Q3 2012 Earnings Call

Company Participants

- Frederico Trajano, Director of Sales and Marketing
- Marcelo Barp, General Manager
- Marcelo Silva, CEO
- Roberto Bellissimo, CFO and IRO
- Unidentified Speaker, Unknown

Other Participants

- Fabio Monteiro, Analyst
- Irma Sgarz, Analyst
- Tobias Stingelin, Analyst

Presentation

Operator

Good afternoon, and thank you for standing by. Welcome to Magazine Luisa's Third Quarter of 2012 earnings conference call. I'd like to inform you that this event is being recorded and all participants will be in a listen-only mode during the Company's presentation. Afterwards, we will start the question and answer session, and further instructions will be given. (Operator Instructions). A replay from the conference call will be available for a period of one week.

We would also like to highlight that any statements that may be made during this conference call related to Magazine Luiza's business outlook, as well as any operating and financial projections and goals, are based on beliefs and assumptions of the Company's management and on information currently available. Forward-looking statements are no guarantee of performance.

They involve risks, uncertainties and assumptions since they relate to future events and therefore depend on circumstances that may or may not occur. Investors should understand that general economic conditions, industry conditions and other operating factors may affect the future performance of Magazine Luiza and lead to results that differ materially from those expressed in such forward-looking statements.

I would like to give the floor now to Mr. Marcelo Silva, CEO, who will open the presentation. Mr. Marcelo Silva, you may proceed.

Marcelo Silva {BIO 17488732 <GO>}

Good afternoon, everyone. Thank you for joining us for the conference call on the earnings of the Third Quarter of 2012. I have here with me all the officers of the Company, Roberto Bellissimo, our CFO and IR Officer; Frederico Trajano and all the marketing department, Isabel from (inaudible), Marcelo Barp from Luizacred, Tatiana from Investor Relations.

On page eight, we have the highlights of the Third Quarter. Let us first address our sales growth. We grew 15%. And same store sales growth, we highlight e-commerce, 25% and CDC as well. Please note that the comparative basis is high and also our performance in the Third Quarter.

Sustainable growth. We've been managing to improve our gross margin, at 33% of the net revenue improvement, 0.8percentage points vis-a-vis the previous year. We maintained this margin vis-a-vis the Second Quarter and we've been maintaining our performance. I'm sorry. We are having some problems here.

Our credit approval rate is very conservative. We have a joint venture with Itau. We always mention that one of our focus for this year will be the completion of the integration process of our northeast stores. Henceforth were already completed in October. And as a result, we expect to have more effects as of the Fourth Quarter this year particularly over 2013. Certainly, with the unification of our systems, we'll be better able to manage our inventory, our price, and reduce operating and administrative, and back office expenses.

Please note that in one year we managed to complete satisfactorily the integration of almost 250 stores, Bau in February and now Lojas Maia in October.

We also continue our program to dilute expenses which was one of the most critical points of the Company in 2012. We managed to lower 0.8percentage points our general and sales expenses. And we have a reduction already in the net revenue compared to 2011. I'm sorry. We are having problems, sound problems but we'll do our best here. BRL45 million now this quarter.

And more conventional stores and investing another nine stores. And at the end of the presentation, we'll be focusing on the number of stores to open in 2012. We have another program in our stores and we keep on investing in logistics and technology, and the integration of Lojas Maia. And we have, in total BRL6 million invested in training -- travels and training in (inaudible) in the northeast and also for the brand conversion of our stores in Salvador.

As to Luizacred, we greatly improved our overdue indicators on a quarterly basis. Our overdue, or 90 days overdue portfolio is becoming smaller and smaller. We maintain our conservative approach and lower approval rates. And Luizacred includes robust provisions for loan loss provisions that come from our partner, Banco Itau.

Finally, the net results of Magazine Luiza on a consolidated basis is absolutely (inaudible). Particularly consider the impact of sales in the Third Quarter. Some results were below the expectation and also the conservative approach of our loan loss provisions at Luizacred. These were the main factors that lowered our results.

And now I would like to give the floor to Roberto Bellissimo, so he can present the highlights -- the financial highlights.

On page four, we show you some slides and some photos of the stores we opened in the Third Quarter, in several different cities and sites. You can see some pictures just as example. And now I would like to turn the floor to Roberto, so he can give you the financial highlights.

Roberto Bellissimo {BIO 17269312 <GO>}

Good afternoon, everyone. Now on page six we give you highlight of our growth in gross revenue, first in retail. We had BRL2 billion in sales in the Third Quarter, growing 14.7% vis-a-vis the Third Quarter of last year, particularly due to same store sales growth, e-commerce growth. And I would like to highlight that in the northeast, BRL287 million accounting for 14.2% of total retail sales. It was slightly lower, compared to the Second Quarter, when we had sales slightly more than BRL300 million particularly considering the integration and transition process of systems and remodeling our Salvador stores that happened in August and September, more specifically.

And after that, sales in the northeast started to grow above the average in south, southeast and midwest as it had happened in previous quarter.

In the first chart on the bottom, we have the consolidated sales. Magazine grew a little bit more, 15.2%, driven by the growth in consumer financing segment, which grew 23% and was encouraged by increased sales of CDC, or direct credit to consumer.

On the next slide, on page seven, we show the growth of our e-commerce sales, reaching BRL269 million in the Third Quarter, growing 25.5% vis-a-vis last year and also gaining a larger share in the market, e-commerce as a whole.

Year-to-date growth is 37%, also way above the market average. And this owing to an increase in our product mix, content, investment in infrastructure, technology and also our multi-channel fully integrated model, fully integrated with retail at brick and mortar stores.

On page eight, we show the growth in our net income -- our net revenue, year to date, 21.4%, therefore growing more than 20% this year, therefore very high results, in terms of growth. Income, we also grew 18% this quarter and 21.7%. The gross margin this quarter therefore was 33.5%, above the gross margin of last year.

And (inaudible) retail, the margin is slightly better than the Second Quarter, about 25%. That's our gross margin.

Operator

Ladies and gentlemen. please wait while we reconnect the speaker. Please remain connected. Ladies and gentlemen. please hold on while we reconnect the speaker's line. Please remain connected.

Roberto Bellissimo {BIO 17269312 <GO>}

Good afternoon, everyone. We are starting the presentation again. Let us start on page eight again. Like we said, the consolidated revenue grew 15.1% in the Third Quarter and 21.4% year to date until September. And the gross revenue (inaudible).

Consolidated gross income was growing above 18.1% in the Third Quarter, 21% year to date. Gross margin in the Third Quarter was 33.5%, therefore above the gross margin of the same quarter of the previous year, 1.7%.

More specifically, in retail, gross margin was slightly lower, compared to last year. In terms of product mix and internet growth, slightly above the gross margin of the Second Quarter and does not reflect yet improvements, especially to the northeast operation, which had a gross margin at 25%, compared to 29% for the stores in the south, southeast and midwest. And we expect to address this difference further on.

On the next slide, on page nine, we show the growth of our operating expenses this quarter, compared to the same quarter of last year. Selling expenses remained virtually at the same level, 21% of the net revenue. Like Marcelo Silva mentioned before, dilution this quarter was very low. There was no dilution. But we expect in the future to have further dilution, as we speed up our growth as well.

As for general and administrative expenses, there was important dilution of 5.6% down to 4.9%, therefore in line with our planning that we started this year.

As to loan loss provision, there was a 4.2% increase to 4.6% increase, like -- or as we explained for Luizacred.

And in other revenue and operating expenses item, there was a reduction of BRL62 million to BRL13 million in net expenses. And we will be breaking that down in the next slide on page 10.

On page 10, we show first of all that booking of deferred expenses, starting at BRL12m. At the bottom we show this quarter BRL8m, which is the recurring level for the future, due to the change in the booking criteria.

Next we have integration expenses, BRL11m, going down to BRL6 million and virtually inexistent now that we have the integration completed in October.

Personal credit and profit sharing, reduced from BRL12 million down to BRL5m. And it also includes a more recurring level in the future. And BRL12 million above also included part of personal loan that migrated to Luizacred and today is part of Luizacred's financial intermediation process.

Last year, we had a reversal of taxes at Lojas Maia. And this year, we had gains of BRL5 million on a tax basis. Last year, in the same period, Luizacred also had benefits here from the sale to Itaucard at BRL22m. It was a non-recurring event that didn't happen this year. And considering all that, there was a drop of BRL62 million down to BRL13 million drop in our revenues.

On the next slide, on page 11, we show the performance of the total EBITDA. In the Third Quarter it was BRL79 million (sic; see presentation "BRL69m") equivalent to 3.7% of our net revenue, compared to BRL92 million in the Third Quarter of last year.

At the bottom of the slide, we show the conciliation of the reported EBITDA, or adjusted EBITDA. And last year our EBITDA was BRL94m. And this year it grew from BRL69 million to BRL70m, a margin of 3.8%, which does not reflect yet the integration in the northeast. It still reflects loan loss provision or bad debt on a conservative manner and does not reflect the dilution of expenses that we expect to have in the full integration of Lojas Maia.

On page 12, we show our growth in our financial expenses, from BRL37 million to BRL40m, or 2.3% to 2.2% growth in the net revenue, positively affected by the drop in CDI and partially offset by an increase in our working capital needs, particularly considering our third-party credit cards.

On slide 13, we show that in the Third Quarter, our net income was BRL2 and at nine months still negative at BRL16m.

At the bottom, we show the adjusted net income this quarter. Non-recurring expense and revenue at a relatively low level. Net income was BRL2 million reported and BRL3 million adjusted.

On the next slide, we break down our investments that are in line with our planning for the year. Third quarter, Magazine had the bulk of investments scheduled for the year, particularly with remodeling, with BRL19 million for the Third Quarter, particularly with remodeling of Salvador stores.

On the next slide, we show some operating indicators, starting on page 16, more specifically. Magazine closed the Third Quarter with 736 stores, growing 52 stores, compared to one year ago. In terms of growth, same store sales growth, brick and mortar showed in the Third Quarter 7.4%, 9.6% in e-commerce, and the total 14.7%.

And on the left side, you can see the growth last year, showing that the comparative base last year had been very high, 20% same stores sales growth in the Fourth Quarter. As a result, the compares to bases will be lower, around 10% comparative base, considering our accelerated growth.

At the bottom, we show 280 stores that are less than three years old that are not mature yet.

On the next slide, we show further growth. And you can see the drop in (inaudible) Luiza to 19%. That's the share, stores inside, or inside Magazine Luiza's store. But this is partially offset by an increase of 11% to 9% in CDC and also third-party credit card sales, from 30% to 34%.

And cash sales and down payments also increased, from 25% to 28%. Luizacred's sales, on the right, at BRL2b, and that includes BRL1,290 million outside Magazine Luiza stores and stores as a whole. And Luizacred benefitted, generally there are additional revenues outside our stores. And we highlight CDC, from BRL170 million to BRL316 million this quarter as well.

On the next slide, we show the growth of our Luiza Card base, at 4m, slightly below what we had last year considering the conservative approach to issuing new cards. And the gross portfolio from BRL3 billion to BRL3.4b, CDC portfolio BRL767 million (sic; see presentation "BRL777m").

On the next slide, we show the same portfolio and we break down by overdue range. We highlight that over 90 days past due portfolio were reduced from 11.6% in June to 10.4% in September, compared to 13.6% one year ago. And we showed significant improvements in the profile of our portfolio. Total past due -- or over 90 day past due portfolio reduced BRL45 million this quarter, moving from about BRL400 million to BRL355 million and maintaining a level of provisions at BRL470m. And the coverage ratio of Luizacred improved from 117% to 129% in September.

Later on, we'll be addressing expectations. But I'd like to give the floor back to Marcelo Silva.

Marcelo Silva {BIO 17488732 <GO>}

I'd like to conclude the first part of our presentation with addressing the expectations for this current quarter and also the outlook for 2013. We underscore our growth in our sales very persistently, the maturity of new stores, the northeast stores, e-commerce. And by the way, the last quarter, our expectations are far better, compared to the Third Quarter, particularly as 2013 will be benefiting from dilution of general costs with the integration of these two new chains, and benefits in working capital management, inventory and price control. And consequently, we'll be able to improve, like Roberto mentioned, improve the margins in the stores in the northeast.

In the Fourth Quarter and in October, we had a brand conversion in Salvador. Last year, we had already done it in Recife, Fortaleza, and Maceio. And now, in October we have in Salvador and we were highly successful.

Due to the increase in product mix, and more modern, attractive stores, now we have the conversion to Magazine Luiza. This quarter, we are concluding and opening another nine new stores, totaling 22 stores, new stores this year, 12 in the northeast and 10 in the south and southeast. And we already expect better results in the Fourth Quarter of 2012, way above what we had in the last quarter of 2011, considering store maturation, lower expenses and a capture of synergies for the integrations we have with Lojas Maia and Bau chains. Particularly over 2013, we'll reap the benefits.

We firmly believe that we'll be having the fruits of these projects, that we decided to focus this year, in order to rationalize costs and conclude the integration of these stores. And now also working on maturity, we believe we will have better results in the Fourth Quarter and primarily in 2013. We firmly believe in what we're saying.

So thank you very much. And now all our officers here will be happy to take any questions you may have. So feel free to ask your questions. You have the floor now.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Fabio Monteiro from BTG Pactual. Fabio, please go ahead.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Good afternoon, everyone. My question has to do with Lojas Maia. You mentioned the gross margin of Lojas Maia is about 4percentage points lower, compared to the rest of the Company. I'd like to know what you envisage when you think about lowering or closing that gap. Can you break it down to zero or by half, that difference? How long will that take and how do you plan to do that? What is the heaviest weight (inaudible) acquisition or adjustments to the mix, or adjustments in product pricing? Could you elaborate on that point? Thank you.

A - Marcelo Silva {BIO 17488732 <GO>}

Fabio, now with the integration, we have a much better view of our inventories and our margins because we have the same systems at Magazine Luiza. As a result, we begin to have more visibility and from the moment our commercial area, by the way, is being -- having joint accounts. Since last year, we have just some local purchases from local suppliers. More than 90% of procurement is a joint process, so we are growing in that direction.

On a quarterly basis we are evolving, improving our margins. We have marked-to-market, different mix. But we're also introducing Magazine Luiza's mix gradually in other stores. We believe that within a year, over 2013, we will get closer and closer, putting the northeast margin closer to the southeast margin. We do have the distance and freight in the southeast and we have to send everything over to the northeast.

We do have differences, e-commerce for instance, with different margins. Some stores in the countryside can have different mix of products but on the large, there is a gradual growth in margins. And certainly they will be closer to Magazine Luiza's margin as a whole.

I believe that over 2013, now that all the systems are fully integrated, we'll be able to see that more clearly. It's just a matter of gradually doing -- adjusting our margins in the northeast.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Great. What about expenses, expenses as a whole and the company as a whole? I'd like to have a better understanding of your expectations for the next 12 or 18 months, when it comes to the economy or the sales per se, or the sale percentage. What can you imagine in terms of improvement of SG&A over the last -- over the next 12 to 18 months?

A - Marcelo Silva {BIO 17488732 <GO>}

We have already started to capture this production. We have a project to rationalize costs and expenses. And this project will remain in 2013 very strongly. So administrative expenses, now that we have the integration of Lojas Maia, we'll transfer many back office functions to the south and southeast, in Franca, Sao Paulo. And that will be reflected in 2013, certainly.

We have already started to have a store-by-store, area-by-area analysis of performance in the northeast. And that will bring impact, both in the sales, margins, expenses, region by region, store by store. So we are very confident to say that we will be capturing the synergy. I cannot say for sure or give you any actual figures. First of all, right now we are just closing our budget for 2013. But certainly, I can tell you that we'll be -- we will show this synergy, absolutely.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Thank you, Marcelo. And just one last question. Not only Magazine Luiza, but other companies, how do you believe increase in CDC or direct credit to consumer, do you see that increase as something that has come to stay or how do you feel that (mood) for this in the market which is stronger now? Could you comment on that, please?

A - Marcelo Silva {BIO 17488732 <GO>}

We conducted a study with Itau about Luizacred and we realized that some customers, or new customers. Sometimes it was more proper to have CDC rather than card, considering the costs related to cards, and so on and so forth. So that -- for that customer profile to which CDC fits better we are using CDC. And for those customers that are more related to cards or also our old customers, we continue to have Magazine Luiza's card at full speed. But for new customers with different characteristics, like the first purchase, first of all we offer CDC. And that's something, that in my opinion, has come to stay. Marcelo, do you have anything to add?

A - Marcelo Barp

Good afternoon, Fabio. This is Marcelo Barp. When we speak of CDC, actually we are considering installments. Some of our customers who used to buy products with a credit card will no longer use the credit card. And we will have to pay all the processing costs of the credit card and also the limits will be permanently there. The customer has to pay -- we have 1%. So now we can better cater to the customer and the same basic concept that we use for the card.

But we can maintain the risk. Maybe we can approve larger number of customers. Another important point to highlight is that some customers during the CDC payment are interested in having a credit card. Well we can encourage him to have relations with the store and maybe have a card in the future. So that's a trend that's come to stay.

A - Frederico Trajano {BIO 17269235 <GO>}

Fabio, this is Federico Trajano. What we just heard of CDC is more positive in the short run, compared to credit cards, which are a longer maturity product. As the impact from Luizacred it has to be positive, improving its share in the total risks.

Q - Fabio Monteiro {BIO 3711690 <GO>}

Great. I agree. Thank you very much to all of you.

Operator

Your next question comes from Irma Sgarz from Goldman Sachs. Please go ahead.

Q - Irma Sgarz {BIO 15190838 <GO>}

My question is about margins again. Let me focus on retail only. Excluding Maia or the northeast stores, it was 29.4% this quarter. (technical difficulty) when you compare this 29.4% with last year. How about the evolution, in other words? How much? I'm just trying to come to an estimate on the magnitude of e-commerce. I would also like to understand how you see the growth or improvement in the future. Is that a plausible offer, for instance, with the margin gains in the northeast? Do you expect to see an increase of the consolidated margin for retail? In other words, the synergies captured in the northeast? Then there's an offset by e-commerce, for instance.

A - Roberto Bellissimo {BIO 17269312 <GO>}

Good afternoon, Irma, this is Roberto. How are you? In terms of the margin of the south and southeast, without the northeast for this quarter compared to last year, I can tell you that last year we had about 29.5% in Magazine, but 23.2% in Bau stores. 29.4% is slightly lower than Magazine. However, it shows that Bau stores already have a very similar margin, compared to Magazine stores in the south and southeast.

Just highlighting that we expect that after the system integration, we'll be evolving our gross margin in the northeast stores, at the same level of south, midwest and southeast. That will be most similar in our region.

We have a level of 29.4%, which is slightly lower than the 29.5% of Magazine. And looking to the future, e-commerce has to grow above the Company's average. E-commerce is almost 15% stake of our sales and they tend to grow even further. So this margin is 7percentage points below the average for e-commerce. But this gross margin is very much linked to expenses that are also below the average. And as a result, the EBITDA margin for e-commerce tends to increase the consolidated EBITDA margin for the future, but less -- reducing less a portion of the expenses.

Q - Irma Sgarz {BIO 15190838 <GO>}

Perfect. Thank you.

Operator

(Operator Instructions) Our next question comes from Tobias Stingelin from Santander Bank. Tobias, please go ahead.

Q - Tobias Stingelin {BIO 1557190 <GO>}

Good afternoon. I'm sorry. I apologize if I have already -- somebody has already asked this question before. I arrived late. Still about e-commerce, we see a clear trend in some players in the market to lower our growth rate once it brings too much competitive pressure on gross margins and also at the bottom line. And they believe that -- well, we believe they also have a clear accounting system. They analyze Luiza as well. I'd like to understand.

Well obviously you do analyze very well the performance and you're very accurate. Do you believe that at a different time, you should reduce or you would reduce this growth? Or do you already have a different mix, maybe more furniture compared to other players and maybe you're better protected for e-commerce profitability? I'd just like to understand your strategy when it comes to top-line and bottom-line growth for e-commerce. Then I have another question on credit. Thank you, again.

A - Frederico Trajano {BIO 17269235 <GO>}

Tobias. Good afternoon. This is Frederico Trajano answering your question. First of all, I'd like to say that our accounting system is very clear when it comes to e-commerce. Figures are internally broken down, separate for our administrative management. We don't report it to the market, just out of a decision -- well, a strategic decision of the Group. We don't show these numbers in our income statement. But internally, we have a very detailed view of sales and specific e-commerce margins, expenses. A very good apportionment of we have shared expenses are broken down to our internal management.

Now more specifically direct at this, this year we are growing. Year-to-date sales are about 37% vis-a-vis last year. And we maintain our gross margins. In our case, more specifically, we're managing (inaudible) market to grow way above what we can see in the market, by maintaining our gross margin for e-commerce, more specifically. Consequently, we prove (technical difficulty) profitability, but also gross income of this channel, although we don't disclose our operation figures. So for us, there is no reason to step on the gas on our growth more significantly because we're managing to grow with improved efficiency, conversion and also better activities in our digital marketing operation.

Q - Tobias Stingelin {BIO 1557190 <GO>}

Thank you for your answer. Can you give us an idea of our mix -- your mix in e-commerce? Has it changed, for instance, compared to last year, for instance? Do you have major changes?

A - Frederico Trajano {BIO 17269235 <GO>}

The mix remains the same. Gross margins are maintained flat, vis-a-vis last year. Virtually all categories are growing at the same level, around 37% and once again way above the market.

Q - Tobias Stingelin {BIO 1557190 <GO>}

What about furniture, 30%, 20%, 15%, electronics, 10%. Can you give us an idea or you'd rather not disclose it?

A - Frederico Trajano {BIO 17269235 <GO>}

Unfortunately, we cannot disclose those figures today. I'm sorry.

Q - Tobias Stingelin {BIO 1557190 <GO>}

Okay. What about credit? I don't know if this question was already asked. How about spreads for the next year? I know that's a strong debate a couple weeks ago. How do you see the scenario for next year when it comes to interest or credit for financial operations, more specifically?

A - Unidentified Speaker

Tobias, this is Marcelo Barp. Good afternoon. Tobias, we are getting ourselves ready. We are present in the market, largely. And we already have this will to charge the least possible from our customers, vis-a-vis the competition. By the way, we were never a player of higher rates. And we are getting ourselves ready, both for sales and to lower our operating expenses. We are in synergy with sellers of Magazine, in order to have a dilution of our personnel expenses and also new products.

Now I mentioned our plan to integrate Itau Card to our operations in 2013. That's part of our planning. Another action we did is to launch personal credit in our credit card at significantly lower rates, compared to what we have before. So we're getting ourselves ready to become more robust and to have lower rates, compared to what the market charges our customers.

Q - Tobias Stingelin {BIO 1557190 <GO>}

So basically introduction of new products. Is that what you mean?

A - Marcelo Barp

New products and a reduction of our current rates.

Q - Tobias Stingelin {BIO 1557190 <GO>}

Okay. Thank you.

Operator

(Operator Instructions). There are no further questions. I would like to give the floor back to Mr. Marcelo Silva for final remarks. Marcelo Silva, you may proceed.

A - Marcelo Silva {BIO 17488732 <GO>}

Once again, thank you very much for joining us. I would like to underscore again, like I said -- it was just mentioned that our outlook is very positive. And as of the Fourth Quarter, we expect 2013 -- when it comes to the Brazilian economy, we expect it to be better, compared to 2012. Our growth will be maintained above the market average, on same store sales, e-commerce growth and also synergy of all our chains fully integrated.

We firmly believe, in the year of 2013, that we will do far better than this year reaping the fruit of our management and also fiscal 2012. And certainly we'll have better results for the Company. Thank you very much again and see you next quarter.

Operator

Thank you. This concludes Magazine Luiza's earnings conference call for the Third Quarter of 2012. Thank you very much for joining us for this call. Enjoy the afternoon.