have affected. And we first used to account for 2.62% of the Company's total sales and it was substituted by a different brand we already have. We tried to capture these sales through Marfinno's brand and we believe that might have been a gap there.

However, this is tactics, daily operations. For the Fourth Quarter we believe we'll be better positioned. We understand we can have better figures. The sales for October are likely better. Maybe Gallo can analyze this better.

A - Jose Gallo {BIO 1822764 <GO>}

(interpreted) You put it very well, Adalberto, cannibalization, for instance. This year, up to now, up to this present moment, of the 15 Renner stores that were open -- that we opened over the last 12 months, for same store sales, well, in 7 stores of the -- 15 stores have been cannibalized.

Salvador, for instance. We have three stores and we opened two additional stores in Salvador. Why to have to open in Salvador and initially be the victims of some cannibalization? Salvador has one-third -- are you there Gustavo?

Q - Gustavo Oliveira {BIO 15129435 <GO>}

(interpreted) Yes.

A - Jose Gallo {BIO 1822764 <GO>}

(interpreted) There was noise and we thought the line was down. Coming back to Salvador. Salvador, if you consider our target public, minus B and C, we have one-third of what we have in Porto Alegre. So what do you have to do? We need more square meters there so we can gain more market share.

At first, you have people who own their cards, they go to other stores -- there is some cannibalization. However, we have two-thirds. And you notice they have the same market share we have in Porto Alegre. We need two -- additional two-thirds of cards. If we have additional two-thirds of cards certainly we'll be growing not only in new stores. But also in cannibalized stores. And probably have the chance to open two or three additional stores in Salvador. But we always have to go through this early phase -- especially now.

The malls -- usually when you open the second mall in a smaller city or the fourth, fifth or sixth mall in smaller centers, that's what usually happens. Cannibalization is included in our map, for instance, in these new stores. We have 15% cannibalization. And that's something we did consider in our feasibility study, for instance, in Porto Alegre.

Bahasu[ph] is a big mall that just opened and we have this large store that is growing in NPC or -- it is growing. So this adjustment -- please understand that Renner has very big operations and we do bet on market consolidation. That's key to us. We often mention that. And the figures show that Brazilian retail is extremely fragmented. Now, if you want to grab or to capture this fragmentation we need square meters and that's what we're doing.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

(interpreted) Thank you

Operator

(interpreted) Gandier Madero, GPG Company.

Q - Gandier Madero

(interpreted) My question has to do with delinquency. I don't know exactly the best way to analyze this. But when I check the share of your portfolio of private label basically, which is past due, it seems to be higher compared to previous year and very close to the cap of the Third Quarter of 2008 and always comparing the Third Quarter. So that's my first remark. And I'd like to confirm if I'm right or not.

In addition, when I check the trend from one quarter or the second to the Third Quarter there is an increase in past due payments. And it's higher, the highest. Well, compared to the Third Quarter of 2003, it is similar. But it's slightly higher still. And the same goes to the variation of the share of the portfolio that is past due 30 to 60 days. I think about the Third Quarter of 2011 and 2010. There is a higher increase, much higher compared to the Second Quarter of the First Quarter. So when I look at this figure, it seems to be stronger than historical figures.

On the other hand, I don't find a provision. And I may be wrong. Correct me if I'm wrong. But I don't see that in your provision when I simply compare. And I don't know if that's the best way to do this. But when I compare these provisions with the past due share, it is way lower. It's only above the levels of 2006 or 2007 when the provisioning policy was very different. So please correct me if I'm wrong but am I right to assume this? Is that how you see it?

Having said that, I'd like to have a better understanding why you believe or you trust -- why do you believe you don't have to increase your provision level? These are my questions. Thank you.

A - Unidentified Speaker

(interpreted) Gandier, we've increased our provision level for private at 0.5%, for interest bearing zero plus 8. Now when I consider the total portfolio past due in the PL, today I have for the Third Quarter 25.8%; for the Third Quarter of last year it was 23% and in the Third Quarter of 2008 we had 26.2%.

So this level is lower compared to 2008 or the Third Quarter of 2009 -- we had 24.1%. When I compare the second to the Third Quarter, this is slightly higher compared to last year. Last year we also had 21.9% -- there are too many figures. I have the spreadsheet analyzing the portfolio in different ways and I can send it to you if you want.

Past due, past due over 90, up to 180, over the average portfolio, net sales. I think we have more details. But we made some adjustments in provision and our coverage curve, that I can also send to you, shows you exactly this. Compared to last year it is lower considering the magnitude. I would be speaking about 30% compared to last year -- 32%. So in 2009 it was 23%. Our coverage level for PL is almost 10% higher compared to past due portfolio. But I think it will become more technical based on the spreadsheet. I think Paula sent it to you in the last call. We can send it again after this call.

Q - Gandier Madero

(interpreted) Thank you.

Operator

(interpreted) Andrea Teixeira, JP Morgan.

Q - Andrea Teixeira {BIO 1941397 <GO>}

(interpreted) My question -- well, actually two questions. Coming back to retail, we had adverse climate conditions. So what about a Fourth Quarter? Any potential recovery? I can see there was a transition in the Third Quarter, different task, different store formats. Could you give us a flavor of the Fourth Quarter and your expectations? Your expectations for 2012?

And the second question also has to do with credit. I'd like to know -- well, a lot was said about provisioning. But I'd like to know if there have been any changes on placements or the level of acceptance in the card? Were you harder in the portfolio or it never happened in the Third Quarter. And I wonder if you expect this to happen later on? Or if you had any increase in interest rates? You expect to increase or to maintain the interest rate?

A - Unidentified Speaker

(interpreted) Andrea, just some comments on the Third Quarter, more related to margin, okay. It's always nice to bear in mind that the Third Quarter -- results of the third consecutive quarter in which we had margin gains in the main operation, 0.2 bps, that's growth margin. And also an impact on the EBITA margin of the Renner operation alone.

Please bear in mind we have the cotton issue involved. We had more challenging sales. And I like to draw your attention to total focus on cost. Regardless to whatever happened in our sales, we keep on delivering. Well, margin is something key. We keep on trying to deliver margin. That's top of the list.

As to the sales environment, maybe Gallo can comment on that. But before that let me talk about the portfolio. I had mentioned that the level of new entries have not changed. We usually update our credit policy monthly. We have monthly meetings with the committee. We discuss if there are any changes in the market, any changes in consumer behavior. And changes have been around 2% -- 1% to 2% in approval rates.

Just to give an idea, in January, our approval rate was about 64% and now we have 63.3%. So virtually the same. As to the sales environment, I'd like Gallo to make some comments

A - Jose Gallo {BIO 1822764 <GO>}

(interpreted) October is definitely better than August and September. And we expect to see a very interesting year end. Well, Christmas is always Christmas. And apparently if you consider the macroeconomic conditions, despite trust, we are very positive and chances are our end of the year will be good and very interesting. Obviously, the quarter -- we know that December is very important. However, October has proved to be good and chances are Christmas will be good as well. As to next year, we are still working on the figures.

A - Unidentified Speaker

(interpreted) I believe the behavior in November and December will be more inspiring so we can think about next year. So much so that we usually work on our first budget approved by the Board in November and then we wait until December so we can ratify everything in January, just to give an idea of how December is important for the trends for the following year. But what we can tell you right now is that we are ready to have a very -- or we expect to have a very interesting year end

Q - Andrea Teixeira {BIO 1941397 <GO>}

(interpreted) Perfect. We've been following several companies and they have been going through this whole movement. They're getting ready. They're getting prepared for some increase in area, which is also your case. Is it hard to measure -- well, I think it's hard to measure how it effects the logistics of existing stores -- and if that could be corrected.

It would be very helpful for the investors community if we could know the impact you really had when you think about the inventorial level? Well, we had excess inventory, right. So that was not a logistics problem. But I wonder if we could measure that?

And another question, Gallo, well, maybe you could tell us about the performance. And correct me if I'm wrong. But I believe that over the Third Quarter there was a lower sales volume? So is that an inflexion point in October?

A - Adalberto Pereira dos Santos {BIO 16803045 <GO>}

(interpreted) Well, it's too early to say anything. But as I said before, our figures for October up to now are better than August and September's. Now, I think we still have to wait and see. But definitely there is an important improvement when we consider same store sales, for instance. We have reasonably positive changes compared to the other months.

You mentioned something very important, which is our logistics area. Today, I would say this is our main challenge and this challenge -- it's not only a challenge but we're going through a process of investing in our distribution centers. In the first half of next year we'll be opening about 50,000 square meters in our DC in Rio. And in the following year or in 2014 we'll have another DC.

We plan to have a whole movement to improve our logistic efficiency. And if we consider our increase in imports -- we have been challenged in terms of distribution or more time necessary to take products to the stores. This summer, for instance, we had 50 or 60 additional imported items compared to last year. So just imagine 30 stores with increased imported products.

And one of the reasons why we have a slight increase in expenses is exactly due to this. Our investment, our plans for this process that will begin next year. And they consider changes in our operation. We'll stop working with a pack, with a grid. And we'll start working with units or SKUs.

So the main goal behind it is to improve our efficiency in product distribution so we can improve our sales and therefore improve our margins. So that's our future. But right now we have challenges; quantifying that right now is really difficult.

Q - Andrea Teixeira {BIO 1941397 <GO>}

(interpreted) Perfect. Just to double check -- so October is also lower compared to October last year, I imagine?

A - Jose Gallo {BIO 1822764 <GO>}

(interpreted) No, no it is not. Not even for same store sales. No, no, no.

Q - Andrea Teixeira {BIO 1941397 <GO>}

(interpreted) Perfect. Thank you, Gallo, thank you, Adalberto, for the financial data.

A - Jose Gallo {BIO 1822764 <GO>}

(interpreted) Just to add to the interest rate. At first interest rates rely heavily on the behavior of the market as a whole. At first it should remain the same.

Q - Andrea Teixeira {BIO 1941397 <GO>}

(interpreted) Perfect.

A - Jose Gallo {BIO 1822764 <GO>}

(interpreted) Upwards nor downwards.

Q - Andrea Teixeira {BIO 1941397 <GO>}

(interpreted) Okay. Thank you.

Operator

(interpreted) Tobias Stingelin, Santander.

Q - Tobias Stingelin {BIO 1557190 <GO>}

(interpreted) Gallo, you've just mentioned that the budget -- and Adalberto, you mentioned December, right?

A - Adalberto Pereira dos Santos {BIO 16803045 <GO>}

(interpreted) Pre-approved -- pre-approved. We're just beginning to work on it right now.

Q - Tobias Stingelin {BIO 1557190 <GO>}

(interpreted) Great, it makes my question even easier. Overall speaking -- well, you mentioned the expansion plans. So we should be working with about 30 stores.

Obviously, we assume that (inaudible) same-store sales is improving, macroeconomic factors are better and you maintain your expansion plan. Now could you give us an idea? For instance, you mentioned the peak of cotton. So that the peak right now, considering the speed of your chain or three or four months, maybe we have a pressure on the Fourth Quarter. But maybe there might be surprise in the first half because cotton prices will be lower.

Now the second factor. You have the new DC. So will stop liaising the current DC. And then your efficiency will be better, right, when it comes to your distribution and import and that can improve your margins? Could you help us understand the positive scenario for the future that we don't identify right now? Or maybe we might be losing something here in addition to lower sales. But can you have better margins next year?

A - Jose Gallo {BIO 1822764 <GO>}

(interpreted) Tobias, the first thing I would say is that we are not bearish at all. Look, we're very realistic. Right now we have to be very realistic. And I would say that we're also positively realistic.

If you want to run a company we should not focus on the first or next two quarters. But this year we've been challenged by cotton prices but we've managed to maintain and even have some margin gains. But all these additional expenses, opening 30 stores, additional expense in logistic systems in order to support this growth, we have expenses in line compared to the previous year. As to delinquency, our financial team was working very well and we're exactly in line with our expectations.

Coming quarter results are a challenge and remains a challenge -- did not lead to any dilution. So we're very positively realistic and bullish and considering that the macro drivers remain the same, there will be consolidation in retail. Therefore, we need square meters in order to consolidate. We can improve our input level and therefore improve our margins. But that takes more square meters.

When you get imported products they are not necessarily on schedule. Sometimes it comes for two or three months and gradually they have to be taken to the stores. We have to improve our efficiency margin as well. So we are changing from packs to SKUs. When you think about all that -- I know it's something that we'll start next year and they will keep going on. Very practical actions showing that the Company is being very realistic right now.

However, the outlook is very interesting when it comes to the future. Look we're going through good times. Our GDP is around 3%, 3.5%. It's not the end of the world. And we also know that in this scenario with a difficulty in credit and loan that might happen. Small and mid-sized companies will be the most affected companies. So that's consolidation. And when we have instability, you have some suppliers that are more cautious. And who will they sell to? To more solid companies with concrete results like Renner. We might even improve our negotiations.

So when it comes to strategy, this is our view and that's how we've been working on. But that doesn't mean we're not trying to improve our efficiency. But we're constantly keeping an eye on it, keeping an eye on our collection. There are always things to be improved. We're changing our visual merchandising in order to improve productivity per square meter. So this is our business as usual, our daily work. And what else did you want to know?

Q - Tobias Stingelin {BIO 1557190 <GO>}

(interpreted) What you said is perfect. My question was more related exactly to this. I can see many things but sometimes these -- the improvement is not so visible. So I'm just trying to anticipate. Maybe we have high growth margin next year? Maybe you don't want to give the guidance right now. But I'm just trying to anticipate if everything that you're doing right now -- and if you consider that next year that scenario is slightly different, not only the macro view. But what you're doing. I wonder if we'll manage to see improved margins -- cotton is down, distribution will be ready by then?

A - Jose Gallo {BIO 1822764 <GO>}

(interpreted) These are mid-term measures. The main measures that I mentioned -- well, our distribution center will be inaugurated in late -- at the end of the first half of next year. So results are not expected until early 2013.

But our point of honor and as our daily effort very well emphasized by Adalberto. Margins, for instance, that's a point of honor. We have to deliver the margin no matter what it takes from us. And we tend to improve our margins as things are right now. But it's not a significant change. It takes more consolidation in the future.

Q - Tobias Stingelin {BIO 1557190 <GO>}

(interpreted) Great. Last question -- I am sorry to go back to same-store sales. But I particularly believe the weather was also terrible in early October and if you consider the macro scenario was the same. It was hard for me to understand why October was better. Am I right to assume that October started badly and then improved. I am just trying to understand the trend. If you compare October with September; for instance, the previous month margins were doing poorly and then began to get better, just to give an idea of this curve. And did it really happen in October -- was worse and then got better?

A - Unidentified Speaker

(interpreted) Absolutely. I wouldn't say it started badly. It was reasonable and began to improve and it's still improving in the second half of the month. Anything else? I think we've talked about cotton already. Well, cotton has to do a lot with margin gains and the behavior of the market as a whole.

Always try to go for better margins but you cannot sacrifice your market share. Sometime if your price is too high you can hurt the market.

Now just add to what we said before. We had this macro scenario that affected same-store sales, specific operating factors and also errors in our tactics in our decision to start with the new collection leader during the month. I am not going to breakdown state by state. But in this quarter, believe it or not, we have several states that grew by two digits in Brazil as a whole and several, several states that grew higher than 10%, some even greater than 20%. So let's see we can have a reversal in October. Obviously, the first days of the month were slightly worse but recently we could find some changes.

Q - Tobias Stingelin {BIO 1557190 <GO>}

(interpreted) Thank you.

Operator

(interpreted) Irma Sgarz, Goldman Sachs.

Q - Irma Sgarz {BIO 15190838 <GO>}

(interpreted) I like to have a better understanding of the Renner format, both traditional compact[ph] as well as women's fashion for the future. On the list, on your breakdown, I can see you are opening a compact store in Diadema. And correct me if I am wrong. I think this is more targeted to C social bracket rather than B or B plus. And at the same time you're also opening a Renner store for women in Vila Olimpia mall and probably is more targeted to Class A or A and B basically.

So I'd like to understand how you've been adapting these stores. And in your opinion do you think that the same name of the Company applies to classes C or more A and B or is there differentiation in terms of what consumers are really looking for?

A - Unidentified Speaker

(interpreted) Irma, first of all, as a Company we no longer consider this name "compact store." We have small, mid-sized and large stores. What we have -- well, we try to adjust our mix. But when it comes to the market -- you mentioned something very interesting; Praca da Moca and Diadema versus Vila Olimpia.

When we decided to open a store usually the mall conducts a study. But regardless of the mall study, we also carry out our own study. We hire a company to do it for us. And in this mall that is opening, we ask ourselves if we have class A and B that can make our sales volume important -- so to justify the investment.

So you can be sure that in Praca da Moca mall you have a sufficient number of A and B clients to make that store profitable. Just to give an example, two years ago we were working on a study for a mall in Duchijekashia[ph]. Duchijekashia is in Rio. It's Class C. So we just wanted to check that better. We wanted to make a comparison, the lot as in Rio Grande do Sul -- A minus, B and C.

How many people do we have in Pelotas, Rio Grande do Sul with very significant sales. And how many people A minus, B and C do we find in Duchijekashia? And we came to the conclusion that the number in Duchijekashia was three times higher for A minus, B and C. So our decision to getting to the new market is based on a sufficient number of people in our target to justify for the investment. And you can be confident that we have this public view.

As for women stores, we keep on accessing that. We have one in Rio Grande do Sul. This will be the second one. And in that area more specifically.

If we had room we would also have a compact store. But due to lack of space -- and we believe we have an important market there. That's why we're opening the store. But the decision is based on sufficient public. We have already refused some malls, sometimes they are not strong enough. A minus, B and C is not enough and we don't get there. It's not worth it. So that's our model, our decision making model whenever we decide to open a store.

Q - Irma Sgarz {BIO 15190838 <GO>}

(interpreted) Great. That's really helpful. Thank you. Now what about the financial and economic signs? This is very solid. But what about consumers? When you look ahead, maybe the next three to five year horizon, what kind of consumer will be reached? What is your target consumer? Would you still have this broad range, A minus, B, C?

A - Unidentified Speaker

(interpreted) We don't have the study right now but we've been conducting a study. And everybody mentions C class a lot. And in our report we have these data. But if we check -- well, I don't know if we had five or seven years. But over the last five years class A -- look, look we have to confirm that. That's to be confirmed. But class A grew by 43%, class B 40% and class C 38%. So we talk a lot about class C. But classes A and B -- there are many people moving from class C to class B.

Q - Irma Sgarz {BIO 15190838 <GO>}

(interpreted) This is clear now.

A - Unidentified Speaker

(interpreted) Look, from 2003 to 2009, class A grew 41%, class B 38%, class C 34%. I have the figures in front of me right now. So that's the profile we had. And it had to come to stay -- it has come to stay.

Today we have a more upscale consumer. We have more services being added. And we have more people that can migrate from class C to other bracket. And if we add our projection in this study from 2009 to 2014, then the growth will be about -- over 50% -- over 50% from people who will be in classes A and B from 2009 to 2014.

If you want maybe later we can give you further details. But there will be a new profile in our population, our socioeconomic demographics. It has come to stay. And there's something else we are very confident in, Irma. The demographic bonus Brazil is going through this time.

Q - Irma Sgarz {BIO 15190838 <GO>}

(interpreted) What is this demographic bonus?

A - Unidentified Speaker

(interpreted) When you consider people under 14 and people over 60, we have this more productive growth. This range of people that generate jobs and generate income. So that's the kind of range that will be increasing in the next 10 to 15 years, very significantly. So there will be more people working, more people generating income and more consumers. So we do that in that scenario now.

Now, look, this scenario drives us well. That's something we envisage for the next 5 to 10 years. That's how we think. We are focusing on this quarter, right, obviously. But we should always be looking ahead and down the road that's what we see, market consolidation, social bracket consolidation, demographic bonus, competitive differentials.

When it comes to product, lifestyle. Consistent communication that has been maintained for 15 or 16 years. All these surveys show us that -- we don't want to build a name, we want to build a brand. And there is a very big difference between building a name and building a brand. And we are building a brand. And that's what really adds value to the Company and to our products.

Q - Irma Sgarz {BIO 15190838 <GO>}

(interpreted) Good.

Operator

Now we will initiate the questions from the English room. Lore Serra, Morgan Stanley.

Q - Lore Serra {BIO 1506730 <GO>}

I wanted three quick follow ups. And maybe to make it simple I'll ask them separately. The first question, I just to make sure I understand the comments on same stores sales as related to your decisions in terms of collection for the Third Quarter. I was under the understanding that you had put your spring collection into the stores in mid-August and that the weather was cold so that the sales didn't sell very well because of that.

But then I thought. And maybe it's the translation based on something you said, that your collection for the spring/summer was late into the stores. So I just wanted to make sure I understood what in fact was the case.

A - Unidentified Speaker

(interpreted) We usually launch part of our collection -- we begin to launch it in August. But usually these are more basic items, transition items. Actually, our collection -- the most important part of our collection, I mean, it arrived in our stores in late September, early October. So we really were late in the arrival of our collection this year. And one of the reasons was exactly the weather, the climate. Especially, in July and August it was not so favorable. That's why we decided to postpone our major items in our collections.

Operator

Mark Buckler, Kromation[ph].

Q - Unidentified Participant

Just a short one. Can you just give me an indication what is the seasonality or what proportion of annual turnover in a normal year occurs during the Fourth Quarter?

A - Adalberto Pereira dos Santos {BIO 16803045 <GO>}

(interpreted) The Fourth Quarter accounts for 35%, about 35% of the sales of the year.

Operator

(Operator Instructions)

Next question, Ms. Lore Serra, you may proceed.

Q - Lore Serra {BIO 1506730 <GO>}

Okay. So I'm going to ask the two questions when I got cut off. When is cotton peak in March and so pretty quickly from March to July, given your supply chain, when will you start seeing the benefits of cotton into your stores?

And then the second question, which is really the more important one. I still don't understand why you don't think that the portfolio of credit has deteriorated. So I know that it's hard to look at numbers. But if I just look at the absolute level of past dues, relative to where it was a year ago, it's growing more than the portfolio. So there's deterioration.

And what I would like to understand is what do you see differently, why don't you think there's deterioration and were there any factors. And you mentioned in one of the questions in terms of collection of credit, if there was anything specific in the quarter that caused your recovery of credit to be different than that what you normally do? So this is temporary. But when I look at this I see very clearly a deterioration and so I would like to understand that issue importantly? Thank you.

A - Unidentified Speaker

(interpreted) Okay. Considering your questions on the benefits of cotton only, next year the cycle -- well, the supply chain, this chain has a cycle, it has a long cycle. From the moment you buy cotton, when you transform and you work on the raw material, the fabric, until you manufacture the product you have a long cycle that takes seven to nine months. And that's why this increase is not completely transferred. Actually, it is postponed when it happens.

We can see the seven-eight months and also reduction because, right now, in recent months, until very recently I mean, we were still buying -- buying fabric that had been manufactured with higher cotton. So that's a long chain from eight to nine months.

A - Adalberto Pereira dos Santos {BIO 16803045 <GO>}

(interpreted) Okay, Lore, Adalberto. Let us discuss deterioration. Yes, there is some deterioration. Now it depends on what you consider the magnitude you consider. There are several ways to analyze the portfolio. "I follow your reports. I know you have specific metrics." And we developed some other metrics with you as well.

Now just imagine a couple of -- a few. When I check the number of the total price due portfolio, the total between the sales financing plus loans for the Third Quarter of 2011 we have 21.9%. Last year, in the Third Quarter, we had 19.7%. 2009, 21% and 2008, 24%, which was the peak.

Last year, I think it was an outstanding year, really exceptional. If we compare 21.9%, you would have to compare it with the worst in 2008 and it's slightly higher compared to last year. But once again, it depends on the magnitude -- 1.5percentage points higher. As to the riskier portfolio, it is the loan portfolio. This portfolio accounts for about 10% of the total portfolio.

In this portfolio you have a specific product "fast drawer." It had higher delinquency rate. So we've made some adjustments for the product. If you put it all together, we can see that our credit quality was not worsened. The portfolio has no signs of significant deterioration. But obviously it means 1.5percentage points deterioration over a 20 is not something so important.

And I also made comments on the collection system, right? There are some timely circumstances; for instance, the postal service strike. It is an important collection method. It occurs when you have somebody negative in the black list. These people are notified by the postal service, by mail. And sometimes you can use SMS and the Internet today. But there is a reduction in the quality of the operation.

Overall speaking, this is a slight worse condition in the riskier businesses. We made adjustments to the product. We reduced the maximum amount. We reduced the fast withdraw operation. And we are also making some changes to collection rules. Then you can start collections slightly earlier or later. Some operating adjustments. But overall speaking, as I said before, we remain comfortable.

Operator

This concludes the question-and-answer section. At this time, I would like to turn the floor back to Mr. Adalberto for any closing remarks.

A - Adalberto Pereira dos Santos {BIO 16803045 <GO>}

(interpreted) I would like to thank you all for joining us. We look forward to seeing you again next quarter. Gallo, Paula and myself will also be here for further information. Thank you, very much.

Operator

Thank you. This concludes today's presentation. You may disconnect your line at this time. Have a nice day.