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Cnova

Half Year 2018 Financial Results Conference Call

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CORPORATE PARTICIPANTS

Emmanuel Wetzel, *Investor Relations*

Emmanuel Grenier, *Chief Executive Officer*

Amandine Lezy, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Cedric Lacasble, *Raymond James*

Fabienne Caron, *Kepler*

PRESENTATION

Operator:

Greetings, and welcome to the Cnova Half Year 2018 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 press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Emmanuel Wetzel, Investor Relations for Cnova. Thank you, sir. You may begin.

Emmanuel Wetzel:

Good day everyone and welcome to Cnova's full first half 2018 conference call. My name is Emmanuel Wetzel and I will be hosting today's call. Our CEO Emmanuel Grenier and CFO Amandine Lezy will be making today's presentation. The conference call slides can be downloaded from our website, cnova.com. This call is also being audio webcast and a replay will be available on our website about an hour after the conclusion of the call. Please take a moment to read the forward-looking disclaimer on the Slide 2, and with that, I now turn the call over to our CEO, Emmanuel Grenier.

Emmanuel Grenier:

Thank you, and good day to everybody. The first half of 2018 was marked by a number of notable achievements. First, strong development in our B2C offer; second, high growth of our marketplace; third, improvement of the customer experience; fourth, the enrichment of our Cdiscount à Volonté loyalty program; fifth, the acceleration of our multichannel strategy; and finally, the ramp up of our B2B revenues. All of that allowed Cnova to cement its position as one of France's top ecommerce players. Our volume of activity continues to grow at a double-digit pace and our financial performance is improving. Let's take a look at each one of these categories in more detail.

Slide 6. We reiterate our position as a leader committed to provide our customers with maximum choice at lowest price. Let me give you an example. At the end of April, Cdiscount initiated the French Days event, kind of like a Black Friday only seven months earlier. Customers could benefit from attractive deals on the main French websites over four days. This event enjoyed a strong success all over France, especially for Cdiscount, and will be repeated in the years to come.

Not only we do base our strategy on promotions, we are also committed to offer new services to our customers. For example, we recently introduced Cdiscount Voyages Travel Service. This has proven to be very popular among our customers with already more than one million visitors. More offers and promotions at unbeatable prices are the core of our business strategy.

Slide 7. Drawing on the success we enjoy with our customer base in France, we are expanding our reach to an additional 200 million potential clients via the delivery of 200,000 SKUs to Belgium, Germany, Italy and Spain. Increased revenues at no fixed costs is the main advantage of this new activity. This allows us to offer the same price across these countries. By the end of the year, all our products, including heavy items and marketplace SKUs, will be available in these countries. We expect this new revenue stream will further enhance our activity growth profile.

Eight. Our new B2C offers launched in the last months are doing well. First, Cdiscount Energie is the least expensive home energy offer on the market in France, and its subscriber base grew by close to 50% in the second quarter compared to Q1. Second, Cinstallé is another value-added service whereby we do not only deliver but also install the furniture or appliances that our customers buy from us. Thousands of them have profited from this service, one that nobody else offers at such scale in France. Third, Coup de pouce, our instant consumer loan offer that we launched last year, is a strong success. In less than five minutes, customers can obtain personal loans up to €2500 with next-day access to funds.

B2C drives our growing business volume and attracts a growing and loyal customer base.

The second pillar of our business is the marketplace and its growth is accelerating. GMV share was up 39 basis points in the first quarter; it increased in the second quarter with 123 basis points and it is accelerating even more at the beginning of Q3. Today, 36% of our GMV is represented by our Marketplace.

Our Marketplace product offering continues to grow. Our Marketplace vendors' improved quality of service has led to a significant decline in the claim rate, and our fulfillment by Cdiscount is now close to 20% of Marketplace GMV. The increase in the number of Marketplace SKUs, the high quality of customer service as well as the success of fulfillment by Cdiscount will all together support further Marketplace expansion.

Building customer loyalty is more than just providing more services. We have made significant investments in our mobile app and delivery capabilities. Our mobile app is one of the top-rated in Apple and Android stores. Mobile now accounts for 63% of our traffic and 42% of our GMV.

In terms of delivery, we are the undisputed market leader: same-day delivery now in the six largest French cities; real-time geolocation on our deliveries of heavy products, and what is more impressive, our Paris-based customers can now schedule their delivery within a 30-minute time slot.

Next slide. Customer loyalty for us is also about creating a bond with the client. We strengthen this bond via our social network leadership with more than 2.5 million fans; besides, a Sprinklr study ranked us number one in France and number three worldwide. We are also proud of our ability to create buzz and engage our followers. For example, we generated almost five million views with a viral video during the World Cup.

Our strategy is to be active on all social networks, and so after Facebook and Twitter, our focus is to develop our Instagram community. Creating buzz and being more than a leading ecommerce company keeps our customers coming back time and time again.

Next slide. At the heart of our marketing strategy is our customer loyalty program, Cdiscount à Volonté, or CDAV for short. Our CDAV subscriber base grew by 33%. They purchased three times more than our other customers. On top of free express delivery, they now benefit from several new advantages. First, special offers with our partners, such as a 5% discount at Casino banners when they use the Casino Max mobile payment app; second, unlimited access to over 200 online press titles. This all drives our business activity. CDAV members now account 34% of our GMV.

Our fifth strategic pillar is our multichannel strategy which we put into overdrive this year. We have established 21 showrooms in Géant hypermarkets in France at end June. These 400-square meter dedicated spaces showcase Cdiscount's Home and High-tech SKUs. Thanks to this initiative, we managed to reverse the negative in-store sales trend. For the showroom categories such as technical goods and furniture, the trend moved to strong double-digit growth. Based on this success, we decided to strongly accelerate and we are moving from 20 to almost 100 showrooms in Géant hypermarkets by the end of the year. This will have the dual benefit of reinforcing Cdiscount's market brand and further increasing revenues.

Finally, our last pillar. Monetization of our traffic offers high-margin revenues. We generated close to €30 million in revenues during the first half of this year, a 35% increase compared to the same period last year. What are the sources of these revenues?

First, advertising. Our agency has developed a data-driven model that has accelerated its performance. It has a unique ability to precisely target customer profiles thanks to its unique database of offline and online client behavior.

Second, Marketplace services. We have created a complete ecosystem of services for our vendors, including fulfillment, marketing and financial services. We market these services mostly as Premium Packs, a subscription model generating recurring revenues.

Third, consumer services such as Energy, Travel or extended warranties, which are profitable commission-based activities.

Fourth, B2C financial services that we have experienced great success with our client base.

Monetization revenues are expected to experience strong growth thanks to the full-year impact of recent initiatives and the launch of new offerings.

That concludes the overview of our first half business activity. I would now like to turn the floor over to Amandine Lezy, our CFO, who will go over the financial improvements that we have achieved.

Amandine Lezy:

Thank you, Emmanuel, and good afternoon to everyone. If we turn to Slide 21, we can see that our key indicators are very well oriented. Traffic and the number of active customers are growing, and as Emmanuel stated earlier, our CDAV membership is up by a third.

If we drill down into the composition of GMV, we can see that Mobile now accounts for 42% of the total, while CDAV and the marketplace have increased their share to 34% each.

On the next slide, we have a clear picture of the benefits of our commercial and client relationship strategies on our business volume and net sales. First half GMV was up 13.7% and this breaks down to 7.5% organic growth and 6.4% coming from the management of non-food sales at Géant initiated last year. We see the same pattern when looking at net sales, up 14.6% of which 9.0% is coming from multichannel. In addition, organic growth accelerated in Q2 vs Q1, both at GMV and net sales levels.

On the next slide, we see the increased diversification of GMV and how the multichannel agreement is contributing to overall GMV growth. In the future, Marketplace and Services, which are our main sources of profitable growth, are expected to become a larger share of GMV.

Turning now to gross margin, this has increased more than 100 basis points to 14.7% thanks to the higher Marketplace share, growth in monetization revenues, as well as optimization of our pricing strategy.

SG&A as a percentage of sales increased slightly compared to the same period last year but is down compared to the second half of 2017. The increase is mainly due to higher fixed logistic costs associated with last year's SKU expansion. As you know, our overall storage capacity is up 50% versus June 2017. Marketing costs were slightly higher, but these were offset by tight control of tech and content costs as well as streamlined G&A.

Now, turning to EBITDA, we can see that despite the higher SG&A, EBITDA increased by €6 million compared to the first half of 2017. In fact, the margin turned positive in the second quarter as EBITDA growth accelerated. Q2 EBITDA was €15 million higher than Q1 EBITDA and €10 million higher than Q2 last year.

The next slide is a summary P&L which more or less encapsulates what we have been discussing over the previous slides. Net profit is slightly lower than last year due to higher financial expenses, reflecting the increase in our installment payment solutions as well as slightly higher Other expenses.

Slide 28 details the impact of IFRS 15. This new standard on revenues came into force at the beginning of this year, and we decided to retroactively apply it to 2017 numbers in order to present comparable data. The main impact for us is that certain suppliers' contributions are now treated as a reduction in the value of inventory, whereas they used to be recognized in revenues.

Moving to the next slide. Our last 12 month free cash flow before financial expenses turned positive. This is mainly driven by a significant positive change in working capital. Free cash flow increased by close to €220 million compared to the last 12-month period ending June 2017, as you can see on the following slide. This increase took place despite higher cap ex versus previous periods. The improvement is even more impressive, close to €340 million, when comparing the first half of 2018 with the first half of 2017.

Net debt is up by €55 million over the last twelve months, a much better trend compared with previous periods. We expect the cash flow generation to keep improving in the second half of 2018.

Thank you, and now Emmanuel will go over the outlook for the remainder of the year.

Emmanuel Grenier:

Thank you, Amandine. We have two objectives for the second half of 2018. The first is to sustain growth thanks to three elements. One, the launch of additional services and expansion of product offerings; two, the increased number of Géant showrooms in hypermarkets; and finally, development of international sales.

Our second objective is to develop the sources of profitable growth. We intend to keep growing the marketplace share of GMV; we are encouraged by its strong performance since the beginning of July, and our monetization revenues are also expected to further increase.

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. We will now be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment, please, while we poll for questions.

Thank you. Our first question comes from the line of Cedric Lecasble with Raymond James. Please proceed with your question.

Cedric Lecasble (Raymond James):

Yes, good afternoon. Thank you for taking my questions. I have two, actually; the first one on your fulfillment by Cdiscount capabilities. Could you maybe tell us what are the main implications on your KPIs, profitability and CAPEX? Where do you see the share fulfilled by Cdiscount in the midterm? What is the limitations for this and how much do you charge your partners? Do you have a markup for this kind of service vis a vis your partners? That's the first question.

The second one is on the monetization of your data. What are your midterm targets? What split can we expect between advertising revenues and data sharing with your partners? Thank you.

Emmanuel Grenier:

Okay, maybe we start with the fulfillment. We are offering fulfillment services to our Marketplace vendors, it means that we offer them to store and ship their products to the customer. As long as the products are stored in our DC the products, the SKUs belonging to us are eligible to Cidscount à Volonté program and it is available to be delivered next day for free. It's objective is to rise up the share of this products and it is why the Marketplace vendors are liking that. For us this is always awesome because it enables us to increase the number of SKUs we can deliver to the customer for the next day, and it is a key advantage to a lot of competitors.

Now, we are managing this fulfillment by Cdiscount in our dedicated DC. There isn't a big impact on CAPEX. Why? Because we are at the same time innovating new mechanization called Exotec. This is a new company building robots which allows us to multiply by four the number of SKUs put in one square meter, and multiply by five the productivity, picking productivity.

So, we can accelerate the fulfillment and we can accelerate our own offer stored in our DCs because we are at the same time investing and developing this solution.

In terms of prices, when a Marketplace vendor is selling on Cdiscount, first you have to take off commission if he's selling the product. If he decides to go to fulfillment, he will have to pay a special fee separated from the commission. This is a logistics fee calculated on how long the product is stored in the DC and the picking cost. This is like a logistic 3PL grid which is apply to the vendors, and this is it. This rule of pricing is available on our site. This is mainly according to the weight and the size of the product.

The last thing is that the share in the medium-term, today we are at 20%, the share would be 30% of the Marketplace.

Amandine Lezy:

I will catch your question, your second question on monetization revenues. We do not have specific target as Emmanuel said during the presentation. We expect the revenues to keep growing very strongly. As of today our advertising agency which is a long-established business accounts for the bulk of monetization revenues, but we expect Marketplace services and consumer services that were launched last year or this year to progressively account for a larger part of monetization revenues.

Cedric Lecasble:

Thank you.

Operator:

A quick reminder, if you would like to ask a question, press star, one on your telephone keypad. Our next question comes from the line of Fabienne Caron with Kepler. Please proceed with your question.

Fabienne Caron (Kepler):

Yes, good afternoon. Three questions from me. To come back on the monetization revenues of €29 million in H1, can you tell us what the EBIT contribution of this number? To continue on numbers, I'm looking more at EBIT than EBITDA given the CAPEX that you put behind Cnova, and I'm wondering if you had some guidance regarding where should we expect EBIT for the full year for Cnova, and where do you expect free cash flow on a 12-month basis at the end of the year post financial interest. Thank you.

Amandine Lezy:

Thank you, Fabienne. I will answer your question. Regarding the monetization, we do not disclose the EBIT contribution of these revenues, but what we can tell you is that the leakage between revenues and EBIT contribution is limited.

Fabienne Kepler:

Okay.

Amandine Lezy:

For the full-year EBIT, our target is to reach breakeven at the EBIT level on the full-year basis, and we also reiterate our guidance to reach free cash flow—to reach breakeven for free cash flow on the full-year basis as well.

Fabienne Caron:

Is it post or before or after financial interest? Your breakeven for free cash flow.

Amandine Lezy:

The guidance has been given before financial interest. So, if this is to be compared with if we reach breakeven that will mean €330 million plus improvement versus last year.

Fabienne Caron:

Okay. A follow-up question, just for Emmanuel. Did you see a change in your product mix over the period or was it stable over time?

Emmanuel Grenier:

It depends on which period of time we're speaking about. 10 years ago we were at 80% of technical goods. We are not anymore at 80% of technical goods. If we look at the very large view of the business, we were at 100%, or 99% B2C and 80% technical goods besides with very low margin. There are two moves in the last year: the growth of the Marketplace and if you remember the slides that Amandine has showed you. I'm looking at the figures. The direct sales are representing 57%, it was 61% one year ago, and it was 100% ten years ago. So this is first main change in mix but we know that marketplace and services are high-margin revenue, this is important.

And if you dig in direct sales, obviously, we are less and less dependent on technical goods, so our target, that has been our target for several years now, is to ramp up household and furniture.

Fabienne Caron:

Can you remind us what the weight of technical goods today? In % of sales?

Emmanuel Grenier:

We don't disclose that information and we don't give information about that, but the trend is the one I explained.

Fabienne Caron:

Okay. Okay, thanks Emmanuel.

Operator:

Thank you. We have reached the end of the question-and-answer session. I would now like to turn the floor back over to Management for closing comments.

Amandine Lezy:

We thank you all for your attention and wish you all a good afternoon.

Emmanuel Grenier:

Thank you very much.

Operator:

Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.