

Y 2021 Earnings Call

Company Participants

- Eduardo Galanternick, Vice President of Business
- Fabricio Bittar Garcia, Vice President of Operations
- Frederico Trajano Inacio, President and Chief Executive Officer
- Leandro Soares, Executive Director of Marketplace
- Vanessa Rossini, Investor Relations

Other Participants

- Danniel Eiger, Analyst
- Irma Sgarz, Analyst
- Joao Soares, Analyst
- Joseph Giordano, Analyst
- Robert Ford, Analyst
- Ruben Couto, Analyst
- Unidentified Participant
- Vinicius Strano, Analyst

Presentation

Operator

Good morning, everyone, thank you for waiting. Welcome to Magalu's Conference Call about the Fourth Quarter of 2021 Results. (Operator Instructions) We found that this event is being recorded and will be available at the Company's IR website, ir.magazineluiza.com.br, where you can also find the release and the presentation both in Portuguese and English. The English presentation link is also available at the chat. During the presentation attendees microphones will be off. Afterwards we will start a Q&A session. In order to ask a question please click on the Q&A icon on the lower part of your screen. Please write down your name, company and the language of your question. When your name is announced the request to activate your microphone will appear on the screen and you may be unmute to ask a question. The questions received in writing will be answered later by the IR team.

Now I would like to turn the floor over to Frederico Trajano, CEO of Magalu. Fred, you may begin.

Frederico Trajano Inacio {BIO 17269235 <GO>}

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Good morning, everybody. Thank you very much for participating in our call about the fourth quarter of 2021 and the year as a whole. Once again, I'm here with all the executive officers of the company who will be available to answer any questions that you might have at the end of the presentation. Today, besides my presentation, our IR Manager, (inaudible) will talk about the results. Unfortunately the father of our CFO died yesterday, and all our solidarity to him and to his family and Vanessa will be stepping in. And she will also participate in the Q&A.

In 2019 after finishing the most successful transformation process of a company in Brazil, in terms of digitalization, we started the new strategic cycle based on the construction of the multi-channel. Marketplace, the entry gate for thousands of analog retailers. And with these retailers we did what we did with Magalu. We conveyed our technology and our know-how, our knowledge, so that these merchants could be participating in the digital world as well. And this strategy also involve the diversification of revenues and the radical creation of the product base, offering this to our over 37 million active clients.

And we made many acquisitions, many investments and many organic investments as well in order to reach the objective, after three years of the end of the strategic cycle and two years of the pandemic that hit the whole world and also Brazil. We consider that we have many things to celebrate in terms of our figures, we are really doing what we said we are walking the talk. And we have a lot to do still for the next few years. And I'm going to share some of these figures with you and part of the progress of the implementation of the strategic cycle and that corroborate all that.

First, of course, I would like to highlight the growth once again. Even in spite of two years of the pandemic we prepare our total GMV including physical, I don't mind. We've reached BRL56 billion of GMV in 2021, or twice what we had in 2019, a growth of 28%, vis-a-vis the previous year, already with 71% participation of e-commerce in the year as a whole. And one of the drivers of our growth has been online and we doubled our GMV online and we tripled the sale of e-commerce from 2019 to 2021. We sold over 200 million items in the whole system of Magalu and delivering 39% growth. And despite being a very high growth base and the retailer that grew the most in the first year of the pandemic, and although we had a very high base we were able to grow an additional 39% in 2021 which means that once again we were able to achieve this extraordinary growth. And in online, the focus as I said at the beginning of the presentation was the marketplace, we grew fourfold on marketplace vis-a-vis 2019, from 3 to 13, GMV, 69%, growth in 2021.

And over an exponential growth of 156% that we had in 2020 to 2019. So you can see these are very robust figures, very important figures for the digital world and for the Brazilian retail as a whole. In terms of marketplace, I would like to highlight a historical fact. Now in February, after five years of its launch, the marketplace -- the GMV or marketplace has already exceeded the sales of the physical stores. The participation is already higher than the physical stores in the overall sales. And February was a month where we repriced our prices for sellers, and in spite of that, we had a growth that was higher than the market. With much better margins in the marketplace, than we had in the previous years that were years that well, some platforms were not even charging the sellers a fee and the competition was very fierce. And in spite of that, in spite of the

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change in prices, we were able to reach a GMV higher than the physical stores ended February. Also a very good performance better than the fourth quarter of last year. So this is evidence of a correct strategy and I will be going into details about everything that we have been doing in order to generate this outstanding growth in this channel, which is so important, which is marketplace. And of course, we have been a primary new sellers and outstanding figures from 26,260. This is a very steep growth in the number of sellers. A 160,000 -- 40,000 sellers in the third quarter of 45 million offerings for the total and over 61 million of diversifying our product lines and the average ticket offered to the client. But I will be going into detail about the geography, regarding the sellers that we are putting onboard, which is a very good strategy. It's very different from most of the players in the market, is very important to reinforce that.

As I said, we have a focus on the digital seller, but also on the analog seller as well. We created at the beginning of the pandemic, we created a platform, a very adequate platform and totally focused on analog sellers, which is the Parceiro Magalu, with end-to-end technology involving the online billing, inventory management, delivery management, totally different from the digital sellers who are native digitally.

Just to give an idea, last year, 80% of the sellers that we acquired on the platform came from Parceiro Magalu. These are analog sellers that by means of our marketplace, we're able to offer their products to clients in the whole world by means of the digital world. And this figure will continue to grow and I will talk about the importance of physical stores in terms of attracting these sellers. One interesting point is that, they have a profile which is different from the product mix, most of the products that are coming onboard, they are long-tail products, that are not traditional categories and these sellers already give us two different characteristics. The main one is the fact that we have a very wide geographic base. We are deconcentrating Brazilian sellers from Sao Paulo and bringing onboard sellers from all over Brazil in order to offer their clients to Magalu clients that are also scattered throughout Brazil. And for logistics this has to work because in Brazil if you have a centralized and low ticket logistic, you will never be able to reach the economic 30, 40 rails average ticket going from the Southeast to the Northeast or is just you will never be able to get a good revenue in this platform, because that margin will be negative because the participation of the freight cost in the total GMV and the take rate will be extremely high.

And we are deconcentrating and concentrating on the average ticket on these geographic locations. So our growth strategy of our market places decentralized and sustainable and we believe that it will be more and more efficient in terms of economics.

One important highlight, is that, 56% of the new clients of Magalu came from the marketplace. So this has been healthy [ph] Magalu to corporate clients that were of not clients that bought the products of the company. So most of the new clients that are coming to the platform, 56% come from the marketplace. And one of the reasons why we have been able to significantly improve the volume of sales of the marketplace and also the conversion rate, where all the logistic investments that we made as of 2021. So we made a follow-on and the objective of the follow-on was to increase our logistics. We went from 31 with cross-docking and DCs -- occlusive DCs to 272, much higher than the guidance that we gave you in the follow-on. And also the total warehousing area owing to

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1,389,000 square meters increasing 2.14 [ph] and also we increased the coverage of our own logistics. We made three acquisitions, GFL, SODE, and Logbee was already with us, in order to increase the participation of our own fleet in Magalu Entregas or Magalu Delivery in the total GMV.

Now some figures that I would like to share with you, 80% of all of the orders are prepaid Magalu went through Magalu Entregas. Almost all these are this went through our own network of Magalu. So, we don't have to rely on the postal surface or third-party trucks. And this generated two very important factor. The first one we increased quite a lot our delivery in up to two days from 18% to 30% last year, significant increase and this also increase the conversion rate.

Our 3P last year increasing 50%, which is very significant vis-a-vis 2020. And I would like to mention that when the decline (inaudible) product on the platform they buy 1P and 3P. It's important to buy with a good price and a very good delivery. In 1P we already have a very good service level, much higher than the average of the market, 78% of the deliveries in 48 hours. And we are further improving the participation of this quick delivery in the sale of 3P. But 1P, it was already a representative part and the experience that we have, you can see that we already have 78% delivered in 48 hours are up to. And we are the only company that -- we do not mix 3P with 1P in the reclamer key, which is the customer complaint website for instance.

So we had a growth of 10 percentage point in the NPS. And we are also developing the (inaudible) ship from seller up to 24-hour delivery. Over 1,000 sellers have already participating, because of the investments that we made and over 21 capitals with a coverage of ship from seller.

Now I would like to highlight the role of the physical store in our marketplace. It has already been very important in our growth and our leadership in 1P, 45% of all the 1P goes through digital -- physical stores and it has become a major competitive advantage. This is why I say that our marketplace is multi-channel and we re-signified once again our physical stores and it is extremely important. They are extremely important both for our client and our sellers and everybody who interacts with our marketplace. And I would like to highlight two points. The first one is the transformation of the stores into Entregas Magalu. And the local sellers that the store brings to the Magalu's system, they can deliver in the Entregas Magalu. And we shared some of the results from the sellers with you. We have almost 10,000 sellers that are using this, as their main point, a 150% growth, with the drop in the cost of freight, in relation to the traditional postal costs.

Stores are also 3P pickup points. We have 1,100 stores already doing this with the store pickup. And the different that really made Magalu the leader at the benchmark is being transported to the market place world. And we want to reemphasize the importance of the stores. The stores are much more than a point of sale which is a logistic point not only for 1P but 3P as well. Besides selling financial products, it is much more than the POS. The stores even if all are breakeven only, we will be happy, because we will over 1,100 points. So it is very important to have this row [ph] people followed by the physical stores. You can see that this is an evolution and it became a very big competitive advantage. 50,000 of the sellers came through the service delivered by our stores, so you can see the

importance of the physical stores attracting sellers. And Magalu is a multi-channel company and not a POS company.

We are going to talk about this a little bit later. You know of course that there will be some difficult take the last quarter, but overall for the full year we were able to keep the sales from the stores even higher than in 2019. We grew a 100, we had already grown 1% vis-a-vis 2019 and now 6%. And the sales for the year as a whole was very resilient and we believe that after this moment as water entered the bridge it will come back again and generating more contribution to the business and playing a very important role for the whole ecosystem.

A second point, I talked a lot about the multi-channel marketplace. And now I would like to mention a very important point that I said, I referred to at the beginning, which is the diversification of revenue streams and the coming onboard of new categories and also new lines of service revenue. We made quite a lot of acquisition, 20 acquisitions over the last couple of years mainly. Some before that, such as Netshoes and Epoca. And we are sharing this with the market to show this very clearly, although we had a very good performance in durables and we continue to be the leaders. It took us six decades for us to become the leaders. But our diversification of categories has a very good result and it's very important to give visibility to you.

These long-tail categories which are not the traditional categories represented about BRL20 billion. And we will be talking about couple more a little bit later. 45% of the online sales coming from new categories, home accessories, peripherals, beauty, grocery, food delivery, all of the categories that are growing very cheaply. And with the marketplace and with the companies that are coming with the group, we have been very successful. And I would like to highlight that the acquisitions besides contributing to the top line, they are contributing to the bottom line as well. So we are very successful in terms of bringing companies to the Group that help us to expand GMV. Then that will help the company to be more profitable. And I would like to mention that they are all in line or higher than the original forecasts. The acquisition strategy is already bearing fruits and then it was core operators [ph].

And I would like to mention each one of them just to illustrate. Like to start with the KaBuM!. KaBuM! is the youngest in the group. We announced the acquisition in July, but we were only able to integrate it into our balance sheet in November 15. So the results of KaBuM! will be integrated in 2022, but it is a company that it's like the Disney Land [ph] of gamers. It's a leading technology in gaming e-commerce site, BRL4 billion GMV, BRL300 million profit more than 2 million active customers. More than 60% of them had never bought in the Magalu ecosystem. It will bring a new customer base that is different, loyal. And in a category that is growing worldwide gaming, it is totally complementary to Magalu. We are talking about IT accessories, peripherals, things that people buy for gaming.

And also people buy these accessories for Bitcoin mining [ph]. So more than 20,000 items assortment. So this has a loyal customer base and we'll be doing a lot jointly in the universe of technology in gaming e-commerce. And this is going to be a very successful acquisition as well as Netshoes acquisition. We are celebrating record results and is

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universe of lifestyle categories that we added to Magalu, particularly with the acquisition of Netshoes. For Netshoes, we had some record marks last year GMV of BRL4 billion. The highest profit in our history, BRL135 million. With the back office integration, logistics integration, store pickup and number of advantages, that Netshoes alone did not have but integrated to Magalu ecosystem. We were able to reduce G&A and of course we had wonderful management.

A 250,000 items assortment, 7 million active customers a loyal base and one of the main sports, e-commerce channels in Brazil. Very high organic access and it's proven to be one of the main e-commerce brands. We sold more than 10 million pairs of athletic shoes and 1 million soccer (inaudible), as we are responsible for managing most of the club stores -- soccer club stores and we managed those.

And with Netshoes there comes Zattini, one of the main fashion channels in Brazil. And there with it came a team with a lot of expertise, how Silvia joined with our expertise to have the Brazilian e-commerce of fashion. So for fashion, GMV was BRL1 billion, at Magalu 170% up year-on-year growth, more than 300 brands available. And I would like to highlight the fashion marketplace. 50% of the fashion GMV was 3P last year. We can see 30,000 sellers in the categories came with the acquisition of Netshoes and Zattini. We have increased the sellers base and also via hub we included eight industrial hubs.

We have a number of factories connected directly to our e-commerce. So also the fashion category has grown a lot. And we are very confident that we will continue to provide and deliver very positive results. We are one of the leaders in fashion and will continue to grow above market average. Another highlight last year was Epoca and the beauty category. GMV of BRL1 billion, in 2021, 60% year-on-year growth of GMV plus 3 percentage points of share in the category. It is profitable. So when I choose Epoca, KaBuM!, all assets added to Magalu ecosystem, adding to the top and bottom line. Altogether lifestyle categories represent BRL6 billion in total sales in a very strong combination of 1P and 3P, with a lot of growth potential looking forward. I'd like to remind you that these categories are underpenetrated in Brazil.

Now, I would like to talk about groceries category. BRL1 billion, this is the GMV of groceries in the whole ecosystem. Last year we acquired web commerce, an e-commerce platform that helps analog retailers of supermarket products to join the online world. It is the only specialized platform specialized in supermarkets. These customers gave us a GMV of BRL330 million. This is still a SaaS model. 200% of GMV growth year-on-year, 190 million items sold and more than 280 cities served. We should be able to integrate a good part of these customers to our ecosystem, particularly to our SuperApp. And we'll have some news for you soon to be announced to the market.

We will integrate all of these customers, all of these cities. And Vip has been able to grow with the SaaS model. So the groceries category growing a lot BRL1 billion GMV but in terms of items sold, it has a relevant share in our total sales being responsible for bringing customers to the Magalu platform.

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I would also like to highlight our food delivery, although it's not present in the capital cities, Magalu generated BRL1.3 billion of GMV for delivery and became the second-largest player in the Brazilian market with the exit of Uber Eats. 5.3 million total customers, we are creating a platform-based on AiQFome. We have 30,000 active restaurants and food delivery -- and I would like to highlight that our food delivery is profitable. AiQFome has always operated profitable -- in a profitable way. We are still focused on small, mid-size cities, but we expanding our services to other profile of cities and we're very excited with this potential growth.

I'd like to remind you that we integrated AiQFome in the super app last year and we're are reaping the fruits of that kind of integration. Another successful acquisition that has proven to be positive book in the top and bottom line.

I would also like to highlight, our Magalu Ads or Ads initiatives we bought three content channels, Canaltech, one of the largest content channels in Brazil, it's only special Magalu Ads, totally focused on the fashion, beauty, home category; Steal the Look, in this category, you don't need just the products and the content; and one of the most loved channels in Brazil, Jovem Nerd, with the acquisition of KaBuM!, it's going to be more representative in our ecosystem. Altogether, including the audience of these three channels, KaBuM!, Netshoes, Epoca, Zattini we had more than 450 million sessions accessed in December of 2021. Across all of the Magalu's ecosystem perhaps we are the ecosystem with the highest audience in Brazil. And last year we had a tie with specific advertising, we were able to sell a BRL100 million in advertising revenue. Particularly with the develop enough new features, self-service, the inclusion of Magalu Pagamentos to the platform and also with the Magalu Ads, they will facilitate for key sellers to advertise across all of the platforms with in a large ecosystem with such a large audience many sellers will definitely want to enjoy many of the functionalities we are offering.

We're very excited with diversification of revenue, BRL100 million is very significant for Brazil and we will continue to grow. And I would also like to highlight our Fintech which achieved significant TPV, BRL65 billion being around last year. We launched our POS machines of MagaluPay focused on analog sellers. We are also in the process of launching a corporate account. The Fintech was profitable last year. We had almost 5 million digital accounts created in the super app MagaluPay. The participation of MagaluPay in sales integration of MagaluPay with (inaudible) helped us a lot in terms of cash in. So that we could have many of the account focused mostly to use and enjoy exclusive promos. In the onboard of Magalu (inaudible) is totally simple. You just have to have the super app and some additional steps it's totally integrated with the super app, a lot more than other digital accounts in the market. Then 3 million new credit cards issued in 2021 with the focus on Magalu Card, gear to online shoppers, it generates cash back, you can look at your balance in the Magalu's super app. And our credit portfolio of Luizacred totaled BRL17.5 billion last year, much higher number than a good deal of the Neo banks in Brazil, showing the potential of our ecosystem to escalate the business. So, the Fintech is doing quite well.

And here, we see the breakdown of GMV, BRL65 billion, BRL41 billion in credit card, BRL16 billion of prepayment of receivables. And also banking as a service with Hub Fintech, one of the acquisitions completed in July of last year. It is responsible for a good part of

innovations and new features. On our platform end-to-end, I think that the number is clearly indicate progress of our strategy, of how many channel approach, diversification of categories and revenue streams with a balanced ecosystem. And now will speak a little about the financial highlights of the quarter and the full year. Vanessa will be handling that part and then I'll be back to answering your questions, together with the whole executive management.

Thank you very much.

Vanessa Rossini {BIO 20538325 <GO>}

Thank you, Freddie. Good day everyone, thank you for joining us in our conference call. I will go over the financial highlights for the year and Q4. Starting with the full year, while Freddie mentioned some of the growth, but it is important to stress the marketplace grew practically 70%. Our e-commerce BRL40 billion tripling in size, growing 39% in 2021 and physical stores even with all of the difficulties related to the macroeconomic situation in the second quarter of the year grew 6% and are at levels higher than pre-pandemic. We grew almost 30% of total sales, BRL56 billion more than doubled and in 2019 when we had only BRL7 billion in sales, so that's super highlight for the year.

In terms of results, Magalu reached 1.5 adjusted EBITA in the year, much enough 4.2% [ph]. Adjusted net income was BRL114 million in the year equivalent to BRL591 million accounting -- BRL591 million accounting net income.

On the next slide, we have the highlights for the quarter, again marketplace grew 60% more than BRL4 billion. Total e-commerce grew 17%, BRL11.1 billion in the quarter. Brick-and-mortar stores given a greater concentration of higher average ticket and higher interest rate time inflation posted a retraction of 18%, resulting in total sales 4% up in Q4 '21 over Q4 of 2020, with BRL15.5 billion total sales. Adjusted EBITDA BRL223 million equivalent to an EBITDA margin of 2.6%. And we had a retraction of the sales of our physical stores as mentioned and we had negative BRL79 million in adjusted net income and accounting net income of BRL93 million considering non-recurring events.

On the next slide, we have the EBITDA margin evolution how it performed compared with Q4'20. We see a positive contribution in terms of gross margin because of the greater share of services revenues. On expenses, selling expenses and administrative expenses, lower dilution of expansions because we have lower sales of our brick-and-mortar or as just mentioned before, the company is working on an agenda to make our 1P durable goods operation more profitable. We are working on a gradual pass-through of the increasing costs we had an inflation of costs in recent quarters and also to reflect higher interest rates. We've been doing this along the first months of the year.

On the next slide, we have a capital structure. Again we had working capital contributing to the capital structure of the company. And here it is important to highlight that we have been working a lot to improve inventory turnover. In the first months of 2020 we had a reduction of BRL1 billion in the level of inventory. So that we can work with a more efficient

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inventory turnover in the short term. In terms of net cash, we ended the year with BRL5.5 billion in December 2020.

And when we look at the next slide, we see our cash flow and I think have to highlight our capital structure, we ended with the highest cash in our history, BRL12.3 billion. In the quarter we invested BRL300 million in CapEx and we captured BRL4 billion in the ventures, with a long maturity, four, five years maturity. They mean to reinforce our capital structure is even more and we ended with 4 [ph] billion. And there we can see the receivables BRL8.2 billion.

Fred spoke a little bit about the portfolio, but it's important to mention that we ended the year with more than 7 million cards issued in the year, practically, 2P. We had ended 2020 with 5.3 million cards, we ended with 7.2 million. Here we have to highlight the Magalu Card launch is very successful. We launched it in April and we reached 1 million cards issued. And complementing Luiza Card in terms of TPV -- 41 TPV, the year growing 40% over last year and 80% of this TPV is outside Magalu stores. So our customers use the Magalu Cards both inside our stores and our e-commerce in also outside Magalu. And this was driven by the Magalu Card and the quarter to be degrow 40% with BRL12 billion.

Lastly, speaking a little bit about the indicators of the card, we ended the quarter with one of the lowest default levels. Our long NPL look 5.6%, a little bit higher, but still much lower than pre-pandemic levels, showing how healthy our loan portfolio has been the growth of our credit portfolio, the growth of our card base that has been very solid growth. Which improves more and more in our relationship with the clients.

In terms of results in the year with a card practically BRL300 million net income, according to the methodology of the Central Bank. And in IFRS, you can see the numbers. And this is related to the growth of the card base and growth of our sales. And the portfolio of indicators in terms of delinquency remain fairly low.

I think these were the financial highlights and we can now begin the question-and-answer session.

Questions And Answers

Operator

Now, we will start the Q&A session. In order to ask a question please click on the Q&A button on the lower part of the screen. Please writer your name, your company and the language of the questions to join the queue. (Operator Instructions). J.P. Morgan.

Q - Joseph Giordano {BIO 17751061 <GO>}

Good morning, everybody, Vanesa, Fred, thank you very much for the call. I have two questions. The first one has to do with the short-run. How do you see the evolution of demand for the other categories? And maybe this is a point of attention. And Fred, could

you talk about the challenge in short-term changes in the long-term strategy of the company?

Will you change priorities? Will you accelerate some and slow down some others, because there are some initiatives that are really working well and the company is setting up the whole ecosystem. I would like to know what you're going to accelerate and decelerate?

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

Thank you very much for your question. Good morning. In the last call, I talked about the short-term. Almost be like a macroeconomist and I spent quite a lot of time in our financial statement talking about that, nothing changed significantly from the last call, so now the situation is the same. I do not want to talk at length about it. The only difference is that we are prepared for what is going on in the second quarter of last year. In a way, the macro economy was rather surprising maybe in terms of the intensity of the change, the headwinds that we had.

So I believe that nobody was prepared, not even the very important hedge fund managers were prepared here in Brazil to face what happened in terms of inflation and everybody had to revise their portfolios and nothing changed in valuation to the short-term situation that you read about in the news. And the only thing is that, we are prepared. And Vanessa has already mentioned, some of the adjustments in order to make the operation more profitable and adapt it our sales to the size of demand. In terms of the strategy, it is quite the opposite.

As I said during my presentation, also in the message from management, the strategy since 2019 is in the diversification of categories. What's happened is that, we had this pandemic and everybody had to buy durables. I was not going to say to Brazil as well, don't come here to buy a smartphone or a refrigerator. I want to diversify, of course, we would never do that. After six decades we became a lot of things and we were very happy about that. We were the leaders in the category of durables. And of course there is some headwind in terms of the pandemic, but we will be much better than the average, and we are already very well positioned in order to tap into this market.

So we are very well prepared to face a period, I'm not an economist. I don't want to be an economist in this call. But maybe we will have to wait for about one quarter and the strategy was very good, all the acquisitions were in different categories and adding new revenue streams and they are all performing very well.

Very successful, BRL20 million GMV, 45% participation online, most contributing to our business. We will just accelerate the implementation of the strategy and the connection between and among all of these companies, KaBuM! is happening. We are doing BRL100 million, but we can do much more. So everything is going very well. Basically we have to execute the plan, which is something that we are already doing, that we did from 2019 to 2021 and we will continue. And of course, focusing on multi-channel that is bringing sellers from all over Brazil with a very special focus on analog sellers. So we are not going to change our strategy, we will continue to implement it with discipline and continuing

with the traditional categories. We know that there are cycles, so we have been through many cycles before. So it's very difficult at a system point, because everybody wants to be in the category.

Operator

Our next question is from Irma Sgarz with Goldman Sachs. Go ahead.

Q - Irma Sgarz {BIO 15190838 <GO>}

Hello. Thank you for taking my question. Freddie, I would like to know more about the design of the logistics network. I think that you have and approached a little different than some other players in the market. So could you please elaborate on where you stand, what are the work fronts you will be focusing this year and improve average delivery time for 3P sale I know, that you have evolved a lot. It was good to hear that it increased from 18% to 30% and I know you're going to grow more. So what are the work fronts you will be focusing on this year?

Any other technology acquisition or will you be working on the right algorithms to look at inventory in the right places and perhaps improve routing or will you be expanding the assortment onboarding more analog sellers or will you be working on physical assets? Well, you brought forward the opening of some new stores. So I would like to hear, what are the hurdles in the short term to improve these delivery rates even faster and even more?

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

Well, thank you very much, Irma for those question. This is a question that we get frequently from investors. I think that we're disclosing some important numbers now to clarify our strategy. I would like to highlight the expansion of our network. Logistics capacity is very important. We increased from 30 cross-docking stations and CDs to -- and DCs to 272 to last year.

Our focus on logistics is based on practically all of the points that you mentioned. First, you have to bring in sellers in the centralized catalog. I have to have a decentralized seller base present all over Brazil. We were able to do this through our hunting efforts by our brick-and-mortar stores and through the Magalu partner program. So we are bringing more and more sellers, more and more outside the Rio and San Paulo area because in Rio and Sao Paulo that's where we have around 70% of the sellers. But now we have people from the Midwest and Northeast and the catalog is expanding. And with our cross-docking stations, we can collect from the sellers and ship directly in our network.

Without necessarily having to store goods because the sellers already have their goods stored in their own stores. So having a logistics with a lot of flow and local inventory that's the logistics we are aiming for. Our focus as you said, is to make the goods travel a little distance. If a customer in Franca, in the countryside of Sao Paulo's brand new product, which is available in the fulfillment in Sao Paulo or in an analog seller in the city of Franca, we want to ship the good from that seller in Franca, avoiding long-distance transportation.

Now with fuel [ph] prices increasing the main cost of e-commerce is shipping in freight costs. So the last, the goods have to travel a better. When I speak about smaller tickets, lower tickets BRL30, BRL40, it is impossible to have a profitable sale. If we are selling a small ticket and making that good travel a lot. So we increasing the logistics base, 272, that help a drop-off and shipping.

We are making 1,400 stores work as logistics drop-off points, 15% store pickup. This is economically feasible for lower tickets. And just like Magalu agencies that we can drop-off point for sellers. And this brings a reduction of 50% in the cost. More than 10,000 sellers are using Magalu stores to drop-off their goods.

From the standpoint of customer experience, the structural change in the searching algorithms and of the data structure that we have it's environmental [ph]. To make all -- we have to make local products available to local customers, it's a total reengineering of our categories. AiQFome is already prepared to serve customer -- local customers with local sellers. So the change in logistics and in IT is very, very complex, a lot more complex than it sounds. But we have a very solid team working on geo-location, because we believe the more the local customer buys from local sellers the better. And of course, we have to continue to hunt for local sellers to make sure that the products are active in our listed products. It's a holistic work. Now with all of the investment made in storage area and also with the fact that 1P durable goods that had consumed practically all the storage area that we had, it tends to create more space in our DCs. In idle, space will use that idle space for the fulfillment buy. We'll add fulfillment by, to our possibilities available to sellers. And we believe that all of these factors together will help us improve their share of ultrafast deliveries for 3P. And 1P already has very fast delivery. When you buy an Amazon product, you don't see whether it's 1P or 3P. In Brazil, the 1P is not good, 3P is good. In the U.S. it's not like that, 1P or 3P, the same for customers, it's delivered fast and customers actually prefer to buy from 1P.

The market prefers 3P, we don't do what the market wants, we do what the customers want. And with that, we believe that we are going to improve also our 3P. And as you said the improvement was very significant last year. We're going to have more stores working as Magalu agencies and will improve the algorithm. And even Magalu Ads, we have features in Magalu Ads, so that sellers can advertise to local customers. So this is being shared by all of our business teams with the highlight going to labs. And I'm sure that we will continue to evolve in that indicator looking forward.

Operator

Thank you very much. Our net question comes from Maria Clara [ph] from Itau. Maria Clara?

Q - Unidentified Participant

Hello. Fred, Vanessa, thank you for my questions. Well, I have two questions. The first one has to do with the work and get dynamic about the inventory of the company. When do you expect to finish the process? And the second one has to do with the physical stores,

with the multi-channel ecosystem and the sales through the platform exceeding the ones in the physical stores what could we expect in terms of this evolution?

A - Vanessa Rossini {BIO 20538325 <GO>}

Thank you very much, I will start and then Fred will answer about inventories. In December, the beginning of the December -- at the end of December, we had the inventories of KaBuM!. And close to December 15, the result was above these days. So this impact the nominal figure and Magalu it also prepares itself in order to sell inventory by means of our big sale. So we have to prepare ourselves during this period. Over the quarter, we had this turnover. We had an improvement in the turnover. But this continue to read the first months of the year, we proposed ourselves to do this. This was very intense. At the beginning the sale was very important for our inventories. It was very important for us to sell the inventory that was there in our storage. In the first two months we already had this significant reduction of about BRL1 billion in the inventory bringing it to the levels that we consider as more adequate for the operation.

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

Thank you for the question. In terms of the future of the physical stores, I have already talked and I reinforce some points. And we will talk about the adaptation of the stores and to give them a new meaning at this level. I have already emphasized the strategic importance of the physical stores in order to post the product, in order to have the store pickup, and this is fundamental for 1P and very fundamental as well for 3P nowadays. And this is a very successful channel in terms of sale or financial products as well. So it is much more than a point of sale for physical merchandise it. This is where we sell financial products and also a very good support for sellers and more it becomes fundamental.

And we have a very big discipline, in what we do with stores. Our stores are very lean. We have small stores that cost for the square meters lower than similar ones. And we have a cost per square meter that is extremely low. And most of the costs are variable, so we are able to adapt to what it is generating in terms of revenue. If they stay on the breakeven it's already, very good. We are talking about 1,400 points of service in our ecosystem. But I would like to call Fabricio to add to what we -- what I have already said. Fabricio?

A - Fabricio Bittar Garcia {BIO 17269261 <GO>}

Good morning. Thank you for the question, Fred has already talked about the stores and we found the role to be played. And in our ecosystem and these last two years as a support for 3P, there is a very big concentration of the core products of Magalu in the physical stores. And we are in a complex situation right now, but this is going to improve. And therefore the physical stores are going to improve in this regard as well. We have been working with some pilots in some categories in the stores, very successful pilot. We should be placing new categories and remove a little bit of concentration of the core product. We have been investing quite a lot in technology in order to improve productivity, usually the back office, the support area, so we can operate the store with less people and this brings down our cost. And we quite able to open the new stores with -- at a very low cost with a very profitable operation. So, the low-income population needs credit and the stores --the physical stores are with the people, in these lower brackets of --

income brackets of the population can come and get credit. So just adding to what Fred had already said.

Operator

Our next question is from Bob Ford with Bank of America Merrill Lynch. Go ahead, sir.

Q - Robert Ford {BIO 1499021 <GO>}

Thank you, Vanessa. Good day, everyone. Freddie, could you elaborate on your cost structure and how should we think about the EBITDA margin evolution this year?

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

I'm sorry -- but could you repeat the question please?

Q - Robert Ford {BIO 1499021 <GO>}

Hello. Could you speak about the cost structure and how should we think about the evolution of the EBITDA margin this year?

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

Well within our app reversals -- we did not have reductions. I'm sorry, I have not understood. Okay. Bob, I think, given the performance and the volume of sales that we posted in the second half, particularly in Q4 of the year. I think it becomes clear that these numbers were below our expectations. The brick-and-mortar sales were below our expectations. We had a capacity size for volume that did not materialize in Q4. And we had to adjust the capacity in all aspects. So we are adjusting variable costs, fixed costs that involve contracts, service provision, the team capacity. In other words, we are making a number of adjustments to adapt our structure to the volume that the market is supporting right now. So we are working very hard in all fronts, people productivity, Fabricio mentioned a little bit of that. Shipping logistics optimization, we are -- we have teams focus then optimizing itineraries, routing, logistics options to reduce the shipping cost as a share of gross revenue.

In marketing, we are making an effort to improve the ROE of our marketing. So regardless of the market being more competitive or not, CPI [ph] is increasing. So we are working to make our processes and databases more sophisticated to derive better results and will be successful, in absolutely all work fronts, vis-a-vis last year. And like I said Bob, we were not expecting what we had in Q4, and that's economic slowdown. Now we know what's happening, so now we are prepared in the first quarter for that. So this year, the margins in my view will improve gradually, of course, first quarter, just like Vanessa said, we still have some inventory adjustments to make hard of the capacity adjustments were done in the first quarter of 2022. But we already see improvement compared to what happened in Q4, significant improvement particularly as of the month of March. I mean, we believe that this is going to continue along the year, will continue to improve as we are successful in our initiatives to improve efficiency. If the economy is not doing well, we have to do our homework in-house. In other words, we have to optimize, rationalize improve the share of interest-bearing sales.

There are a number of initiatives of the company, is implementing to try and improve and adapt our core. As you know new initiatives as I showed you are doing very well in terms of top line and bottom line. But we need to adjust the size of the company to the new macroeconomic scenario. Still have a number of initiatives ongoing and we are executing them according to plan and to schedule. Along the year this will become very clear in our results.

Operator

Thank you for the question. Ruben Couto from Santander. Ruben, you may proceed.

Q - Ruben Couto {BIO 20636571 <GO>}

Good morning, everybody. Adding to the previous question. And in terms of cash generation for 2022, could you talk about how these drivers that you have just mentioned will be impacting the result of 2022? Do you believe that the second half could be improving in terms of cash generation and what other actions are important so that you may go back to the previous cash generation, is that the marketplace or the relevance of 1P vis-a-vis 2P and 3P. And recovery of margin and also cash generation for 2022, what can you tell us about that?

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

Good morning. Thank you very much. I will start and Vanessa will join me. In terms of cash generation there are many aspects involved. The first one is the working capital, who as I said, we have been very vocal about that. We have been adapting our working capital, we have always had a lot of discipline in terms of generating cash and also a good management of working capital would be. It is good, when you have a good planning for sales and for inventory. I do have a very good market reading. So this year, there is a lower unpredictability than last year. We have been working to go back to the traditional levels of Magalu having a positive working capital. We are working on that, we still have an adjustment to do this, still in the next quarter, because it consumes cash, because of the natural cycle of the company.

We are very much focused on going back to our normal levels of working capital of the past. So we have -- let's say monetization of assets, the default [ph] of last year did not become cash. In many locations, it will be cash and other assets and of course there is a discount, we will only do things that are positive for the company. We are working on that. Only if we have very good opportunities and we prefer to monetize assets as the case maybe.

We would never do anything that could hinder our result. And I also see many benefits. Marketplace was not good last year for cash generation, because as a whole market was having zero take rate and free freight it consumed more cash than generated cash. So in February we changed this and now we have a positive contribution. And it is now what it should be, always an economic model of positive cash generation because the market is more rational now.

So I think this is very positive, but I'm not saying that, it is good in 1P and rather than 3P. No, it depends, because you can have an 1P that is a very good cash generator and a 3P that is not a very good one. It has to do which we're juggling with these. And the scenario makes things more difficult, but we have a very good team and a very good team in our physical stores as well. I would like to go back to our physical store team, they are spectacular. We have a great culture, we have thousands of people who work there and deliver result and deliver the goods and they give service to the sellers and to the clients that you must not forget that the physical stores have -- has a very big difference, our competitive advantage the most motivated team that we have in this area in Brazil.

Operator

Our next question is by Vinicius Strano with UBS. Go ahead.

Q - Vinicius Strano {BIO 20854812 <GO>}

Hello. Thank you for taking my question. In the previous earnings call you mentioned a premium Black Friday. So I'd like to know what is the company thinking regarding the product mix? Do you intend to focus on more premium products in core categories? And what is the general competitive landscape, perhaps the competition is a little bit more aggressive right now. And if I may ask another question, Freddie, could you speak about the initiatives to increase organic traffic for the company? Thank you very much.

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

Well, I'll answer the first question and then I'll let Edu answer the second question, and thank you very much. Well, unfortunately, in Brazil we have a situation in which the low-income classes lost purchasing power, given the economic issues, we feel that. At the brick-and-mortar stores because the profile of our buyers in the physical store is are on average 2,500. And of course the impact of inflation is huge on family income. I'm not going to speak about macroeconomics, but had to mention this. In the presence of inflation, Brazil is for just a few people, just for the people who feel lost the impact of inflation of food items, of power, inflation of fuel. So the premium categories remain more resilient than low ticket categories. But this is bad for the Brazilian economy, it's bad for Magalu and for practically all retailers in Brazil. There are very few that are exclusively focused on premium customers.

Black Friday happened as it did, but of course we want to sell to everyone, we have the passion of Magalu to bring products to low-income consumers to bring digitalization for small sellers. We are inclusive, so this situation makes me sad. And I hope that we can quickly go back to controlling inflation, to again continue to distribute incomes of the Brazil, will be for many and offer just a few.

The characteristic of Black Friday was what it was, because of the macroeconomic situation. And as regards to our audience Edu will answer the question.

A - Eduardo Galanternick {BIO 20410320 <GO>}

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Edu Galanternick. Speaking about organic, traffic and reducing the reliance on marketing investments there are two dimensions to answer the question. One is a technical dimension. Continuous work that we do, to evolve SEO and CRM, whenever we add customer base by growing Magalu brands or adjacent brands, we can enrich our recommendation algorithm and improve our CRM strategy. But these are more technical aspects. From these strategic standpoint, though what makes a difference, what we have observing and we saw that a lot in the second half of 2021 is that adding new categories, increased frequency, particularly in our app, increases recurrence and makes customers to end up choosing, a better traffic mix for our smart organic traffic.

This is not data that we disclosed, but our share of paid sales in the year was reduced more specifically in the second half of the year. In the -- because of this growth of new categories added. And I'd like to remind you last year we completed integration of AiQFome in the Magalu app, still at an incipient stage, but we completed that. And as Freddie mentioned, we're completing the e-commerce [ph] integration into Magalu. KaBuM! is already fully integrated in our marketplace. And as we move forward as we convert Magalu customers to these new services and new categories, we have higher frequency and the reduction and the need for investments. So we can choose to invest or not, it's our discretion. But in an aggregated form we'll see a reduced need for investment. And this is our app and this is -- diversification of categories is a strategy for us.

Operator

(Foreign Language) Danniela from XP.

Q - Danniela Eiger {BIO 20250080 <GO>}

Hello. Thank you for the question and I have two question. The first one has to do with your inventory position made in the last quarter. How much has been used already in this quarter? And how much could be expect remaining for the three quarter, because I believe that you'll have (Multiple Speakers) M&A strategy. (Multiple Speakers) maybe carrying out smaller and (Multiple Speakers), so maybe you could give us an update of your frame of mine about future M&As?

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

About the provision, we used the significant part of that during the quarter. As I said before, the inventories started at the beginning of the fourth quarter, they continued at the beginning of 2022 with the fantastic sale we gave one additional step in this direction [ph]. So in February the level was much more adequate. So it was used in the fourth quarter but also in the fantastic sale as we call it. And I will give you further details later on.

A - Vanessa Rossini {BIO 20538325 <GO>}

Thank you for the question and still about the M&A, 20 acquisitions in two years. And now we will have to digest all that. And we have a lot of work in our hands, our integration team has a lot to do in order for us to reap all the fruits from all these acquisitions, although all of these acquisitions are performing very well. We believe that right now, not

because of the macroeconomic scenario, but due to execution reasons we are going to focus more on the assets that are already here with us and evaluating all the possibilities and making all the connections among all of these acquisitions. So we are going to halt this for a while and we are going to focus on doing the best possible with what we already have inside our system.

Operator

Our next question comes from Joao Soares with Citibank. Joao, go ahead.

Q - Joao Soares {BIO 19213781 <GO>}

Hello everyone, thank you for taking my questions. I have a couple of brief points to raise. First, I would like you to elaborate on the 3P growth, which was very positive in this quarter. I would like to understand what are the main drivers of 3P growth? Is it the arrival of new sellers that you hunted in recent months? Is this a legacy seller selling more or the maturing of some of the sellers? Could you give us more color on 3P growth? And also Fred, we have a lot of services that you're providing, which you're offering, when we look at Magalu agencies and Magalu Ads we're selling advertising. So you're evolving a lot in your service offering. How does this reflect in the take rate and the commission that you're charging from sellers?

And the last point, if I may. Regarding the short term, I don't want to insist lot Freddie. I know that this is a little unpredictable. But lately in February we saw an improvement in the foot traffic of some stores and the whole sector being more optimistic. I don't know, if you share this optimism, could you share what you're thinking?

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

Thank you for the questions Joao. I will let Leandro Soares, responsible for our marketplace answer your first question. He can give you more color on that, and then I'll come back to answer the rest.

A - Leandro Soares {BIO 21479348 <GO>}

Hello. Thank you very much for the question. Our marketplace growth has two components as you mentioned. There is a component of new cohorts. We added a large amount of new sellers over the year. They started slow, but after a few months they're selling at an accelerated pace. In the component of old cohorts I think that there is a little of both. And we can see that this growth stems from both factors, the new sellers and the old sellers in this centralization. So that we can start selling across Brazil at affordable costs.

In September, we also had our free shipping policy that accelerated those processes. We were offering free shipping for up to 100% discount for our partners. Now starting in February, we updated offering up to 75% discount in shipping costs, so that changed a little. So from the standpoint of building, we maintained the percentage, we added a BRL3 fee in the adjusted shipping to make it economically feasible to serve all of our

partners and so as to sustain growth for longer. I think that this is the main component that explains the growth that we had in Q4 and -- sustainability for the coming quarters.

Operator

We are now ending the Q&A session. I would like to turn the floor to Frederico Trajano for his final statements. Freddie, go ahead.

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

I think that Vanessa's recording came too early, let me answer the second part of Joao's question. Well, like I said initially, I didn't see a significant change in the macroeconomic scenario from Q4 '21 to Q1 2022. The differences we are more prepared to cope with this new scenario that we are dealing with. So are we -- in my opinion, we believe the most significant improvement will happen in the second half of 2022. I think it's the opposite of last year. First half will be a little harder. Second half will be a little better from the macroeconomic standpoint, but the company is prepared for that more challenging scenario, improving our operation along the quarters. This is what I envision for the future. But again, I don't have a crystal ball. Things might get better before, anything can happen, I should say. But I'm not expecting great surprises though.

Operator

Thank you. We are now closing the Q&A session. Freddie, let's move to your final statements.

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

Well, I would like to thank all of you for joining us in this earnings conference call. We have all the management here with us, and I would like to thank the management, I would like to thank all Magalu employees, who are working hard to execute our strategy. I would like to say that we obviously understand all of the challenges in short-term scenarios. But we are absolutely motivated and excited to execute on our strategy. And instead of looking at a snapshot, we want to look at a film, a film is better than a photo. Thank you very much.

A - Vanessa Rossini {BIO 20538325 <GO>}

Magalu Earnings Conference Call is ended. Our Investor Relations team will remain available to answer further questions and doubts. Thank you very much for your participation and have a good day.

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FINAL

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