

Q3 2019 Earnings Call

Company Participants

- Eduardo Galanternick, Executive Director of E-Commerce & Member of Executive Board
- Frederico Trajano Inacio Rodrigues, Chief Executive Officer and Member of Executive Board
- Roberto Bellissimo Rodrigues, Chief Financial Officer
- Unidentified Speaker

Other Participants

- Joseph Giordano, Analyst
- Luiz Felipe, Analyst
- Robert Ford, Analyst
- Thiago Macruz, Analyst

Presentation

Operator

(Starts Abruptly) Participants are connected in listen-only mode and later, we will have a Q&A session when further instructions for you to participate will be given. (Operator Instructions)

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

Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Good morning, everyone, and thank you for participating in our call for the third quarter of 2019 results. I'm here as usual with all the executive committee and everybody will be available to answer your questions at the end of the call. I will be making the presentation, the introduction and then Bellissimo will continue, and then, we will be opening for questions.

This quarter was a historic one full of very important things, mainly -- well, even if you consider an over 60 years of age company, I would like to highlight some of these brands for the Company. We opened the number 1,000th store in August in (inaudible) practically after the first one that we opened. And the coming on board of two new states in Brazil, Mato Grosso and Para and the purchase of Netshoes -- the acquisition of Netshoes, although we announced it in the previous quarter, we integrated and now it is part of our financial statement as of this quarter. In the previous quarter, it was only three

days. So now, it's the first time that we have a full quarter with the consolidation of the results of Netshoes.

And we held the first large B2B event at (inaudible) in our history, and it was held in September with practically 1,500 people, most of them entrepreneurs that are trying to make their businesses digital by means of our platform. So it was an event by marketplace and with sellers and service delivery people in our ecosystem. It was in the (inaudible). It was a very special event for us.

And I would like to highlight as well, specifically in September, another very important point that shows the results of all these efforts of digitalization of the Company. In September, as we said in our executive message, with the growth of marketplace, we had 50% of our sales of Netshoes. And I think this figure is very important, is very emblematic of what we have been saying, we digitalize the Company and this represents quantitatively the digitalization of the Company.

But I think it is especially relevant if we take into account the fact that was not to the detriment of our physical stores. The physical stores, as you will be seeing, had a very robust quarter as well, besides having a number 1000 store being opened and same-store sales 9% over 16% of the last quarter. So overall, our physical stores growing by 20%. So multi-channel, omnichannel strategy and the summation of the channels. Once again, this is very well evidenced in this quarter.

And also, this quarter, there was a lot of competition, a lot of PR, a lot of investment, a lot of moves and from the viewpoint of competition, both from foreign players and Brazilian players as well. So I think it's very interesting, because for over 15 quarters we have been delivering very positive results and most of them are much higher than the market expectation. And in some moments, I heard that these results were coming from weak competition and the competition was not well structured and that they were sub-optimal from the investments viewpoint.

And this quarter nobody can say this, because there are many things happening in the market and I would like to mention those, because the result that the Company has been delivering is driven by a totally talented and hard working people and our staff and our team is excellent and performed in a strategy that I believe is extremely winning and assertive and this strategy is being implemented with a lot of discipline over many, many years.

And recently, it went through a redefinition, I would say. And I would like to start my presentation by reinforcing at this point we presented this during the Magalu Day at the end of last year and trying to give one example of this strategy. We digitalized Magalu and now we want to digitalize Brazil, starting by the Brazilian retail. So everything that we lived as a Company and all the effort that we made in terms of digitalizing the Company, now we want to roll this out by means of 3P and the Superapp and all our endeavors in terms of building a technology and a platform. We want to make this available, we want to roll this out to the market as a whole, and this is the new strategic cycle that we are already living.

FINAL

So I would like to start with the first slide here, which are the strategic drivers of the Company. Here you have 2019, but of course, it is truly annual. As we said at the beginning of the year, we are focused on these strategic pillars, exponential growth, platform leverage, Superapp, new categories growth, best retail experience, fast Delivery and data driven and automation culture.

I'm not going to get into many details. I'm going to focus on the result of the third quarter, but what is very clear based on our figures is that when you start a new strategic driver, consistency, you have to show it, in your figures, in your quarterly results more than in a PR narrative and you have to show this quarter-on-quarter. And the big highlight of the third quarter is exponential growth, which is the first driver.

If we look at the results and I would like to start by the e-commerce slide and continue to the next page, you will see that we grew 96% in e-commerce. Of course BRL700 billion Netshoes, about 54%, but even without considering Netshoes, we had a 54% growth over 50% growth base in the previous quarter. So this is exponential growth, based on an exponential growth that we achieved in the last quarter.

We have been talking a lot about the Superapp as a main growth driver and I always say that this is the future and including the apps of the companies, Netshoes, for instance and we reached a MAU, monthly average users, of 14 million MAUs In this month. So this is a major growth vis-a-vis last year, 14 million people, and including Magalu Superapp, Netshoes, Zattini and Epoca. So the number of expressive users using the app this month and now, we want to grow it even further, that is to say, from now on. But we have already reached a very important figure there, if we consider all the apps in the group. The group of the highest number of downloads.

If you look at the Google Store and iOS store, you will see that we have 2, 3 apps, and the Magalu app fighting to be the first in shopping. And in downloads, we are in the top 20 and competing with social media apps that are very relevant to the market, shows that the strategy from the viewpoint of apps has been very good and also for sales. It's not only for downloads, the apps are very representative in our sales growth and the app sales are driving the sales overall besides marketplace that, I will refer to on the next page.

And I would like to focus now on Netshoes' market share and (inaudible) will be talking too. And you see that is much higher than we expected. The full quarter totally integrated from the view of financial statements and not from the view of integration of systems. We had BRL700 million sale, much higher than what we expected initially, and in the dynamic of supply chain of this category and we have been learning consistently with the Netshoes team.

Some of these purchases are made ahead of time. So we are programing for next year and we have condition to increase our supply for the next quarters because these purchases were made in cycles that were before our acquisition. And as part of that, we had a very expressive result from Netshoes both in sales, based on the previous quarter, as well as in a positive direction regarding balancing the profitability because we already

FINAL

have practically a breakeven in our EBITDA of operating results and we reported this as well.

(inaudible) from the Executive Committee, so already reaping the fruits from this match, from this marriage, from Magalu and (inaudible). And the bulk of the savings, mainly in SG&A, come from the logistic integration, most of them and mainly from the back office that will be done over next year. Logistics, we have already announced and in the presentation you already have the in-store pickup at some Magalu stores, one of those stores had over 1,000 orders in this modality.

And on the Netshoes' platforms, that in mobile, you can select the Magalu you can select the Magalu Store for the in-store pickup and one store of -- I think it was on the (inaudible) Street, had over 1,000 orders in two days only. The client bought and chose to pick it up there. And if we roll this out to all the stores and we only have a handful of stores, the power of penetration and the savings in terms of shipping, because you also have free freight, there will be a very good impact in the fourth quarter as well.

So this is very positive and a few days later or after the authorization by CADE and the integration of Netshoes, we integrated the catalog and we put it in the Superapp and the brand. As they authorized us, we integrated in the catalog and from the viewpoint of search and catalog. So we already have most of the brands that we integrated at the beginning and some authorized us recently such as Adidas, and we are still going up in these categories. And we are seeing a very good evolution in our integration. And Eduardo will be give you more flavor regarding app -- Net.

And I'm particularly satisfied and positively surprised with the first quarter of Net and also the way that we are integrating and so congratulations to all of you and to all of us and you responded very quickly after this process because this process of acquisition, M&A, et cetera, is not an easy task. From the viewpoint of e-commerce, besides the in-store pickup, which is already over 30% of the e-commerce purchases, we are rolling out the shipping from store in order to delivery, and we have over 145 stores already in this modality and rolling this further out. So this is another factor that will help us a lot in terms of our delivery. And I will come back to that later.

One of the highlights of the e-commision in the quarter, as it was in the previous quarter and all that I have already talked about, ExpoMagalu, but I would like to talk the 300% growth of our 3P vis-a-vis the previous year. So this is a very robust figure. We are talking about almost BRL1 billion of GMV in the quarter. So it's incredible from the viewpoint of growth and over one-fourth of the sales of e-commerce overall of Magalu, 11,000 sellers.

And I would like to remind you that we have a very good curator-ship for sellers. By far, we have the most rigid process for the authorization of sellers coming on board and also the most robust process in terms of obliging the seller to issue invoices in all sales. So we are extremely careful in our marketplace and we want to grow, but grow in the right direction, in the right way. We don't want to have people who are not in the legal market just to say. And we want to have sellers that are as serious as we are in terms of paying their taxes and issuing their invoices and delivering the best service to our customers.

FINAL

In Magalu, I interacted personally with many of these sellers and I saw that there are so many good people there with the same commitment as Magalu regarding the level of service and by the way, it has been improving a lot with this exponential growth. All the NPS indicators of 3P have been improving. They are not yet at the level of warranty, but there is consistent improvement with sustainability. And informal companies, they do not grow. If you look at the productivity of the informal companies, they come to a ceiling and they can no longer grow more. And you cannot have a large company growing informally or not paying taxes.

We want these companies in our platform to become bigger and bigger in the future. So we made it very clear from the start that in order to work for Magalu all sellers have to abide by our requirement and delivering the same level of service. And it's very good for the sellers as well in the long run. And I would like to talk about the Magalu Entregas, our delivery system. We have to tap into this base even more and we want to monetize this base with additional services, both in Entregas or deliveries, and Magalu Pagamentos and Magalu Payment.

There is a lot of room to improve the GMV and we do not really monetize this very much. So we are delivering a basic model and as we roll out special delivery services and special payment services, we will be able to tap into this more and more and delivering a better and better service to our sellers and to our consumers.

And here, I'm talking about two points, delivery or fulfillment, and payment, which is the prepayment of receivables and credit and financial operations for these three actions that go through the marketplace. So we have opportunities there and we will probably be able to tap into them as we roll out the services that we are developing in our Labs and with the help of our business people win marketplace. And the most basic model of delivery, which is Magalu Entregas, we already have 72% of our sellers. But I still consider this very basic cross docking and other things. We will be growing over next year. During the Q&A, we will be able to talk about this.

Talking about the physical stores, it was a very positive quarter-after-quarter in which we grew less because of the comparison base with the World Cup. And I highlight the entry into two new states Mato Grosso and an historical inauguration in Para. And we practically -- the whole state practically came to a halt, because of this. Even in the Greater Sao Paulo, Santa Catarina, Rio Grande Do Sul, for instance in the Northeast as a whole, but this entry in Para was released symbolic because we started very strongly with a very assertive market, a very well located base of our stores and a fantastic team. And I went there on the inauguration day and I was really impressed and it continues to be very robust.

And it is very positive also the fact that we are getting into Mato Grosso. In this quarter, we opened 52 new stores. And with an expected gain of market share, we're very well distributed in all categories, technology, white line like product. So our core categories continue to be very good and we are getting into new categories with our marketplace and Netshoes, and 1P, many of our categories. And we want to be a one-stop shop, but we don't forget our traditional categories. They are the cash cow on the Company. So it's important for us to continue to gain share.

FINAL

And there is a lot of room to grow. If we look at the standard categories, our market share is about 15%. So we still have a lot of room to gain share in our core categories. So we are growing in other categories, but we have a lot of room to continue in our core categories online and physical and many -- about 15 quarters in this good dynamic.

And to end my presentation and give the floor to Beto to for the financials. The clients are one of the most important KPIs for us. We involved a lot, 24 million active customers. We reached this and here I include almost 5 million active clients of Netshoes with a lot of representation in our base, which was of one of the big objectives of Netshoes acquisition. So you can see, we grew 44% versus the 3Q '18 and we are growing not only the base, but service level much higher than the others in the market. We are the only one that has the RA1000, and we have the best score in the Reclame Aqui site and we have to grow exponentially, but top notch service level. So I'm very happy with this evolution.

And it's very difficult to grow as much as we grow and at the same time improve the level of service at the call center. We have a first call wait time less than 2 minutes and the first-call resolution reached 95%. So we're improving our level of service. We don't want any problems to arise, but when one arises then we need to have a first-call resolution. We have been doing a very good job in terms of avoiding problems, but if there is a problem, we have to solve it quickly.

And the average NPS is 79%. And those who are familiar with the net promoter score, this is an indicator by means of which you compare with companies all over the world and this is the first time that we opened this. So we went up 3 percentage points vis-a-vis last year. So this NPS of 79% is one of the highest levels of retail, not only in Brazil, but in the rest of the world. This is totally impartial, that is to say, we hire external companies in order to evaluate this. And based on that in the next quarters, I will continue to show you our NPS. But the NPS is very important and it is also one of the indicators for the compensation of executives, including the COO of the Company. So it's very important for all of us.

And one of the things that has been helping the NPS is the fact that we are raising the bar for logistics as well for 1P. The data that I will talk about is for 1P. We have over 42% of total last mile deliveries that is just the express delivery. And in Brazil, the average was five to six days and we are bringing this down with the fantastic work being done by the logistics and supply people, the commercial people and the operations people as well and the stores also participate in that too. 42% is very high. If 5% in 48 hours that we deliver in two days, we are talking about over 60% that are delivered in up to two days. We promised 42% but, in fact almost 60% we deliver in two days. And in some cities, we promise one day delivery for most of the categories of our SKUs.

In terms of -- I talked about, 1P and 3P, and we are making our best endeavors to roll this out to 3P. So as I mentioned before, this refers to 1P and rolling this out to 3P and using Magazine Luiza and Love Bee, and everything that we did for 1P, we want to do for 3P, but undoubtedly the NPS is very high, mainly because of the brilliant job done by our logistics team. And I would like to highlight these factors.

And now, Beto -- I give you the floor to (Technical Difficulty) to talk about the financials.

Roberto Bellissimo Rodrigues {BIO 17269312 <GO>}

Good morning and thank you for participating in our call. I will be talking about our figures. We talked about sales already. And the adjusted highlights now. Here, first, we will be talking about the adjusted highlights, because we had tax credit and non-recurring credits and provisions and the results are more comparable to last year's, but they include Netshoes for the first time.

Our gross sales growing -- we were able to increase our gross margin 0.9% because of Netshoes itself, that has a gross margin which is higher around 40% and also because of the marketplace. Marketplace helps us a lot and marketplace is based on gross profit and this helped a lot Magalu and Magalu with Netshoes.

On the operating expenses line, we increased our operating expenses a little bit because of the acquisition of Netshoes and due to the first set of integration and also because of the increase in service levels and faster delivery and acquisition of new customers in line with our strategy.

With that, we had an adjusted EBITDA of about BRL300 million, with a 6.2% margin already including Netshoes, practically with a breakeven in the EBITDA margin. And we had a dilution of financial expenses and benefits regarding interest on equity. And we got BRL136 million adjusted net income including Netshoes, 2.8% margin. Net income growing vis-a-vis last year. So, this was a very sound result.

And we continued to generate a lot of cash, practically BRL200 million in the last 12 months with a ROIC of 20% and return on equity, very high as well. And we continue to have a very comfortable cash position, BRL600 million net cash, BRL1.8 billion total, including receivables. And I think the main message is that we continue to grow profitably and generating cash. And including the non-recurring events, the EBITDA was over BRL500 million and IFRS 16 margin of over 10% and net income of BRL235 million.

Then we go to our client base, the MAU, Fred has already referred to this, then we show you the evolution of new stores. We opened 52 new stores, and we started investment to open an additional 50 stores in the fourth quarter. And this is already -- most of that is included in the total investments that were BRL186 million in this quarter, growing over 65% vis-a-vis last year. And in the year as a whole, we have already invested almost BRL400 million, in line with our strategy.

On the next page, we show you the quarterly evolution of our sales. Year-to-date, 33% growth with a major market share gain online and offline, and also the evolution of market rate of almost BRL2 billion in the year. And we show the quarterly evolution of our gross profit. On the equity income line here, we see a better result of Luiza Cred in IFRS 9, already impacted by the improvement of the short-term delinquency indicators. So this was the best IFRS quarter this year.

And expenses, they went up. Operating expenses went up, due to the acquisition of Netshoes and also investments in increased service level.

FINAL

We show you the EBITDA on the next page, the evolution of the EBITDA. Once again, very consistent, around BRL300 million every quarter. Margin 26.2% -- EBITDA margin 6.2%. And here we are talking about operating expenses over net revenue, but in GMV, expenses have a lower weight, because we are growing a lot with marketplace. And the performance of e-commerce marketplace, et cetera. Helped growing the nominal EBITDA that went from BRL281 million to BRL301 million, margin from 7.7% to 6.2%, but due to the factors that we have already referred to.

Financial results, we were able to dilute our financial expenses in spite of all the investments made this year, not only in CapEx, but also the acquisition and the payment of previous debt. Financial expenses, 1.9%, dropping. And then adjusted working capital, we continue to generate cash, based on the working capital around 70 days. The average term for purchases 90 days. So unfavorable cycle for cash generation. And Netshoes has already improved its working capital profile as well and has already improved the inventory turn over and the average term for purchases and generating cash for its own operation.

Here, we show the adjusted cash flow. Adjusted cash flow in the quarter over BRL200 million from the operations and we invested a BRL186 million. As we have already said, the net income BRL136 million, BRL367 million year to-date, 2.7% adjusted, including non-recurrent events, the higher results.

In Luizacred, we continue to sell a lot of Luiza cards. We increased our base reaching almost 5 million cards in total, 90% active with a very high utilization. We highlight that the (inaudible) of Luizacred reached BRL7 billion, BRL1.6 billion inside Magazine Luiza and BRL5.3 billion practically outside Magazine Luiza. And our card is co-branded, so this means that it can be used in the whole market. And our credit portfolio reached over BRL10 billion, growing more than 40% in the last 12 months, a very healthy figure.

And we show that the NPL 90%, had a slight increase from 8.5 to 8.8, reflecting once again such as in the last quarter we explained, the very high number of new customers, but on the other hand, we highlight the reduction of the short-term non-performing loans, which is very positive and it ultimately generated benefit in our net income in IFRS 9, as we shared.

So these were the main financial highlights. And now I would like to give the floor back to Fred. And I would like to open for questions already.

Questions And Answers

Operator

Ladies and gentlemen, we will start the Q&A session. (Operator Instructions) Our first question comes from Thiago Macruz from Itau.

Q - Thiago Macruz {BIO 16404924 <GO>}

Good afternoon. I have two questions. Could you share with us the KPIs of the 200 sellers that are doing cross docking with you? And what about the improvement in the sellers service that you're piloting? And it's very clear that you're going towards the Superapp and the brands are already many apps inside. But you have always said that payment will be part of the strategy. Could you give us an update in this sense? What about the FinTechs operations and how do you see this?

A - Unidentified Speaker

Good morning, Thiago. Thank you for your question. There is an important component, strategic component there so some information is not public. I will do my best to answer about the sellers that are in the cross-docking model. I can give you an overview, but as I said, we have 60% of our deliveries up to 60 days for 1P. And if you consider 3P, I believe that we have well less than 20% in T+4. So the service level and the delivery time in 3P is much worse than in 1P. And these 200 sellers, they already -- well there is time regarding you sending this through the Mayo et cetera and the operation becomes a little bit more complex, but for the seller that can do this up to one day, we can already bring them on board for the three day delivery. So we see a significant reduction already in delivery times and 60% 70% reduction on average. And also, significant reduction in the delivery costs, because we have a level of extension that is much lower than with the standard carriers, both for higher-volume products such as gourmet.

I would say that 20%, 30% but overall, just ballpark figures so that you may understand. So delivery time and the reduction in delivery cost only these 200 sellers are benefiting from that. And Magalu Entregas, already have a benefit, because they contracted a large carriers, which is Magalu Entregas. They are not cross-docking which is a 70% that I talked about. The volumes are much higher than the small sellers. So, there is an advantage that mainly in terms of delivery cost and the level of service is better because when it is in Magalu Entregas, tracking of the good is much better. So for the consumer, it's much better, the NPS is better of the deliveries.

So more or less, this is the answer, but the focus is to roll out the cross-docking modality. In Brazil, I don't believe that storage will be as relevant as it is abroad, but we will be prepared to do this as well. So we are going to expand our area to have it also but mainly in cross-docking and not so much in shipping from store. And then we collect from the store, we pick up in the store and then we do the cross-docking. You see the whole mesh and storage will be part of that, but it is not necessarily the core in my view.

We will be prepared for both situations.

About payment. I can say even less because in order to increase the MAU the monthly active users in the app, we want to do this with new categories and with lower ticket categories and higher shopping frequency such as the net categories and Magalu which is already representative 25% of the website customers already come from e-commerce but we will not achieve the high frequency. We are talking about monthly average users. We want to go to daily active users and we cannot do this with goods alone. We will have to have other services and you talked about mini apps and we are preparing to connect these mini apps and payment is important, mainly in the context of increasing the

FINAL

frequency of utilization. The Superapp is the major part of our strategy. However, I cannot get into details regarding the timing, et cetera, but we will certainly be doing something.

What is more in the short run, it is the prepayment and there lies a good monetization opportunity. Payment to customers, today is like a red sheep. Although it is important from the viewpoint of generating frequency of use, which is important for our strategy, a major investment is being made. And it's like having the current magazine without elite. And in the market elite for bonus and cash back and coupons, et cetera. In order to give this kind of attraction, it is too expensive, but from the viewpoint of profitability with everything that is going in the world -- going on in the world even the online -- well, of course, sometimes you can have a trade-off, but we have to be very careful in terms of the direction. Not to get into this world of cash back, et cetera. We will make some move, but not show quickly and it has the possibility of representing something more significant to our bottom line.

And we have a very good opportunity in receivables discounts for the seller. So this is the priority. In terms of our endeavors in this direction, I'm not saying that payments to end customers is not important, but from the viewpoint of results and monetization the payment or the prepayment for sellers should be the first direction.

Q - Thiago Macruz {BIO 16404924 <GO>}

Thank you very much and congratulations for the quarter.

Operator

Robert Ford from Bank of America.

Q - Robert Ford {BIO 1499021 <GO>}

Good morning, everybody. Congratulations for the results. Could you talk about the response of mass Magazine Luiza service? How does it work in terms of monetization and how do you expect this to evolve Magazine Luiza service?

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

Good afternoon, in fact. Well, thank you for the question. Magazine Luiza service, the concept is retail as a service. What we do today in marketplace is a standard operation. We are generating sales for the seller. We are working with customer acquisition and taking advantage of the traffic that we already have in our digital channels and stores, but it's the basic service level in the context of the market base. And our strategy is to be a digital platform that will help the Brazilian retail to become digital and we have to have value added services such as payment. That was the object of the previous question, Magalu Pagamentos as part of Magalu as a service. So that the seller may use working capital, et cetera, from the viewpoint of FinTechs for sellers in this component, this is the most basic one. But there are many others, regarding payment and credit that we can offer to sellers that will be coming on board.

FINAL

And we also have the deliveries and Entregas. If I take to delivery of that I do for 1P, I make it available as a service to the seller. It will be under the context of Magalu as a service. And I talked a lot about delivery in the previous answer, and we have a new opportunity to monetize here over the window short run. It is more to increase the level of service and decrease the numbers of base for delivery. So those who use Magalu Entregas here it is free shipping and Magalu subsidizes this. So we announced this from Expo Magalu and it helps to increase the delivery service. This is a service. I have contact with carriers, and I have a delivery service and I either make it available to the seller or via technology, via API, via platform, I'm doing the delivery for them. That is to say a retail as a service again and there is an important component that we announced during the Expo Magalu, which is the following.

Today, most of the sellers that are selling online are companies that have -- there are maybe 50,000 to 100,000 companies that sell online, but it is over 1,300,000 retailers overall, and only 50,000 to 100,000 sell online. So we are growing over 1,000 sellers online per month. And via Entregas Commerce, that was the company that we acquired in our platform, we want to develop system so that the analog sellers may sell. And we announced one of the first product, rather a startup ,Shop Works, developed the IPDV, the physical retailer places in their store. The small and medium-sized retailers and most of the large ones already sell online and they installed this in their physical stores and this system does all the tax part and inventory and issues invoices. But when you have the inventory on this iPDV, It is made available through the Magalu app. So it is still a pilot. We intend to roll this out, we have already had some sales of goods, but we're in the physical world only and that were showed over the Magalu app and we intend to develop this even further.

During Expo Magalu, we launched a Magalu Tech for the sellers that do it by hand that is they issue their invoices by hand. And even in the 11,000 sellers that sell through Magazine Luiza marketplace, some of them have the financial ERP, but don't and they do this manually. And very small sellers among these 11,000. So we launched Magalu Tech in order to help them to collect taxes and issue invoices in the major fashion. So these are services that we will be delivering to sellers to make their lives easier and we will be charging a very small fee. And these are opportunities that we have to improve the level of service. In 3P, we want to be as good as in 1P and at the same time monetizing this space that has already grown 300% in this quarter, almost 2 billion year-to-date. So, we develop labs. At Labs, we will be developing everything digital with software as a service and on the platform, we will be making this available to the sellers and of course, deriving some revenue from that.

Q - Robert Ford {BIO 1499021 <GO>}

Thank you, Fred. There is a question about Netshoes. You said that the Netshoes has already reached equilibrium or breakeven. Which is the highest gross margins in the category, how should we think about Netshoes margins in the long run?

A - Unidentified Speaker

I will ask Eduardo, to describe the integration process. Okay. And I will come back and talk about margins.

A - Eduardo Galanternick {BIO 20410320 <GO>}

Well, this last quarter, we made a commitment to get to November with the design of this integration already completed with many work groups and we reached the final process, the organization design. And we are getting to the Black Friday and we have to be totally focused on that, but right now, we have already been able to tap into very important things, integration of catalogs and the possibility of having store pickup for Netshoes. And we launched a new version, which is much more user-friendly with filters. And this is already in our app in Netshoes and we have already Love Bee to cater to Netshoes orders, in order to reduce delivery times. And we have already done the work in terms of synergy with contract for service providers. And collectively, we have already decided to marketing initiatives, the Champion League, which will be broadcast by Facebook and we are sponsors only because we are together with these two brands.

And from the viewpoint of structural integration, we are finalizing the plan to be executed in 2020 and from the business viewpoint, we are already capturing some advantages. And I would like to for to refer to Marcos to be talking about this.

A - Unidentified Speaker

Adding to what Eduardo said, it's very important to have the inventory levels with a bad situation possible and this is what we have already achieved. We have new inventories and the payment terms, already we expect the partnership that we have with all our suppliers, with our partners and growing more than 20%. And with the EBITDA already capturing everything that is Fred said, it's important to stress the new sponsorships with marketing and this places Netshoes as a very beloved mark. And is a tenure of course as well, but sports growing up. And the creation of a world within Magalu, together with the brands in a very well structured model, we are bringing gradually to a controlled environment, a healthy environment all that, so that we may grow very quickly. Just to give you an idea, we are already completing over 50,000 products on the base of Magalu, on November 4, Black Friday. So these are some details of the business.

From the margin viewpoint, we do not give guidance, but together with integration, we are doing strategic planning for Netshoes. We hired a consultancy company and we are drafting a business plan tapping into opportunities. And my view is the following: net sales BRL2.5 billion last year in a market of BRL140 billion, the penetration of fashion in Brazil is still very low if you compare this to any other place in the world. So, one of the biggest opportunities for growth in e-commerce is fashion. And there I, include sports. We're just well Net has achieved a high penetration in Brazil. It really change the world of sports goods, but if you look at fashion as a whole, the penetration is low, about 5%, not considering some figures from marketplace. But some countries already have 20% penetration. So the focus of Netshoes is growth. We want to balance the result and we already have some sign of this breakeven. We want to improve the cash generation of the company and this quarter we already have evidence of that, achieving this breakeven.

The focus of the Company will be growth, growth in revenues, because looking at the opportunity as a whole, we are including the fashion opportunity, we can further increase the GMV of all the categories that Netshoes operates with. And this is Marcos focus and his team's focus, growth with balance, because Magalu grows with balance. So this is the

way we do things. So working with higher margins, this is the principal, after we get to a higher revenue, but the advantage is that this helps dilute fixed cost and part of the dilution will be with the integration of the back office next year.

And Netshoes would have to have a large structure for 2.5 and Magalu for higher DMV means less and part of that has to do with Magazine Luiza and the store pickup, reducing in many geographies. Sao Paulo, not so much, but in many of the places that will help reduce the delivery expenses of Net. But the focus of Netshoes is to tap into this great opportunity, which is the apparel and fashion and sports goods market. I believe that the major wave that is coming in these categories such as like the case with electronics and appliances before.

Operator

Luiz Felipe from BTG.

Q - Luiz Felipe {BIO 17478308 <GO>}

Good afternoon, everybody. I have two questions. The first one has to do with Netshoes. Can you already see some cross-selling? You said the 25% of traffic in the platform already come from new customers. So, do you already see some cross-selling, Netshoes customers buying products that were only showed in Magazine Luiza? And the ways you monetize this is the second question. You talked about Magalu as a service. So what are the opportunities when you think about monetizing traffic. In terms of advertising, can you already see an opportunity, such as already seen in more mature markets, more mature than Brazil?

A - Unidentified Speaker

Thank you for the question. From the viewpoint, of course, very little. We are ready -- well, we do have some categories at least that will be coming on board this week, so the major brands are coming on board now, and the iOS store was updated during this last weekend. So, we still have integration in CRM that are already being debated. But it is still scratching the surface. Basically, we have grown with the new categories that were already in Magalu and the new categories that were already in Netshoes. So within Magalu, but far from achieving the potential, we already see something. And we have to celebrate every million that we generate. But we are still scratching the surface. It is the tip of the iceberg. And we have a lot of room to grow in terms of CRM and cross-sell.

About Magalu ad, the focus now and when we talked about the strategic priorities, I said that, we have a lot to grow in GMVs. And audience and we have to grow sustainably the focus well -- we are very much focused on growth to the detriment of margin even, because when you have a large margin base, it's easier to monetize. I'm not prioritizing new services yet, Magalu Pagamentos is the focus in terms of monetizing in receivables of sellers and not end customers. Magalu Entregas and even less in Magalu Pagamentos. But I would say that the main focus is to increase the active client base. We are talking about 25 million of 150 million economically active population. So, we want to have a much bigger base.

FINAL

We already have Magalu edge, but this is not our focus, main focus. We are focused on an increase in the base and the frequency and we want the customers to return and more and use the app more, This audience has to be monetizable. It's not only having the clients that bought in the last 12 months, but always going to the app, et cetera. Then we will have relevant results in the future. So this is a business line, an important business line for the future. And this is an important fact for our monetization, but the focus is to increase monetization, the frequency of use and the DAU as well. First the audience and then the revenues, we are focusing on the audience first.

Q - Luiz Felipe {BIO 17478308 <GO>}

Excellent. Thank you very much.

Operator

Joseph Giordano from JPMorgan.

Q - Joseph Giordano {BIO 17751061 <GO>}

Good afternoon. Thank you for my question. The first question has to do with the customer base. I would like to understand the behavior in your physical stores and how the Luiza Card, which is a major part of the total revenue of the company, how do you compare, the using of the Luiza Card in the physical world and the (Ends Abruptly)

Bloomberg Transcript

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.