

Q3 2021 Earnings Call

Company Participants

- Eduardo Galanternick, Vice President of Business
- Frederico Trajano Inacio, President
- Roberto Bellissimo Rodrigues, Chief Financial Officer and IRO
- Robson Dantas, Head of Fintech
- Unidentified Speaker

Other Participants

- Analyst
- Andrew Ruben
- Danniela Eiger
- Irma Sgarz
- Joseph Giordano
- Luiz Felipe Poli Guanais
- Richard Cathcart
- Thiago Macruz
- Victor Saragiotto

Presentation

Operator

Good afternoon and thank you very much for waiting. Welcome to Magalu's conference call related to the results of the third quarter of 2021. For those of you who need simultaneous translation just click on the interpretation icon in the bottom of the platform and then choose the language of your choice, English or Portuguese. We would like to inform you that this event is being recorded and the recording will be available on the company's IR website at ir.magazineluiza.com.br where the earnings release and the presentation is also available both in English and Portuguese. The link for the presentation in English is also available on the chat. During the presentation, all of the microphones are the participants will be disabled. At the end of the presentation, we will initiate the Q&A session. For questions, please click on the Q&A icon in the bottom of the platform. Write down your name, the name of your company and language of your question. When your name is announced, a request to activate your mic will appear on the screen and then you must activate your microphone and proceed the questions. Questions received in writing will be answered later on by our investor relations team.

Now, I would like to turn the floor to Frederico Trajano, CEO of Magalu. You may proceed.

Frederico Trajano Inacio {BIO 17269235 <GO>}

Good afternoon, everyone. Thank you very much for joining us today to hear about our earnings release call related to the third quarter of 2021. Once again, I am here together with the executive team of Magalu and we will all be available to answer your questions at the end of the presentation and the presentation will be led by Roberto and I. Well, the second quarter of 2021, we faced two challenges. The first challenge was to be able to grow based on a historical base because 2020, I mean, we had the best quarter in the entire history of Magalu that was one of our best numbers growing 81% when compared to 2019. So growing on top of that base was per say an enormous challenge and we also found a very challenging economic landscape, which was in a way expected, because we expected to see a better economic condition due to all of the vaccinations, but what we found was a different landscape with high inflation, high interest rates and the devaluation or the depreciation of the Brazilian BRL.

I mean, with all of this background -- despite all of the background, we were able to -- in terms of MV growth, we were able to grow 12% on top of that high base and then we were able to grow GMV above that number. So it's important that when you look at the numbers of Magalu and compare it to other numbers in the market, I think you'll have to look at first the base of 2019 because in 2020 our results were extraordinary in terms of growth, both in terms of brick-and-mortar stores and also the 1P and 3P online markets. And in this third quarter, the online accounted for 72% in terms of share of the total pie and I believe that this quarter as well reveal two different aspects. First of all, physical stores, our brick-and-mortar stores. This is our most traditional channel. This is the most mature channel and is a consequent more profitable, but there was a drop vis-a-vis the numbers from last year and even though, we posted 9% growth vis-a-vis 2019.

We opened many stores. So when you look at the same-store concept, we also had a decline vis-a-vis 2019 and despite this very challenging scenario, which was an expected because with the vaccination, we hoped that people would return to the stores, but the situation nonetheless was a bit more challenging and we were not able to deliver the growth numbers that we expected for the time. And as the stores are very important in the entire composition of our profitability, I mean, we saw that in the second half of last year when we had to shutdown many stores because of social distancing and COVID-19, we saw an impact on profitability because of that and we will give you more details about that when Roberto to starts his presentation.

I mean, considering the fact that the stores underperformed, the online channel did quite well once we compared it to the year 2019. So the online channel grew more than three folds. There was a very significant growth in 2019. We grew BRL3 billion and then now BRL10 billion. This is a an all-time high for a quarter. This was very much driven by the 3P. We reached RBRL3.5 billion in the 3P area in the first quarter. It took us 20 years to reach that in the 1P in a quarter, but in five years time, we are able to surpass that mark with the 3P. This is a channel with enormous growth potential. And now we will see the reasons behind this growth and what are the main features behind this growth because these are characteristics with cohorts and very positive seasons. So we would just bring some analysis that we hadn't disclosed to the market yet, but this shows enormous potential and this also talks in terms of our strategy, which is quite different when compared to other kinds of marketplaces in the market. So especially growth comes from 3P.

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Next slide. When we look at 3P, we see an exponential growth of the sellers -- we -- 120,000 sellers. The majority of these sellers came through the new platform that we launched in the midst of the pandemic that was a great innovation on the part of Magalu. That's why I said that our strategy is very different than the strategy of others in the market because we launched the platform to digitalize analog sellers. So Magalu already accounts for more than half of the new sellers that are joining the platform. So we are growing on sellers, well native digital sellers, but our focus because of all of our expertise and our capillarity in physical stores is basically focus on digitalizing the analog stories.

And I would like to elaborate a bit more on this because as this is not a very common strategy elsewhere. It's important to say that when you look at China for instance, the largest 3P market in the world, it was -- they went from channel [ph] is listen to online directly. They didn't have to go through the digitalization of the physical channel because years ago India has the lowest possible number of retailers per square meter in the world and here is the opposite. So to digitalize the Brazilian retail, you have to go through analog digitalization. And the Magalu partner is indeed the platform that we launched than we are investing all of our tokens in this new platform to address this market and the number of offerings went from 17 million to 50 million and I'm about to show you a bit about the nature of these sellers and their characteristics and the offerings as well.

Next slide. The sellers that are entering right now, I mean, this is just an overview of the season. Here, we have the season of sellers that joined in 2017, which is depicted in green 2018, 2019, 2020 when you look at the season of sellers. We are showing here that in fact our marketplace growth shows an evolution from older sellers, but a good addition of new sellers. Well, older sellers that joined in 2017, we multiplied the sales of these sellers by three folds in only five years and the performance of new sellers that are joining the platform just now is 50% higher than the GMV of previous season. So we have very -- a lot of positive cohorts and this really shows that the growth of our marketplace comes from a very sound and solid base and you will see that also happens in different categories in different regions.

Now looking at the traditional categories, when you look at the chart on the left, when we started marketplace, most of the sellers that joined Magalu's platforms, they were sellers from our own categories meaning air conditioning, furniture, home appliances. But as time went by and we invested in bringing companies from different categories and also bringing onboard other sellers like Zattini and cosmetics, the percentage of sellers from new categories that we call here the long tail started to increase. So the seasons for 2018, 2019, 2020 and 2021 in particular come from sellers from different categories and I'm about to tell you what these categories are very soon. So more importantly and in view of our logistics strategy per location is that we are able to concentrate sellers from the Sao Paulo real distance.

So 70% of the seller base is in Sao Paulo and you see that the sellers that we are bringing in the new seasons are sellers that come from the Northeast and from other geographies rather than just a state of Sao Paulo. And this also shows that we are walking to talk because we are now expanding our logistics base. And this is very important to us because it's important that consumers buy from the local sellers that we don't have to travel too much to deliver the products, because the more -- the longer it takes to deliver

the good, the more expensive it is because there are subsidies for delivery, et cetera. So we want to build a profitable marketplace in the long run. It has to be sustainable in the long run and that's why we made this very strategic choice in terms of bringing analog sellers, regional sellers from new categories.

Next slide. And another interesting feature is that we are bringing a lot of fashion sellers. So this is a large growth driver, I mean, home, gardening, and interior design. We are also getting into 3P and we are about to plug in all the sellers that want to be plugged in our e-commerce hub marketplace that we acquired earlier this year and also sellers in beauty and personal care. There's another interesting category, which is another category that we are analyzing now, which is auto parts. This is very important in this marketplace world. So we will certainly getting to auto parts as well.

I would like to highlight the fashion category now. In October, there were important launches and everything starts from revisiting the Magalu app including new filters. We improved the search engine, new window shopping and PDP, the product page. Therefore, we had an important development and that was due to hard work from our team. We brought more than 300 new brands now from the fashion world. We have over 21,000 sellers in the platform. We also have more than 3 million offerings in the fashion universe and we launched our own brand, our own label because I think it's important to have our own exclusive label and (inaudible) who is joining us today. She came up with our own brands that came in with a new positioning, very inclusive, larger sizes like plus sizes and also very inclusive in many different aspects.

Therefore, I wanted to say that we made important developments in net shoes as well even though it doesn't show in the slide posted the first positive result throughout their history, good growth, growth way above the market average in the fashion categories with many different launches like NFL, NBA. So new categories. Certainly, we still have a very significant share coming from traditional categories, but it's undeniable that we are making important developments in the new categories and cosmetics is one of them because we posted impressive results.

Now next Slide. Also, we said that this would be the year of logistics. So now I have some interesting information to convey to you. Our logistics, we deliver in one hour. So it went from 42% to 57%. This is up to one day delivery and this is the highest share of one day delivery in the market. Not only we have a complete base of distribution centers, et cetera, but it's very important to have a physical store in this concept and this is a major differential in this regard, and this is becoming a great differential for 3P as well. And in June, we launched one-hour delivery. More than 290 stores are already equipped to deliver in one-hour. We just acquired another company that uses Asogi [ph] that's what we acquired. This year with more than 2,000 motorcycles covering 80 cities and delivering in up to one-hour, this is an extraordinary trigger and I'm sure that many other companies will take some time until they can beat us, because this certainly helped us to defend or to advocating favor of our extraordinary figures.

Well, we had given you some guidance in terms of our capillarity, our guidance was 25 cross docking and we surpassed that number. This is a very significant growth when compared to the previous year. The numbers are quite extraordinary. We have 1,400

stores. 30% the area is for storage and if we consider store area and distribution centers, we are talking about a two fold growth involving 1.4 million square meters. More than 3,500 municipalities are covered by Magalu's proprietary logistics. This is our proprietary logistics. That's what we call Magalog. Magalog means that we have our own exclusive vehicles, the used motorcycles and small vans.

Next slide. I would like to highlight that this -- I mean, this has been a very relevant and frequent question. We get this question all the time from our investors and this relates to our own 3P logistics. What about 3P logistics? I would say that in the year, we had a very relevant development in terms of 3P delivery and this evolution will roll further. So this has been a year of a turning point. I mean, last year, we grew 1P. Nobody expected that to happen because of the pandemic, but we had to dedicate a lot of our resources to 1P. But this year, as 1P had a slight decline and 3P was growing, we shift our focus to 3P and now we are ready. Looking at this number for the first time, we see now almost 30% of deliveries of 3P happen in two days and we started with the base of only 13% last year. So we grew 15 percentage points.

The delivery volume for 3P increased by 298% vis-a-vis the numbers of last year. This is a very relevant number and this is a number of that tends to grow more and more with all of our logistic investments and everything we're doing, and also adding new things that are being deployed right now like ship from seller, the 2,000 motorcycles that are not only picking up products in the Magalu's stores, but they're also picking products from all of the other sellers. So more than 1,000 sellers where we are delivering in one-hour. So the same logistics that served Magalu's stores, but also serves all of the sellers. We already have 19 capitals with this coverage of ship from seller and we want to increase our coverage in the next coming years. This number of 28%, tent to increase. Yes.

Another important highlight is that our physical stores when it comes from sales channel, which is going through a moment that is very challenging. Naturally grow in less than we expected. However, it has turned out to be more and more critical to our marketplace strategy. It is a center of seller attraction. Most of new sellers in Parceiro Magalu come from this commercial partners in physical stores and particularly on service center. So today 250 Magalu stores or Magalu postal agencies, they are ready to work on drop off. So they sell in Magalu marketplace platform and rather than having drop off at a postal agency, they can do it in Magalu stores and Fabricio can tell you more about the expansion plans and also Roberto can also make comments. And we have 3,000 sellers already used in the stores as a postal agency.

Another point of uniqueness to 1P is larger [ph] store pickup. Sometimes the customer doesn't have somebody to collect the product at home. So they cannot have anybody at home and also because economically it's feasible better than last mile. So we enabled store pickup in 3P more than 1,000 stores and 10% of all 3P purchases are picked at physical stores showing that physical stores are an important component. Our marketplace is multi-channel and our proposal for growth is also to focus on sellers that are analog and multichannel. So there is some connection. We are very much in sync in this strategy and it's the right option. Once again in Brazil, analog retail is very relevant. Over 80% of total Brazilian retail and the platform that supports retailers to be online managing

to add online to the physical sales with full IT conditions and a support base, we believe this is our unique option in 3P.

And finally, I turn it over to Roberto Bellissimo to talk about the financial highlights and then I can back for the Q&A.

Roberto Bellissimo Rodrigues {BIO 17269312 <GO>}

Cool. Good afternoon, everyone. Thank you for joining our conference call today. Let us begin on this slide on fintech. As you know, fintech starting this year is one of our strategic pillars. And the third quarter -- in this third quarter, we completed the acquisition of Hub and now are disclosing more information on our fintech. Here we consolidated all the figures. We are speaking -- as you know by the way, our fintech has the mission to increase our frequency and also to monetize the whole ecosystem. We have the TPV, total TPV, total payments processed by our companies in our fintech around BRL18 billion to BRL19 billion. Later on we can give you a breakdown, rowing a 100% year-over-year and at the end of the day, we are among the top fintechs and financial digital institutions in Brazil.

On the left-hand side we show the seller base recently we launched and by the way benefiting with integration with Hub Fintech, now we have our digital account to our sellers and also our machines -- our POS machines, mini, super and smart. And within Magalu payments, we show net profit for the year up to September almost BRL120 million. On the right hand side we focus on customers. We also overcame our number reaching BRL4.4 million growing more than 60% year-over-year. The credit card space, Luiza and Magalu card which will launch this year, both cards are growing a lot 6.6 million cards, nearly all active, growing very strongly year-over-year. And today at Luizacred, we have a credit portfolio that totals BRL15 billion, which is also one of the greatest credit portfolio or credit card operations in Brazil. So very happy with the whole progress of our fintech. And later on we can give you more detail on Luizacred.

So now let's talk about the financial highlights. On this Slide, we show the financial highlights. 12% total sales growth, 22% e-commerce growth like Fred said before and total sales nearly BRL14 billion. Our EBITDA BRL351 million. Later on we can show the variation of the EBITDA margin from last year to this year and our adjusted net income is BRL23 million, and total net income reported of BRL144 million, a difference of BRL120 million including non-recurring gains. We also had a number of tax gains that we posted this quarter in addition also inventory provisions that we can explain later on around BRL400 million. If we hadn't done these inventory provisions, our income would be nearly plus BRL400 million or on top of BRL144 million, but we decided to work on these provisions.

I believe some of you also asked us why that happened. We wanted to say that firstly these are provisions, not expenses. This is in the balance sheet and our explanatory notes provision for inventory. It's not going to turn into expanse or cash exceed, but will be reversed in the result from the moment we sell inventory or excess inventory that we have today. So it's just a simple provision. So we can benefit and sell excess inventory. As you know going to pandemic, there was a global risk of lack of products. Since the beginning of the year, we have been increasing our inventories and also now with the

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recent slowdown of the economy and our retail industry, today, we have a little bit of excess inventory. It's important to say this is not obsolete, not excess, well -- but the turnover moved from 70 days, which was always our average inventory turnover and currently at 100 day. So we increased inventories expecting higher sales, a better economic scenario for the second half of the year and today, we have a coverage around a 100 days. We want to benefit from this timeframe and Black Friday, big sale, Christmas sale in order to bring our inventory turnover rate back to 70 days. And as we do it, we revert the provision and increase our cash with more healthy inventories.

Now, on the next slide we show our EBITDA margin evolution. Basically we had a contraction in the gross margin and this has to do with the reduction in physical store sales and a little bit of inflation on costs in the industry. There was an increase in nearly all raw material prices and also FX effect and we haven't transferred everything to our cost price. So there is a mix effect and inflation effect and in the expense line, this reduction is also associated to the channel in fact. Physical stores did not have an operational leverage vs-a-vis the sales slowed down and we also invested more in marketing in order to grow more and particularly in e-commerce and marketplace. As you could see, marketplace is growing a lot.

We diluted administrative expenses. Today, we are in a single office in Sao. Paulo. Last year, we had four offices with the acquisition of Netshoes and now Netshoes now is integrated. So everybody in the same office. And equity income was slightly lower year-over-year, but quite good as you'll see later on. I Luizacred, the profit and Luizaseg both had a lot of income this quarter as well and other subsidiaries are consolidated. So they are not in the equity income line, but like Fred said, Netshoes had net income, Epoca Cosméticos also being profitable, Luiza Consortium, (inaudible), Magalog which is our logistics on nearly all our subsidiaries are very profitable as well. And year-to-date, we have BRL500 million nearly in total as income.

Moving now to the next slide. Here we show a little bit of our working capital -- adjusted working capital. This quarter, we improved our working capital vis-a-vis June and September last year particularly owing to the growth in market place and also thanks to the acquisition of Hub. This is not only for inventory turnover versus suppliers. We have a chance to improve inventory days, but marketplace and fintech are helping working capital in total as well. On the right hand side, we have evolution of our net cash which increased by BRL3 billion this quarter and nearly BRL1 billion vis-a-vis last year. And this will be explained on the next slide. We have nearly BRL7 billion net cash, BRL9 billion total cash. So this quarter, we increased the total cash from BRL6 billion to BRL9 billion.

Once again, cash flow from operations was positive around BRL200 million. We heavily invested this quarter BRL500 million, including acquisitions, investments in logistics, new stores, our entry in Rio de Janeiro, IT. We paid BRL200 million as leasing, store buyback BRL400 million. We paid a Hub debt and we also had a follow-on of BRL3.9 billion in June. So if you put it all together, we closed the quarter with BRL9 billion, including cash, receivables, adjusted cash position. And in October, we also had additional funding of another BRL2 billion for a four to five year term. So we further increased the total cash position.

On the next slide, we show evolution over the last 12 months. It's the same trend, but with more investment and more share buyback as well with a cash total cash position from BRL7 billion to BRL9 billion last 12 months with the same trend. Lastly, on the next slides, we'll be addressing Luizacred -- no, prior to Luizacred, let's talk TPV. BRL9 billion to BRL18 billion TPV, BRL11 billion in credit cards, BRL4.6 billion in payments, our digital account and also payment split and BRL3 billion in banking as a service, which comes with Hub, which was recently acquired. So totally BRL18.5 billion.

On the next slide, we show the evolution of Luiza, credit card base of the last 12 months from BRL5 million to BRL6.6 million. The success of Magalu Card and Luiza Card growing 100% with the issue of new cards vis-a-vis last year, TPV growing by 47% year-over-year for cards, 41% year-to-date, nearly BRL 30 billion already. And then we show the evolution of Luizacred portfolio. We continue to have a portfolio that is top quality indicators over 90 days overdue at 4.9%, much lower than last year. Short-term market very low historically speaking. So Luizacred once again posted very good result BRL84 million income, a BRL167 million net income year-to-date.

So these were the most important messages. And I give the floor back to Fred.

Frederico Trajano Inacio {BIO 17269235 <GO>}

So recently we were awarded and we were very excited. For many years we wanted to have it. We were the winners in 2003. But now once again, we are the best place to work in Brazil awarded by GPTW, a award that makes us really proud and naturally helps in terms of talent retention. So before we open for the Q&A session, on the next slide, I would like to give you more color and an outlook. So once again, I believe our strategy or our echo system,, our strategic position is clear. I guess, the numbers and indicators have been disclosed to you in our balance sheet and also in our earnings presentation and also in the earnings release. They all show that our strategic planning, our long-term, our directions for the future certainly are right. We can see the cohorts, the indicators. At the same time, we have a short-term challenge in our results particularly for traditional categories, specifically stores, but not exclusively for durables with high interest rates and high inflation rates.

According [ph] the purchasing power our consumers and the price of goods because dollars are also depreciated. Historically, Magalu always managed to do both things simultaneously, deliver strategy, short-term result and this quarter was more challenging in traditional categories particularly more mature channels. I believe this scenario will remain challenging for a while. We are working very heavily. Magalu does have a track record to move away from crisis. We went fine after the COVID pandemic. We had an important turnaround in 2016. So it's the same team that has been through different challenges different times. So I'm very confident. We've be working very -- we'll be tough, but also calm and diligent. So we can continue to have things together. We are tech company that likes to deliver results not only in the long-term, but in short-term, we have this challenge owing to the economic scenario.

What about the future? For next year, in December, we have the emergency aid, Brazil aid to contribute to recover or resume the momentum in physical stores. And next year for

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the first quarter, we don't have a lot of news, but in the second quarter, we have two important things on the horizon. One of them is the World Cup in the second half of the year. It won't be in June unfortunately, but it would be in the second half of the year, the World Cup. Maybe in Q3 we are going to have a positive impact on sales of our more traditional categories and also 5G. Starting next year, it will be generating a change in telephony, which is very good in the core category. So short-term is challenging.

Black Friday our focus is on premium products like we said before in our interviews about the earnings results, maybe we can talk more about it. But mid to long-term, we continue to be confident. Naturally, we've been through these turbulent times before and I'm very confident in our team and we manage to overcome this challenge as well and even more confident in our strategy, which has proved to be successful and that's why we share it all with you.

So now we can open for questions, and I'll be here to take questions and all the management is here. Thank you very much.

Questions And Answers

Operator

(Question And Answer)

We will now initiate the Q&A session. (Operator Instructions) Our first question comes from Victor Saragiotto from Credit Suisse. Victor, you may proceed.

Q - Victor Saragiotto {BIO 19504427 <GO>}

Thank you, Vanessa. I would like to elaborate a bit more on that short-term discussion related to your Black Friday's strategy. You put a lot of focus on the premium products, but one thing is that last year's Black Friday had some restrictions because of the pandemic. So, the question here is given the improvement in terms of mobility or people, don't you think that this could help in the short term your sales from the brick-and-mortar stores or whether we should expect some gradual improvement towards the fourth quarter. This is point one.

Second point is that some of our clients were asking about the stock buyback program of the company. Can you tell us a little bit about the strategy, whether you see some buyback, given the current price of the stock?

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

Well, thank you so much for your question. Well, speaking about Black Friday, as I said at the beginning of the call, our expectation in terms of the post-pandemic economy mean with everyone already vaccinated, the expectation in terms of traffic in the store is much more positive. There was an impact because the population's purchasing power was much slower, especially in the lower brackets of the population because there was increase in interest rates and cost of products increased substantially because of the

depreciation of the Brazilian currency. And I think this was the most severe impacts and at least in our categories, things didn't happen as predicted.

We envision a reality and what we saw it was a different reality. So, I don't think things will change substantially. So the thing is that people will then start agglomerating. Until September, we were very concerned in terms of generating more traffic in the stores and to get a lot of people agglomerating in our stores. We were very careful with every move we did in real when we launched the new store. We didn't run any promotions. We were very responsible company regarding all of the protocols related to the pandemic.

But as of October, we have this mandates to agglomerate. We wanted to increase store traffic and we are making some campaigns in that direction and some campaigns are already generating more traffic into stores, but the economic landscape is still a bit complicated. So, I don't have a crystal ball. I know that we are working hard to change that scenario with our brick-and-mortar stores. We want to change it in a significant way. But I do not have any visibility of that yet. But also in December, I do believe that we will have a different Christmas season. I think that people probably forgot about Christmas. So, we want to have a stronger Christmas. I mean, last year's base was not so strong in this holiday season, but we will certainly make an effort to regain momentum and to increase store traffic in the short run.

And at the same time, we will maintain our long-term strategies as well. And Black Friday premium, that's our strategy. In fact, inflation with highest average ticket was lower when compared to other products and it's a segment of the population that have a higher purchasing power. So this is one of our best. I mean, I'm not saying that we don't have other products. We will have products for everybody. But we're just focusing more on these premium categories because Magalu has usually a very good reading of the market and we try to react accordingly. We were always able to have good strategies and present specific solutions to specific issues. So this is part of our DNA.

Now in terms of the buyback program, we concluded the program. Our buyback program focuses mainly on having shares in treasury to follow the profit sharing programs of the company. So, we usually buy companies buying one or two-thirds in shares. And we also think that this is a time that we cannot use the buyback just to hold the price of the share. This is not the role of the buyback program. So we have to follow best practices. We believe that with the passing of time and once we can resume the growth in our brick-and-mortar stores and if we improve our short-term results and we are working hard to do so, I think things will go back to normal levels. This has happened in the past and I think it will happen again in the future.

So, I don't know Roberto, whether you want to give any additional explanation.

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

I think you said it all. Well, thank you, Victor. We just opened a buyback program and that has been concluded. We already purchased 40 million shares and any other eventual program has to be analyzed very carefully. So, for the time being, we have no other announcements to make, but we are constantly evaluating having in mind all of the -- I

mean the objectives of our buyback programs, I mean to make acquisitions, remuneration and to attract talents. So, that's the spirit behind the buyback. Thank you, Victor.

Q - Victor Saragiotto {BIO 19504427 <GO>}

Now thank you, Roberto and Fred.

Operator

Our next question is from Luiz Guanais from BTG Pactual. You may proceed.

Q - Luiz Felipe Poli Guanais {BIO 19933939 <GO>}

Good afternoon, Fred. Good afternoon, Roberto. I think I have two questions. The first point Fred is, I think you said it well at the beginning, when you said that, you're evolving logistics towards 3P. Could you comment on how this has evolved in terms of the conversion? I mean, the seller using the stores more in terms of drop-off and ship from seller, how has this turned into conversion?

And the second question is related to the market. Whether you could elaborate in terms of how aggressively you think the market will be in the next coming quarters or months? Apart from Black Friday, how aggressive or irrational this market could be in the next few months?

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

Well, Luiz, thank you. In terms of 3P, I think that we gave you a lot of information already and I also brought some analysis about the seasons. And certainly we were able to grow sellers that came on board in 2016 and '17 and now looking at a very positive base in 2021 with a very good flow. That is a clear indication that we are evolving well, especially in terms of delivery terms and logistics. And in terms of the stores, this is still -- it's early to tell, because we want to improve delivery times, especially because the growth across in our private labels, we still have some things still. The great majority of processes are just working basically with 3P in terms of collection. So, conversion is increasing, but we still see a lot of room to grow.

Now in regards to market aggressiveness, I think it's a matter of context. There was, I mean the exchange rate had a significant impact on the price of products, but we want to continue to grow, the market wants to grow as well. So having said that, there is still some price aggressiveness, especially in the most traditional channel. So I believe that this is something that will be amongst us for a while. This Black Friday will be very competitive, December as well. And I have no visibility about the third quarter related to all of these things that I mentioned because very difficult to predict a future in Brazil because future is very volatile.

But still in the short run, the market -- even beyond the market, I think we have to look at the consumer's capacity to absorb all these price increases. Consumers have a low purchasing power now -- lower purchasing power and it's hard for them to take up to

absorb all of the price increases. So, it's not just a matter of competition, but market reaction.

Q - Luiz Felipe Poli Guanais {BIO 19933939 <GO>}

Okay, Fred. Very good. Thank you.

Operator

Next question is from Joseph Giordano with JPMorgan.

Q - Joseph Giordano {BIO 17751061 <GO>}

Hello. Good afternoon, everyone. Good afternoon, Fred and Roberto. Thank you for taking my question. I would like to explore marketplace. Two points more specifically. You talk a lot about Barse do[ph] Magalu, partner Magalu strategy and the seller is in the metric of the store manager, not only hunting, but also as a service. I'd like to better understand, when you look at this new seller, for instance, can you see it as exclusive for Magazine Luiza as the best marketplace concept? And how does it help you leverage the fintech platform? I understand you'll give a software solution and sometimes a POS solution to the seller.

The second point about marketplace, you talk a lot about logistics. I'd like to dive into the mix topic. How do you see the progress in the mix and how different is it today in marketplace, when compared to the mix or the broader mix at Magalu Luiza? Thank you.

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

Thank you, Joseph. Thank you for the question. Actually, like I said in the beginning, that's a different strategy compared to the market pattern. So, it's an option we had. We wanted to have this base and we also attract and have integration with all e-commerce platform providers for digital sellers. We are also evolving in the master fire for digital aspects. So this is different but not exclusive. We also have other players integrated like Vitex[ph] and we also improve the integration system for this audience.

We see a different alternative for something like our strategy because we have capillarity in physical stores. We also have to have the analog seller digital. We already made this turnaround, and our IT sector has the characteristic of companies that were analog and became digital. So we have new category sellers. Like I said before, they are more regional, different average ticket characteristics compared to what we originally had.

Obviously, we have significant numbers already, but we still have a lot of room to grow and a lot of execution to be performed, but the early indicators are positive. Just to give an idea, the number of our SKUs 3P already surpassed 1P, showing that although well 35% of sales, so the category is actually far more comprehensive than traditional categories. We still have a lot of things to do. We have to work hard, but we are excited about the cohorts and also with our directions and drivers. I don't know if Robson[ph] would like to say something about the products, fintech products for these sellers and what we're doing at the hub.

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A - Robson Dantas

Sure, Fred. Joseph, thank you for your question. I think you touched upon an important topic about the strategy. At the end of the day, what I say to the market in general is that our strategy is slightly different. We are not fighting for the same clients or customers, we are adding technology and service and the service of the sellers and therefore they could be more loyal to us. At the end of the day, we are making companies digital and creative solutions so these companies can sell more and it's no different with fintech. In the past, we began with a sub-acquiring processing payment methods with the acquisition of Hub. Now, we have a digital account for free to all these companies. So we processed in the last quarter 4.6 billion in our sub-acquiring alone. This money is not in Magalu yet, but it's not in the client's account, they are to accounts where customers have another banks.

So, first we want to have these company at the company level, so we can provide a product that begins to generate high levels of revenue and also having softer at the end. Once we launch our own POS machines, we have a clear acceptance of the sellers about this product having partner Magalu embedded in a machine that will allow the company to sell online offline with a fully integrated inventory. And when it comes to financial services from the moment the company evolves into the concept of a platform, naturally we'll see a fintech platform of several services are even mentioned credit cards.

We acquired a credit card processing company, so be close to the sellers and part of our teams are placing efforts on this.

Thank you, Vanessa.

Operator

The next is from Thiago Macruz with Itau VDA?

Q - Thiago Macruz {BIO 16404924 <GO>}

Fred, you made a lot of comments on the moments we are going through in the physical stores, this macro headwind and challenges. This business was important to me because it was a driver of profitability allowing you to go deeper into investing in the digital world. My question is the following, this timely circumstance of the physical stores. Does it physical stores. Does it somehow change your strategy in the digital journey, does it speed up (inaudible) project more urgent and postponing another project. Thank you.

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

Thank you, Thiago. The answer is no. We don't have a strategic driving force here. What's happening is, the context of the economic scenario now. To some extent, there are cycles in the business and we're going through the downwind of the cycles. So we cannot change the strategy, we have to work hard so we can be in a more positive context and increase sales in the channel, have a stronger focus. And please, bear in mind, this channel is key to the marketplace strategy as well, it's fully integrated. They are symbiotic, the store and marketplace and the strategy we want to adopt, so we don't see a significant driving force.

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That we might speed up the sale or -- on our profitability in the channel, so that's the focus right now. The most important point is macroeconomics and not strategy so, not a problem in the business model. This is something very specific, something unprecedented. We never saw this kind of slow down in inflation and high interest rates all at the same time. These are concomitant things and to our category and more traditional category and for this channel eventually, we are affected that physical store always contributed positively to profitability would naturally with a drop in sales is very hard to do that. But we also engaged to make it happen again and 1P also has to play its role and 3P as we invested. From the moment it becomes more mature, it tends to contribute to results, mostly with monetization opportunities at the fintech and ads, but both things take time. So we don't have a strategic change. I don't see it's a problem in the business model. What I see is the economic context and the execution that we have to deliver in the short run.

Q - Thiago Macruz {BIO 16404924 <GO>}

Perfect, Fred. Thank you for your answer.

Operator

The next question is from Andrew Ruben from Morgan Stanley. You may proceed, Andrew.

Q - Andrew Ruben {BIO 20391468 <GO>}

Hi. Thank you. Regarding inventory and supply chain. Can you talk a bit more about your inventory position for 1P into the holiday season? Also, what you're hearing from 3P sellers regarding their supply and you touched on it in the presentation, but any greater comment on the inventory provision would be helpful as well. Thank you.

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

Thank you very much for the question. I will give the floor to Eduardo to talk about the inventories and then Roberto will answer the other part of your question.

A - Eduardo Galanternick {BIO 20410320 <GO>}

Well, thank you very much for your question. In terms of our inventory position for the holiday season, I know that the supply chain is being shaken up all over the world. Some categories have been more effective than others. And what we managed to do, especially now in this third and fourth quarter when we get prepared for the holiday season, well, we had to sit down with all of the industries to negotiate to ensure the inventory we need to deliver according to our sales. In terms of some categories, we already got some positive signs. I mean, we see some television panels and the manufacturers of TVs already getting their housing orders and some other areas are still facing some difficulties.

But on our part, we did our homework quite well. We made other purchases we needed to make and now our inventory level is according to expected and it will be enough to cater to the demand. Now then as, in terms of sellers, I mean this varies a lot according to

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each seller. So some negotiations are being reviewed, because there are some categories that need to be complemented in terms of IP, but we are very confident that we have the necessary inventory to cope with Black Friday and the holiday season. As Fred was saying, we do believe that this is a very interesting moment in terms of growth opportunities, Christmas has been leveraged by the -- by Black Friday, this has been the case in the past few years. So now this year, this Christmas season we have the opportunity to come with a different proposal to recover our sales. And so in the first week of January, we just finished the holiday season with our fantastic sale. And so, we are coming in pretty strong.

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

Andrew, good afternoon. I would just like to add a few more things in terms of inventory provision. I believe that what is important is that we need provision just so that we can distribute the excess inventory. We are not talking about obsolete inventory or anything like that. Our inventory level is above what's necessary. Our inventory is good and the best moment to sell that surplus inventory which is that surplus inventory is this moment because now we have people going to the stores, there will be increased traffic in the store and then we will have the Black Friday and the Christmas season and in January, our fantastic sale. And this is enough to adjust our inventory levels.

And so that come next year, our inventory levels will be closer to 70 days which is our historic level. I think this is the most important thing and we have enough inventory as Edu said, we have enough to cope with the Christmas season sales. Thank you for the question.

Thank you, Andrew.

Operator

Our next question is from Eric Wonk[ph] from Santander.

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

Good afternoon.

Q - Analyst

Good afternoon, Fred and Beto. I think the question I have is related to marketplace and even looking at some of your most recent initiatives, especially regarding furniture because you relaunched that category. I just want to understand your view for the furniture segment and other areas when we see lower penetration of e-commerce, like gardening and interior design. I mean, maybe these are the segments when you have pure player names and how do you intend to position yourself so that you can gain relevance within these segments? I just want to understand how the acceptance is this for. I just want to get some color on the furniture segment.

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

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Well, thank you for the question. I think I'll start answering and I believe then Silvia[ph] will add to my reply. Okay, we have a base but I think the main aspect of Magalu, I mean we are not category killer. The idea is to have horizontal categories, a one-stop shop for purchases. Our app is the one that receives over, we have over 30 million monthly users is a very popular app. So the idea is to take advantage of this flow generating conversion into other categories rather than only the more traditional categories and this has been our strategy for the for the past two years with organic launches and acquisitions. So the idea is to expand the number of SKUs so that we can have a higher conversion very much similar to other platforms outside. I mean, Amazon has started with books, now look where they are. They have lots of other categories. So, it's very common for you to leave your four categories and just be more horizontal, in terms of your mix of products entering into new categories.

So just as I was saying, with the growth in the seller base, positioning and navigation, everything is growing and the numbers are growing, too. I mean, this year the growth is not so substantial, but I have a large base of traditional categories, but you have to maintain consistency, long-term discipline, execution and as I was saying, although the KPIs are positive, we disclose some numbers and certainly, I know that you are following up and some other numbers that we disclosed during the presentation. I don't know whether you want to say anything.

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

Yes. Thank you. Thank you for your question. If I just to add, we often say here that one of our major strategies is to digitalize retail and digitalize Brazil, and fashion retailers, they are very spread around. There are 1.5 million fashion sellers and less than 80,000 of them are digitalized. So in our view, the fashion strategy is very much linked to our digitalization strategy. When I say that, we want to digitalize the entire Brazilian retail, so what we want is to have this large platform that will support the digitalization of these retailers in the fashion segment.

And now our strategy, as mentioned by Fred, we are a player that takes advantage of all of the traffic that we have in our SuperApp and also leveraging into other categories. We want to leverage our ecosystem and by doing so, we will be able to support all of the sellers helping them to reach consumers that are already inside our platform. So, in our fashion mix, we have major brands, we have more than 300 Brazil large brands, I think are now with us within Magalu and for them, it makes sense to be where their customers are or consumers are there. So why not be there as well? Especially know that we have a more customized experience. We are heading towards being an expert in fashion in our SuperApp. We have all of the major brands and we have all of the sellers that we call mid tail or long tail. We have sellers throughout Brazil, fashion sellers throughout Brazil. And for them, it makes a lot of difference when they have access to our ecosystem because of our logistics, our content, the possibility of using our content platform is also something that I'm sure they will like.

And there are also the plants or the factories. Brazil is a major fashion producer. There are many factories producing fashion and they are potential sellers within marketplace. But they don't really know well how to operate within the marketplace. Therefore, our strategy is to be unique vis-a-vis other peers and other players be experts or other

marketplace. So we want to provide some specialized service allowing factories to become more digital within a marketplace via our Hub company.

Q - Analyst

Great. Thank you very much.

Operator

The next question is from Irma Sgarz with Goldman Sachs. Irma, please go ahead.

Q - Irma Sgarz {BIO 15190838 <GO>}

Hello. Good afternoon. Thank you for the opportunity. I would like to ask about the percentage of deliveries within 48 hours at marketplace. I think it was 28% last quarter. We know the market leader in the marketplace in Brazil already has a slightly higher indicator around 70%. When do you expect to close this gap or even overpass your competitors in this metric? Do you think you can achieve that maybe in the first half of 2022 or do you think it will take longer?

Fred, you also said, that the hubs of cross docking NDCs are important levers to meet those targets and with higher penetration rates of fast shipping. But I'd like to understand the logistics. Is it a question of physical infrastructure or other roadblocks related to IT and onboarding? Thank you.

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

Irma, thank you for your question. Anyway, our marketplace has been on for five years. Starting again, thank you. Our marketplace, Irma is a new marketplace, it's the newest channel. And the bulk of our logistics capacity, well, when you compare Magalu with a pure marketplace, if you think about delivery terms, it would be right to include 1P. Otherwise, might 1P is like fulfillment by a marketplace when consumers get into Magalu SuperApp to buy, they want to know the product and the delivery term. It doesn't care whether it's 1P and 3P, so we have a lot of groceries which is 1P and can be delivered within one day.

We have 58% of deliveries in one day and for two days for 1P as well. So this is part of the consumer's experience those who are buying the product, not investors. We have to consider the consumer's mind set and I think it's more fair to consider that you get into the app, check the term available the delivery term and then we evolved a lot and we already have the best rate for 1P and we are evolving a lot at 3P like I showed you before. I believe we need a time. We need some time. So we get into 70% or 80% of the guidance, but obviously we worked very hard. We moved from GFL for instance. The company that works with a seller pick up as well from 150 cities to 3,500 cities slightly more than 100,000 deliveries to 6 million deliveries per month. So it's a very good evolution within one year and we'll try to do it more and we're investing on this, our recent funding are targeted to this growth. But a fair comparison is to consider both together, because once again, when consumers look, they check 1P and 3P. For IT, we still have a long way to go, plenty of things to do, expansion, we also have room for growth, but we are moving forward and we can see significant improvement in our indicators.

Q - Irma Sgarz {BIO 15190838 <GO>}

Thank you. Perfect. My question was more related to the fact that we could have a hurdle or a barrier for growth even faster in marketplace. Thank you.

Operator

Thank you. The next question comes from Richard Cathcart with Bradesco Bank.

Q - Richard Cathcart {BIO 16457807 <GO>}

Thank you, Vanessa. Good afternoon, everyone. Just one question about the development of the long tail in 3P. Fred, you showed an interesting chart in your presentation. I just like to better understand the purchase frequency of customers, who are already buying in 3P, specifically considering the long tail and when you compare with clients who are 1P only?

And the second part of the question, what are you doing to encourage 1P or store customers to begin to buy more in the 3P long tail? Thank you.

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

Richard, obviously, the base is still growing. We've been having an increase in frequency. We don't disclose the figures, but year-over-year, we see an increase in frequency, especially owing to the long tail. 1P market is very relevant as well and also 3P in all the categories. 1P with groceries and 3P in all categories. We have many tools to encourage that, and cashback is important. MagaluPay fully integrated in the account, but not exclusively. We also have promotions for gold customers in the SuperApp world. So that are several actions, including coupons, activities that's our KPI, increasing SKUs by -- bought by customer per year. Richard we still have a long way to go, but directions are good and also with a good cohort [ph].

Q - Richard Cathcart {BIO 16457807 <GO>}

Thank you, Fred.

Operator

Our next question is from Danniela Eiger from XP Investimentos. You may proceed.

Q - Danniela Eiger {BIO 20250080 <GO>}

Thank you. Thank you, Fred. Thank you, Van. I have two questions. The first is a follow-up on the Black Friday issue. Just to make sure that I understood, I don't know whether it was Fred or Roberto who said that you want to focus on a premium mix this Black Friday. So out of your inventory, how much of that is made out of premium items? And could you probably read your inventory as a greater appetite to be more promotional? Because what we see is that in fact consumers want to consume. I mean, that's consumer intention, that's what we've been reading in several surveys. Consumers want to

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consume, but yet they are waiting for more attractive discounts. I think that one thing will depend on the other. So, if prices are attractive, so then they may buy the products.

So, I don't know whether you whether you chose premium products, because you have the same reading, you think that with good discounts they will buy. And the second thing is about the resilience of our marketplace. And in fact, we do agree because even because of the category that you're venturing into now fashion, sometimes that is a neglected category and there's still a lot of room to grow. But what would be the main avenues of growth within marketplace, that would probably try to compensate for that weakness in 1P and brick-and-mortar? Would be like all of them in general or there's a particular one that shows greater potential?

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

Well, there are two different things when it comes to Black Friday. First of all, premium. Well, we are now focusing on products with a higher ticket. Well, that doesn't mean that we are changing our inventory base. We are just putting our -- more chips on that online world and also the stores as well. Well, more in the one line world because we believe that it will be easier. So, we bought more items we are betting on a higher every ticket for all of the reasons I mentioned before. In terms of provisioning and I believe Roberto already explained that well. At the end of the quarter, we had 100 days of inventory. And in our view, this is very high. We hope to work with 70 inventory days also because of the stock out, in the chain, we were not expecting deceleration in the third quarter particularly in our brick-and-mortar stores. We expected to see better results so at the end, we had higher inventory than expected. And we thought it would be just more prudent to bring our inventory to more healthy levels by the end of December and even in the first quarter of next year.

Yes. It's a matter of working capital. We did the same thing back in 2019. So I think it's just a matter of doing what we think it's more adequate in that regard, but certainly sometimes you have items on promotion because you want to lower your inventory level, but we also want to go back to our previous inventory levels closer to 70 rather than 100.

And on the marketplace side do you have any main category that you see as the main category or is something more general?

A - Unidentified Speaker

Black Friday and November in particular the category is still very much focused on durable goods. 3P participation in Black Friday is usually lower. 3P perform very well in October, in December, I think it would perform very well as well. So, we're expecting a very good performance in December for 3P. But November usually, what we sell more our durable goods, goods with a higher average ticket. I mean other categories will be present, but they will not be so significant. This is something that will come with time, but once again even within total GMV of the company, this is a long-term construction, it is not something that is done in a short term. We still need a few quarters until we get to a good ratio of new categories in GMV. I mean, these categories have a lower ticket.

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I always say that in Amazon, Home Appliances share is not so high. I mean, it is very high. All over the world, these GMV categories have a good performance. Well, certainly we have to work hard so that these categories go back to good old days because we used to have good profitability levels in the past. And as soon as we equalize all of the operating issues and if the marketing proves, we will see traditional categories performing well and the new ones will also be an important contribution and the profitability avenues in all of the opportunities to monetize through our fintech. Because we did a lot of new things this year. Robson already talked about them. And the app tends to grow and all of these things combined will help us to perform better and have better profitability, but we will certainly deliver.

Q - Danniela Eiger {BIO 20250080 <GO>}

Yes. My question about marketplace was for a longer period of time. It was in the long run, but you already gave me the answer I was hoping for. Thank you.

Operator

Our next question is from (inaudible) from UBS. (inaudible), you may proceed.

Q - Analyst

Good afternoon, everyone, and thank you for taking my question. My question is regarding acquisition cost. Fred, can you tell us -- can you tell me a little bit about how this has evolved and how do you think that this will perform in the next coming years? And whether you can make a connection with the evolution of your organic traffic coming from the SuperApp. And my second question is just a follow-up question on the fashion side. Now with the development of your private label, how should we look at the evolution of Zattini from now on? Do you think things will change?

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

Well, thank you for the question. I will give the floor to Edu first and then I will come back after he finishes answering that part of the question.

A - Eduardo Galanternick {BIO 20410320 <GO>}

Well, thank you. In terms of acquisition cost, there has been a little bit of pressure throughout this year due to two factors; one of them is lower demand, because of also competition. The second point is the entry of another company that they are not yet fighting in the same territory, but in regards to the media, there is some inflation, especially when we talk about download costs. And at the end, this brings about some cost pressures. So, it's just natural that when you have a better market, more -- on the purchasing side, the competition is a bit more intense.

In terms of organic traffic, it's important to say that our growth when we look on the side of the structure, we outperform. We outperform in terms of other things and in marketplace, there was a dropping ticket because of our own strategy. And this traffic growth is well distributed. All of our initiatives of SEO, CRM, et cetera, they've been

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performing well, very balanced. There might be some variations but there are one-off situations and that has to do with some structural changes. But -- that's it.

Now, in regards to fashion. Well, I'll try to be very direct. The focus is -- the fashion world at Magalu, we have well established channels. They are all leaders in their categories, Netshoes, Epoca Cosméticos bring some traffic, but we believe that the major focus of the fashion category will be within Magalu, but we will take advantage of the traffic that already exists. Well, fashion category sells well, and Netshoes sells well as well. So we have fashion within the Netshoes channel. It's growing. It's one of the apps that is most downloaded in Brazil. Fashion sells well within Netshoes and within Magalu. So the strategy is for us to continue to grow within these channels. I think I already answered the question.

Q - Analyst

Yes. Yes. You did. (inaudible) I had a question about your private label. But how does your private label connects to Zattini?

A - Eduardo Galanternick {BIO 20410320 <GO>}

The private label strategy does not have any relationship with the channel strategy. Like Fred said, I mean we just have to focus our energy to develop the Magalu channel. The private label is part of this very broad strategy to develop fashion within Magalu and the role of the private label and I would just like to mention three major points. First of all, it's important that we have our exclusive product and to post trends in an exclusive way and our positioning has to be linked to the mother brand Magalu.

There is another aspect, because with all of that, we understand that we will be able to attract more flow. We will be able to attract more people to our fashion category and this in turn will benefit the mix as a whole. It will benefit the experience as a whole of the world of fashion. So, these are some main aspects about our private label strategy because it's part of a broader strategy. Our objective is not just to grow within our private label, but it's part of a broader strategy.

Q - Analyst

Thank you.

Operator

This concludes Magalu's earnings conference call. Investor Relations team will be there for any further questions you may have. Thank you for joining us. Have a great day.

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

Thank you for being with us. Enjoy the rest of the day. Have a good holiday.

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