

Y 2020 Earnings Call

Company Participants

- Andre Fatale, Chief Technology Officer
- Frederico Trajano Inacio Rodrigues, President and Chief Executive Officer
- Roberto Bellissimo Rodrigues, Chief Financial Officer and Investor Relations Officer

Other Participants

- Danniela Eiger, Analyst
- Guilherme Assis, Analyst
- Gustavo Oliveira, Analyst
- Irma Sgarz, Analyst
- Joseph Giordano, Analyst
- Luiz Guanais, Analyst
- Ravi Jain, Analyst
- Richard Cathcart, Analyst
- Robert Ford, Analyst
- Ruben Couto, Analyst
- Thiago Macruz, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Magazine Luiza's Video Conference referring to the Fourth Quarter of 2020 Results. We would like to inform you that this event is being recorded and simultaneously translated. All participants will be in listen-only mode during the conference and during the company presentation. Afterwards, we will have a Q&A session and questions should be asked by telephone. Questions received via webcast will be answered afterwards by the Investor Relations team.

Now, we would like to turn the floor over to Mr Frederico Trajano, CEO of Magazine Luiza. Mr Trajano, you may start.

Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Good morning, everybody. Thank you for participating in our results video conference.

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This is my 20th as the CEO of the company. This is a very special call. Given the fact that we had a very non-typical year 2020, as we said before, the message of the Executive Committee was that we live many years in one last year. And of course, we are keenly aware of the situation of Brazil as a Brazilian, as a citizen, I'm very sad about everything that happened in Brazil and in the world. But ultimately, from the viewpoint of the company, our team was able to overcome all the hurdles that existed in this period, then we had a very fast reaction.

We were very agile, and we worked with human warmth and with all the care with our 40,000 people with millions of clients and thousands of suppliers and thousands of sellers as well. And this is an epic event and ending with extraordinary result. And during this call -- during all this COVID crisis, we had longer calls, as the message from the Executive Committee was a longer message. And during this call, I would like to take the opportunity to talk about two subjects.

The first point. In relation to 2020, I would like to mention that it was not by accident 2020 was another good result and a sequence of excellent results that Magalu has been delivering. And of course, the pandemic accelerated the digitization of Brazil and it worked as a catalyst, but the process was already happening historically. So in the fourth quarter, we grew 66% over a growth of 50% in the previous quarter and 35% in the previous one and 31% in the previous one.

So, we have been delivering consistent results and our results last year were not by accident. If you compare Magalu to the other companies in the market, the other players, mainly online players, we grew 325% since 2018. We grew significantly in 2020 and during '18 to '20, we gained over 13 percentage points of market share. And if we look at that in relation to my first four quarters as the CEO, which was in 2016, Magalu increased ten-fold the GMV, BRL900 million to BRL9 billion. So, this is a very consistent work being done in these five years and even more we grew 10 times, twice the second ranking among the major players. So this growth is consistent year-on-year and the base of e-commerce, specifically in the last quarter grew quite a lot in relation to the previous quarter, which was one of the best results of the company. But I believe that more important than that was the fact that we defined growth based on sustainability.

If you look at our historical base since 2016, you can see BRL2 billion in accrued net income. The only company in e-commerce that had consistent results all year, every single year, BRL3 billion cash, BRL2 billion in the last quarter vis-a-vis BRL1.5 billion in 2019, BRL1 billion before. So, we generate cash and we deliver consistent results every single year because of the superior business model and the focus on a very efficient execution, so that you may grow your sales exponentially, not to the decrement of your growth and your profit generation. Of course, we have a trade-off in margin, but very far from representing any losses ultimately or cash consumption or cash burn. So, we do a very consistent project.

In relation to sales, we've reached almost BRL44 billion in sales last year, in spite of the fact that many of our stores were closed in comparison to the previous year to March last year. From March to August, we operated with sometimes at 100% stores closed and we grew 60% year-on-year and 66% in the quarter. So, we were able to deliver a fantastic

extraordinary year in spite of going through one of the most difficult situations I have ever faced, which was the closing of 100% of our stores on March 2020.

And in fact, this is driven by our online operation, which already represent two-thirds of our business. We grew 120% in the last quarter. And over a base for comparison -- and I really wanted to show you 93% in 2019. So, we grew 120% over 93%. So everybody, as we saw, what about '21? Because you had such an accelerated growth in e-commerce. We grew 120% online, over one of the best quarters ever in our history, which was 92% in the fourth quarter of '19, 7 percentage points of market share being gained and another quarter in e-commerce that grew the most in Brazil.

We are consistent with sustainability, which is our focus. And if I show you here 1P and 3P, we grew 120% in 1P, extraordinary. The growth of 1P was higher than we could possibly imagine. When we started the year and we expected an exponential growth in 3P but not 1P. And in 1P, we are reaping the benefits of our superior logistics, our multi-channel operation, and half of what we sell go to the stores and store pickup or ship from store. So, our operation is really the best.

It's very difficult for anybody to have the same level of service, the NPS that we have and the short lead times. So, we are gaining a lot of market share, even in the B operation, which is growing more than we expected. But not only in 1P, we setup our marketplace four years ago and we had a spectacular year. Evolution of sales, 120%, the biggest in the market. It had already been like that in the second and the third quarters.

And we launched, we made an extraordinary launch last year, the first platform to help the offline vendors to sell online. We launched the Parceiro Magalu, Magalu Partner, one week after the closing of commerce in Brazil at the end of March last year. We went from 15,000 sellers to 47,000 sellers and many of these sellers were saved literally by the Parceiro Magalu platform that we rolled out to the whole country.

So in a few hours, they uploaded their catalogs and they issued their invoices online, everything online and they got their authorization. The end-to-end platform developed -- and the Luiza Lab that saved many companies. And what I'm the most proud in 2020 was the fact that we are having this digital inclusion being rolled out. We went from BRL13 million to BRL26 million offers. And today, it's almost impossible to look for a product in our app and not find it. And you will see that we have already achieved to extend our assortment base and the number of categories that we offer.

And one thing that makes me very proud in the process was -- is the fact that our sales did not grow to the detriment of physical stores. We continue to have a very strong growth base from our physical stores. We grew last year 10% same-store sales in the last quarter, 11%, the biggest growth that we had during this period. And in spite of the reduction of the corona voucher from BRL600 to BRL300, we got this increase. And I would like to mention in relation to this growth of the fourth quarter, specifically, that we were not able to have the Black Friday in our physical stores. So it was in spite of that a very positive year.

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Okay. Let's continue the growth in physical stores is extraordinary. And I would like to highlight that it was not to the detriment of stores. And we had record online growth, as I said, 120%, and we grew in the total of the company, 66% in the quarter. And the NPS is an all-time high for the company, 75 in November, the Black Friday month and an extraordinary figure. And this shows that all our investment in service level are already having a return and keeping a high level of service in spite of all the problems that we faced. Having all this growth is a heroic achievement on the part of our team.

And I would like to talk about the categories now. We had a very big highlight here for the non-core category of the company. So as you can see; sport, 166%; fashion, 436%; beauty, 293%; market, 300%, the big highlight of the company and book, 276%; smartphones, 149% growth. So you can see significant growth in all the category in a year in which we wanted to show this diversity and we delivered exceptional outstanding results. And I would like to mention our SuperApp. We have been working very hard on this strategy. 76% of our online sales came from mobile, 33 million MAU through our app in the last period. So, you can see consistent growth. And we also launched, and I will be talking about that MagaluPay in the SuperApp, fully integrated to the SuperApp. And we are the only digital wallet that is not separated from the SuperApp into last year. We had 2,700,000 accounts opened. So it's really incredible, and I will be talking later about this opportunity. But having the SuperApp at the core of all our ecosystem makes a huge difference and still talking about -- I talked about 1P, I talked about service level.

And let's talk about the logistics, Logbee. We have the fastest logistic in Brazil. 45% of all the products we delivered in one day, and this number was 5% in 2019, from 5% to 45% of all the products delivered in one day. It's a fantastic job. And we acquired Logbee some years ago. It was a start-up. And today, it represents almost all our deliveries in 1P. And when we look at the reason behind this growth of fast delivery, it's because we use the store differently from the monoline competitors that have one single channel.

We have all the power of the stores and half of everything that we sell goes through a store or either store pickup or ship from store. And the store is a central part of our platform, our sales platform, our digital system. And this helps us to have very fast deliveries, over 1,200 points scattered through cities in Brazil. And the objective this year - - and later, I will go into detail, but this is the year of logistics. Everything that we did to have this very high level of service for 1P, transporting this to 3P.

So the focus of Magalu this year, such as was the case last year with 1P, the focus is 3P. We want to invest in logistic and reduce even more the lead time from 24 hours to a few hours and increasing the 3P. And we have already started, of course, to put in place, all these initiatives in 2020. 32% of all the orders from sellers already over BRL10 billion GMV, already used 1,400 -- already use cross-docking when we collect the product and it goes through our network. And 324 stores are already enabled for the client to buy from the seller and pickup from store. And this is a significant evident of our superior logistics and what we do for the sellers. And we made two acquisitions this year, GFL and SincLog, because we wanted to drive this. And we should be extending and increase our investments in this area as well.

Now, I would like to give the floor to Beto, so that he may talk about the financial results of the fourth quarter. And I will be coming back to talk about the future.

Roberto Bellissimo Rodrigues {BIO 17269312 <GO>}

Good morning, everybody. Thank you very much for participating in our video conference.

I would like to start by our financial highlights. We have already talked about the very strong growth in sales, 66% of total sales growth over 120% in e-commerce, 16% in physical stores. In the quarter, we reached almost BRL15 billion in sales, total sales and a cash generation of BRL2 billion -- BRL2.1 billion in operating cash flow. And then adjusted net income of BRL232 million and 2.3% margin in the quarter and growing in this quarter 40% in relation to the same quarter last year, or year-on-year growth. So it was a great growth in all the parameters.

When we look at the year as a whole, we grew 60%, e-commerce over 130% in the year as a whole, physical stores growing in spite of so many stores closed for a long time. And we've reached BRL43.5 billion in sales with over BRL3 billion in cash generation and the adjusted net income of BRL378 million, a very robust one, especially, if you consider the first quarter where most of the stores were closed.

And now I will explain the evolution of our EBITDA margin as a whole. Our EBITDA margin went from 7.8% to 5.2%. And we -- the gross margin going down 3.9% because of the very fast growth of our e-commerce. So, we always explain that. In e-commerce, our gross margin is lower than in the physical stores, but due to the model multi-channel fully integrated, we offset most of this difference, most of this gap in the level of operating expenses, logistics, marketing, and all the expenses are diluted with the e-commerce. And I would like to remind you that last year our e-commerce went from 45% of total sales to 65%, 20 points increase. And today, practically represent two-thirds of all sales of the company. So, this has an impact on the gross margin, but we offset this in our operating expenses. And we have -- in this quarter, we had the level of operating expenses that was the lowest ever and the lowest in the market.

SG&A lower than 20% in this quarter and it was 19.7% to be precise, much lower than the market average. And also, administrative expenses lower than 3 percentage points in a very efficient level.

Now let's go to the -- one detail and the reason why we didn't have an additional dilution of operating expenses because as we have been repeating very often, we increased our investment in service level and faster deliveries and in service in general. So, we improved our operation and we showed our NPS at the highest ever level in our history, so an all-time high.

So, all these investments that we're making are helping us grow and go to the next level in sales. And in spite of that maintaining our net income with 5% of EBITDA margin, for instance, in the quarter, we diluted our financial expenses and we had a net income that was 40% higher year-on-year.

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On the next slide, we talk about our capital structure. And I would like to mention that the financial expenses went from 2.9% to 1.2% of our net revenue. And coming from not only the drop of the CDI, but the strong cash generation of the company, and we show the evolution of the working capital that has improved over the year. And in the last quarter, inventory turnover 70 days, improving inventory turnover 90 days purchase time. And the difference from 70 days to 90 days allows us to generate cash and grow by generating cash. And other accounts in the working capital were very positive. Accounts receivable, recoverable taxes and other assets and liabilities, short and long-term, so a very efficient management of our working capital. And with that, we show that our adjusted net cash increased by BRL1 billion, going to BRL7.3 billion adjusted net cash.

On the next slide, we show the total cash that went from BRL7 billion to BRL9 billion, and we closed the quarter with the best ever cash position in our history, an all-time high, starting with an operating cash flow of BRL3 billion. We made BRL600 million in investments and we paid interest and leasing, and we had share buyback and we paid dividend. We raised BRL1 billion at the beginning of the pandemic, and we increased our total cash by BRL1.8 billion, BRL1.9 billion. So, this is the breakdown of our cash flow.

And on the next slide, we talk about Luizacred. During the last call, we said that we recovered our growth and we were selling more cards every year. The base of Luiza Card grew, reaching 5.3 million cards at the end of the year. Billings growing, reaching BRL9 billion in the quarter and BRL29 billion in the year, growing inside and outside by value.

And lastly, the result of Luizacred, which was spectacular over the quarters. We talked about the level of collection and receiving and the indicators of past dues dropped to the lowest levels in our history, dropping here from 2.4% to 1.4%, 8.2% to 6.5% and the coverage ratio increasing at the same time. So, you can see that the portfolio performance reached over BRL12 billion and this is outstanding, exceptional really. And the net income of Luizacred grew over 50% in the quarter, reaching BRL53 million in the quarter and over BRL200 million in the year. One of the best results ever for Luizacred. So, these were the best results.

Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Thank you very much, Beto.

When we prepared the material, the message from the Executive Committee, I think it was very important to really highlight the opportunities that we had. I saw the market only looking at 2021, and very much concerned with the consequences for the e-commerce companies in the post-pandemic world. And I would like to make something very clear. I know that is very obvious, but I think we should emphasize this.

The pandemic accelerated and was a catalyst in the digitization of the Brazilian companies. And when we -- but on the other hand when we compare the Brazilian market to any other economy in the world in terms of digital maturity, even the post-pandemic world, we are at a very low level. So, I would like to highlight the market that we are

addressing in, also Magalu, in spite of the fact that the cash position is excellent, BRL7.3 billion, much better than we were at the beginning of last year, the pre-pandemic world.

Although, we are very strong there, we made 11 acquisitions during this period. And the 11 acquisitions are for a strategic purpose. We want to set up a strategic world and a platform, but to address certain markets. So, I would like to make it very clear that everything that we do, we do based on our strategy. Of course, I'm not going to talk about our strategy in detail, but I would like to emphasize the markets that we are addressing. And we want to be the operating system of the Brazilian retail.

In terms of opportunities in the Brazilian retail, the opportunity of BRL1.200 trillion. It's gigantic. It's one of the biggest retail markets in the world. And even in post-pandemic world, only 10% of that is online. So a little bit of more than BRL100 billion online. So, this means that there is a gigantic opportunity to grow participation. So if we apply the penetration of China to Brazil, the market if -- even if it doesn't grow anything.

And the previous slide, please. Even if it doesn't grow at all, it will go to BRL300 billion. So if we apply the potential of China to Brazil, this is the number. And even if retail does not grow, only with digital maturity and more people buying online, the potential of the market is BRL300 billion. So, you can see that we only have a very small fraction of this business and we see a major opportunity, which categories have bigger opportunity. And the main one -- one of the main ones is the market categories, then food, hygiene, cleaning, products. And if you take half of the Brazilian retail, they sell food, beverages, hygiene and cleaning products and penetration in Brazil is 1% only, even after the pandemic. So the penetration is very low. It's not a very well penetrated market in the whole world. There is a small penetration because of logistics and cost of freight, et cetera, but any creative team, intelligent team in any multi-channel operation could solve.

There is nothing, whatsoever, that human beings are not able to solve. If you take the China penetration and you put it to Brazil, in Brazil, it's a BRL64 billion potential in Brazil. So, I see a major opportunity here. Magalu started organically in this market last year, and we had the launch of the category to help the consumer that didn't want to leave home. And today, we already have the same policy of all the categories if you take the GMV of 1P that we launched in the third quarter and you annualize it, run rate, you reach BRL1 billion.

So a little bit less than one year. We already have a very relevant operation. If you take the BRL1 billion over BRL64 billion, you can see that it is still too little. So the opportunity is huge. Of course, our view is platform. It is growing, not only 1P, but 3P as well. And for that, we made a super strategic acquisition last week. We acquired VipCommerce, which is a technology company that help supermarket owners online. And today, the companies that operate online, they don't have many supermarket clients. And one of the major players in the market, although very incipient is VipCommerce itself. It is one of the only players with a 100 market change and BRL450 million GMV annually and we are going to make this grow. And besides growing 1P in the dark store format that we launched, we are going to grow in 3P as well. And another major market that we have is the beauty market, the fashion market, BRL223 billion.

(Technical Difficulty)

So let us resume now. Is everything alright? Okay. Another important market once again. We apologize for this connection problem. So the other market is the fashion market, addressing BRL220 billion in Brazil, a very low penetration around 5%. If we apply the same penetration process considering markets, for instance like China and Brazil, the total addressable market is BRL67 billion.

Magalu has already been in the market. We had Zattini, Epoca as acquisitions in the past and also HubSales, which digitizes fashion hubs. Actually, we have a huge opportunity. We only have BRL5 billion of the total potential market. So, we still have a lot of room to grow and tap into this market.

On the next slide, we can see another opportunity. This time in the food delivery market, approximately BRL200 billion GMV on an annual basis in the market. Penetration rate -- a potential penetration rate of BRL24 billion using the same rationale, consider a percentage of a developed country and applying to Brazil.

Developed in terms of digital maturity, it's the total addressable market of BRL24 billion. We acquired AiQFome last year. And this operation already has BRL1 billion as GMV with 20,000 restaurants in 44 cities. So it's a huge opportunity. AiQFome, the focus this year is integration with the company's SuperApp. It's growing on its own right now with an independent app. And now connected to the system, we believe there'll be a greater potential for growth.

What about retail or tech MaaS services for seller? We have a huge opportunity ahead. 5,700,000 retailers in Brazil, only 47,000 are in our base. Around 100,000 selling online. So it's a huge opportunity for growth in this context as well. And as for restaurants, 1,600,000 restaurants, our estimate tells that only 300,000 restaurants today use delivery apps. And we only have 20,000 of the market. So it's a huge opportunity to digitize these companies and doing the same as we did in Magalu this time for third-parties.

Now, we also have a huge potential when it comes to financial products. By far, we have the greatest opportunity in terms of market size and also opportunity to be profitable and to monetize our sales, our GMV. Everything we do is either inside the ecosystem and payment is very much related to the surrounding areas of retail as well. If you think about, everything about debit and credit cards in Brazil, we are talking about BRL2 trillion. And although we have one of the greatest credit card portfolios in Brazil, we launched an account, a digital account last year, and we only have BRL41 billion of the total market.

So last year we acquired Hub Fintech at the end of the year to tap into these processes and boost this service we already had, MagaluPay, Magalu Pagamentos and Luizacred. Just to give an idea what Hub can bring and deliver, I would like to break down the opportunities now. MagaluPay is the digital account for the end client. We have a digital account in charge of all the digital account operations and it's embedded into the app, 2,700,000 points. And we also have Magalu Payments, Pagamentos, focused on sellers,

47,000 sellers. And it is a sub-acquiring with speed of payments, receivables prepayment with \$7 billion TPV. So what does Hub have to add to these digital ecosystem?

First of all, it's a payment institution integrated to SPB with a license for PIX. So, it adds value to bring something to our digital account; cashback, offline, online payment of consumption. So it adds a number of functions. TED, DOC, prepaid card, payment, banks slips and also, including, lottery stores and recharge transportation added to accounts we already have and also payroll services, which can also be good to our sellers; MagaluPay Magalu Pagamentos, tax payment, expense management, food voucher and even a license for acquisition. So it's a very strategic acquisition. This company has million of cards processed and seven billing as well with a very strategic acquisition.

So just to close before we move into our ecosystem and opening for questions. We also have a huge potential to monetize and have our profitable GMV with the digital media. So the total media market in Brazil drives BRL48 billion, potential to be a BRL34 billion digitally, considering digital media. And we only have BRL19 million last year with ads. So, we acquired two strategical companies to address the market. Canaltech, with more than BRL20 million [ph] hits and expanding our assets, also helping us with e-commerce. And we brought Inloco Media, one of the unique platforms in Brazil with media service, a great player in the segment in order to launch Magalu Ads, which will be powered by Inloco Media with the technology and the team will make available a very user-friendly to our sellers so they can perform their sales and have digital operations.

So, we believe these are huge addressable markets, potential growth. It will all depend on our execution ability. But like I said, we have a very strong track record with execution. So, I'm very confident that we'll be a relevant player. Not necessarily, we are going to be leader in all markets. That's not the idea. The idea is to be a relevant player in all these markets. And why not leader in some of them?

But maybe we can start with the model we choose, which is the most common in China, being a digital ecosystem. There is a lot of synergies here. For instance, AiQFome, on its own would never have the same capacity to grow compared to Magalu ecosystem. And the same goes for HubSales, Canaltech. They already benefited from relationships with our suppliers. So, that's a systemic concept, an ecosystem, an integrated digital platform.

The go and the mission is to go digital in Brazil and particularly in retail and naturally bring fruit to our shareholders via monetization in these opportunities. So, that's what I wanted to say. I just wanted to show the highlights of the business. And now I would like to open for the Q&A session. By the way, we have all the Executive Management here available to take your questions. And we're here for you.

Questions And Answers

Operator

Thank you. Ladies and gentlemen, we are beginning now the question-and-answer session. (Operator Instructions) Our first question comes from Mr. Joseph Giordano with

J.P.Morgan.

Q - Joseph Giordano {BIO 17751061 <GO>}

Hello. Good morning, everyone. First of all, congratulations on the earnings. Fred, you gave a lot of detail on the ecosystem strategy of the company involving several growth fronts, which are very robust. And we believe the company in the future will be standing out. But what about the platform? The company today has a lot of M&As in the platform, in order to strengthen some capabilities. If you look at your current ecosystem, where do you think you should dedicate and allocate more capital to speed up the process? And I'd like to have a better understanding of the next steps within FinTech and its integration with Magalu as a service and the connection, particularly with small retailers that are essentially digital today. Thank you.

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Joseph, first of all, thank you for your question. Well, I believe our strategy is multi-dimension. Actually, it's hard for you to -- well, we don't have a silver bullet in terms of where to invest. We want to diversify our options, our opportunities. Sometimes, you dilute risk by having several opportunities. So all the addressable markets that I mentioned will be our focus. We want to increase digitization in Brazilian retail based on the opportunities I mentioned. I'm not saying that we don't have opportunities in core categories, but big opportunities are under-penetrated. And we believe we can be a key player in the delivery of food, for instance.

So, this opportunity both in FinTech and also in ads, that's a big opportunity and we have to invest on this. And also become relevant in these categories. We had to move in Hub, and I will tell you more about it later on. But naturally, the development of systems and more money in Luizalabs in developing more people and we have outstanding IT programs to have more opportunities.

Now more specifically about penetration in new categories and digitization in Brazilian retail, there is a means for that. And one of the possibilities is logistics. We described in our earnings release, as you mentioned, that we expect to invest heavily in logistics. This is a logistics year. So, we improved capillarity with new stores, new DCs, new cross-docking operations, increase in frequency of supply and new technologies.

Anyway, we expect to keep on significantly investing in logistics in order to work more in lower tickets, high-frequency categories. It's a competitive edge. So transfer from 3P, what we already have in 1P. More specifically about FinTechs, opportunities are endless. Now our focus is on trying to have the approval by CADE and the Central Bank to absorb the Hub and managed to implement all the functions I mentioned before, both for MagaluPay and Magalu Pagamentos. Fátima, Robson, they are also here to take your questions about FinTech. We are working on that. And we are just launching in March, PIX in the account.

We managed to have the approval indirectly to operate PIX in the month of March in our account. And we will accept PIX on our sales checkout as well, starting with e-commerce

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and also brick and mortars later on. We believe PIX is going to bring bank slips to an end, and it will be a very key tool in order to grow the digital accounts and bring in at the same level the new accounts with established operations. And we also launched a card. Remember, we have five million credit cards today, one of the best credit card portfolios in Brazil, much higher than fintechs in the market, about BRL12 billion of credit card portfolio and our Luiza Card. But this is not so relevant on the web. It was launched for brick and mortars. We expect to launch in April, the credit card, Magalu Card, fully integrated with the app purchase experience and also integrated to the purchase. No annual fee. And I think it will expand a lot. We already have 160,000 cards for month. And with Luiza Card, we expect to see a higher relevance.

Beto, Robson, would you like to make comments on Fintech and elaborate on that? Roberto, would you mind opening your camera, please? We cannot hear you. Why don't we take the next question and then we go back to Roberto?

Operator

The next question is from Robert Ford with Bank of America. Please go ahead, sir.

Q - Robert Ford {BIO 1499021 <GO>}

Thank you. Congratulations on the earnings, and thank you for taking my question.

Fred, what are your thoughts about this long-term balance between 1P and 3P? And what about pain points for 3P this year? What about the response on demand?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Bob, I've been talking a lot about this. First of all, thank you for your question. Good morning. We talked a lot about the focus on 3P and marketplace, and the operating system of the Brazilian retail, trying to help retail to go digital. In the last cycle, we increased on our own. And now we want to grow by supporting the others and being supported by them, being basically an enabler of retail in Brazil. So in the long term, the big opportunity undoubtedly lies on 3P.

1P is really surprising us during the pandemic. Actually, they are the greatest sellers, those who have a structured 1P operation that have the ability and high inventories to deliver. But once we go back to normal, the future of retail will necessarily go through 3P. It happened worldwide. Amazon, for instance, boomed after it started 3P. The same happened to China. So the future, necessarily for big digital platforms, will come from 3P. As for the balance, I really like to work in an integrated manner.

So first point, why is it we still want to have a strong 1P? In my opinion, 3P -- our 3P is somebody else's 1P. So, 1P supports you to work on logistics operations and support you in several aspects in terms of understanding the economics of the categories to deliver services. So if I want to deliver services to a seller -- well, many 3P started with 1P, and they learned from us to create interesting platforms and services to sellers.

I believe 3P's economics -- well, naturally, we cannot destroy this economics. So, I can see many operations exaggerating their input to 3P in terms of take rate, free shipping. We grew at 1P. Well, we became leaders of 1P in Brazil without concessions, with a sustainable operation. And for many years, we had very irrational competition. So when I started e-commerce at Magalu, everybody was losing money. Most 1P lose money in Brazil up today. But we never put aside sustainability and a long-term view. We want to do the same for 3P. We want to have a rational structure, a sustainable structure for the future.

A secret for that, Bob, lies in multi-channel. One of the changes we made last year -- and by the way, in the organizational structure is the following. What supported our 1P? What helped it to be unique? It was brick and mortars. Like I said, 50% of what happens -- or the volume in 1P goes through brick and mortars.

And I'd like to make brick and mortars relevant to 3P as well. But we also have hunt and farming. So benefiting from the synergy of multi-channel is one of the doors to have a sustainable 3P in the future. Naturally, it will take a huge additional capacity, but we intend to keep on opening stores. What I meant by logistics investments also includes investments in more physical point-of-sale, a geographical performance. And that's also important to sustain 3P. So having -- this is one of our strategies to have a sustainable 3P in the long run.

Q - Robert Ford {BIO 1499021 <GO>}

Thank you, Fred. And like you said, if you think about this huge supermarket, but nobody cracked the code. What is different from the way you want to do with e-commerce?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Well, I believe, first of all, in terms of VipCommerce, Bob, we have 1P operations. And our 1P operation increased a lot without a huge impact on our bottom line. We even increased our net profit. Last quarter, we had an annual GMV that was very interesting with no impact on net profit. So it's breakeven in our business, which is difficult worldwide. And we increased this category, basically, with the ex-door [ph] model. So we have 1,300 stores, and last mile with a low-cost. So when it comes to 1P, that's a sustainable manner. And obviously, in order to have a huge impact on the market, we have the support from the five million retailers, mostly they are grocery merchants. So 50% of them sell food and this type of product.

So, I need to bring this inventory to our platform. And one of the possibilities is by acquiring a company that is an expert on this. Vip today works with small and big retailers, but they also can help smaller ones. Just as we did at Magalu with other categories, supporting online and platform operations in our SuperApp, where these products will be available from these partners. The consumer buys locally. They can check the filters, geolocation, buying local products. And then the last mile is shorter. So this is very important, this inventory distribution, I mean, having the inventory close to consumers. And that's why we need to bring the higher number of local sellers into our platform, and VipCommerce is going to help us tremendously.

As for categories, the grocery category is not going to improve our profit that much, but it's very strategic because it will improve our frequency. So a digital platform, if you consider why all retailers in the world are investing in groceries, they're doing that because it brings frequency. In China, from 0 to 600 million customers basically owing to grocery categories. So, this kind of product is absolutely key for those who want to run a recurring customer base. You cannot be a dominant digital player if you only have high-ticket categories. So, there are other strategic components, and not only generating margin to the company.

Q - Robert Ford {BIO 1499021 <GO>}

Very clear, Fred. Thank you.

Operator

The next question is from Luiz Guanais with BTG.

Q - Luiz Guanais

Good afternoon, everyone. Thank you, Fred. I have two questions. And adding to what you said before about diversification. On the one hand, the average ticket goes down owing to the new categories or at least the majority of them. There are two impacts, engagement and frequency. So, can you tell us more about what you expect to see in these indicators in years to come?

And the second question about multi-channel. Could you tell us more about the role of brick and mortars now in 3P? I think you have been evolving in the latest quarters, moving in that direction, a natural evolution from -- ship from store rolled out last year. So, could you tell us more about it, Fred, please?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Luiz, thank you for the question. With regards to the average ticket and frequency, naturally, like I said before, about addressable markets, in the long run, the trend in Brazilian e-commerce is to grow in lower ticket categories. It happened in all markets, started with electronics, home appliances or media products, like books, for instance, or music, and even turning to streaming. And it also added to lower ticket categories. So that's the digital maturity level of market. So the trend in the future, if you want to grow online, you have to grow in lower ticket categories.

The thing is, is that in the short term, Luiz, owing to the pandemic, and people are staying home are often, are not traveling that much. They're investing more in what they do at home. So durables, for instance, traditional categories, they had an outstanding year last year. And they keep on delivering very well this year because lockdown measures continue, and they're expected to continue for a while, at least in the first half of the year, maybe until the year end, depending on how the pandemic evolves. So in the short term, we don't expect to see major changes. And not because the smaller categories or lower ticket categories are not growing. As you can see, they're even growing more. But because other traditional categories are also growing at very high rates, 150% for mobile

phones, for instance. And they have a high share in GMV. So, I believe this will happen later on.

And what was the second question, Luiz?

Q - Luiz Guanais

It was about multi-channel. Now for 3P with brick-and-mortar spread, you are evolving in recent months. So could you tell us more about how we imagine to see this evolution going forward?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Well, I don't want to share too many things because that's a strategy for us. But conceptually speaking, like I said before, the store is very important for 1P. And it was the decisive driver for an operation that posted growth above the market, and so profitable, which is very rare in recent years. So, we want to replicate this model for 3P. We want to turn the store into a logistics support point to the seller, but also delivering other services for sellers. We have a very strong regional footprint and we want to benefit from that, not only for 1P, but 3P as well. I'm sorry, I'm not going to disclose too many details on this strategy.

Q - Luiz Guanais

Okay. This is great. Thank you, Fred.

Operator

The next question is from Thiago Macruz with Itau.

Q - Thiago Macruz {BIO 16404924 <GO>}

Hello, everyone. Good afternoon. Thank you for taking my question, and congratulations on the earnings for 2020. You talked about some generation results. MagaluPay with recurrent frequency, but once again, we'd like to talk about the app. It's reasonable to assume that the track record of SuperApp which is what you want to see in Brazil and Latin America should include opening a platform for third-party and partners. What about the next steps? (inaudible) is already involved in there. So I would like to understand if it's still on your radar and the next steps for this initiative? Thank you.

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Hello, Thiago. Thank you for your question. Totally on our radar. I think we have a platform-oriented mind, not only the techniques, but technology as well. We expect to see the first experiences involving the companies acquired. And we want to connect via many apps. We're going to integrate the companies to be connected.

Fatala, are you with us? Could you share more detail on this? How we can move forward, if you could give us your input?

A - Andre Fatala {BIO 21479328 <GO>}

Good morning. Thank you for the question, Thiago. Like Fred said before, since last year, we've been working on a change in the app architecture to allow us to develop third parties, developing solutions into our app. And we -- actually, we already started putting into practice last year, when we brought Luiza Card into the app. And now we are going to expand it to our partnering companies. And this will allow us to have a lot of feedback from developers, including companies on how they use our solution. And SDK, that's what we're doing now, which is a small development kit. You develop it once and then you can post and have it on the web, on the SuperApp, and then you won't need to have a native development for Android or iOS, which simplifies the operation. So like Fred said, we will start with partnering companies, getting feedback, and evolving with this internal development community. And then our strategy is to open as a second moment.

Q - Thiago Macruz {BIO 16404924 <GO>}

Perfect. Crystal clear, Fred and Fatala. Thank you for your answer.

Operator

The next question is from Irma Sgarz with Goldman Sachs.

Q - Irma Sgarz {BIO 15190838 <GO>}

Good morning. Good afternoon. So I'd just like to ask you about purchase frequency. I don't know if there is any data that you can disclose. And in the past, you also showed us, for instance, there are some people who download the app and never use it again. They even delete the app. But I imagine this scenario is changing a lot, considering the number of MAUs, and also all the new categories and everything they are adding. So anything that you can share with us so we can have a better understanding of this journey, the customer journey over 2020?

And the second question has to do -- and I apologize if I missed something here. But the CDC -- I know that a small part of the portfolio, but I know there was a dramatic drop. Is it right to assume this product is migrating into other lines in financial services? Or what is actually happening? Well, maybe this is related to managing risk in the whole portfolio. So, I would like to have a better understanding about this move because there was this drop in the portfolio. Thank you.

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Irma, good afternoon. Thank you for your questions. When it comes to frequency, it's very hard, if you consider a company that is growing so much in the customer base to check the number, the total frequency based on an indicator alone. Last year, we doubled the number of annual sales based on a very low base. However, we still have a number which is behind what is the number of Alibaba, which is 80 purchases per year with one customer. So that's a key indicator to the company.

However, for a company that is growing with a new customer base, many new customers kind of pollute the average of annual purchases. Some purchased for the first time last

year owing to the pandemic. So if you check cohorts, I already have cohorts of customers who buy significant groups, they buy 25 times per year. And we already have this kind of product, this cohort. And I can see that's a trend.

So in the long run, we want to have more and more of our customers moving into this type of segment, of very high annual frequency. Today, we have the right products and categories for that. And naturally, grocery, beauty, fashion, they boost this frequency. And the same goes for food delivery. The frequency of AiQFome is three times per month, which is way above our standard.

The idea of acquiring the platform and integrate the SuperApp is precisely this. So, we already have cohorts, which encourage us, and allow us to have high expectations about the future. So, that's a very significant goal for all the management of the company in terms of increasing the annual purchase and frequency. I'm sorry, I cannot disclose too much in addition to what I said before or how we want to achieve that. But that's a big strong focus at the company.

As for CDC, Beto, can you help us?

A - Roberto Bellissimo Rodrigues {BIO 17269312 <GO>}

Good afternoon. Can you hear me? Good afternoon, Irma. Thank you for your question. With regards to CDC, there was a mixed effect, actually. CDC was always -- well, it was only relevant and only available in brick-and-mortar stores. And with a very fast growth in e-commerce, the total share of brick and mortars became smaller compared to total sales. And consequently, CDC compared to the rest also got smaller. If we check CDC only in brick-and-mortar stores, it increased a little, nothing significant. Because our focus is Luiza Card, which for us is far more important and it's a long-term relationship tool bringing many benefits, those who are more loyal to Luiza Card.

CDC is a secondary product in our strategy. For customers who don't necessarily want to have a Luiza Card or have not been approved to use Luiza Card, so our strategy is to have the card in brick-and-mortar stores. And when you check the total of the card, apparently, it decreased a little owing to the mix of stores. Because of the web, the card is not so relevant. And then Fred told you about the next card. And with the new card, we want to be more relevant in e-commerce as well, and therefore, increase this relevance in the total sales, adding particularly Luiza Card and the new card, plus CDC and brick-and-mortar stores. So that's about the strategy.

And if I may, just adding to something about fintechs from a previous question by Joseph. With Magalu Pagamentos, which we launched last year, with sellers, the result was outstanding, more than BRL100 million net profit with sub-acquiring, prepayment or receivables, and the whole processing of sellers payment. And the beauty with hub is that we can pay sellers in a hub account. So the question is how to get to sellers. Well, if you get to sellers naturally, we're going to make the money available in a hub account.

And today, we make it available in Magalu Pagamentos account that doesn't have -- and not so minimal for sellers. So actually, they transfer to a different account. And now with a

simple payment in a digital account at the hub, our cash flow will be very high in the account with a lot of services at hub, and also others to be developed in the future. And naturally, the seller is going to use the account a lot to make payments, to work on payroll and cards, et cetera. So that's also a strategy behind Magalu Pagamentos and hub fintech, very fine-tuned for sellers as well.

Q - Irma Sgarz {BIO 15190838 <GO>}

Thank you very much.

Operator

Ruben Couto from Santander.

Q - Ruben Couto {BIO 20636571 <GO>}

Good morning, everybody. I apologize if I have lost something. What could we expect in terms of CapEx and OpEx in order to be able to deliver all that? Is the idea to maximize the use of these two assets in the company now? And a follow-up on the previous question. How much could we expect for the service line or the revenue from services in about three years' to five years' time, I would say?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Good afternoon, and thank you very much for your question. Differently, from the logistics, the idea is to follow. We have already had three acquisitions, Logbee, GFL, that have similar business models. And SincLog, a tech platform for logistics. So three acquisitions, they are fantastic. And the people there are fantastic. And the platforms are fantastic. And the idea, well, of course -- we, of course, could consider new acquisitions, but we already have a very robust platform over which we are going to make investments. And the focus will be to accelerate the organic investment and a significant one. And this acceleration will be in the increase in the penetration when you open a store in the format that we work, omnichannel.

We increased logistics and new cross-dockings, for instance, which is a model of Logbee and GFL, and new distribution centers as well. In 2022, we are also going to do this. So it's a significant expansion of this network of frequency of supply, and investment in teams that are going to develop algorithms and geolocation systems and transactional systems as well. So investment mainly organic in relation to lines, as you know, our style is not to give any kind of guidance in this regard. We are showing the potential of the market, ads and fintech, and the potential of retailer as a whole and that should be explored mainly on 3P. But we do not like to give the market any kind of an estimate, I would say.

Q - Ruben Couto {BIO 20636571 <GO>}

Okay. Thank you.

Operator

Gustavo Oliveira from UBS.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Good afternoon, everybody. Thank you for the question. Still talking about logistics and your 3P strategy, I would like to better understand the hypothesis that is adjacent or that underlined. It seems to be a little bit different from the other players' logistics approach. Mainly, will you talk about the educational aspect of the stores in the process and the store pickup and delivery and the assortment being located in the stores.

So, what I would like to understand is the following. As you grow the long tail with smaller retailers coming on board, your 3P becomes more and more localized, and you were talking about the geolocation development that you're carrying out. Have I understood it correctly? Or is it a desire on your part because this is going to facilitate your cost and the delivery of local services and your matches between buyers and sellers?

So what is your idea about geolocation? Because I think this is where the big difference lies between what you are doing and what the other players are doing. Everybody is taking the product to the fulfillment center. So they imagine that the seller has a more nationwide presence. And you're doing something different because maybe you're thinking, well, I already do this very well and I can refine it locally. Or do you believe that the local approach is much more important? Could you clarify your approach, please?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Thank you very much for your question. Well, more than a hypothesis, this is a bet that we are placing. We like to think with our own heads. And we understand that we know Brazil in depth, and we know everything regarding logistics. We are a great 1P operator. So logistics is no mystery to us. And we know the cost of operating a system. And I believe that many, many operations in Brazil, they replicate the Amazon long-haul system. But Brazil is not the US. You do not have very high frequency of flights and lots of airports. And you don't have the same structure. You only have a few airports, and they are very concentrated in the capitals.

When you go to a small city in the interior of Brazil, the long haul is very expensive and very slow. So the idea of having 10 centralized distribution systems and having fulfillment for the whole country, it is not feasible for any -- for the situation that I have just described about Brazil. We want to address opportunities of having short-haul deliveries, more short-haul deliveries. And bringing the inventory of the local vendor to our platform and having the local delivery. This is our bet. I'm not saying that I'm right and the market is wrong or the other way around. Only the future will tell.

What I can tell you is that having a logistics operation for sellers, totally long haul with gigantic distribution centers and making the goods travel long haul, the cost isn't feasible. The cost is huge. And companies who have a very serious problem in terms of results and cash generation. When I placed my bet on multi-channels way back then, you know that it's very difficult for me to place my bets on any system that I cannot see a light at the end of the tunnel. I don't see the economic feasibility in the other system.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Well, this is very interesting. But when you look at your data, you already have a big critical mass. You have 14,000. You went from 14,000 -- I don't know how many are companies or individuals. But do you have enough data to show this?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Well, we're scratching the surface. As I said before, we have 5.7 million retailers in Brazil. And I only have 40,000 on our platform. So since last year, I have been talking about the Chinese growth. And it's very important for us to gain scale. And the company has to grow a lot and much, much more than the market in all aspects. So, we need to continue to focus on growth, on GMV, top line, scale gains, provided there is an economic rationale that really makes sense in terms of ROE. And so, of course, we cannot waive that. But you have to gain scale. You have to have more sellers. You have to have more inventory here. And the digital platforms operate in large figures. If you are small, if you grow just a little bit or less than your competitor, you have no chance or don't stand one chance in this market. So growing scale and addressing these opportunities and be ambitious and making big investments is imperative. So, you cannot just start and be small.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Thank you, Fred. And I have one last question, if you allow me. The impact of the AiQFome on your result, I believe that you're going to accelerate quite fast because there is a learning curve. The first year is slower, but I believe you are already accelerating GMV, and that opportunity that due to the pandemic, it even becomes bigger in the short run. But what is the impact that we could see as you accelerate your GMV? What is the impact on your take rate? How much of the GMV is converted into take rate? And what is the impact on your profitability?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

This is a BRL1 billion operator of GMV profitable. They are outstanding entrepreneurs. They have a fantastic technology. The commercial people are great, and the business model is great. It is similar to some fintechs acquirers that work with local strategy, and they operate in a very efficient fashion. And this is a business that is good by nature. Of course, we know some companies that have a lot of cash burn. But the beauty of our model is the ecosystem. When you integrate the AiQFome in this app, this is going to go down. You already have clients.

When you have a local operation for sellers [ph], helping not only to bring on board new sellers or even veterans or whatever, I see synergies in the front, that is to say in the integration with the SuperApp. And also in the hunting [ph] and the farming teams, there is integration. So the economics will be even better. This is a market that is still very difficult, mainly in the big cities. So the smaller and the medium-sized cities have a lower cost of operations. So, we're going to follow this line. We acquired Netshoes that was the only company that we acquired that was in the red. And the price was very good. All the other businesses that we acquire, they are sustainable and they are lucrative when we acquired them.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Thank you very much.

Operator

The next question is from Guilherme Assis with Banco Safra.

Q - Guilherme Assis {BIO 16143141 <GO>}

Hello, Fred. Good afternoon. Good afternoon, everyone. Thank you for taking my question. Fred, I would like to go back about economics in new categories. I think you just announced this acquisition, VipCommerce. And like you said, this segment has a very big potential, maybe hyper-sized of e-commerce potential or retail, I mean, in Brazil, with a low penetration, even though it is expected to increase. We can see there are many players, including food retailers and also players in the market. And we also decided to be part of it during the pandemic.

So, we can see fierce competition. We can see a lot about vouchers being used in order to attract consumers. So now that we have this platform and you are going to deliver services to physical retailers, so if I understood you correctly, your strategy is to use the platform as a seller. So, what about the economics? I think it's similar to Gustavo's question about AiQFome. But what about take rate and acquisition cost, specifically in the grocery segment?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

There are several different manners to answer your question. First of all, good afternoon and thank you for your question. We run 1P grocery category. In this category, if you think about new categories, you are only considering groceries, right? Or are you relating to all new ones like fashion, for instance?

Q - Guilherme Assis {BIO 16143141 <GO>}

Groceries only.

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Okay. Groceries, well, that's a worldwide challenge. If you think about online e-commerce operations, it entails a challenge because the average ticket is low and the price is high. Logistics is price overweight or price over cubic meter. So groceries are hard to be profitable.

So let me go back to the question before. Geolocation is key. You have to have a local inventory with fast delivery, very high frequency, high level of use of the frequency capacity in order to have a lower cost vis-a-vis the purchase basket, both in 1P and 3P. For 1P, we're using brick-and-mortar like dark stores in order not to travel so much. We have 1,300 stores. All of them have a grocery inventory. And we are improving our algorithms to identify which product should be in all markets, naturally are not going to have full basket everywhere. It has to make sense for 1P.

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In order to have a higher capillarity, it's important to have the 3P modality. And that's the rationale about VipCommerce. It has to be integrated with local small grocery stores or local networks to help them sell directly online. And then you have a direct participation in the system or selling via the closest marketplace. It's not that they're only going to sell at Magalu, but they'll keep on selling directly via their own website as well. And we are going to support them with IT systems or logistics and payments.

So locally, I believe there is a good opportunity for the business to be relevant. It's growing worldwide. All companies are investing in this category. And I see it with good eyes. As for the economics, it's a matter of choice. Historically speaking, like I showed for the last five years, if you check the historical series, we always try to work in areas with economics that make sense for us. It doesn't necessarily have to be profitable, but it delivers good frequency, not all categories have to be a cash call. Maybe there is a different strategy that is important for you.

For grocery, it's not necessarily that it has to have a wonderful economics or be a great cash call. All it has to do is not to burn cash that much. But if you add frequency, it needs another strategical need. So, you have to have a global systemic view. Overall speaking, you have to grow a lot, generate cash and as much as possible, improve profitability in order to bring return on invested capital. So that's always on our radar. We are a rational player. We'll continue to be that in the future, but not all categories have to deliver the same high margin of contribution.

Q - Guilherme Assis {BIO 16143141 <GO>}

Fred, just a follow-up question about this. And not only about groceries categories, but also about marketplace in general. We know marketplace is the kind of business that brings higher margins. Naturally, you have the support that you mentioned. You talked about logistics and how efficient you are. And you do have the long-haul model, which, in my opinion, allow you to have a smaller average cost to get to the last mile in an integrated system. So when we talk about marketplace and take rate, the idea is that we have a high-margin business unlike 1P.

Sometimes, you have more fierce competition and sometimes you need to move away from margin. So, we have seen competitive moves in marketplace that are very aggressive. Now if we think about a long-term view, do you believe marketplaces, economics will be accretive for margin as we expect? Or considering the circumstance of the market, it's something that will make economic sense, but maybe the margin is not much higher or as good as we expect. So how do you see that, Fred?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Guilherme, first of all, marketplace, intrinsically speaking, should be -- or could have better economics compared to 1P. You need to deploy less capital, and you grow with somebody else's assets. So conceptually speaking, okay, think about a bank, bank has a huge profit pool. It's one of the best segments, highly profitable. Think about the number of banks that when broke in Brazil. So even in an intrinsically good segment, you can have a poor operation. You can lend to somebody else that you shouldn't have. And you maybe -- you have a higher cost in the end.

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So including marketplace, which has a good economics, maybe you can have mediocre circumstances. And I saw that in 1P. I've been for 20 years in 1P. And many companies went broke in 1P because they wanted to grow without being profitable, but we have a profitable 1P. And if you can do that with 1P, I can't see why we won't do it with 3P. So it depends far more on the company.

Naturally, in my case, in 1P, I competed with extremely rational companies that would burn cash. At that time, not only at the stock market to subsidize consumer, at that time, it was VC2C, venture capital to consumer. VC2C rather than B2C. And today's IPO2C [ph], the company gets the money for consumers to subsidize. So, we managed to grow in the past, even though we had to compete with this kind of company. So maybe in another quarter, we're not going to play the game and we might slow down, et cetera. But in the long term, I trust our business model. I trust our rationale, our capacity of execution. And when I show that we have five million retailers, the majority is not even online yet. I believe competition has been overrated because that's such a new market. I think competition is more related to mature companies.

If you think about price, take rate, mature markets, you have more issues related to that. But when the market is in the first steps, 10% of the Brazilian market, [1 trillion to 100], only 100,000 sellers online. So, there is plenty of opportunities. So, I don't waste my time that much looking to the site. I think we have to focus on blue oceans and opportunities. That's what I want the market to see, so we can move away from this dilemma of looking to the sites.

Q - Guilherme Assis {BIO 16143141 <GO>}

Great. It's clear. Thank you.

Operator

Richard Cathcart from Bradesco.

Q - Richard Cathcart {BIO 16457807 <GO>}

Good afternoon, everybody. I would like to ask two questions. The first one has to be the -- is about the fashion category. Are you going to accelerate this category still during this year? Maybe you need a little bit more marketing or maybe you already have everything you need in place.

And the second one is about the 24 hours. What was the role played by the market category? Was it this category that drove the faster lead mark?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Thank you very much. So fashion, we talked about market quite a lot, but we should really consider this fashion because it is even -- abroad, it is more consolidated than other markets in developed countries. And the economics are better than market. For instance, you have many operations that are going very well online. And we made a very high investment there when we acquired Netshoes that came with Zattini, one of the biggest

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in our life as a company. And then Epoca Cosméticos that had a brilliant performance last year. So you have sports, for instance, which is also a gigantic operation.

But fashion and beauty, you have a penetration that is very low in Brazil, still much lower than other countries in the world. And they are good. They have a good growth market. They have a good average ticket. And we invested quite a lot in infrastructure already. We created two departments in Magalu last year, one for sports (Foreign Language) and one for fashion, (Foreign Language) who came from a previous experience in (inaudible), for instance, (Foreign Language) is setting up a fantastic team from product development going all the way up to marketing and everything exclusive and dedicated to this category. And the M&A already happened, which was Zattini. And we have Stoque, which is one that we will be developing as our private label and Epoca Cosméticos, I have already mentioned and HubSales that operates B2C models.

And our objective is to have it in -- well, it is in Franca, which is where most of the footwear in Brazil is produced, but we want to take this to other places in Brazil. So it has to -- we are investing both organically and inorganically in the case of HubSales, in order to be able to take advantage of the opportunity. It's a big investment, mainly now investing in teams and talents. We are attracting fantastic people that are bringing a know-how to this category that the company didn't have before. Of course, we have people that came from Netshoes, but it was more focused on sporting goods. And there is a very big opportunity here for the team to work.

And your other question, could you repeat it?

Q - Richard Cathcart {BIO 16457807 <GO>}

So about 24 hours lead time?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

No. No, it was not driven by market. Smartphones, mobile, TVs and other categories are being operated. With the store inventory, market does help, but it's not limited to market.

Q - Richard Cathcart {BIO 16457807 <GO>}

Excellent. Thank you very much.

Operator

Our next question comes from the Daniela Eiger from XP Investments.

Q - Daniela Eiger {BIO 20250080 <GO>}

Thank you for the question. Congratulations for the result. My question has to do with profitability. You said that many competitors are very aggressive in terms of incentives, et cetera. But looking at your margin, what we see is that there is a major pressure, even higher than your peers, although they already have significant gains coming from the digital channel. So, I would like to understand the dynamic.

You are having a stronger pressure on your gross margin than your competitors. I understand that you are offsetting this with lower operating expenses, but you said you're making major investments in service level and logistics. But what are the main drivers? Does it have anything to do with categories or some incentives that would make sense in the short run?

You said that it's important for the cooperation to be sustainable, but it must have scale. So, this investment should make sense in the short term because your company becomes more robust to face the future. So, I would like to understand the dynamics of the past and how you see this for the next year. Should we continue to expect this pressure? Maybe it will be smaller because digital is already there and maybe it should flatten out. But what is the trend for your gross margin and EBITDA for this year?

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Daniela, thank you for the questions. Gross margin, it has to do with mix and mix alone. We are the company that has been growing the most digitally. We went from one-third to two-third of our sales coming from digital. Nobody has this kind of share. Online, two-thirds of the sales of -- so nobody has that. If you look at the online operations, they will be working with a low gross margin, all of them, an operation that is mono-channel is easier to compare.

So you can see that the gross margin of digital channels is always lower than the gross margin of the offline channel. On the other hand, the digital operation has lower expenses. So although the gross margin is lower, our expenses are much lower. But I believe that the major point here about the margin is the following. Your margin is my opportunity. We talk a lot about Amazon, for instance, Jeff Bezos. And he said that the consumer will always want to pay less and receive faster. This was the only certainty that he had in his life. So it's important to have an operation that is profitable and generates cash. And including last quarter -- the last quarter, our expenses are the lowest in the market by far. And if you can have this level of expense, you can have lower margin and grow more than the rest of the market.

So, we have been growing more than the other players. And I reemphasize, Daniela, the importance of scale. This is a business of big numbers. No medium-sized platform can be a player in this market. So having a growth much higher than the market and having a high GMV annually is fundamental for a successful business. So, we have to look for scale. And Chinese growth is one of our strategic pillars. So, this is very important for us to grow. So, we do not believe that having a high margin is a competitive advantage, quite the opposite. And our decisions have nothing to do with the market. We grow online because this is where Brazil is growing. I know that you're [ph] in the company. In the company, it's only based on the mix.

Q - Daniela Eiger {BIO 20250080 <GO>}

So if you can add to what you said, what do you expect for the year? Do you see a fierce competition? Do you see this as an additional challenge for Magalu? Or do you believe that your position protects you enough? Or should you do something in order to help the seller further in this more competitive situation?

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A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Daniela, I have already said that to Guilherme when he asked the question. Our decisions are all made for the long run. We never make a decision for this current quarter or anything like that. So BRL44 billion GMV, when I look at the position of BRL1.02 trillion in the market, I see that this is a multiple opportunity, multiple category, multiple fronts. And in each one, I have a different competitor. So it's Fortnite. It's not a World cup. You compete with many in many different categories. So it's very difficult to map this.

I don't spend a lot of time looking at that. The financial market does, but we focus on the opportunities and the level of service that can be improved and trying to be sustainable at all times. And this is what we have been doing in the last few years. So, I'm not very much concerned with the short run. It could happen in one month or one quarter. The company has BRL7.3 billion in cash. We generate quite a lot of cash. We have a profitable operation. And we can accelerate, should it be necessary.

You have 20% operating expenses. This allows us to be more aggressive than any other player in the market. So, we are very comfortable that we have a superior model. We have a proven execution. We have, if you will, which is cash. And we have an ambitious view for the future. So it doesn't make sense to be looking to the sites.

Q - Daniela Eiger {BIO 20250080 <GO>}

Congratulations for the results.

Operator

The next question will be in English. Ravi Jain with HSBC. Please go ahead.

Q - Ravi Jain {BIO 16135293 <GO>}

Morning, Fred. Thank you for the questions. The first one is probably for you and maybe Fátima as well. Digging deeper into Magalu as a Service, if you can give us some color on your initial focus, what kind and size of merchants are you going to look at? What services would you prioritize in the near term for the smaller retailers?

And the second question is on fresh. Maybe, Fred, you can lay out your vision for groceries. What is the mix going to be? Is it going to be driven mainly by the 3P picking and delivery services, specialized 1P fulfillment centers or something like a community group buying that we have seen in China? That would be really helpful. Thank you, Fred.

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Ravi, thank you so much for your question. Let me begin talking about Magalu as a Service. Fátima can also add to that. Our vision is very focused on small and mid-sized. We have a purpose, which is to generate digital inclusion in Brazilian retail. Usually, larger networks and chains have their own digital initiatives. Big grocery networks, they have their own digital teams. They don't depend so much on Magalu compared to small and midsized. So, we want to develop technology for those who need it.

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When we move to the small and mid-sized business universe, there is a broad range of necessities. Some can be very basic, including education, that's why we acquired ComSchool. ComSchool is a digital business school, allowing businessman to do basic things in e-commerce. So, we acquired an education company to support SMEs to go digital. You also have to, for instance, have an online invoice. You have to know how to do that. And you need approval by some federal agencies to do that or cataloging or inventory or logistics payments, anyway, go-to-market strategy and so many options. And in all of them, the idea is to develop applications, our own or like Fatala said before, plug other in the market, in our ecosystem, to meet the needs of SMEs. But these are broad opportunities. Nothing that we haven't done before to Magalu. So, we are making everything available for them according to their size in the segments and categories there.

Fatala, anything to add?

A - Andre Fatala {BIO 21479328 <GO>}

Yes, Fred. Fatala speaking. Thank you for the question, Ravi. One of the points in order to address, at first, Magalu as a Service, has to do with providing several services, which allow us to have a digital seller. And from the beginning, with this catalog geolocated in our platform and with that, help consumers to find the needs that are closer to them. Like Fred said, it's part of the strategy of logistics, deliver what is closer to the customer. So, we need to try and support them with the right tools, very friendly tools. Many of them, like Fred said, are not familiar with marketplace and sales on the web. They don't know how it works.

So, we're trying to remove complexities of issuing an invoice or logistics, delivery to consumers who are close to them. So, these are the main first tools that we are considering Magalu as a Service. And based on the information that we are going to send about these merchants, we will learn a lot about other services that we can also deliver, this time involving other pillars of the company. Like, for instance, the financial areas. What are the main financial systems that are obtained to these people? And how can we help with the current tools we have without having to contract or use others?

So, we can benefit already from the services we have. And other things we have, for instance, about advertising and publicity, we also want them to have a simple operation to make it easier for them to have publicity on the web. And drive more traffic to the products they have on the list and also support them in one of the points that we learned to do, which is to drive traffic to the point-of-sale -- physical point-of-sale, trying to boost revenues. So, these are the first steps. As for the size of the super small business up to an average size, which is already a small network, for instance, or a small merchant chain. We want to -- well, we had an acquisition of Stoque, which is a little bit more robust and we want to use this solution as a channel to deliver these services as well.

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

As for groceries, Fred speaking now, I think I've made a lot of -- I've made many comments about 1P back store and 3P with e-commerce. And you mentioned the Chinese model, which is community group. And it has similar characteristics to Magazine (Foreign

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Language). This is an operation that we're watching very closely. To tell you the truth, Ravi, nobody in the world managed yet to be ultra relevant. Like I said, penetration is lower compared to any other category, including US and China. It's great in Brazil, but it's still very low.

So, there is a lot of opportunities. China is tapping into new territories, particularly now with the model you mentioned, and we are keeping our eyes open. We have similar tools of social commerce. And I believe there can be alternatives for the future. So, we'll be running tests. We'll be experimenting several opportunities and see the best to scale. Considering our characteristics, we always test, experiment, run, make mistakes. Then we'll learn and scale or whatever makes sense to us.

Operator

This concludes the question-and-answer session. I would like to give the floor back to Mr. Frederico Trajano for the final remarks. Over to you, Mr. Trajano.

A - Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Thank you very much. Thank you all for being with us. We apologize for the technical glitch.

And I'd like to say, well, actually, we want to thank you, particularly our team, 40,000 employees, our leaders, our direct people, who have been with us in this extraordinary year. Like I said before, I'm so sad about what we have been living in Brazil right now. It seems to us we went back to zero when it comes to the pandemic. However, we are happy with our team's ability to react to all those difficulties to make a difference to support other businesses and take care of our peers and our customers. My admiration, my gratitude to the team is absolutely huge, and also to investors who still have confidence on us and stakeholders and sellers, who are growing with us.

Obviously, finally, our customers. And once again, we have to think about the highlights. Upside, Brazil is relentlessly generating negative news since I was a little boy. I started e-commerce in the year 2000, and I wonder about all the difficulties. So many sad news throughout this time. And -- but we continue to be a huge country with plenty of opportunities, amazing companies. They see the glass full and keep on flourishing. So many entrepreneurs, many companies with good cash generation.

I don't believe bad news will come to an end. They will always be here, but we will focus on what we can do, what is up to us to do based on our talent, our ability and always have a bullish view. Opportunities for us who are digital are huge. Addressable markets are huge as well. There will be obstacles ahead, difficulties. Now, we have 800 stores closed out of 1,200. Last year, we had 1,200 closed. Obstacles will come, and it will depend on our ability to react, to be firm on our purpose, our mission.

And obviously, I would just like to close, like saying that we have to do the right thing and fight for more retail in a sustainable manner. I think that's what Magalu has been delivering successfully, with no pathways, but just trying to do the right thing.

Thank you very much. Enjoy lunch.

Operator

Thank you. This concludes Magalu's conference call. Thank you all for being with us. Have a good day.

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