



Cnova N.V.

Second Quarter Fiscal Year 2016 Financial Results Conference Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Richard Cathcart, *Bradesco BBI*

Pedro Fagundes, *Goldman Sachs*

Cedric Lecasble, *Raymond James*

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PRESENTATION

Operator:

Greetings, and welcome to the Cnova Second Quarter 2016 Financial Results Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please push star, zero on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Mr. Christopher Welton of IRO. Thank you. You may begin.

Christopher Welton:

Good day to all, and welcome to Cnova's Second Quarter 2016 Financial Results Conference Call. My name is Chris Welton, Cnova's IRO, and I will be your host on today's call. Joining me today are Emmanuel Grenier, our CEO; and Stéphane Brunel, our CFO.

The presentation slides that go with this call can be viewed at and downloaded from our website. This call is also being audio webcast, and a replay will be available on our website about an hour after the conclusion of this call. The agenda for today's call is to go through the slides, highlighting key points, and then to open it up to the Q&A session.

If we look at Slide 2, this contains our forward-looking disclaimers, and I emphasize that these apply to the entire presentation and the related documentation, and I strongly encourage everyone to read these disclaimers now.

Before we go over the slides, our CEO Emmanuel Grenier, would like to provide you with some opening remarks. Emmanuel?

Emmanuel Grenier:

Yes, thank you Chris, and good day to everybody. So, before we go over our second quarter results and answer all of your questions, I wanted to address three things upfront. First, Cdiscount is doing well. Our volume of activities is being pushed by our price positioning and customer value proposition. Our marketplace continues to grow and we're working to add other revenue to our traffic. We are leading the market in France, in terms of new delivery options; we are the only player in the market who can deliver so many heavy products on the same day, on weekends, and during the evening.

Second, we have gone through the major cleanup at Cnova Brazil. We are taking care of logistical problems, inventory management is coming under control, the out-of-stock situation and delivery times are improved, we are moving to improve the quality of our customer call center and on top of that, the new ERP rollout is completed, and the internal review that has been ongoing for the past seven months is now completed. Management can now concentrate all of its time and energy on commercial activities.

Finally, now that the internal review in Brazil is over, we can move forward with the talks with Via Varejo regarding the possible reorganization of Cnova Brazil. We see this as a win-win-win situation. Cnova wins because it will be able to focus on its most dynamic market, France. Via Varejo wins because it will be able to grow its multichannel offer. Cnova Brazil wins because it will be able to take full advantage of Via Varejo's excellent logistics infrastructure in Brazil.

With that, I turn the floor back to Chris. Please.

Christopher Welton:

Thank you, Emmanuel. So, as usual we have separated our presentation into four sections. First, we'll take a look at the key indicators for the quarter, after that Stéphane will go over, in more detail, the financial performance of the Group, before he takes us through the conclusions of the internal review in Brazil that we just completed. Finally, Emmanuel will come back and give us an update on what is going on in France and Brazil.

So if we look at Slide 4: Key Indicators. There are two main takeaways here. First, Cdiscount continues to do well. GMV is up 13%, nearly a third of that GMV is coming from the marketplace, net sales increased close to double-digits in a market that has been affected by labor strikes, unseasonably cold weather, and of course, unfortunately, terrorist attacks. Second, the reset at Cnova Brazil is underway, but its impacts are not expected to be felt until the second half of 2016.

Moving on to the next slide, let's drill down a bit into volume of activity. This pretty much matches what I just said: Cdiscount is doing well. It had close to a 13% increase in its GMV; this is a combination of the value proposition of direct sales, marketplace expansion, and other revenue streams coming online. Then there is Cnova Brazil, which had a 30% decline in volume. Yes, a good portion of this is due to the recession that is racking the Brazilian economy, but some of it is also due to internal dysfunctions that we have to iron out ourselves. We are doing this and we expect to see fruits of our labor soon.

Moving on to the next slide, here we look at three metrics that are driving our growth. First, the marketplace is growing fast. The number of sellers is up 37% year-on-year, the number of product offerings is up even more, plus 90%, 9-0 percent, and the marketplace share of GMV is up more than 760 basis points. It is important to note that this is positively oriented in both France and Brazil.

Second, traffic, up more than 16% at the Group level, with the mobile share climbing more than 1,000 basis points, our SEO expertise and Customer Loyalty Program, Cdiscount à volonté, in France are key factors behind this very good performance. Third, the number of items sold is making gains as well, primarily due to our positioning in electronics in France.

Now, I would like to take you through some of the operational improvements that we have been working on. First, looking at Cdiscount, we have upped our delivery game. You can now receive your purchased items at night, on Sunday, or even by appointment. We are also moving into 3D packaging, a first in France to our knowledge, this optimizes the size of the package for the customer on one hand, and increases truck fulfilment capacity, on the other. And it's worth noting, that customer satisfaction as measured by NPS continues to grow.

Over at Cnova Brazil, as we said earlier, the ERP migration caused some clear short-term customer disruptions, but we are working through that. Our logistics are greatly improved and we are trying to improve our customer's overall experience as well.

Now, I'm going to turn the floor over the Stéphane, who will take you through the financials, as well as details of the internal review in Brazil.

Stéphane Brunel:

Thank you, Chris. On the key figures slide, if we focus for a minute on Cdiscount France, we see improvement across the board. GMV up, net sales inline, gross profit up with a gross margin better by 40 basis points, operating EBIT improved. When you turn to Cnova Brazil, it's pretty much the opposite. Given the reset that we initiated at the beginning of the year, and the ERP migration, which is almost completed, we are confident that improvement is around the corner and that the second half of 2016 will be better than the first.

On this next slide, we clearly see the potential for improvement at the Group level. While Cdiscount continues to do well, there is ample room for improvement at Cnova Brazil. Now, there might not be much that we can do about the effects and ICMS impacts, but we can reduce the minus \$127 million significantly over the next few quarters, trending eventually towards break-even.

Now, turning to gross margin and SG&A. The gross margin at Cdiscount is progressing, up 40 basis points, while that at Cnova Brazil have clear room for improvement. We expect it to get better in the coming quarters. In terms of SG&A, Cdiscount has decided to increase its marketing spend, resulting in a 20 basis point increase, which remains at the low-end of our 20 basis point to 30 basis point increased guidance we gave you for the full-year.

The Cnova Brazil cost structure has been penalized by the low-level of volume, as well as the ERP migration, and beyond that needs to improve through an expense reduction plan. As a percentage of net sales, we expect fulfillment expenses and G&A should reduce while tech and content should level off. This will give us the operating leverage we need to drive sustainable improvement in operating EBIT.

We see the potential for this on the following slide: Operating EBIT at Cdiscount is moving in the right direction, resulting in an €11 million improvement for the first half, and we intend to continue this. Cnova Brazil's operating EBIT is expected to improve on a consistent basis over the next quarters.

The negative cash flow is a reflection of the challenges that we have been facing, but our focus today is to build from here, and improve operations. We have closed most of our international operations to cut cash flow losses, and 12 months free cash flow in France is expected to remain positive. We expect that negative cash flow to start to reduce and eventually move to zero over the next few quarters. For the

time being, we have put in place short-term financing in the amount of \$180 million to handle out near-term cash needs in Brazil.

Finally, let's take one minute to summarize the issues we have come across at Cnova Brazil. As more fully described in our 20-F from 2015, we have discovered employee misconduct at our Brazilian distribution centers. In addition, we have discovered misconduct as well within Cnova Brazil Accounting Department. As a result of the findings, we decided to restate our previously issued financial statements. Additional details concerning the findings of the review and the resulting adjustments are set forth in the 20-F.

In addition, during and after the internal review, we performed a thorough review of Cnova Brazil's accounts, and we have decided to adopt more conservative accounting practices with respect to deferred tax assets and supplier's contribution to the valuation of inventory.

Now, I will turn the floor back over to Emmanuel.

Emmanuel Grenier:

Thank you, Stéphane. So, what are we working on at Cdiscount? First, customer service, innovate in delivery, push our loyalty program, Cdiscount à volonté, which is working out quite well. As a result, customer satisfaction, which is measured by net promoter score or NPS, is growing; this is helping us to increase the pool of our repeat customers.

Second, mobile. If you don't move towards a mobile navigation platform, you are nowhere. We are well ahead of the curve here. Third, "home is where the heart is", it is also where we have a major competitive advantage in the market. We are going to grow in this category and make our number one position in France even stronger. Fourth, the marketplace. It is a low-cost revenue, we are growing, we are bringing in foreign vendors, and we are adding new services, such as fulfillment. Our plan is to multiply the number of value-added services here. Finally, our Express Grocery Service is going according to plan; all of our customers in Paris have 90-minute access to more than 4,000 food items.

To finish, Cnova Brazil. Look, we have been quite transparent about the challenges we face in Brazil, both internal and external. We have cleaned up internal problems and have also identified three other areas where we can improve and see benefits in a relatively short time frame. First, be good at what we do. Have products that our customers want, increase free traffic toward the sites, and most importantly, put the customer first in terms of service and how you treat them on a day-to-day basis.

Second, marketplace, increase, it's not rocket science, we are making good progress here. Finally, increase the productivity of our DCs. We have streamlined procedures and we are working with Via Varejo to promote synergies and share reduced costs.

In closing, Cdiscount is doing well, and we are working to build on that performance. Cnova Brazil is making progress, but still have some way to go, and we are confident for the future.

That concludes our slide presentation. We are now ready to turn to the Q&A. Operator, may we have the first question, please?

Operator:

Thank you. Ladies and gentlemen, we will now be conducting our question-and-answer session. If you would like to ask a question, please push star, one on your telephone keypad now. A confirmation tone will indicate your line is in the question queue. You may push star, two if you would like to remove your

question from the queue. For any participant using speaker equipment, it may be necessary to pick up your handset before pushing the star key. One moment while we poll for questions.

Our first question comes from the line of Richard Cathcart, a Private Investor. Please go ahead.

Richard Cathcart:

Hi, it's Richard Cathcart from Bradesco BBI here. Just a couple of questions on the performance in Brazil, first of all on the gross margin fell around 300 basis points. If we looked just at the direct sales business it must be even more. Can you just go through a few of the drivers of the decline in that gross margin? I mean, is it more promotions? Is it kind of lower prices across the board? Has any of this got anything to do with the improvements you need to make in customer service or deliveries or the move to ERP system—the new ERP? Then secondly, how much kind of that transition to the new system has kind of had a negative impact on sales growth over the last three months? Thanks.

Stéphane Brunel:

Okay, thank you very much, Richard. Your question, with respect to change in gross margin in Brazil, is quite a tough one to explain. For sure, we believe that the 300 basis points decrease in the overall gross margin reflects as well the impact on the gross margin for 1P product. In addition, you have a positive impact, of course, of the share of the marketplace, which is counterbalanced by negative change in the gross margin of B2B activities in Brazil.

With respect to the overall market environment, yes, the market is competitive as you know. Yes, we have been quite promotional on this quarter. With respect to the transition to the ERP, I will let Emmanuel answer your question.

Emmanuel Grenier:

Yes, hello Richard. In fact, this is very hard to answer the question very precisely, but what I can you tell you, during some weeks after the ERP migration, we had to make longer delivery times because we had to learn how to work with this new ERP. So as the delivery times were longer, people were ordering less, but now, this is fixed. The system is stabilized so we went back to the delivery times we had before the migration.

Richard Cathcart:

Okay, thanks, and then just kind of quickly a follow-up. You mentioned in your comments before about making improvements to your customer services centers; again, is this linked to the issue of the new ERP system? Do you have any kind of metrics to show perhaps the duration and improvement in customer perceptions and —?

Emmanuel Grenier:

Yes. When we started in February, our action plan in customer service, we improved a lot in the last—in the first two months, and with the ERP we have the same impact as in logistics and delivery times. We were not as good as before during the one and half to two months. Now, since last week we are recovering and we have now have the same results as before the ERP migration. So, we had some tough times during the two months, but we are recovering and now we are going to improve and to be better than before the ERP migration.

Richard Cathcart:

Okay, thanks, and then just a final question. You mentioned before about moving back towards break-even in Brazil over the following few quarters. I mean, is there any specific target on when you may get back to break-even at the EBIT level in Brazil? Thanks.

Stéphane Brunel:

Yes, Richard, it is true that we mentioned in the early days of this year that our internal target was to reach break-even in Brazil at the EBITDA level for the full year, which basically translates into a minus €15 million, something like that at the EBIT level. I mean, obviously after the performance of the first half, or minus €58 million EBIT loss for the full first half of 2016, we don't think that this internal target is likely to be achieved. For sure, I think that we have two key priorities for the second half of this year. The first one is to improve the net sales trends significantly from where it is, and secondly, to improve the second half of 2016 EBIT significantly from the second half of 2015 EBIT last year.

Richard Cathcart:

Okay, thanks very much.

Operator:

Thank you. Our next question comes from the line of Pedro Fagundes from Goldman Sachs. Please go ahead.

Pedro Fagundes:

Hi. Hello everyone. Thank you for taking my question. The first one—I have two actually, the first one more specifically in Brazil. I was hoping you could run us through the trends in terms of take rates in Brazil, specifically for your marketplace? The second question is regarding the MOU with Via Varejo, what are the next steps and planning or anything else you could add in this regard? Thank you very much.

Stéphane Brunel:

Okay, so just answering briefly your questions, with respect to the marketplace in Brazil for the second quarter. The marketplace share of the GMV was 16.6%, up close to 800 basis points year-on-year, so we are quite pleased with our marketplace growth and positioning in Brazil; it goes well.

Then let's take your second question, which is the status of the discussions with Via Varejo regarding a possible potential combination with Cnova Brazil. Obviously, we are actively pursuing discussions with Via Varejo, Via Varejo's special committee, and its advisors, and as you know we have finalized and published our 20-F and concluded our internal investigation, which is obviously a key milestone. We will communicate in due time, once or if a definitive agreement is reached.

Pedro Fagundes:

Thank you. On the first question in Brazilian marketplace, what could you add in terms of trends with regards to the take rates more specifically? Have they increased even in your marketplace or your competition?

Stéphane Brunel:

Thank you very much for this. Our take rate is about stable for us so no, nothing has changed, and it has been stable for the past quarters, and we are happy with the position we have.

Pedro Fagundes:

Okay, could you give us a reference of what are the levels for your current take rates?

Stéphane Brunel:

So, as you know it differs category-by-category, so different take rates according to the kind of product we are selling. On average we are around 13%, 1-3 in Brazil, which is obviously an average for the whole product mix and that can change according to product mix.

Pedro Fagundes:

Okay, that's very helpful. Thank you very much.

Operator:

Thank you. Ladies and gentlemen, as a reminder, if you would like to ask a question, please push star, one on your telephone keypad now.

Our next question comes from the line of Cedric Lecasble from Raymond James. Please go ahead.

Cedric Lecasble:

Yes, good afternoon, gentlemen. A very easy one from me on the way you manage the French business, could you tell us for Cdiscount how you managed the couple between profitability and market share? How you invest? How you decide to invest more or less in marketing expenses, client acquisition costs? How do you manage that over the long-term and what are your mid- to long-term targets in France? Thank you.

Emmanuel Grenier:

First, our long-term target is to increase our market share year-after-year on the French market, this is first. The second thing is our strategy on that is very clear, it has been the same for several years. We have—we are the leader on prices in France between 5% and 10% compared to the competition. On the second point, we have been investing in very low marketing in the last years, around 1% not more, so when everybody is investing between 4% and 5%, we are at 1% of net sales in marketing. So our price positioning is very low and leader on prices and low marketing.

Now, we decided this year to innovate and push really hard on delivery options, so we developed in the last two years Cdiscount à volonté, which is growing very fast and the number of subscribers this year grew 120% compared to last year's same-Q. As we explained, we opened lot of new delivery options for big products because as you know, certainly we are leader by far in home appliances and furniture. So we are able to deliver Paris and surroundings same day, on Sunday, and at night. So to conclude, a leader on prices by minimum of 5%, low marketing, and push very hard on delivery options.

Cedric Lecasble:

Okay, but you don't include the promotional campaigns, for instance, in this marketing spend?

Emmanuel Grenier:

Promotional campaigns are in the gross margin. Promotional campaigns are included in the gross margin.

Cedric Lecasble:

So, maybe my question also relates to how do you decide from time-to-time to be more aggressive on promotional campaigns? How do you—and maybe the same question, if I may, than the previous one, on the take commissions in France for your marketplace. That would be very useful also. That would be all for me.

Emmanuel Grenier:

In promotions, we are very promotional, and this is key because coming from our, this is our D&A, where are Cdiscount, so low in prices and high promotions. But this is a culture in the Company, to be highly promotional, and our customers like that and they are coming back to Cdiscount for that. This is not a choice, not to be or to be; we are and this is returning our business as well. About the take rates of the marketplace, this is around 12% for France.

Cedric Lecasble:

Thank you very much.

Operator:

Thank you. Ladies and gentlemen, once again, as a reminder, if you would like to ask a question, please push star, one on your telephone keypad now.

Our next question comes from the line of Stephen Ju from Credit Suisse. Please go ahead.

Stephen Ju:

Okay, thank you. So Emmanuel, I think unfortunately in France you had your share of external distractions and I think major sports tournaments during the second quarter. So, is there anything you can share about the current state of consumer activity in the country? Brazil also I think, if there is anything you can share in terms of whether the overall consumer sentiment is improving there? Also, in terms of your marketplace's platform share improvements, where do you think you are gaining share from? Okay, thanks.

Emmanuel Grenier:

So about the environment in France, as you know, French environment has been soft, bad weather, terrorist attacks, not only one, but several. There were strikes due to some changes by the government so, it didn't help us, but at the end these are things we cannot control. We are focused on things we can control. This is why I spoke about Cdiscount à volonté, delivery options, marketplace and mobile.

About Brazil, this is not soft, this is challenging, you know that better than us, and all the players are facing challenging conditions. So all what we can control there is different, this is more basic, it's more about out of stocks, delivery times, things which were solved in France five or six years ago, we have to solve them now in Brazil. We are working on search engine, we are working on mobile, so we have cleaned up the back office. We have to clean and to improve the front office and the customer experience on the site.

Now, according to—about the marketplace, I think that there are three things that our vendors love on our marketplace. First, we have a lot of traffic. Just for you to know, in April and May, Cdiscount had the second in April and first in May, second and first growth in traffic in France in all the websites, which means that we were ahead of Amazon. This is according Mediametric, which is a French institute which is measuring traffic on the sites. So first we have sites, we have this traffic.

Second, we have these services like four times—four payments in installment. I know that it is very common in the US, but in France we are the only player to be able to offer payments in installment

without documents, without papers for the customers. We are the only one. It seems strange to US people, but this is like that in France. The third one is our fulfillment services. We started off to offer fulfillment services to vendors one and half year ago, and we have now more than 700 vendors taking advantage of our fulfillment services. It means that they are taking advantage of our click-and-collect network, of our same-day delivery, of our Cdiscount à volonté program, and this is why they like that.

Cedric Lecasble:

Thank you.

Operator:

Thank you. Our next question comes from the line of Richard Cathcart with a follow-up. Please go ahead.

Richard Cathcart:

Yes. Hi, just a final follow-up on Brazil. I'm just wondering if so far in the third quarter you have seen any improvement in the topline trends, so a second quarter GMV is down almost 20% in constant currency, and is that beginning to improve or are we still at the kind of level of around minus 20%? Thanks.

Stéphane Brunel:

Thanks, Richard. For the time being, the current trading in Brazil into Q3 is basically in line with Q2 performance.

Richard Cathcart:

Should we—okay, then does that mean for the gross margin as well, or is there any kind of different trends going on at the gross margins?

Stéphane Brunel:

It's too early; it's perhaps too early into the quarter to tell. What is sure is that we are convinced that having done all what has been done, we should improve the topline and sustain gross margin in the second half. It's perhaps a little bit too early to be extremely precise about the third Q outlook given the status of our performance right now. But we can say that from a topline perspective, for the first three weeks of July, we are in line with the 2Q.

Richard Cathcart:

Okay, thanks very much.

Operator:

Thank you. Ladies and gentlemen, once again, if you would like to ask a question, please push star, one on your telephone keypad now.

Our next question is a follow-up from the line of Pedro Fagundes. Please go ahead.

Pedro Fagundes:

Hi, thank you. Just a follow-up question, I see in your presentation that one of your key initiatives to expand the marketplace in Brazil will be, and I quote, "expense sellers phase, focusing on coaching, and

quality control." Could you elaborate a little bit on what are these coaching and quality control initiatives you are putting in place in Brazil, in your marketplace? That's it. Thank you very much.

Emmanuel Grenier:

Yes, coaching means—US, UK, and France are quite mature in the marketplace, but Brazil is not mature at all. This country is not mature, so we have to explain to the vendors—this is coaching—how does this work, what do they have to do, and how do they have to behave with the customer. It seems to be very obvious but it is not and about quality, obviously all these vendors, even in France, they don't have the best quality, so we have to check this quality every week, every month. We have stopped the vendors, which has not the good level of quality, because when these guys don't deliver the good quality, they have an impact on the quality of the site.

Pedro Fagundes:

Okay, just on the coaching, is this just specifically for your platform, or do you provide any kind of guidance with regards to product offering or any consulting service in that regard?

Emmanuel Grenier:

So far, this is only about the platform.

Pedro Fagundes:

Okay, that's clear. Thank you very much.

Operator:

Thank you. Ladies and gentlemen, one final time, if you would like to ask a question, please push star, one on your telephone keypad now.

Emmanuel Grenier:

So just to sum up...

Operator:

Ladies and gentlemen, we have no further questions in queue at this time. I would like to turn the floor back over to Management for closing remarks.

Emmanuel Grenier:

Yes, Emmanuel speaking. Just to sum up very briefly, France is doing well and gross margin is expanding. We have gone through a major clean up at Cnova Brazil, and the 2015 20-F clears the way to create, and this is key, a win-win-win situation for Cnova, Via Varejo, and Cnova Brazil. Thank you very much.

Operator:

Thank you, ladies and gentlemen. This does conclude our teleconference for today. You may now disconnect your lines at this time. Thank you for your participation and have a wonderful day.