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INRETC1.LM - InRetail Peru Corp Acquisition Of Makro Supermayorista
SA M&A Call

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PRESENTATION

Operator

Good morning, and welcome to InRetail Peru's Special Conference Call. (Operator Instructions) It is now my pleasure to turn the call over to Rafael Borja of i-advize Corporate Communications. Sir, you may begin.

Rafael Borja - *i-advize Corporate Communications Inc. - SVP*

Thank you, and good morning, everyone. We are very pleased that you could join us today. From InRetail Peru, we have Mr. Juan Carlos Vallejo, Chief Executive Officer; and Mr. Gonzalo Rosell, Chief Financial Officer, they will be discussing the acquisition of Makro Peru as the press release distributed last Wednesday, December 23. If you have not yet received a copy of the press release, please visit www.inretail.pe on the Investors section. The presentation, which will be reviewed today will be posted on the company's website after the call. If you need any assistance, please contact the Investor Relations team of InRetail Peru.

Before we begin, I would like to remind you that today's call is for investors and analysts only. Therefore, questions from the media will not be taken. If you're a member of the media and wish to direct any question to the company, please contact the company directly after the call. Also, please be advised that forward-looking statements may be made during this conference call, and they do not account for economic circumstances, industrial conditions, the company's performance or financial results. As such, these forward-looking statements are based in several assumptions and factors that could change causing actual results to materially differ from the current expectations. For a complete note on forward-looking statements, please refer to the press release, which was issued last Wednesday. At this point, I would like to turn the call over to Mr. Juan Carlos Vallejo, Chief Executive Officer of InRetail Peru for his opening remarks. Juan Carlos, please go ahead.

Juan Carlos Vallejo Blanco - *InRetail Perú Corp. - CEO*

Thank you, Rafael. Good morning, everyone. I'm Juan Carlos Vallejo. Thank you for joining us on this special conference call. Today, we will review a brief presentation to discuss the main highlights of InRetail's M&A transaction announced last Wednesday after market close. Before going through the presentation, I wanted to highlight that we are very excited about this acquisition, which represents a unique opportunity for InRetail to further develop its multi-format strategy, in the Food retail segment, strengthening its value proposition for the professional and individual clients to continue offering everyday low prices to the Peruvian population.

Now let me pass the word to Gonzalo, who will walk you through the presentation. And as always, we look forward to answering any questions you may have by the end of this call.

Gonzalo Rosell - *InRetail Perú Corp. - CFO*

Thank you, Juan Carlos. Good morning, everyone, and thank you for joining us on this special conference call. Please turn to Page 2 of our presentation. On Wednesday, December 23, we announced the acquisition of Makro Supermayorista for a total consideration equity value of \$360 million in cash. Considering pro forma LTM numbers, this results in a multiple of approximately 14x EBITDA. However, this multiple is not very useful since it incorporates operating expenses related to COVID and the negative impact of a pandemic on the HoReca channel, particularly in the second and third quarters of this year, which were dramatically impacted by the lockdowns and stay-at-home policies, by the closure of nonessential activities and by the absence of business and leisure traveling, which have started to experience a recovery since the fourth quarter and that are expected to experience a clear bounce back throughout 2021.

Considering the strong recovery expected next year, Makro should conservatively generate EBITDA in excess of PEN 120 million as we gradually integrate the Makro operation and capture the synergy's full potential through 2022. Established in 1972 in LatAm, Makro is a leading cash and carry wholesaler, supplying food and nonfood products to professional as well as individual clients. Makro has presence in LatAm, in Peru, Brazil, Argentina, Colombia and Venezuela.

InRetail has acquired 100% of the operation of Makro in Peru, which includes 16 stores in the Makro and its well-regarded private label brands and that generated PEN 1.8 billion in revenues in 2019. As Juan Carlos mentioned, we believe that the acquisition of Makro Peru will allow us to further develop our multi-format strategy in the Food Retail segment, strengthening our value proposition for our professional individual clients to continue offering everyday low prices to the Peruvian population. The acquisition was funded with a \$375 million bank bridge loan facility.

Now please turn to Page 3. Makro is the leading cash and carry operator in Peru with sales of over PEN 1.8 billion in 2019, having registered a compounded annual growth rate of around 9% since 2016. Makro started operations in Peru in 2009 and now has 16 stores, 8 in Lima, and 8 in provinces. Makro Peru was part of SHP group, which has decades of experience in developing the cash and carry model in Europe, Asia and LatAm. In Peru, clients of Makro are mainly professional HoReca clients, basically hotels, restaurants, catering and other food and nonfood retailers as well as individual.

Please turn to Page 4. The acquisition of Makro Peru represents a unique opportunity for InRetail's food retail platform. First, we will be able to accelerate the growth and penetration of our Cash&Carry format with a highly recognized brand such as Makro. The Makro team has strongly developed know-how in cash and carry from decades of experience in developing the models, which will help strengthen our current operations. Makro's 16 stores have a minimum store overlap with our 5 Economax stores and have a hard-to-replicate store footprint. As I mentioned before, finding big spaces for retail in Peru is challenging due to a lack of urban planning in the country. These locations are a great complement to our platform. Makro stores also have the potential to serve our distribution hubs for our Mass stores, especially outside of Lima.

Second, the acquisition will help us continue strengthening our value proposition for our professional individual clients allowing to capture untapped demand. Makro has more than 10 years of experience in Peru, which has consolidated into strong client relationships with professional clients, such as hotels, restaurants, catering and other retailers. Makro also has a well-regarded portfolio of private label brands and a broad assortment for both professional and individual clients, which will positively complement our own private label brand. We also see an opportunity to expand our leading e-commerce solutions to the professional individual clients of Makro since they didn't have an established e-commerce platform in place.

Third and last, we expect the acquisition will bring logistic and commercial synergies for our Food retail segment. We will optimize logistics and transportation, leveraging on our state-of-the-art distribution center and enhanced commercial efforts to continue strengthening our everyday low price strategy.

Please turn to Page 5. As I already mentioned, we are excited about strengthening our multi-format platform. The food retail industry in Peru is still at low levels of penetration in terms of modern retail. Currently, only 25% of the total market is in the hands of modern retail players. And the other 75% is in the hands of a traditional trade composed of more than 400,000 bodegas and more than 2,600 traditional markets. So our multi-format platform, we have started to continue developing modern retail in Peru, reinforcing our everyday low price position into the Peruvian population to our differentiated formats, which are tailored to satisfy different customer needs and purchase missions.

Our Compact Hypermarkets continue to be our flagship format, which together with our supermarkets, will represent approximately 59% of our food retail total revenues. The 16 acquired Makro stores will complement our 5 Economax Cash and Carry stores and will now represent approximately 25% of our total retail total revenues. Finally, our Hard Discount format, Mass, will represent approximately 7% of food retail total revenues. On a pro forma basis, our full retail revenues will total PEN 8.3 billion, a 26% growth over our reported Q3 numbers.

In terms of our business mix at the consolidated pro forma InRetail Peru level, the acquisition will not represent material change. Food retail will now account for approximately 53% of the consolidated revenues of InRetail, up from levels of 47% pre-acquisition. Mifarma business and the shopping mall's business will represent approximately 45% and 3% of total consolidated revenues, respectively.

Please turn to Page 6. With the acquisition of Makro, we expect to strengthen our value proposition for our professional clients, continuing to capture untapped demand in the Food retail segment. Makro has a strong track record of serving the professional clients with approximately 70% of Makro Peru's revenues coming from different professional clients, such as hotels, restaurants, catering, service providers, retailers and high-volume professional clients. Makro stores are designed, thinking on the needs of high-volume clients to big parking lots for truck space and strong customer service.

Makro's diverse portfolio of owned brands, which include Aro and M&K, are also a key differentiating factor for both professional and individual clients with good customer loyalty and margin.

Finally, Makro has shown an ability to expand in different cities within Peru through 3 different store sizes, which will greatly complement our expansion plan.

Now please turn to Page 7 of the presentation. The transaction was financed with a \$375 million bank bridge loan facility to InRetail consumer. After the acquisition, InRetail's 2020 estimated net debt to pro forma adjusted EBITDA ratio will reach approximately 3.2x. We expect to return to pre-transaction levels within the next 24 months. The bridge takeout is expected to be executed as early as possible with Q4 2020 financials, most broadly with a 144A Reg S International Bond Offering. Finally, we do not anticipate any equity issuance needed to complete the deleveraging process.

This covers the presentation. Now we'll be glad to answer any questions you may have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll go first to Luis Pardo with Compass Group.

Luis Adolfo Pardo Figueroa - Compass Group Peru - Co-Portfolio Manager & Head of Research

Congratulations on the acquisition, Nice Christmas (inaudible) you gave us, on -- just quickly, on the pro forma post-synergy EBITDA, you said you're going to get to by 2022, you mentioned the recovery in operations would get you to PEN 120 million by 2021, how much incremental EBITDA do you expect to surface with the synergies by 2022 on top of that PEN 120 million?

Juan Carlos Vallejo Blanco - InRetail Perú Corp. - CEO

Thanks, Luis, for your question. I had some issues listening precisely, but I understand the question goes along the expected EBITDA not only for 2021 but further. At this point in time, we would rather wait until we have our Q4 numbers -- and when we normally give a more precise guidance for current retail within our different business segments. And earlier, we have identified several synergies -- synergy opportunities for this acquisition that keeps us very excited that we would like to fine tune, particularly in terms of timing and the speed of capturing them in order to share them

with more detail in our next quarterly earnings call that should take place late February. So with regard to that, now we wanted to give just a hint on a very conservative guidance for EBITDA for 2021 of the PEN 120 million I mentioned. Complementing that in a qualitative way, I can share with you that at the end, there's plenty of opportunities to optimize this acquisition with, not only the synergies mentioned in the presentation with regard to optimizing logistics and transportation, leveraging on our state-of-the-art distribution center and also enhancing commercial efforts to continue strengthening our EV strategy, but there is other synergies related as well to increasing the sales of our own Economax stores' sales and EBITDA as we rebrand those stores to the Makro well-recognized brand. And also, by sharing the equity to know how Makro has developed throughout the years in terms of the relationship they have with the professional clients.

And on the other hand, we have also value situation opportunities to contribute to Makro's platform in terms of the relationship with direct end consumers. And in terms of sales mix, Makro tended to have a larger share of the sales from professional clients, while in Economax, we had a larger share of end consumer and given the fact that we have a well-developed food retail platform with strong relationships with end consumers. There's opportunities to contribute to Makro's development as well by sharing that know-how and expertise with realtime consumers from our side.

And there's other synergies as well related to the private label portfolio optimization, sharing brands between the 2 businesses, Makro, Economax and even with Plaza Vea, and evidently, e-commerce is another opportunity as well, Makro didn't have and established e-commerce platform, they basically operated through third-party e-commerce operators. Its strategy was to have persons to last (inaudible) players, such as Cornershop in Brazil. And currently, we have a well-developed expertise in e-commerce solutions that we intend to extend not only to Makro's end consumers, but also to Makro's professional clients.

And on top of that, there is the opportunities to optimize some relevant items in Makro's cost structure with good commercial conditions of food retail business, not only in the retail (inaudible) in particular, but also in marketing expenses, for example and energy expenses and other relevant items of the P&L where our food retail business has really good commercial conditions.

So in general terms, the short answer is we will give more detailed guidance in a couple of months when we have Q4 numbers reported to the market, when we have fine-tuned not particularly the synergies themselves, but the timing of capturing them. Definitely, 2021 will be a transition year where we expect to capture part of the synergies, but the full potential will come only in 2022. As you know, these integration processes take a little while. That's what we experienced in the acquisition of Quicorp in the past where we only capture the full synergies potential in a matter of a couple of years.

Luis Adolfo Pardo Figueroa - *Compass Group Peru - Co-Portfolio Manager & Head of Research*

Yes. And I think you guys have earned the benefit of the doubt. So I don't see any problems there. Thank you very much, Juan Carlos, for your details.

Operator

(Operator Instructions) We will go next to Alonso Aramburú from BTG.

Alonso Acuna Aramburú - *Banco BTG Pactual S.A., Research Division - Strategist*

A couple of questions on my side. First, Gonzalo, can you comment on your CapEx plans for 2021, does this change in any way your CapEx plans are related to that, how do you see the development of growth of Mass, now that you have the Makro footprint, is this going to accelerate the development, is this going to stay the same, how do you see that? And what do you plan to do with the 2 brands? Are you keeping the 2 brands Economax and Makro or do you plan to, at some point, potentially merge those?

Gonzalo Rosell - *InRetail Perú Corp. - CFO*

Thank you. Alonso, for your questions. With regard to -- maybe the last question first. With regard to the brands, in the short term, we will keep both brands, Makro and Economax, in the very short term. Having said that, Makro is a well-regarded and highly valued plant in the HoReCa and professional clients channel. Something we expect to build on and strengthen going forward. So the Makro brand should definitely prevail. The question is whether we keep any Economax store under the Economax brand or whether we rebrand them all as Makro and how quick? We will evaluate these questions as part of our integration plan and share the more detailed answer when we report the Q4 numbers.

With regard to CapEx plans, I would say that we don't expect a significant increase in CapEx and, as usual, we intend to go as fast as we can in terms of expanding our different formats or would-be format strategy to continue serving Peruvian population directly to the end consumer or through a professional clients. And in terms of that, I would say that the incremental CapEx will not be material considering that the pipeline for Makro was not that different from the one we had in Economax. As you probably remember, normally in terms of big boxes within Supermercados Peruanos, our food retail platform, we were opening between 1 and 3 or 4 stores per year, depending on the particular year, Makro had a pipeline of opening about a similar number of around 2 to 3 stores per year. In terms of pipeline, actually, they had about 5 locations to be developed and opened over the next 2 to 3 years. Two of them on their own land plots, no stores that would be open outside of Lima. And 2 other -- 3 other projects in lease land plots. Two of them already secured and one -- additional one under negotiations. So I would say that probably for the next 2 to 3 years, we will add only a couple of stores per year, which doesn't represent a significant increase in our budgeted CapEx plan, which we will share as well in the Q4 quarterly earnings call that we will have probably at the end of February then we will share an updated guidance in terms of our 3-year CapEx view, which is normally shared at that time in the year.

And then with regard to the development of Mass, indeed, as we mentioned, Alonso, we believe that Makro stores have the potential to serve as distribution hubs for Mass stores, especially outside of Lima. As you probably know, we have started already piloting Mass stores in the city of Arequipa, and we had the intention to start piloting as well a Mass course in other relevant cities in the coast of Peru like Trujillo, for example, or Chiclayo. And with this acquisition, and again, as part of the fine-tuning that we have to do over the next couple of months and with that share more beside guidance, we indeed intend to accelerate the development of Mass going forward. On the back of these stores as a hub and spoke strategy that would allow us to have a more efficient logistics platform for a small store format like that. So again, the specific guidance in terms of how much do we intend to accelerate will be shared later on, but the idea is to accelerate.

Alonso Acuna Aramburú - *Banco BTG Pactual S.A., Research Division - Strategist*

Okay. And one more question related to financials. You mentioned PEN 120 million EBITDA for next year. How does that compare to the EBITDA that Makro had in 2019 or basically, in other words, I mean what's the decline that you're seeing in 2020 for Makro in terms of EBITDA?

Gonzalo Rosell - *InRetail Perú Corp. - CFO*

The increase, Alonso, is higher than 20% versus what we have seen LTM this year. Makro, as opposed to Supermercados Peruanos our food retail platform that has a larger share of their sales coming from professional clients that evidently suffered significantly during this year of pandemic where nonessential retail was closed, where hotels and restaurants were dramatically impacted by the lockdown and stay-at-home policies and the -- basically a total restriction on business and leisure traveling and so on. The Makro experienced a dramatic decrease in -- a temporary dramatic decrease in sales to the HoReCa channel, particularly in March and April, but the good thing is that throughout the year and mostly evidently through the end of Q3 and along Q4, the sales have bounced back. And we feel very comfortable that 2021 will be a strong year of recovery given that despite this impact of a pandemic in the HoReCa channel, Makro gained share and compensated a significant part of that negative impact from end consumers. So the idea going forward is to keep those sales of end consumer that they are serving already very well and recovering the negatively impacted sales from HoReCa and evidently as well complement their value proposition with some of the strength that we also have in our food retail platform, and with regard to end consumers, commercial negotiations and penetration of a prior level portfolio for the end consumer as well.

So in general terms, this PEN 120 million EBITDA expectation for 2021, we feel these are very conservative estimation in order not to meet guidance, but it will be fine-tuned to the increase as we continue fine-tuning the timing of the capturing of the additional synergies that are pretty evident

and plentiful for our synergistic and complementary transactions like this where we are basically marrying a very successful food retail operator with a lot of expertise serving end consumers with the most successful cash and carry operator in Peru with a lot of expertise serving the professional clients. And the synergies and complements between those 2 business segments is really big, and therefore, we feel very excited that this guidance is very conservative. And when we share more details in terms of the synergy's potential will be able to translate that into a more specific guidance year for 2022.

Operator

We'll go next to Nicolas Larrain with JPMorgan.

Nicolas Larrain - *JPMorgan Chase & Co, Research Division - Research Analyst*

At this time most of my questions have been answered, but I wanted to touch just a little bit on what's the expected timing for the transaction to be closed? And also, like should we think about like any antitrust problems with this acquisition. I just wanted to get your sense on those 2 issues.

Juan Carlos Vallejo Blanco - *InRetail Perú Corp. - CEO*

Thank you, Nicolas. The transaction has been already closed. It was signed and closed on December 23. So there's no pending matters with regard to the acquisition execution strategy. Our focus and energy going forward is we'll go along what I've been mentioning with regard to putting additional details and timing and ownership internally to capturing all the opportunities, value creation opportunities for Makro and for food retail platform as a whole. And with regard to pending approvals or anything this, the transaction has been already executed in accordance with Peruvian laws, and there is no pending regulatory approvals or requirements to execute it. So we are -- this is done. This is consummated, and we, again, are focused now on the integration plans and the value creation mission.

Operator

(Operator Instructions)

Juan Carlos Vallejo Blanco - *InRetail Perú Corp. - CEO*

Well, thank you all very much for joining us on this special call. As usual, we are fully available through our IR channels. And again, we will share additional information with regard to this acquisition and our Q4 results in the next couple of months very likely at the end of February. So thanks again, and let's keep in touch. Take care.

Gonzalo Rosell - *InRetail Perú Corp. - CFO*

Bye.

Operator

And this does conclude today's program. We appreciate your participation, and you may now disconnect.

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