

## Cia Hering's Earnings call transcript – 10/23/14

**OPERATOR:** Thank you for holding and welcome to Cia Hering's 3Q2014 earnings conference call. We would like to inform you that all participants are in listen-only mode during the Company's presentation. After the Company's remarks are completed, there will be a Q&A session, when further instructions will be given. Should any participant need assistance, please press \*0 to reach the operator. Before we proceed, I would like to clarify that eventual statements made during this conference call, referring to Company's business perspectives as well as projections, operational and financial goals are forecasts based on the management expectations. Such expectations are highly dependent on the domestic market conditions and on the overall economic performance of the country and the international markets, therefore they are subject to change.

With us today in Sao Paulo we have Mr. Fabio Hering, Chief Executive Officer and Mr. Frederico Oldani, Chief Financial Officer and IRO. The managers will make a brief introduction and then will go on to questions and answers.

I would now like to give the floor to Mr. Fabio Hering. Mr. Hering, you have the floor and you may proceed.

**FABIO:** Good morning and I would like to greet all the participants at this conference call for the 3Q2014. Although we are facing an extremely challenging consumption and economic scenario this quarter we have had a slight growth in our [audio interrupted] I would like to highlight the launching of all the collections of high summer and the main impact to Hering brand which brought significant impact to the product offered by the end of this year on the store. In the showrooms we have introduced new concepts of supply to the stores, in the most pre-guided regarding the supply of the franchisees and our own stores. This quarter we also saw the end of the new communication plan

with the new logo for the Hering brand. This will be launched now in October. We also concluded during the 3Q our strategic plans and businesses plans for Dzarm. In October we had our internal launching with the sales team and for the next Autumn collection we have new perspective for Dzarm as a brand. Also during Q3 we acquired and build our first Hering4You, which was inaugurated in October, in the 4Q. So, we understand that the developments are growing strong and our organizational structure is well prepared, well equipped so that for now on we can improve our performance even more. I'll ask Fred now to talk about the results for the Q3 and then we'll be back for the Q&A session.

**FRED:** Good morning everybody. Let me start by the results with slide number 3, where are we going to talk about the gross revenues for the Company. In the quarter, we reached R\$ 431.1 million, a drop of 0.9% vis-à-vis same quarter in the previous year. This performance was weaker practically in all brands. In Hering we had a drop of 0.5%. Hering Kids a growth of 8.0%, PUC 1.3%, Dzarm a drop of 10.0%, and in the international market we had a growth of 5.6%. Regarding the channels, also we saw a weaker performance in the retail. We have to highlight the webstores, after some adjustments to the operation we saw a resumption of growth, 23.2%.

Slide number 4 talks about Hering store network. We are talking about sales of R\$ 329.3 million in the quarter, a growth of 0.5%. This was mainly due to the opening of 55 new stores, regarding the previous period we still had a negative performance of 6.0% mainly due to the World Cup effect which also had the proportions on the first 15 days of July. After the World Cup, we noticed better results, not at the levels that we would believe would be good for performance but better than what we saw during the World Cup. Also during this quarter we were having a number of promotional campaigns which started in July, specially with basic wear and autumn-winter which helped perform and helped clean up the inventories, and prepare the network for the news which are

projected since the end of Q3, specially in the 4Q, as Fabio has already mentioned.

Slide number 5, is going to talk about gross profit and net margin. Gross profit had a slight drop in the quarter, just like the gross margin, due to promotional activity, conducted ever since the 2Q with two objectives: to decrease the level of inventories, we are prepared for the new basic apparel and new collections; and also to reduce the inventories at the Company level because we still have remainders of the collections of Autumn and Winter collections. So we ended up having an EBITDA performance which was a little below what we expected, R\$ 54.7 million for the quarter, a drop of 9.4%. This EBITDA is a combination of both the drop in the gross margin and the increase in operating expenses, still as a consequence of the investments that we have made in our management structure, investing in marketing, budget in new brands and new campaigns. So, this led to this performance and a drop of 9.4% in EBITDA and a small contraction in the margin.

Slide number 6, we see the net income, in spite of the negative performance in terms of EBITDA, we ended the quarter with R\$ 70.9 million, a growth of 21.7% vis-à-vis the same quarter last year. The results were impacted by the acknowledgement of the tax benefits, income tax and social contribution, regarding tax benefit for Goias and new agreement signed with the government, now these investments are characterized as incentives and therefore they are not to be taxed for social contribution purposes. It's worth mentioning that these R\$ 21.2 million in benefits relative to the 9 months of 2014, in other words, part of this effect is non-recurring and part of it is recurrent, in other words it will continue as it maintains the same levels of tax benefits. In terms of investments, we reached R\$ 28.0 million in investments in this quarter. We will go on making investments specially in the area of IT, where we intend to deploy SAP. We also have projects to renew the e-commerce platforms which have been taking up a large amount of our

investments. At the end of the year we have an accumulated of R\$ 59.3 million and we should end the year with investments very close to R\$ 100.0 million, as we had projected for this year.

Slide number 7, cash flows and cash generation. We had a very good cash generation, R\$ 64.4 million, basically twice as much as we have had in the same period last year and for YTT, we have R\$ 181.0 million in accumulated free cash flow. This free cash flow despite EBITDA being a little lower than last year's, the improvement specially in terms of working capital, as a result of inventories which are now more normalized, this is basically what led to better free cashflow this year. We should also note that there is an important increase in cash generation regarding social contribution. This was not something that impacted this quarter. The acknowledgement of tax benefits, even though it improved the income tax, it impacted other aspects in the same magnitude. So, income tax and social contribution did not have the same impact as we had expected, there is an impact in January and February, of course, when we have the actual payment of income tax regarding the fiscal year 2014. Also in terms of free cashflow, I will note that the Company decided to declare R\$ 50.0 million in dividends, entirely paid at the end of the quarter, sorry, the 3Q, at the end of the 3Q, a total of R\$ 0.30-0.37.

Is that in the 1Q of 2014 that there will be an improvement compared to the last quarter of this year. Once again, we do not expect very significant improvement during this semester but we are doing the best we can in the stores. It's worthwhile speaking about Hering as I mentioned, formerly we have had significantly improvements in terms of assortments as well as in the other brands. We have had a considerable evolution specially in Hering4You where we opened the first store in the Morumbi Shopping mall. We will be opening a second store in the Center Norte mall, coming in 45 days as they should inaugurate the stores and once again this is fundamental to be able to disseminate the brand and for consumers to have an experience not only with

the product but also with everything that our brand represents. Dzarm business have been concluded and the brand is undergoing significant changes specially when it comes to our value proposition and positioning. Once again, this is going to be geared exclusively for the women smartkids as well as other important changes that we are presently exploring for the coming months. In terms of our plan to open new stores we have cautiously reviewed the opening of new stores for the year 2014. We have reviewed our plan to open 100 stores and have reduced to 75 stores. Once again, this underscores our belief that the potential to open stores with our brands continues the same, but given the economic situation and given the occupancy costs we will have a significant drop. And the pace of store opening that is more adequate for us would be to reduce what we had planned previously. Therefore we have a slowdown the pace of store openings in 2014 and in 2015. Once again, the expectation is to open less stores that had been planned. Finally, I would once again like to reiterate the confidence that we have in this Company and in its growth, where looking towards that will be implemented and we are convinced that despite the challenges posed by the presented scenario we have the right people, we have the right structure and once again based on what we are doing at present hope to attend some improvement. Once again, thank you very much and I would like to open the floor for questions.

**OPERATOR:** Thank you. And we will now begin our Q&A session. If you have a question, please press \*1. We would like to remind you that this conference is exclusive for market investors and analysts. We request that questions made by journalists be forwarded to Mrs. Ana Claudia Camara, Press Relations through the phone (11) 3846-5787, extension 48, or through the following e-mail [anaclaudia.camara@approach.com.br](mailto:anaclaudia.camara@approach.com.br)

**OPERATOR:** We have a question from Mr. Marcel Moraes, from Deutsche Bank.

**MORAES:** Good morning to all of you. My first question refers to the multibrand sales. I would like to know if you have other weakening in the retail market which is very important for the Company and if there has been a change in your trade policy or if this slowdown that we have observed is due to a very uncertain turbulent scenario?

**FRED:** thank you for the question, Marcelo. The multibrand channel, in our opinion, is much weaker than our franchise channel and there are good reasons for that. Since the beginning of Q2, the Company has put in place several actions in the market, all of which have been focused on a decrease in our inventory, generating new products and prepare the market for the entry of our new production and all of these actions have focus on franchises. Once again, promotions for the basic apparel, the Winter promotions, a series of activities that helped us to resolve several of the problems that the franchises faced during the 2Q. In the retail market, once again, we haven't worked in the same way. What we observe at the present therefore is that the franchise channel is fully prepared for the end of the year while the retail channel is still trying to digesting the problems that we faced in the Q2 due to the World Cup and a reduction in sales. There haven't been any significant change in the way we work. And it is our understanding that as we work in the multibrand channel we will be able to mix some correction and this channel showed once again be able to growth. Nevertheless, we are going to observe the result of the franchise market and once again the results in the regional market will take sometime before they appear. I don't know if this responds to your question.

**MORAES:** Another question, referring to the corporate expenses, especially your trade expenses, there was an increase above and beyond what we expected if you could please give us further details on this. This refers to an increase in marketing, and all of this geared towards the new structure and I would like to know which would be the impact of this in the Q3, simply to understand the dimension of the factors and what do you expect from this?

**FRED:** The new structure started to be deployed in the middle of last year but in practice the comparison will only be good after mid-November. So, in the middle of last year we had structure very similar to the one we have today. In Q3 we're comparing new structure to a situation that we had, only part of the new structure. In the Q4, when you compare year-to-year, of course for 2 months it's comfortable but October is still not the full structure. In terms of the marketing expenses, yes, we did see an increase in marketing expenditures, this is not very relevant but there have always been some changes regarding how this expenses are distributed along the months. This year, we were more concentrated in Q3 than usual. So, the increase seem larger than what it was. This year we started to spend earlier and now we are tending to spend more in the Q4.

**MORAES:** In terms of the launching 75 stores, how about the geographic distribution? which are the regions that are going to be hit. And what about the market or the brands mix? What do you have to say about that?

**FRED:** It's a bit for all the regions. All the regions are impacted and there is no specific region which was more hit like we are going to stop only at this region. No, we are going to slow the pace for all the regions, specially in malls more than on street stores and when we look at that on a brand-by-brand basis for 2014 we would have 50 Stores, 23 children stores, among them PUC and Hering Kids, so, this is how we should end the year of 2014.

**OPERATOR:** Mr. Fabio Monteiro, from BTG Pactual, would like to ask a question.

**MONTEIRO:** Good morning everyone. In terms of sell out, due to the World Cup there have been two aspects. So we had the first 15 days of July when sales were very very slow, and then after the World Cup, at the end of July, August, September we saw an improvement. So, the phenomenon, the first 15 days of July, how could you explain that? And then August and September

presenting figures like -1.0 or something. How can you relate these two things?

**FABIO:** What is noticed is a lot of volatility in same store sales. As you know, we measure that on a day to day basis, every week, on weekends, we started spotting some different characteristics due to Q3 until July 13 we had the World Cup, of course, so there was this impact and then we had holidays and this and that. But, not considering this aspect of very very strong impact of the World Cup and son on, and then thinking about the first 15 days, July was negative results, then we saw a regularization and improvement, and then in August we had some positive numbers, but volatility was consistent all the time. We understand that this volatility is also associated to our operations, perhaps the entry of new products, to the budget, which is common, which is the way it usually is. But of course, consumption has been behaving this way. And, now, talking about the Q4, in mid-September we had our pilot in a group of stores with an electronic counter to count the inflow in the stores. With that we can keep track of conversion, we still have the end data to talk about but in this short period already noticed a very large volatility in terms of flow, sometimes one week into the other, this also allows us to, they also have more than 15 thousand points of sales around Brazil so we compare flows with other stores, with similar competitors and different products too. So, what we see in volatility, instability, sometimes a drop in flow from one week to the other, this has been what we have seen. In the Q3, if you look at the last 3 months, the level of performance was very different. July was very bad, August was OK, September more or less, so this has been the way it goes. The figures ended up being below what we expected, but we believe that there will be a certain normalization of this volatility and with the efforts that have been doing we believe that the future will be better.

**MONTEIRO:** OK, very clear. You talked about sell in, regarding the collection of high-Summer which will be now in the stores. It's important to map that. I



think it's more important than Summer itself, which was in June. Because that started, the sales started in the middle of the World Cup, the sales to the franchisees, I mean, and so they were naturally very slow. My question is when we talk to franchisees they have very different opinions, some are very positive, some are very negative, but the feelings about August regarding the showroom for June were more consistent than usual. We felt this and also felt that since sales in August were lower, the franchisees had a less for profit. I also believe that your efforts having a larger team and also marketing actions aligned with the franchisees and all that, I think this somehow conveyed a positive message to franchisees. So, my question is: the sell in for high Summer collection, what about the mix and the budget for growth for these purchases?

**FABIO:** So, we are talking about Hering Store network, right?

**MONTEIRO:** Yes.

**FABIO:** Those for the franchises and for own stores, as of mid-October, and from now until the end of the year, the most important season for us which is Christmas, we have good supply, well prepared, well planned, quantitatively and qualitatively in terms of product mix, so all prepared to increase, to grow same store sales. But this, of course, will depend on the consumer, but we are prepared. And the franchise stores, they responded positively in terms of the showroom, getting ready for growth which should come in the Q4. Now, let's intensify our efforts at the end, as the store operation, as the point of sale, to make this happen and also see what happens in terms of the consumer behavior.

**MONTEIRO:** Just to wrap up, would you draw attention to any aspect of the collection in terms of Hering stores? Any aspect that is as positive, highlight something, a change in strategy, anything you would draw attention to?

**FABIO:** I think three important aspects. The first one, the introduction of more innovation for the basics, in the Q3 we have already seen this, but we are going to have many more novelties in this area and I think this is creating for the basics in the mix from the the entry to the more premium products which are selling very well in the A-B class shopping malls. I think this is very positive. The second front is the female collection with patterns and some special products that are more intensely introduced in some markets and increasing the efforts in P2, P3, P4, and also some novelties in the area of jeans, for example, jeans made out of a mixture of jeans and sweat fabric, so, in the field of products, we have many novelties being introduced. So, in that strategy of mix that we have, we have many, many new things. And together with that, there is our communication campaign which has just started, the new campaigning, with efforts in the print media, digital media and so on. In addition to the fact that the whole chain is very well supplied, we have a very good package of actions being deployed, in order to help points of sales. The question is how are consumers react after all that.

**MONTEIRO:** Thank you very much.

**OPERATOR:** So that we can answer all of your questions, we would like to limit the questions to one per participant. From Goldman Sachs, we have a question from Mrs. Irma Sgarz.

**IRMA:** Good afternoon Fabio and Fred. Once again, I would like to continue on with the questions about marketing expenses, that have had an increased in Q3 and with the new campaigns that begin in October. I fully understood that previous comments and that we should perhaps expect a lower concentration, or a drop of marketing activities in 4Q, considering that you have just launched the campaign on October 15th. Of course this is a campaign geared to Christmas. This is the first question. The second question once again reffers to the results, based on the comments I understand that we

will once again be at zero during the Q3 as well as during the 4Q. And the participation in results, in theory, should be according to historic levels, the question is, will they be at lower level due to some structural problem or is there something that has changed in the employees compensation plan that is leading to this results?

**FRED:** Irma, first regarding your question about to marketing, when you look at all results, the marketing investments have increased vis-à-vis last year. More specifically, during the Q3, our investiments were more concentrated than usual, and once again our expenses have been deeper in marketing compared to what they will be in the following quarter, in the Q4 our total marketing expenses will be lower than those of the Q3. When it comes to the participation in results, there was no provisioning for results in the Q3 but for the accumulated figures of the year, yes we have had some provisioning. Based on the results we have accumulated up to this point, we truly believe it was not necessary to make additional provision . For the following quarter, the results should be better than those of the Q3. And I wouldn't say that there is no expectations in paying results and participation. Yes, that does exist and I'll look forward this evidently all of this will depend on our results. If our results improve, the participation in results will be better. If the results are worse, once again, perhaps for what we have provisioned will not be sufficient. I would not like you to maintain that impression that there will be no participation in results. Once again there should be profit sharing for the Q4 and the EBITDA margin for the year is taking into account payment for profit sharing as well as additional provisions for the Q4. Regarding your question about how this can become more normalized during the coming years, the levels of the total profit sharing this year because the results are not aligned [ audiointerrupted] as we begin to have results aligned with our expectations, we may go on to a more normal situation. This would represent profit sharing activity.

**IRMA:** Thank you.

**OPERATOR:** Mr. Guilherme Assis, from Brasil Plural, would like to pose a question.

**ASSIS:** Good morning and thank you for the presentation. I'm referring to the collection performance that you spoke about very well, that you have implemented several novelties and more innovations, nevertheless, you sold the first batch in the quarter and once again you did have that very strong impact due to the World Cup. I would like to get a better understanding of the adjustments that will have to be made with the new collection that is coming in. If there will have to be a new adjustment, what this adjustment will refer to? To fashion? What is this that will picture an improvement in the collection from now onwards. This is my question, thank you.

**FRED:** The performance of the Q3 was quite impacted by the results of July and by the first 15 days of that month. We can say that we have two completely different moments during the quarter, and as was mentioned by Fabio after the world Cup, we did have a great deal of volatility and our performance so far still does not reflect all of the improvement that we have implemented in the collection. And the indication that we have before is that we still have to make significant adjustments. The collection you are referring to which is the collection were we have implemented several innovations was launched during the last 10 days of August. And the impact that this new collection had on the quarter evidently was quite limited. We also increased our products supply, and we have done a great deal in terms of working with more intense communication in the stores regarding what we are doing. Most of the changes that we have implemented, the consumers are just beginning to see. If we look at the basic collection, at the point of stores, we have quite great deal of communication explaining the benefits of the new collection. Once again explaining what have changed, and we held a campaign where the shop windows of the stores began to speak more about this campaign. And we believe that the initial results of the summer collection showed a need

to work in this fashion. We once again need to focus ever more on our activities in the point of sales, show how we are changing our image. And all of this will be supported with our media activities. Our diagnosis so far is that we are on the right path that we need to intensify our communication activities both within and outside the stores and once again that will [interrupted audio] and we do believe that the results will appear by the end of the year, regarding the high summer collection in terms of competitiveness it is much more competitive than our Summer collection because of several aspects. We have been able to come up with the collection with a great deal of novelty. Their value proposition is very good at an intermediate price level. That is to say we have a very commercial collection and we have the right assortment, we have the right time and now we simply have to wait for sales.

**ASSIS:** thank you very much.

**OPERATOR:** Ms. Andrea Teixeira, from JPMorgan would like to ask a question.

**ANDREA:** Thank you for the presentation. My question regards the operation you made about the year at the multibrand which basically has this behavior of anticipating the collection. So what should we see in terms of trends? do you think it's a trend for a very weak Christmas and so the same growth trend? so the focus should be more on franchisees and do you think the franchisees would improve the sell out with this collection?

**FABIO:** Hi. What we see for the end of this year, our projections are that our own store, or rather, the franchisees are more prepared, better prepared. That's why during the showroom they did have a better performance than the other ones for high summer. They were better prepared. Due to promotional actions which have been with the new basics, so with the promotions with all this we also conducted promotions for the Winter collections because we had a very slow second quarter due to the World Cup and the weather which

wasn't helpful either. So these were important actions to better prepare our stores and the franchisees for the end of the year. Of course this does not happen with the multibrands. With the multibrands, we just own one of the brands offered. Therefore, our perception is that multibrands in general is a chain that is not as prepared due to higher inventories. I'm not talking about our own inventories, Hering inventories, inventories in general. They are not as prepared as the other ones were during the showroom in order to buy for the high Summer. So, what we see is an effort to better supply this multibrand chain but I must say we didn't have a positive result. Or a positive response in the showroom. As we had with the franchises. But we are still moving on, we are still making our efforts and this leads us to believe that the franchises are better prepared in terms of their supplies than the multibrands but this is not to say that we are expecting worse performance in terms of sell in for the Q4 for multibrand, not at all, we are still making sales efforts. With this commenting will happen in the showroom basically. And among the large number of multibrand customers we have as you all know a project called Qualified Retail, which is a small number of clients, or customers, customers that work exclusively with our products and this is where we are keeping very close track. It's not as much as we would have in our own stores but we keep very close eyes and track. And we have been making every greater efforts with the point of sales materials and so on. And for the end of the year we have a more robust, a more complete package in terms of the high summer collections and also in terms of the communication package. So, our projections are that multibrands will have not very good performance in the Q4, worse of performance but I must say that in the showroom, the franchises they faired better in the showroom.

**ANDREA:** Thank you very much for the explanation, and investments made in terms of the margin, to increase the gross margin, we also see that the mix is more affordable, so to speak, so maybe the basis is a little smaller now. Is there intention to expand this regarding that program that tries to organize or

to have more previsibility in the projections. Do you think this is going to happen in the multibrand channel? Do you think we are going to see this movement? What I'm trying to say is do you see a structure development of the brand and a drop for the future?

**FRED:** The drop in gross margin that we had in the last quarter was a result of more promotional activities and not intentional promotionals too. In other words, is not a strategy for sales to promote or to make promotions to attract our customers. It was a reaction to sell out movements. So, please, don't read what happened as something structural at all. What we do have is that as we go on, as we see sales going back to normal, as we see fewer remainders, we believe that the gross margins should stabilize and perhaps even improve. So there is no major changes, structurally speaking, in terms of our strategy, no, in structural in mark up and so on. What we have is that we have inventories above normal and we have some tools to eliminate this amount that are left in the inventory.

**ANDREA:** this should happen for the winter collection?

**FRED:** we believe that in Q4 the margins will be better and from then on it will depend on how sales perform. But our margins are actually very much impacted by a higher than usual inventory.

**ANDREA:** Thank you very much.

**OPERATOR:** We would claim to people to ask one question. Now, from Mr. Tobias Stingelin, Credit Suisse, a question.

**STINGELIN:** Good morning, Fred and Fabio. You said that there are many novelties regarding the basics. And you also have started a campaign which have been going on for more than a month, so this new campaign, how is it working? How was it seen by the franchisees? because as far as I see, you have the summer collection, with certain novelties, but you really were backing

in the new basics. This is my first question. The second, which one of the three months, just we understand what really happened in the quarter in terms of sales? And I would also like to understand this idea of slowing down the expansion? Is the franchises who is saying "we do not want to open because we are not making money" or what is it exactly that is happening? Why are you slowing the pace?

**FABIO:** Once again, and we are going to give you a joint answer. First of all, referring to the slowdown of our expansion, when it comes to the new basic collections in September, in the beginning of September, if I'm not wrong, we began our campaign. But as I mentioned before, month after month, we introduced new basics for a very renewed mix and with different apparel, we introduced basic product with different price points of R\$ 19.90, and our intention is to maintain this price point. And we have some premium products, such as the "cooling", fabrics, within the coolings, fabrics some varieties both are geared to men and women. All of these novelties will be found in the stores as of October. Now in September, part of the basics were already be found in the stores with a very good performance. When it comes to entry prices, when we launch products with slim models, something traditional and very popular in the market we observe a sales increase in our points of sales. And what we are trying to do is avoid canibalization of our portfolio. Therefore as you can see, we're offering much more varieties to consumers, not simply offering the basic collection. And the responsiveness have been very good, very positive. In the premium collection, evidently, and the their performace in the stores that are in the bracket A shopping malls, our premium products are being sold at R\$ 69.90, therefore the price is considered to be premium and the performance has been very good, once again, focused on those points of sales in the shopping mallls. After a month of the launch of our basic collection, we can say we are having a good performance in the entry products while the other products we have launched. As the third part of your question, I'm sorry, I've forgotten it.



**STINGELIN:** I think that responds to my questions Fabio. Thank you very much.

**FRED:** being our breakdown month by month and... [interrupted audio]

**STINGELIN:** Sorry, I was on the telephone, when you began to answer there was a cut and I wasn't able to listen to the response.

**FRED:** during the World Cup, the results were negative, in 20.0%. Same store results were negative after the world Cup, the same store were single digit, also negative at that point.

**STINGELIN:** because of this, I would like to understand what happened in the month of July, August and September, because this is very relevant.

**FRED:** Once again, the first, well, 20.0% negative for some stores immediately after the World Cup, then a slight improvement and then once again a single digit number. For the whole period, it was negative. I'm sorry, we are having problems with the connection. The phones are cutting. We are having problems with the sound. So, your question was about the extension. I didn't get the other thing that you asked.

**STINGELIN:** You talked about -20,0 and then improvement?

**FRED:** I said that the remained of the period was slightly negative.

**STINGELIN:** are you talking about the YTD or month by monyth?

**FRED:** No, in the YTD

**STINGELIN:** in terms of extention, tell us about what the process is like? Is that the franchisees do not want to open the stores? What is happening that you are slowing the pace?

**FABIO:** Actually, this was a decision because, on the one hand, we have seen some delays in the malls, some new malls when they open up, they have a very complicated process, in terms of occupation. In some cases, some malls open up with a very few stores, very low occupancy rate, this reduces the flow. As Fred has said, we are reducing the pace more in terms of shopping malls, because we are assessing the issue of occupancy costs and all, so we need to review these process in the industry as a whole, I would say. Not as much as in the street stores, street stores were still in the same pace. Our expansion is planned internally, so at the beginning of the year, when we said we intend to open this many stores, this was an expansion that was mapped by us. It's not something that the franchises decide, "I do want" or "I don't want to open". It's something that we plan. And along the year, we see our analysis where it's worth while opening up stores, how the performance is in this or that mall, it's the occupancy rate higher or not. This, together, of course, with the franchisees. The franchises, I would say, I'm not as willing to open the stores, as they were a little while ago due to the scenario, but we don't see them not opening the Hering stores and opening another brand. Not at all. We are one of the most desirable investment choices. So, we are not losing ground to competitors, but the businessmen today due to the macroeconomic scenario and all, they are more conservative. In spite of that, we don't think that this is the reason why we are reducing the pace in terms of store openings. If we were to rely on the franchises we would have people willing to open with us. But we are being more conservative, more responsible, we want to open stores where we see good probability of results. And the new malls are still an issue for us.

**STINGELIN:** Thank you very much. Thank you for your explanations.

**OPERATOR:** Mr. Gustavo Oliveira, from UBS, would like to ask a question.

**OLIVEIRA:** Good afternoon Fabio and Fred. It's a simple question. Apparently, during the math, EBITDA guidance for the year is very conservative. This quarter or last quarter you had a promotional activity that was very strong in the Q3. There was a drop in gross income despite all the efforts in same store sales, so it's a result that could be very catastrophic, it was not in the margins but the very slow same store sales, very weak margins. Do you see any improvement in same store sales? Do you expect the margins to grow for the Q4? Because I think a flat margin seems conservative. Is this the way we should see it or do you think that the new collections has a smaller, a narrow margin than the previous one? because you have adjusted prices, because you have adjusted quality or whatever. So, what should we think? And why not an expanding margin for Q4? Thank you.

**FRED:** when we talk about EBITDA margin this is much more related to other aspects, other than the new collections. So, looking at the Q4, depending on the results, we see a better profit sharing and this, although it can expand, with this profit sharing, this might tend to be offset. So, we need to think about the gross margin performance for the Q4, the gross margin effect is not necessarily linked to the margin of the new collections, but it's more related to higher inventories than usual, some inventories still going to be sold in the Q4 even at a discount. So, with the promotions we had in the Q2 and Q3 quarters we did not sell everything so we still have something to sell. The EBITDA margin for the Q4 is realistic. Of course, it could be something around the figure that we projected. But it shouldn't be very much off what we projected.

**OPERATOR:** Mr. Abelardo Franco, from Morgan Stanley, would like to ask a question.

**ABELARDO:** I have a question regarding the expansion plan. You talked about 75 new stores, but this is gross, right. You had 8 stores closing in 2014, so would be around 67 new stores. Is that it? And regarding the stores that

were closed, could you give us some color as to the reasons, is it the state where they are located, geographic location, I would like to really have some color on this and why they were closed. And if you have any other stores being closed for the next quarter.

**FRED:** Franco, the number of stores opened is always net of the closed stores. So, 75 except for the stores that were closed or not considering any other stores that might be closed in the next quarters. I will know, Fábio might answer if we are going to see some stores closing but this is part of the game. If you have a chain of almost 800 stores, maybe 5 or 6 stores closed this year is not really very material figure. In terms of the last quarter, we closed 3 Hering stores. From these, one was not exactly closed, it was reallocated, so we moved it to another location. The other two were specificated in the same chain, we decided that they should leave the chain so they had 5 stores, 2 were closed and 3 other ones were passed on to other franchisees. I mean, nothing very unusual at that, right? It's part of normal management of the chain. We also closed Dzarm. We have a new business plan for Dzarm as a brand. We have a new positioning and number of developments. And the store we had did not fit for new business plan that we have for the brand. So, we are going to open Dzarm stores but this will be according to the new strategy, and the new format. We also closed another store in Venezuela. Venezuela is not exactly a focus of international expansion for us at the moment.

**ABELARDO:** OK, thank you. Could you please talk a little bit more about the EBITDA margin? Because it will go to 200 bps and perhaps to 300 bps accumulated. You do expect an expansion?

**FRED:** the figures that we gave you is the figure that considers already profit sharing.

**OPERATOR:** Alan Cardoso, from Safra, would like to ask a question.

**CARDOSO:** I would like to gain better understanding in terms of that consolidation of your new strategic plans. And I would like to hear the estimates you have for own stores and if this was better in the 3Q compared to the Q2 where you had to work with a great deal of promotions and if you already observe a better performance and own stores compared to franchises. That is to say, something that could have an impact on the performance of franchises during the Q3 or Q4.

**FRED:** The same store performance during the Q3 was somewhat better than that of the franchises. Evidently, in our own stores, specially when we speak about change of strategy, we have a great deal of expedition on implementing this in our own stores. We are much more nimbo and we don't need to base ourselves on explanation and buy on as we have to do with the franchises. The performance was not significantly better compared to franchises simply, slightly better. Perhaps this is the reason for the growth in the same stores during the Q3, once again, also because we took back some of our franchises and we began doing this in the Q2. And all of this helped the performance of the own stores.

**CARDOSO:** Thank you very much.

**OPERATOR:** Mr. Luis Cesta, from Banco Votorantim would like to pose a question.

**CESTA:** my question refers to the improvement in inventory and in working capital. Once again, I would like to know which was the improvement in the management of inventory and what have contributed towards this growth during the Q4?

**FRED:** working capital depends on the variation of our inventories as we have a great deal of increase in inventory throughout the year and previously this year we tried to contain the growth of inventory. Once again, we did not

require additional working capital compared to the year 2013. Our inventories continue to be higher than what we deem to be ideal and throughout the Q4 the inventory should have a considerable drop because of seasonality reasons. The Q4 quarter is one in which we always have larger sales often times more than we can produce and we are going to attempt to anticipate our production to be able to comply with the sales differently from what happened last year when we had to maintain strong production schedule to be able to have sufficient inventory for the end of the year. This inventory was not needed. Once again this year we will eliminate this problem. The inventories will tend to become more normal as our production pace in the Q4 will also become more regular. Once again we're avoiding having surpluses as we had intentionally last year.

**LUIS:** thank you.

**OPERATOR:** Mr. Marcelo Moraes, from Deutsche Bank, would like to ask a question.

**MORAES:** Good morning, thank you for taking more questions. The first question would be an update on the project to launch outlets, which is the percentage of stores at these outlets are working with? And if you believe that this initiative could clean out your stores from previous collections, once again, allowing you to decrease your inventory levels.

**FABIO:** We have Hering space stores as they are called and they sell not only our products but products from the Company. We are began doing this space on an experience that we had in Blumenau, and introduced this project in some of the outlets and shopping malls in Sao Paulo, Brasilia, Salvador, Rio de Janeiro. This has given us revenues and has worked very positively and we carried out a survey to investigate the profitability and perhaps deploying greater efforts in outlets and to work towards operating as a channel that will fill a previous collection. We have not concluded this project so far, we were

simply discussing this expansion in some specific areas and outlets with this characteristics. We have 5 stores to comply with concepts. We have found these stores to be very interesting once again to help us sell out our collection. This is simply another business alternative.

**MORAES:** Thank you. Second question that refers to the speed of conversion of stores for the coming years. You mentioned in the presentation that you are investing intensely in communications, you have a great deal of investment in communication. Which will be the pace of expansion in the franchises for the coming years for 2015?

**FABIO:** In 2015 our goal and our efforts once again are to intensify the renew of our stores, the renovation of our stores. We already are working with a project that in house we have called Evolution project. This project exists in SP in Morumbi and Ibirapuera shopping malls. We have carried out pilot studies gone on to some adjustments and presently they are operating extremely positively and all the new stores are built according to this new architectural project and we are going to carry out a very well defined review and beginning 2015 we would like to ramp up the renovation or renewal of our chain. Now, how can we do this? Considering some new movements with the franchisees so that this can happen in new incentives. It has been proven that through this renovation, store performance and improve and of the package that we would like to offer is to include this evolution project in some of our stores. We have some stores with new architectural projects for more than 6 or 7 years and we also have stores that need this renovation and this should create a very positive result. Alongside with this, for the coming years we have developed what we have called internally a new architectural project which is called Revolution and this is something that we hope for the future and this will be a project that will be implemented in the beginning of 2016. Evidently we have a schedule of renovation, we also have new openings and the new project revolution will pertain only to the stores that will be opened later and some of

these stores are very part of our schedule and we have more than 600 Hering stores at present and because of this it is important to maintain this evolution of projects, always updating our image to be on a constant goal. And I believe that it will be very [unnintelligible - 1:23:01] to encourage the renovation of our chain of 2015.

**MORAES:** Thank you very much, Fabio.

**OPERATOR:** as there are no further questions, at this point we end our Q&A period. I would like to once again to give the floor to Mr. Fabio Hering for his final comments.

**FABIO:** Once again we would like to thank all of the participants at this earnings conference call. Once again reinstating the commitment we have with this Company of creating a growth cycle for all of our brands, although the results for the quarter are not what we have expected ourselves, we have made significant strive when it comes towards our projects of growth strategies to change brands, Hering Kids, PUC, Dzarm, Hering4You and our mul [audio interrupted] e-commerce. Once again, all of these have had improvements. The company management is convinced, once again we are in the right path, we face consumption and a very challenging macroeconomic scenario. Nevertheless thanks to our strengths, our strategies and the well structured team. We believe that we will be able to move forward in the future. Once again, thank you for your participation and we hope to see you at the next conference call.

**OPERATOR:** The conference call Company Hering is closed. We appreciate your participation and have a wonderful day.