Q&A Session

Question:

I understand the increase in selling expenses was mainly a result of a big effort to register new clients; 1,700 promoters exclusively dedicated to that registration process were hired.

I would like to know if we can expect to see this sales effort continuing in the future, having an impact on the coming quarters or if this was a one-shot action for the end of the year only.

Answer:

The registration campaign is booked in a quite conservative form, we book all the expenses related to the acquisition of a card, around R$ 15 – R$ 20, when the customer is registered, or when the card is activated. There are several criteria, because the revenue resulting from this expense will come in the next three years, I would say this investment matures in the second year.

This cost is a gift that 2005 is giving to 2006. I have no doubt that 2006, 2007 and 2008 will benefit a lot from this first-time registration effort. Since we have already felt some degree of saturation, we slightly reduced registration costs. It shouldn't be repeated quarter after quarter, and we will reap the benefits of the cards and will doubtless make a big contribution for at least the next three years.

Question:

My second question is regarding the provision for bad debt: is it possible to say how much the provision for bad debt increased as a percentage of net income, its variation in the last 2 quarters, so that we can have an idea of how this greater aggressiveness, let's put it that way, in personal credit has had an impact on the provision for this expense.

Answer:

We have the graph that shows from January 2002 to December 2005. To give you an idea, in December 2004, as I said, the default was 4.2%, but it really was the lowest level in recent times. In December 2003, this default was 5%, and it is worth bearing in mind that it was before the 8 months interest-free installment plan, and that we had an extremely severe and restrictive credit concession conditions. In December 2002, it was 4.8%.

Question:

How much was it in the end of 2005?

Answer:

In December 2005, it was 6.6%. But as I said, I would say that this increase of two percentage points is due to the 8 months interest-free installment plan, but has been strongly offset by the increase in interest revenues. I can assure you that everybody agrees that this loss is fully offset. This can be mathematically proved first with the sales increase shown here. This sales increase at 36% per square meter in the year is a result of our attempt to overcome that extreme rigour on credit concessions, another factor is the introduction of the interest plan, which accounts for more than half of the EBITDA of financial products.

Question:

I would like to know if you have any plans about corporate governance for 2006, has the company got any plan to be listed on the "Novo Mercado", is there any action plan to achieve that, or is it still in discussion?

Answer:

What I can assure you is that in the long-term I cannot imagine the company not joining the "Novo Mercado", not being a true corporation, not having the highest levels of Corporate Governance. There is only some resistance to structural changes, abrupt changes. But I can tell you that I do not see any obstacles preventing us from being listed on the "Novo Mercado" at some point – this will only take an internal persuasion process –, we have already met all the requirements, or almost all of them.

Question:

My question is about financial services, where are you booking the expenses related to these services, and what was the annual cost for all private label card operations, not only personal credit, but also sales with and without interest.

Answer:

If I understood it right, you want to know where the expenses are booked, is that correct?

Question:

Yes, private label card operations and financial operations.

Answer:

These expenses are booked under selling, general and administrative expenses.

Question:

So they are also booked under administrative expenses, not only under selling expenses?

Answer:

Yes, but a just very small part of it. The part that has to do with the parent company's administrative personnel, but the lion's share of these expenses is booked under sale expenses.

Question:

Could you tell me approximately how much this operation's costs amounted to during the year?

Answer:

I do not have an exact figure for the year, but it corresponded to approximately 33% of total expenses.

Question:

Selling, general and administrative expenses?

Resposta:

Exactly.

Question:

I would like to know if you could tell me how much credit expenses were during the fiscal year of 2005, I do not know if it would be possible to break these expenses down and say how much was related to interest and how much was unrelated to interest. Credit expenses, provisions.

Answer:

Our total expenses, are you talking about the provision for bad debt?

Question:

Yes.

Answer:

It was R$ 80 million; R$ 64 million from product sales and R$ 16 million from financial products, basically personal loans.

Question:

This R$ 64 million include sales with and without interest?

Answer:

It does. We were not able to separate sales with and without interest because many customers buy both ways; therefore, it is complicated to separate them. But, for sure, the highest increase was due to interest sales, especially since the result, as a consequence, is also much higher.

Question:

Were there non-recurring expenses in the quarter? Perhaps the remodeling of the main office? Were there any expenses in this quarter that we might say you are not going to have in the coming years? I am worried about how much these expenses represent in terms of net revenue, will they remain at 40% or will they go back to what they were before? Is this a structural change or not?

Answer:

The remodeling is booked under fixed assets; therefore, there has been an R$ 15 million investment, but they are fixed assets. No, I would say it is not caused by the construction here at our main office. I am sure that the last quarter of 2005 was really abnormal because of these two extraordinary factors; I believe that we can really bet these expenses will go back to the level of sales increase.

I do not expect to see an increase in selling expenses higher than the increase in sales from now on, in the worst scenario, they would be equal. I believe there is space for these expenses to be several percentage points below the sales increase.

Question:

Because there is dilution, right? Some costs are fixed, so there would be a margin for you to dilute a little, or even to reduce [...]

Answer:

Exactly.

Question:

Do you not expect expenses to fall as a percentage of net revenues in 2006? Perhaps, given that you will have new products, including personal credit, the provision for bad debt, now may be a bit higher and this might raise expenses as a percentage of net revenues, I don't now if you see that as a structural change or if you believe that the opportunity to dilute fixed costs will be worth it.

Answer:

I believe there is a seasonality of the provision for bad debt, and we are at its peak. We believe the provision for bad debt will fall, maybe not to the level it was before these longer-term plans, but it will fall due to seasonality.

My associates believe that we will get back to 35% of net revenues.

Question:

I would like to hear your thoughts on what you said about your fast fashion strategy, the speed with which you are bringing new models, all these new trends, and also working with lower costs, not having so many advertising costs, I would like to have an idea of what you expect for the next steps. I would like you to give more detail on what the AV project is, and what its benefits are in practical terms. In terms of results, would you say it will lead to an increase in revenues - the expectation for a 40% growth in revenues you mentioned for this year - or can there be a margin increase?

Answer:

As I said, 2005 was really a milestone year. I believe that the great source of value generation, sales and growth will be this great and yet unexplored synergy for fashionable products; I believe this agility we have been discovering day after day is a much more relevant, much more meaningful advantage than lower production costs, and the tax benefits also contribute for us to have lower production costs.

Something around 25% of what Riachuelo sells is internal production. We believe that this may gradually grow in the coming years, to a level close to other known international benchmarks, in which this percentage reaches 50%.

At the same time, we are reopening, tuning our channels with Asia – Newton himself went to China with several executives, consolidating the relationship with traders up there, so that we can take advantage of the enormous competitiveness of Asian products. It is true that there are sanctions and that the Brazilian government has been taking protective measures. But we really can take advantage of it, of course not of the most fashionable products because, in this case, agility is essential; fashionable products will certainly be produced internally, in this fast fashion system. But we believe that imports, which allow better margins, will grow from 5% - which was what it represented this year – to something around 10%. This is also an opportunity that we see for the future.

And, as I mentioned, imported products have a slightly higher margin.

Question:

Are most AV products aimed at men or women or are they equally distributed? How is this distribution nowadays?

Answer:

The distribution is rather uniform. Of course in 2005 we had a greater increase in the female group since it was underexplored. A plant was built in Natal, with total exclusivity to make this kind of product and, therefore, we grew a lot. We had a significant increase in the production of women's fashion, especially cottonwear.

We are also developing the weave part, which are plain fabrics, and in 2006 we intend to substantially increase the production of children's products.

Question:

My second question is mainly about financial products. It was mentioned that in a scenario of falling interest rates, there might be an even greater increase in private label card interest sales or in personal credit. I would like to know if you have an idea of how much sales may increase in a scenario with lower interest rates, a lower Selic rate, and how this would affect the fees Riachuelo charges its customers, which nowadays are around 9.9%, in some cases, in refinancing and personal credit, what would happen in a scenario of decreasing interest?

Question:

A lower interest will certainly lead to an increase in installment plans, especially interest sales, because when you lower the fees charged, the sales growth rate increases significantly. I believe that all the retail industry will benefit tremendously from the reduction of these interest rates, especially companies like ours, which sell to the masses, who depend basically on credit to be able to buy

Of course that if we sell at lower interest, there is a great chance the average ticket will increase since customers will be able to purchase more products, the fee increases due to lower interest, and that facilitated our sales as a whole.

Question:

Most new stores will be in malls and if I understood it right, rented from third–parties; there will be no continuous increase in fixed assets then, or is that a possibility?

Answer:

We will also open some street stores. An example is the store we will open next June in Fortaleza, which is a street store located in a property belonging to us, but most of our inaugurations will be in rented spaces in malls.

Question:

Of the 77 stores you have today, what is the percentage of stores already in the new profile; I mean the Midway store's profile? How many still have to change? I mean, I terms of visual remodeling.

Answer:

This Midway model is quite new and is present in about 20% of the stores. There are 20 stores that might be remodeled, and we will get into this pace of remodeling approximately 10 stores per year; therefore, soon all our stores will be in this model.

Question:

And what about these stores? Besides the 500 m² expansion, will they be adjusted to suit this new store profile?

Answer:

This figure may vary a lot. These 20 stores will have an additional area of approximately 500 m², but many stores will be remodeled without being expanded, while, there is, for example, a store being remodeled in Natal whose area will triple.

Question:

My question is on the guidance for 2006.When you announced same store sales data in February, the press release mentioned guidance for sales growth of approximately 40%; yesterday I saw your interview in Agência Estado and you talked about 30%. What is the real guidance for sales growth in 2006? And for CAPEX? What are your expectations for the year?

Answer:

Many people in the company have criticized me because I and to transparent in relation to future guidance. There is no such a thing as too much information, but really, […] representing a commitment to the market. Our internal planning foresees a growth of […] 30% for this year […] which is even lower than this year's and 10% related to this 20% increase in sales area. Why will this 20% contribute with only 10%? Because these new stores will contribute to this increase during an average period of six months, if all the stores had been inaugurated by the end of January, they would contribute with 20%, but this increase is represented by a 30% growth in sales per m² and a 10% increase in interest sales.

This is just an indication that we are confident we will make it.

Question:

OK, and in relation to CAPEX?

Answer:

The investments in private label cards will be around R$200 million: R$7 million per store, R$3 million per remodeling, something around R$30 million in plants, R$20 million in technology and logistics and something around R$30 million in private label cards, so we reach these R$200 million, of which the R$30 million referred to private label card is booked as expenses and from R$160 million to R$170 million as investments.

Question:

I would like to have your view on the sector, on the competition you expect for this year. Will it be more or less fierce? An overview of the apparel retail sector in Brazil for 2006.

Answer:

Well, the sector as a whole is influenced by GDP fluctuations. What is happening is an accelerated consolidation process in which the more organized, more formal retail sector, allied to credit, is taking over the space of the more uncertain and informal segments of the retail sector, such as “mama & papa store”, home vendors, street vendors, which have a 70% market share in Brazil.

I believe that this professionalization process will be long, which is very good for us. I also believe Brazilian consumers will allocate an increasing share of their income to apparel, to self indulgence, let’s put it that way, especially low income consumers who have not yet woken up to the allure of fashion, the consumers who are still price focused, who are being clearly overwhelmed by the mass communication media and who are acquiring information and changing their focus from price and trying to express themselves through clothes. And this is also another factor which benefits us, consumers are leaving informality behind, are no longer only worried about price, he wants to add value to his personal image through fashionable clothes.

So, this is another factor which benefits the retail segment in which we act”

Question:

One of the investments scheduled for this year is the modernization of the distribution center, I would like to understand the impact these investments will have in terms of reducing the inventories turnover and increasing gross margin.

Answer:

In relation to investments in distribution centers, we are indeed planning to make investments, but not necessarily this year. We intend to make investments in 2007 and 2008. However, this does not stop us from making, as we have made, several improvements along the year in our two operations here in São Paulo and Natal.

In relation to the average turnover, between the arrival and departure of distribution centers, is nowadays around 3 to 4 days, depending on the time of the year.

Question:

Do you expect any impact in terms of gross margin already in this year, resulting from these investments, or not yet, only when you make more massive investments in 2007 and 2008?

Answer:

I would not say this investment in distribution centers would have an impact on the margin, what should have an impact on the margin of the group is the expansion of the value added program.

Question:

In the last quarter of 2005, same store sales were 26%, which is quite good, although a little below our 30% guidance for 2006. I would like to know what you intend to do to reach these 30% and if this estimate already takes into account the increase in minimum wages and Bolsa Família programs or if these are positive surprises that may come along in 2006?

Answer:

We are exhibiting our strengths and they will be at their peak in 2006. Added-value products will give a very important contribution and the participation of imported products, which are really attractive, is in the beginning now, but will have a stronger presence in stores. The remodeled sales area – records show that a remodeled store in the same circumstances, per se, increases efficiency per m² by 20%.

We have many stores in the old format, some exactly the way they were 10 years ago, which will have a new layout. There is also the maturation of 2 million new private label cards, brand new accounts, which will start contributing as of 2006. So, we have a series of advantages which are coming along and I believe this will assure us this 30% increase in the level of sales per m².

I repeat this is a signal, a forecast, a projection, I could even say a personal one, but it is within the Company's medium-term planning.

Question:

I have some questions, the first is: can you isolate and quantify the effect of the new private label cards on selling expenses. I mean you said it should be around R$30 million to R$40 million in 2006. This is an investment which you actually booked as an expense. My first question is: how much was that in 2005?

Question:

If I understand it correctly, the total investment in private label cards […] in 2005.

Answer:

To increase the private label card base.

Answer:

In 2005, R$28 million of which I believe 50% fell during the previous quarter.

Question:

In the AV (Added value) Project line, I would like to know the approximate percentage of products that would be classified as fashionable within your sales mix? How much refers to products that change from season to season and how much refers to basic products, which are more promptly available?

Answer:

Fashionable are those products with any adornment, finishing, color, fabric or anything which expresses current fashion. Our buyers are always searching for new things, representing around 50% of Guararapes production for Riachuelo.

Question:

Concerning tax benefits, they start in 2009 up to 2013.Do you have any internal studies on the possibility of renewal, or if there would be any increases for that?

Answer:

Concerning tax benefits, despite the expiration dates which varies among different plants, I saw some analyses in which it is estimated as if it in 2008 – when there will be the fiscal benefits of our plant in Fortaleza – and this analysis considers that as of 2008, this plant will no longer have fiscal benefits. However, what I would like to say is that these benefits are almost automatically renewed for over 30 years, and I think that governors in the Northeast see the apparel industry as a very strong job provider at a low cost.

So, the impression we have is that these benefits can only grow, and in the worst possible scenario, they would remain stable, in current standards, but I ca not imagine a governor giving up on a 4, 5, 6.5 thousand people plant – as our plant in Natal. So, I believe it is feasible to consider that these are perpetual benefits.