Q2 2013 Earnings Call

Company Participants

- Adalberto Santos, CFO and IRO
- Jose Gallo, CEO
- Unidentified Speaker, Unknown

Other Participants

- Guilherme Assis, Analyst
- Ricardo Boiati, Analyst
- Tobias Stingelln, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen, and thank you for waiting. Welcome to Lojas Renner's Second Quarter 2013 results conference call.

This teleconference is being recorded and simultaneously translated. All participants will be in a listen-only mode during the Company's presentation. After the remarks, there will be a question-and-answer session. At that time, further instructions will be given. (Operator Instructions).

This event also being broadcast live via Webcast and may be accessed through Lojas Renner Website, www.lojasrenner.com.br, investor's page, where the presentation is available. Participants may view the slides in any order they wish.

Those following the presentation via the Webcast may pose their questions on our Website. They will be answered by the IR team after the conference is finished.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Lojas Renner management and on information currently available to the Company.

They involve risks and uncertainties because they relate to future events and therefore depend on circumstances that may or may not occur.

Investors and analysts should understand that conditions related to macroeconomic conditions, industry. And other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Jose Gallo, CEO of the Company. Please, Mr. Gallo, you may begin your presentation.

Jose Gallo {BIO 1822764 <GO>}

Good afternoon, everywhere -- everyone. It's a pleasure to talk to you.

Before I pass the floor to Mr. Adalberto, I would like to make some comments on the current business environment.

In recent years, we have experienced a period of prosperity in Brazil that enabled all companies in various industries and with different business models to obtain good return, outperforming the results year upon year.

The consumer segment and retail in particular were responsible for a significant portion of economic growth based on higher income, lower unemployment rate, controlled inflation. And relatively low interest rates. All of this coupled with greater access to credit, which also boosted consumer confidence. In brief, that was a good period for everyone.

Now, in 2013, we begin to see the economy adjusting. But, I assure you that, at Renner, through the First Quarter 2013, though the First Quarter 2013 was still very positive, we've already anticipated some changes.

And we began to brace ourselves as we saw the emergence of opportunities to grow and gain market share in a somewhat fragmented apparel industry with higher inflation rates than over the recent past and with depreciated currency.

We should note, however, that all of these points that I've mentioned are not seen as problems but as opportunities. We fully understand that we must continue expanding our business by offering credit and delighting customers.

We have seen that, in times past, we see that smaller retailers that have more fragile structures always take it harder. And there are retailers who are not really very prepared in terms of competition. So, we see this as an opportunity to snap up more space on the market.

And in the recent past, when times are rough, we've seen that suppliers seek the reliability of large chains because they wanted to sell and to have guaranteed payment. And it's very important that we also say that the leading consolidated brands usually do fare better because they convey greater safety to consumers.

This is why, despite the warm weather in the Second Quarter 2013, a certain slump. And the street protests in major cities that ended up denting our sales performance, we believe we have to look to the future and forge ahead with all planned investments that include store renovation, new store openings. And even the operation support projects, such as the shared service center and the new distribution center.

We have a lot of room to grow in the Renner model by growing the store network and consolidating the brand across the country. We have maintained our goal of 408 stores by 2021. And we see that the Renner market is present everywhere in Brazil.

It's very recognized. It conveys positive attributes. And in recent research, we appeared as the second most valuable brand in retail. So, this gives us courage to forge ahead.

Talking about Camicado, Camicado's operation is about to rule the domestic segment. Camicado is already a leader. And we can have about 125 stores in operation by 2021.

Over recent months, we've focused on improving sales. And (inaudible) volumes have grown. We have a better knowledge of our customers. And therefore, we've seen sales posting double-digit growth and margins recovering to what we desired.

We have also started expansion of YOUCOM, our baby, which is meriting all our attention. We intend to open at least 400 stores. And in the second half year, we opened the first YOUCOM stores and will migrate all Blue Steel stores to the new brand. And as of early September, all stores will be YOUCOM and will have an exclusive YOUCOM collection inside stores.

We have migrated a few stores. Sales are performing well. We are very excited. And we expect to go through the year with at least 14 operating stores.

And lastly, we continue optimizing the structure of Renner e-commerce, which within another seven or eight years may come to 5% of the Company's total sales. And we must remember that we still have to deploy e-commerce at Camicado and YOUCOM. All of these projects will enable us to have nearly 1,000 stores in operation and a quite consolidated online store in the apparel segment by 2021.

We know we need to brace ourselves to grow and rule the segment where we operate. We know that our structure must be solid enough to ensure speed and quality management of all our business models in terms of IT and logistics as well. And we must be alert to the opportunities that crop up when uncertainties abound.

And I'm very fond of a line by Warren Buffet that says we will continue to ignore political and economic forecasts in our investments, which are an expensive distraction for many investors and businessmen.

This does not mean that we will not look at what is happening around the world, though we must look ahead. Perhaps the consumer market will no longer be the locomotive of the economy. But, it will certainly continue reporting positive growth rates.

And I understand that, although growing at a lower pace, we will continue pushing in the same direction. And studies prove that. We see studies by the Boston Consulting Group published by the (inaudible) Magazine and have predicted that consumer spending will grow around 40% by -- between 2010 and 2020 to 3.2 trillion.

And there are estimates that 11 million people will migrate to classes A and B. And this is our universe. And this will mean a growth of 52%. So, we as apparel, youth. And home fashion retailers focused on the middle class, we must certainly be prepared to tap all these opportunities. Since we're talking about an apparel market worth over BRL100 billion, it's a very large market, lots of opportunities, very fragmented.

And (inaudible), I'd like to highlight that the Second Quarter was somehow proof of everything I said. Though we saw some negative rates in the industry, we continue to grow at Renner, exceeding the numbers of the monthly retail trade service P&C [ph] in several regions.

Between January and June, we reported 13.2% growth versus 8.2% in IBG's [ph] P&C for apparel and (inaudible). Despite the protest, the Cup of the Confederation and without the cold, we expected to see, because during the Cup of the Confederations, there were holidays in most cities. But, even then, we managed to grow same-sale stores -- same-store sales by 3.7% and posted good performance on both Mother's Day and Valentine's Day.

In gross margin, our greatest impact was due to the effect of the payroll tax under burning -- under burdening and to lesser extent the anticipation of discount sales.

We also felt an impact on Camicado's margin below estimates. There were some retailers who started their discount sales in May. And when the winter came about, we were selling part of the merchandise but at a discount price. And it didn't -- and our gross margin was not that good. So, Camicado's margin was below estimate. But it is already recovering.

YOUCOM reported 61% gross margin, still on the same Blue Steel mix without the exclusive collection that YOUCOM will have.

Our greatest challenge. And we started last year anticipating a few challenges, we started really leaning over our operating expenses, which have remained under tight control, despite new openings, the new distribution center. And 10 stores undergoing renovation. And expenses are high. We remained only -- we remained 0.2percentage points above 2012.

Since May, we've been revisiting contracts, doing negotiations, looking at expenses. And cutting down nonpriority costs.

And finally, again, this quarter, we did see significant growth in credit operations with very low default levels. And as a tradition at Renner, for years, this has been a pride, a reason of pride among us, very low default levels. So, we continue very confident that, despite the challenges, we'll have a good 2013. And there's lots to be done.

I will now pass the floor to Adalberto, who will talk about the presentation.

Adalberto Santos {BIO 16803045 <GO>}

Thank you, very much. Paula Picinini is also here, our IR Manager. And Luciano Agliardi, our General Manager.

So, starting on page four, we have the highlights for the period. Net revenue grew by 10.8% in all operations. And same-store sales grew by 3.7%. I will soon talk about the INSS [ph] and the impact of protests.

Operating expenses were BRL328 million, increasing by just 0.2percentage points. Results from financial services grew by 27.6%, a very robust growth, considering that all portfolios are very healthy.

Total adjusted EBITDA is BRL201.8 million with total adjusted EBITDA margin of 21.3%. And net income was BRL98 million, with net margin of 10.3%. Nine stores were opened, six Renner and three Blue Steel.

Moving onto the next page, we have net revenue from merchandise sales that grew 10.8% in the quarter, BRL947.2 million and in the half year grew 13.5% to BRL1.673 billion, 3.7% in the quarter and 6.1% in the half year.

April sales recorded similar levels as of May, owing to warmer temperatures below Sao Paulo. Sales took up again. And there was an important recovery in Mother's Day and Valentine's Day. But, then, into June, as we had the Cup of Confederations and the street protests, we felt an impact.

Gallo talked about the unburdening of payroll that took 1% in comparable basis. And conservative estimates gets to 1%. We're talking about 5.7% in the half year, which is a very interesting number.

I think it's important to talk about Camicado. Camicado grew 1.6% in the period, after growing 27.18% in the First Quarter. And we expect it to grow 2.6% and 10.9% in the First Quarter.

Now, these are important processes because they're different. There was a lot of discount sales. In the Second Quarter, there were new items, new assortment that started coming in, new products, imported products that had a very important effect on the margin that I'm going to talk about.

So, on page seven, we see gross profits from merchandise sales. In the quarter, you see a growth of 8.5%, despite a decrease of -- in the margin.

Basically, this is a number relative to the INSS. And we had a growth of 10.5% in the half year. And now, in the Second Quarter, we also see the effect of the change of labels that had an impact on the First Quarter.

So, we have a new INSS on sales revenue and the winter collection. And lower margins of Camicado have had an impact when we compare the half years.

Camicado had lower margins. But as of April, Camicado margins have started to recover, 39% in the First Quarter. And now, they will close Second Quarter at 41%. Gallo mentioned that these numbers are recovering. These numbers that we will have in the Third Quarter will continue to improve.

Now, interesting enough, Renner isolatedly would have had a gain of 10 basis points, despite the street protests and the process relating to the anticipated discount sales Renner would've been -- performed well.

In page eight -- on page eight, we have operating expenses, 34.6% against 35.5%. In the half year, the variation is very similar. The performance is very similar, 38.6% against 38.5% last year. And here, we have impact of the distribution center, the renovating stores. And a slower pace in sales.

Now, we are really making a huge effort to control expenses. Just to give you a flavor, despite a smaller sales growth, here, if we included the expenses of the distribution center, we would have a reduction. Even with worse sales performance with the new initiative, the Company would have had an important reduction in expenses.

On page nine, we have adjusted EBITDA from retailing operations. That reflects what happened to sales and margin. We've had growth of 1.6% but a drop in percentage from 18% to 17%. And we see in the half year a growth of 1.1% and the percentage falling from 13.6% to 12.1%, which reflected the margin and the sales performance.

On page 10, we see financial services results. We had a very positive result in revenues in personal loans that had a small reduction, owing to lower interest rates. And an important piece of data is the growth of expenses below the inflation. I think this has been questioned over recent periods. And as the area's consolidating, this expense will grow in line with inflation rate.

In the next chart, page 11, we see financial services on the Renner card portfolio. This is our main portfolio of BRL1.8 million. And here, we have a reduction of BRL60 million in losses. And we have maintained the level.

Now, in the BRL130 million portfolio, there was a slight variation. And this variation doesn't mean that we have more losses. But it indicates a smaller recovery. And as the portfolio grows more healthy, it is clear that it falls from 19% to 15%. The recovery will be harder.

Now, on page 12, we have total adjusted EBITDA, growth of 6% to BRL201.8 million. In percentage terms, we're talking about 22% to 21%. In the half year, it grew 6.5%. And despite the control of expenses and important contribution from financial services, the margin effect contributed to a smaller total adjusted EBITDA.

Here, on chart 13, we have financial result and net debt, BRL19 million negative. The financial results was slow. And we had lower rates than in past year and financial expenses that reflect the expansion of the Company in the period.

We had a nonrecurring event relating to the payment of interest in BRL4.1 million relative to a fiscal process that we had there. But, we are using our other compensatory measures.

On page 14, we have a chart with the current debt of the amortization of debentures issued. And last week, we concluded the process of leveraging the Company. Here, we see the amortization period. And you will see that, even if we consider expenses, the total cost of the debt service will overshoot 21% of our EBITDA. That is, we have -- we continue being very conservative.

On the next page, we have graphs about the net income, BRL98 million, a reduction from last year's BRL103 million. And in the half year BRL119 million, also a fall of 14% compared with last year. This reflects higher depreciation cost arising from a more aggressive growth cycle and a higher level of net financial expenses related to the capital structure.

On page 16, we have investments. In the quarter, we had BRL65 million against BRL75 million last year. And in the half year BRL102 million against BRL145 million. Despite lower numbers, there's nothing different. The expansion plan of the Company has been retained, investments in technology as well. And the distribution center and Camicado, YOUCOM. Here, we just have a mismatch of cash flow.

On page seven, we have the business breakdown. So, we broke down the data. Renner, we opened six stores in the period, 195 stores, 371,000 square meters, net revenue BRL892.1 million, up 9.7%. And gross margin 54.2%. So, in Renner, we would have had a gain in the gross margin in the beginning of the Second Quarter.

Camicado totaled 41 stores with 21,000 square meters, net revenue BRL44 million, up 26%. Again, we had grown 27.18 same stores 2.6. And we could've grown 10.9, gross margin 40%, slightly -- although it is below the 45% of the Second Quarter last year, we see already a reaction from the 39%. Our quarter was 39%. And the numbers of June, July. And August have recovered. So, this makes us very optimistic for the Third Quarter.

YOUCOM, we opened three stores, total stores of seven, net revenue BRL2.3 million. And the most important thing are these two pieces of data, the gross margin 61% has been retained. And sales efficiency has also remained the same. And the virtual store has had a very important growth 57.2.

Now, talking about the outlook, July sales and August sales are in line with what we saw in the First Quarter. The plan for new rollouts and remodeling are exactly as expected. Perhaps there may be mismatches of cash flow etc. New product mix and an improved gross margin at Camicado, more visible than other operations, rollout of the YOUCOM brand.

And for the half year as a whole, Gallo already said sales growth will be more contingent on gains in market share. We've seen this so far. We've had a 3.7% gain on noncomparable basis. 1.8% came from larger traffic. And the first and Second Quarter, we continued with this process in which traffic contributed greatly.

Gross margin from the retail operation stable year on year, even when nonrecurring losses for First Quarter 2013 are taken into account.

We've had an interesting about turn in inventories. But this reflects the arrival of greater imports at Camicado. And the Renner operation inventories will close below the level we expected. So, in -- when we go into the Third Quarter, we find ourselves in a very good condition so that margin will be positive.

Total adjusted EBITDA margin stable. And we shared that with you. We will keep the same percentage as last year, despite certain operations still maturing, Camicado, the remodeling of stores, same-store sale, the shared service centers, etc.

In terms of labels, we have confirmed the replacement. And it was in line with the business case. Historically, Renner in recent years had operated at 75% of the average market. That is, we consider -- we were considered a benchmark in premium years.

Now, the average has been 75% with the replacement of labels. We've just confirmed that this would go to 0.98. This represents 20 -- well, this is an impact on the gross margin. So, we're talking about BRL10 million every year. But we will continue pursuing the numbers that we expect.

So, these are our considerations. I believe we can now move to questions and answers.

Questions And Answers

Operator

We'll now continue with questions and answers. (Operator Instructions). Our first question comes from Guilherme Assis from Brasil Plural, please.

Q - Guilherme Assis {BIO 16143141 <GO>}

Good afternoon, everyone, Adalberto, Gallo, Paula. I've got two questions. The first one, I'd like to know whether you could give us same-store sales breakdown of the Renner for the Second Quarter. I'd like to understand the impact. So, it seems to me like Camicado continues giving a positive contribution. So, I'd like to know about Renner.

The second question is about the rollout of YOUCOM. I understand that you have already opened a store in Campinas. And the other Blue Steel will still migrate. So, I'd like to -- I'd like you to confirm whether you have already migrated Blue Steel. And how is this purchase of the rollout? Thank you.

A - Unidentified Speaker

Good afternoon. Thank you, Guilherme. What I can tell you, we haven't got the breakdown. Now, April was very similar to what we saw in the First Quarter. And then, we had a drop. But this drop was not really negative. Even in June, despite the street protests, etc., when the thing [ph] was really intense, we continued with a positive number.

Blue Steel, if I understood your question, the stores are already undergoing the migration. And the process is expected to be concluded in the coming months. I don't know whether this is exactly what you asked.

Q - Guilherme Assis {BIO 16143141 <GO>}

Yes, in fact, I'd like to understand because you've inaugurated three stores. Are they still Blue Steel or YOUCOM?

A - Unidentified Speaker

Well, YOUCOM, we have two stores, Pompeia and Campinas. We had planned to launch the brand now in August. But what ended up happening, two important malls where we'll open stores, (inaudible), they (inaudible) the stores still in construction work. So, we ended up opening a Blue Steel. But the store is already ready to migrate to YOUCOM. So, we are in an intermediary phase.

We cannot have YOUCOM and Blue Steel goods at the same store because the codes are different. The systems are different. So, we are in this transition period now.

Q - Guilherme Assis {BIO 16143141 <GO>}

And what you have now in terms of Blue Steel. So, you're using the Renner collection at the Blue Steel stores because YOUCOM will be exclusive.

A - Unidentified Speaker

Yes. But, in a limited way because we cannot put all products there. Now, for YOUCOM, really, it will only be YOUCOM goods.

Q - Guilherme Assis {BIO 16143141 <GO>}

And the migration plan and your idea of focusing on YOUCOM and the launch marketing, how -- when will it happen?

A - Unidentified Speaker

The First Quarter and the first half of September.

Q - Guilherme Assis {BIO 16143141 <GO>}

Okay. Thank you, very much.

A - Unidentified Speaker

So, September will have the YOUCOM stores inaugurated.

Operator

Our next question comes from Ricardo Boiati from Bradesco.

Q - Ricardo Boiati {BIO 16528742 <GO>}

Good afternoon. I have two questions about the sales performance. I'd like to know how the cold that has arrived can influence your sales performance. Do you see any kind of benefit owing to the colder weather and this quarter?

And the second question is about the occupation cost owing to this more challenging economic scenario. I'd like to know whether you have benefited in the renegotiation of existing contracts or for new POSs, where with a lower occupation cost with lower demand.

That is, I'd like to understand if you can, although you are a very relevant anchor store. And you've had benefits in the negotiations with malls, I'd like to understand if, marginally, you see any advance in this respect.

A - Unidentified Speaker

Thank you, very much. As regards your first question about sales, we -- July sales were very good. But, part of it was a markdown project. So, there must be a compensation, sales versus the product with the discount price.

Now, as regards new negotiations, this is not immediate. But it's not quick. But, we see a few malls that want us to go into the store earlier. But, we continue doing good negotiations. And we know that, from now on, really, we will have a greater clout to negotiate with shopping malls.

Q - Ricardo Boiati {BIO 16528742 <GO>}

Okay. Thank you, very much.

Operator

Our next question from Tobias Stingelln, Santander. Please go on.

Q - Tobias Stingelln

Thank you. Good afternoon, everyone. I'd like to understand, I -- the INSS had a negative impact on your gross margin. But, what could you say about that?

A - Unidentified Speaker

Well, the retail EBITDA is around BRL30 billion, BRL40 billion in positive impact. And this would be the INSS impact for Camicado, though. That is, even if you discount the gain from the DC, you'd still have some dilution in the operations. That is, it's not a dilution that came from the INSS. It came from the operation.

Q - Tobias Stingelln

Wonderful. And now, this legislation that -- of the provisional measure, there was a task. Now, you're in, this is permanent for you?

A - Unidentified Speaker

Well, yes. This is permanent. It's been renewed.

Q - Tobias Stingelln

Now, very quickly, about the guidance for the year, you have kept the guidance unchanged. But, from what I understand, this change will cost you an extra BRL8 million. So, you would have to seek an extra BRL8 million in terms of improvement in costs.

A - Unidentified Speaker

Yes, exactly, if nothing is done, obviously, we're looking at that. This loss may represent between BRL8 million and BRL12 million on an annual basis. Obviously, we're taking measures to mitigate that.

Q - Tobias Stingelln

And in the -- so, you have this loss because -- but you won't have greater speed on the system. You'll have other gains from other sources.

A - Unidentified Speaker

Tobias, exactly. We're not going to sustain a loss. These labels will bring a number of advantages. We will cut, choose. Customers will be a lot more satisfied. We know that the critical point of a store is the line at the cashier. And there is the point of reverse logistics that will be eliminated.

So, what we do in the plastic labels, you send them to suppliers. Suppliers send them to the distribution center that sends to the store that takes off the label that reclassifies them and sends to suppliers.

All this logistics is done away with. So, today, we see nonquantifiable advantages. They're very important today. Personnel, our regional managers, our store people see that customer service will really be improved. But there are a number of things that we can do. We can reinforce safety cameras, for example, put more safety cameras. So, there is a list of 10 items that we can do because we're not going to cross our arms and not do anything.

Q - Tobias Stingelln

Thank you, very much. And last question, could you give us an update about the push and pull logistics? What is the utilization level, just for us to understand the evolution? Thank you.

A - Unidentified Speaker

In June, we leveled off. And Rio de Janeiro is operating at full capacity. And this means this is something really very complex because there is the mechanical side, the equipment, software. All of that has been sorted out.

We are delivering products by SKU with a specific list to each store. And 100% of hang items are being delivered by SKU. And in the Second Quarter, 15% of the merchandise of the Company has been included.

And by September, we will move around 35% of the volume of the Company, getting to around 40% of the capacity of the DC. So 30%, 35% of the volume, 40% of the capacity of the DC. So, we're doing fine.

Q - Tobias Stingelln

And can you quantify the gain? 30% seems to be very significant volume. Can you have a clear idea of what's going on?

A - Unidentified Speaker

We're monitoring that. We're monitoring by sample. We are monitoring the sellout of these products because, when you internalize an SKU, you can monitor that.

We have SKUs that are renewed. If everything works out, the re-SKU [ph] comes in. And it's out in 40, 45 days. When the cycle is closed we can look at it. What was the gross margin and particularly the markdown and the sales speed? And we're monitoring that.

Q - Tobias Stingelln

Okay. Thank you, very much. Good afternoon.

Operator

(Operator Instructions). Our next question comes from Tord Haggar [ph] from the HSBC.

Q - Unidentified Participant

Good afternoon. Can -- I know that it has been open only for two weeks. But can you talk about the perception of consumers towards YOUCOM?

A - Unidentified Speaker

It is meeting with great acceptance. We operate in a segment, in a middle segment, in an average segment. And in the segment, there's not that much competition, particularly the lifestyle that we want to focus on, which is young fashion. And in the segment, we want to offer a diversity of young fashion at very competitive prices.

And this has been recognized already. So much so that sales per square meter was very interesting around -- in the year, around BRL20,000 per square meter, which we deem very good.

Now, launching the brand and enlightening consumers about it and doing marketing, for sure, we will see a greater improvement. We expect to consolidate and move brand. We cannot expect a miracle. But we believe it will take between two and three years.

But, our strategy has been to pick qualified premium shopping malls in Sao Paulo and startup. You start building the brand with all the marketing effort. And we were competent enough to continue making products at very competitive prices, appealing products. So, we are very excited about this project.

Q - Unidentified Participant

Thank you.

Operator

(Operator Instructions). If there are no more questions, we would like to close the questions-and-answer session. I would like to pass the floor to Mr. Adalberto for his closing remarks.

A - Adalberto Santos {BIO 16803045 <GO>}

I'd like to thank everybody for participating in our conference and particularly our employees, who are with us remotely. Thank you, very much. See you next time.

Operator

Thank you. The teleconference of Lojas Renner is closed. Thank you, very much for your participation. And have a good day. Thank you.