

## Q2 2018 Earnings Call

### Company Participants

- Eduardo Galanternick, Executive Director of E-commerce
- Fabricio Bittar Garcia, Chief Commercial Officer
- Frederico Trajano, Chief Executive Officer
- Marcelo Ferreira, Vice Chairman
- Roberto Bellissimo, Chief Financial Officer

### Other Participants

- Andres Estevez, Analyst
- Fabio Monteiro, Analyst
- Felipe Cassimiro, Analyst
- Franco Abelardo, Analyst
- Maria Paula Cantusio, Analyst
- Olivia Petronilho, Analyst
- Richard Cathcart, Analyst
- Robert Ford, Analyst

### Presentation

#### Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Magazine Luiza's Conference Call, referring to the Results of the Second Quarter of 2018. At this time all participants are in listen-only mode. Afterwards we'll start the Q&A session, when further instructions for you to participate will be given. (Operator Instructions) Now we would like to turn the floor over to Mr. Frederico Trajano, CEO of Magazine Luiza. Mr. Trajano, you may proceed.

#### Frederico Trajano {BIO 17269235 <GO>}

Good morning, everyone. Thank you for participating in our call regarding the earnings of the second quarter of 2018. Once again, as usual, I'm here with all the other officers of the company, that will be with me all the time and will be available to answer your questions at the end of this presentation that Roberto Bellissimo, our CFO and myself will be making now.

Talking about the quarter now. I can say that we had an outstanding result. Growth in sales is the best use for a retailer and undoubtedly this was the major highlight of the second quarter. We grew 43% of our sales in all channels and we have a sound and consistent

result coming from work done by the whole organization brick and mortar stores, growing 27% same-store sales of historical record and e-commerce once again showing 66% increase -- outstanding increase very much, because of the proof that we are reaping from our marketplace development and marketplace had a very big contribution.

And we have been reporting this since, this is the third quarter in a row that we are reporting gently of marketplace. So this is really even a Chinese company would be proud of that. And although we had a very balanced growth in our channels and all categories, all categories went up. I would like to highlight the fact that we had a very assertive action, a very successful one, on the part of everybody. We had the World Cup, and the effect of the World Cup on sales already start in the first quarter, but it is mainly on the second quarter. And we set up a campaign, a very successful one which is called Sai Zica, which means, go away bad luck. And we invited our clients to exchange their old TV for old news and we even bought the old TVs from our consumers. And this was a very creative action on our part and with a very good and interesting process engineering behind it. And we bought back thousands of TV sets, during this period.

And the campaign was successful internationally, it was highlighted by international media and even the German TV talked about our campaign. We had a very big voice share equivalent to brands that were the sponsors of the World Cup, because we were not sponsors this time. And we were very successful with this campaign and of course this is reflected on our figures.

During our management we had many crisis, and we had a big one now, which was the strike on the part of truckers and in spite of that, this not decreased our sales. At the first signs of the strike we set up a crisis committee involving the Executive Committee and all the areas of the company that could one way or another make decisions regarding minimizing the effects of this crisis, and we did a wonderful job there during this period of the truckers strike. And that of course had repercussions all over Brazil.

First, we increased the delivery times both for e-commerce and for the brick and mortar stores before the competition, and we were totally transparent. We had even over 20 days delivery times because we knew that there would be a big impact on delivery times because of the work the truckers strike. But this is the consumers year for us. We are totally focused on our consumers and we had to start this way, even if we risked losing sales and we channeled the marketing campaigns of brick and mortar stores in e-commerce and very much so in the stores where we had or the product that we had the necessary inventory giving special conditions. And for e-commerce for this long delivery times, we carried out a campaign that was called, it is worth waiting for it. And in the sense of making a lemonade from a lemon. And I would like to highlight the work done by our logistics, our team is more and more aligned with our business both in terms of express delivery and in normal days or the commercial area as well.

And with normalizing inventories, after a few days we already had 98% of our inventories already in normal levels. And we in a few days we reduced the delivery times of e-commerce. This was exceptional and we did not lose our CEO for e-commerce and for all the other areas of the company. And I would like to talk about this now. As we said during the first call of this year and we had been repeating this. What is really impressive about

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our company, is the total focus on our clients and with improvement in all indicators, both in terms of the active base of client and repurchase and those who buy with credit card and that have a higher value and also indicators of level of service.

Talking about the express delivery and time for you to make an exchange of our product. And NPS as well, which is an indicator that is important for all channels and also is a part of the variable compensation in all levels of the company and we were able to evolve a lot in all indicators. And in spite of very high targets we have been growing our client base, marketplace helping us quite a lot. Most of our clients are generated from marketplace now or many of our clients and we also have new brick-and-mortar stores.

We are conquering new clients and opening new stores, opening new market -- 27 stores in new markets and areas such as Goias and Maranhao, which are smaller compared to the other than we doubled the number of cards issued vis-a-vis last year. And we also increased our credit to clients, and we brought express delivery to over 100 cities and all operators working in this modality. In these sites, we reduced 60%, the average time of the return of the amount to a client that returns a product or wants to exchange the product. And last week, we had 30 seconds wait time at the call center and it was a fantastic work done by the stores and a lot of application of technology in the stores and the offices in general in all areas of the company and also a lot of use of IT with growth in our investment in systems development. And we have a new fact, we have the lab, we have the headquarters in Sao Paulo, and the team moved to a new area, new location by the end of May.

And we are going to take the Franca people to another area between August and September. So this is the estimate for this change and we continue to be focused on our digitalization process, and also in the application of technology in our business end-to-end. And I would like to finalize my introduction before giving the floor to Robert, by talking about our outlook.

We do not have a World Cup every single quarter, so there was a one-off situation in the second quarter. And of course this growth will be more similar to other quarters without the World Cup that we have been delivering.

We also have some factors that make us more cautious regarding the second half of the year, which is the depreciation of the real and also the pressure on the part of many companies in terms of price increases. And they still have to be absorbed by consumers. So we already see some pressure on prices, and of course this changes costs and -- in a way, it also impact sales. And I would like to remind you that I have been giving you this warning that we are also accelerating our investments in clients.

These are investments that could bring about a reduction on our margins, vis-a-vis last year, because we have a huge objective, which is to have the biggest growth in the client base in the Brazilian retail and the best service level. And of course there is a trade-off involved, you cannot make an omelet without breaking the eggs. And I see that these investments and this characteristic will be reflected on the results of the next few quarters. So I think it would be prudent for us to inform you that before, investors review

their expectations without considering these aspects. So I would like to give the floor to Roberto now. And at the end I will return to answer your questions.

## **Roberto Bellissimo** {BIO 17269312 <GO>}

Good morning, everyone. Thank you for participating in our call. Let us start with the highlights of the quarter. As Roberto (Sic - Frederico) said, we grew 43%, 4.6 billion in sales, over a very high base in the second quarter of last year when we had already grown 27%, so it is growth -- overgrowth.

In a market that didn't grow that much, but up to me the growth of the market was quite low and in some cases it was even negative. In brick-and-mortar stores we grew 34%, 27% same store sales over a very high base, which was 14%. And we highlight the participation of the new stores driving growth in 7 percentage points, with the very good result as well since the beginning.

In e-commerce we grew 66%, also on a 61% base. E-bit published 13% growth in the second quarter, so we gained much more market share and marketplace went from 30 million to 150 million, so a fivefold increase reaching 10% of our overall sales in total e-commerce. In relation to our gross profit, 0.9% margin drop, inline with the other quarters and slightly higher because of the World Cup, because of the major participation of e-commerce, which increased about 5 percentage points. And during the World Cup, we had a very good performance in the image category and TV category.

And on the other hand, we further diluted operating expenses 1 percentage point dilution, mainly in terms of fixed expenses and bringing our SG&A to 21.8%, even if we consider the investment in this new phase, the acquisition of new clients and the higher service levels. EBITDA grew 32% with a record level for this quarter, BRL312 million with an 8.5% margin. We also diluted our financial expenses and our net income was BRL141 million, practically a two-fold increase vis-a-vis last year. We continue to generate a lot of cash, 1 billion from our operations in the last 12 months. And in the quarter, we also had a very good cash generation and our working capital continues to contribute around 200 million in the last 12 months.

We reduced our net debt in 12 months, going from net debt to net cash, BRL1.3 billion and closing the half-year with a total cash position and cash equivalent of 1.9 billion. On the next slide, we see the evolution of the new stores. The biggest organic growth, 61 new stores in the last 12 months, and for this quarter, 27 stores opened. And in this quarter, we will be opening an additional 30 stores more or less and so the expansion pace continues to be accelerated, and the CapEx in the quarter doubled vis-a-vis last year to 85 million, in line with our growth plan.

And with the funds that we raised in our offering in the follow-on last year and in the half-year our investment grew over 50% reaching BRL121 million. We show the evolution of sales on a quarterly base, almost 5 billion in sales in the quarter, 1.5 billion in e-commerce sales, growing in the half year 65%. And the other figures that we have already reported

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and mentioned here. This is the 10th consecutive quarter in which we accelerate our growth and also with gains of market share.

On the next slide, we see the evolution of our gross profit, operating expenses and we diluted SG&A quite a lot, in fact office expenses and the management of our DCs and also the fixed expenses, such as rents. We decreased this and rent increasing because of the new stores and with a very low adjustment, lower than inflation for the other one. Selling expenses growing, mainly in variable expenses impacted by our decisions to increase our investments in marketing and logistics and payroll in order to further improve our services both in sales and after sales. And equity income, well, we had increase in provisions because of the IFRS 9 and afterwards we will show you the results of Luizacred but contributing 10 million in the quarter, 0.3 percentage point. On the next slide, we see the quarterly evolution of the EBITDA, highlighting the growth in sales and the very positive contribution by e-commerce and also dilution of operating expenses.

Then we show the financial expenses. We reduced significantly our financial expenses by 0.5 percentage wise going from 3.7% to 1.9%. And excluding the prepayment of receivables we had net revenue, and the expenses with this area are in line with the growth in sales and the increase in the participation of the Luizacred, which is also part of our strategy.

Talking about the working capital, 73 days turnover with an average term of 90 days, which means that we maintained a positive cycle of almost 20 days. And with that the need for working capital continued to improve, giving a contribution of about \$200 million in the cash generation in the last 12 months. And when we look at the net cash position, we increased this significantly vis-a-vis last year and even vis-a-vis the last quarter. And in this quarter, specifically, our operating cash flow was almost BRL300 million. And in spite of significantly increasing investment and paying dividends and interest on equity, we increased our cash -- net cash position in the quarter and also highlight here is the fact that our S&P upgraded us to AAA. And this is very important for our capital structure. And another highlight has to do with our shares. We joined the NSI this quarter, and the average daily traded volume increasing significantly between BRL150 million and BRL200 million per day.

On the next slide, we show the capital structure, reducing our debt -- our net debt over 200 million in our gross debt reduction, maintaining a sound cash position. Net income, a 141 million went up significantly with an ROI of 26% and ROIC 29%, ROE 26% and ROIC 29%. So consistently growing and maintaining a very high ROIC and also generating quite a lot of cash. Afterwards, well, let's turn our attention to Luizacred, the evolution in our card base.

In the quarter we showed two times the number of cards vis-a-vis, the same quarter last year and in net terms 240,000 new cards added to the base. Ever since the beginning of this year we had decided that one of the top priorities in terms of our focus on client was to further increase our Luiza Card base, because they are more loyal, they have more repurchase and they spend more higher average ticket and higher frequency. And in the last three quarters we have been growing our base significantly. This increases the revenue of Luizacred growing 37% vis-a-vis the same quarter last year. And the highlight

here is the growth inside Magazine Luiza is 78%. So these clients give a very good contribution to the growth of e-commerce and also in brick-and-mortar stores.

Now the portfolio of Luizacred, over dues are improving, this rate is healthy, 1.3 percentage points vis-a-vis last year improvement, and NPL and additional 0.6 percentage points, which means that we are growing our client base and our card base with a very good quality. And net income had the negative impact of the new methodology of provisioning by the IFRS 9. And we highlight here that the coverage ratio, for instance went from a 132% on the same date last year to over 200% this year.

According to the IFRS 9 we are obliged to make provisions, not only higher provisions for our portfolio and new provisions for -- or the limits available and that have not been utilized yet by our clients. And as in this quarter we increased the sale of new cards and also we increased the limit or the cap for the best client. There was an increase in the level of provisions required. Nevertheless, they are not permanent and the quality of the portfolio continues equal. And if we look at the net income in BR GAAP, which is comparable to last year, it was BRL40 million in the quarter, growing vis-a-vis the 32 million in the same quarter last year, and with an ROE at 22%.

So once again Luizacred gave this contribution to our total earnings. And we will continue to focus our sales and our efforts on increasing the Luiza Card base. With that we finish our financial highlights.

Now I would like to give the floor back to Frederico and then we will open for questions.

**Frederico Trajano** {BIO 17269235 <GO>}

We can go straight to the Q&A session.

## Questions And Answers

### Operator

Ladies and gentlemen, now we will start the Q&A session. (Operator Instructions) Our first question comes Robert Ford from Merrill Lynch.

**Q - Robert Ford** {BIO 1499021 <GO>}

Thank you. Good Morning, congratulations for the results. Could you give us more details about this quarter and the rest was not understandable, we apologize.

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

Good morning, Bob. Thank you for the question. How many TVs, how many TVs were sold? The information that we published was that we doubled the share vis-a-vis the last World Cup and we also gained a lot of share vis-a-vis last year and we were already gaining share over the last quarters. We sold over 1 million units. I believe in the half year.

But more than that we showed other products as well, because for instance, people wanted to exchange their TVs for a better one. So we sold a lot of big screen, 50 something inches and better TVs. And it was a very good performance, but we did well in all categories. In this quarter, TVs or the image line, as we call it have a very good share, and exceptionally high share because of the World Cup. But we gained share as well in other categories, Fabricio, if you want to add?

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

As Fred said, both in e-commerce and brick-and-mortar stores we more than doubled the growth in TV is three digit. But our performance in wide line and furniture and portable, we grew a high two-digit both in brick-and-mortar stores and e-commerce as well in all categories. So this contributed a lot to the overall growth in sales. So we gained a lot of share everywhere. Our performance was very good in all categories of the company. So you can see the volume that we sold and --

#### **Q - Robert Ford** {BIO 1499021 <GO>}

What is behind that and what is your expectation for the remainder of the year?

#### **A - Frederico Trajano** {BIO 17269235 <GO>}

Bob, I will start to answer and then maybe Roberto or Marcelo Ferreira can add to this. The growth strategy for our card base is mostly based on the study that we carried out of customer like value at the beginning of the year. And what we saw was already -- we knew it was true, but it was much higher than we thought. The consumer who buys with the card has a higher value than the client that buys without the value. Because the repurchase rate is much higher than the clients and they're also more faithful, they're more loyal and they become a strength for the maintenance of growth also of the brick-and-mortar stores, because the card is very much a phenomenon of brick-and-mortar stores yet. And the penetration in the Internet is still low and we are carrying out many initiatives in this sense, and we will be announcing news in terms of approving the card for clients that buy for the first time in e-commerce.

So we decided to increase our target of investments to attract credit card clients and we increased the limits as well for the purchase by these clients. So the strategy is very much based on that, because at the first moment you have some impact that is felt, but this is more than offset in the long-run. This is a typical decision of short-term vis-a-vis long term, if we are investing part of the short-term results in our long-term investment -- long-term growth.

#### **A - Marcelo Ferreira** {BIO 16849609 <GO>}

I would like to add to what Fred said. The card has a dynamic that is different, as we say in the industry, the first two years, they do not give us a real income and it is only after the two first years, that you see that what you generated will bring you net income. IFRS 9 also increase this bar. It brings all the expected losses to the beginning. So this is why the allowance for bad debt happens in the short-run. And why did it grow in this quarter? Of course, with the World Cup, we had increase which was higher than in the next quarter. So the strategy of placing the card at the core and as you saw all the communication about

the card, this was very much mentioned in the promotions of Magazine Luiza so this brought a higher effect in the second quarter in our provisions.

And as Fred said, this was a decision that we made and in spite it looks like a reduction in Luiza Card. Everything is correct. The performance indicator, as you can see are better and better consistently. And the BR GAAP is being shown to you, so that you make this comparison, because BR GAAP, you had a very big growth. And here you have the investment in the card and without that this would be higher. And the strategy continues to be the card at the core and the clients, becoming more and more loyal.

**Q - Robert Ford** {BIO 1499021 <GO>}

Do you expect a higher number of issues and is this what you are preparing?

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

Yes, we will continue to grow, we will continue to invest a lot in the growth of our card base. Bob, we launched a new campaign for instance to encourage our employees to channel their efforts to clients in terms of acquiring and using our card and we started to have merchandising of Luiza Card in TV show, and we're doing marketing campaign, focusing on the Luiza Card and exclusive promotions for those who use the Luiza Card. And with Luiza Card we are able to give longer terms and sometimes no interest charged. And with -- just to give you an idea, 90% of our clients are active. 66% use the Luiza Card every month and on average seven times per month. So this is a very active card, this is the main card for our clients. And if you look at the statements by these clients they very often even cry during their testimonials because of the happiness that this brings them.

And one thing that is important and we started to do this year was to place printers in the stores, inboxing real-time online. So the client exits the line -- the store already with a card printed with his name or her name with a password and already active. That is to say unblocked. And we are doing the rollout of these printers and by the end of the year, we will have this in almost 600 stores. So this is part of our strategy of increasing our active card base.

**Q - Robert Ford** {BIO 1499021 <GO>}

One additional question. What are the cities involved and what is the percentage of sales in these markets for you? And what about the delivery?

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

The express delivery is D plus 2, up to 48 hours after the purchase. And the indicator for the long-term objective that we convey to you by the end of next year, we have already said to the market that half of the sales we expect to have in this modality. In how many cities well, well we do not disclose this information, Bob.

**Q - Robert Ford** {BIO 1499021 <GO>}

Thank you. Congratulations.



## Operator

Fabio Monteiro, BTG Pactual.

### Q - Fabio Monteiro {BIO 3711690 <GO>}

Good morning, everyone. I have two questions. One has to do with online. You talked about the clients that have already bought items from the marketplace, 19% in the second quarter. And I would like to know about the new clients. Could you give us an idea, first, of how much online is growing in terms of number of items and the percentage of new clients that are coming onboard on your base and how many are buying items from the marketplace? And maybe you could give us an idea of categories as well. Net of the TV effect that was very specific because of the World Cup, you doubled the share and you carried out campaigns related to the World Cup and so on and so forth, I would like to understand net of that, which categories were the highlight in the quarter and including in the marketplace?

### A - Eduardo Galanternick {BIO 20410320 <GO>}

Fabio, this is Eduardo. Thank you for the question. We have been saying all last calls that we have been growing in terms of conversion and in this quarter, there was a drop in the ticket -- average ticket but this was totally caused by the frequency of purchases although we grew 66% in our sales in terms of items, we grew over a 100%. In terms of marketplace, as we said, although, which represents 10% of our GMV of everybody that brought from Magazine, 19% brought or bought products from the marketplace in terms of categories.

Marketplace, takes all the categories that we have but also represent an additional assortment which is important. And also in number of clients are in the toiletry, cosmetics, automotive category in the market. Category, they are very good to bring onboard new clients. And this has to do with the drop in the average ticket and the impact that we have been achieving in our business as a whole and by the marketplace or from marketplace and our client base.

### Q - Fabio Monteiro {BIO 3711690 <GO>}

Okay. One last question. You had 918 million in operating cash flow in the last 12 months, and what we see on your part is a very major focus on strategy and may be a clear lack of interest on M&As or relevant M&As.

And we see this very positively that is to say you're turning your eyes to organic growth and you're advancing a lot in terms of market share without any additional acquisitions. So my question has to do with the use of your cash. You talked about the opening of new stores and you even accelerated that. You had 27 new stores opened in the last quarter and 71 in the last 12 months. And we see this one of the major front of Magazine and all the investment in marketplace as well, but maybe you could say a few words about the level of indebtedness that you consider as adequate or comfortable to be maintained?

And do you see any other use for the cash that you are generating considering that you might not have an M&A or at least any relevant M&As in terms of size?

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

Fabio, we have been very successful in the management of our working capital and having growth and even with certain stability of margins now. And we were able to reduce our debt, and we have now a very comfortable financial position with net cash. And when you look at our capital structure, you have considered the number of receivables of cards that is to say. And when we consider our indebtedness, we have to take into account the prepayment of the cards, which is different from a classic debt. Because it generates a financial expense and this financial expense, we wanted to be up to 20% of the EBITDA tops.

We have a lower interest rate now, but the international perspective could generate higher interest rate next year. Remember the World Cup of 2014 and afterwards 2015, this was a very complicated year for Brazilian retailers and for us, especially because we had very low interest rates in 2014. And in 2015, the interest rate doubled, and then the financial expense consumed practically the whole EBITDA of the year. So it's very prudent on the part of the company, even if we have a very good moment now, we have a good revenue, we have low interest rate, we must be careful, because in Brazil, there is a huge volatility in interest rate. And as we mark discount receivables to maintain our capital structure, we have to consider this.

So I think I have already said this that in some of our calls, we need to keep this conservative policy because of the volatility of interest rate and the market. In terms of investments, we are accelerating a lot Vis-a-vis last year, new stores that you mentioned and we have already reported. And we will continue to follow even a more intense pace in the third and the fourth quarters and, most probably, for 2019 as well. We also have remodeling of our stores or some stores to become mini DCs, and we have already started the project and we are accelerating.

We have about 100 stores for this to be rolled out to, and we will be doing this in additional stores in other areas as well, and we are investing also in DCs, extending, increasing and changing the location. For instance, in Bahia, we launched a new distribution center in Goias and in Fortaleza. We extended it, and we are also investing in equipment and in software -- automation for that investment in technology, both in OpEx and CapEx.

We are investing a lot, increasing the number of people in the lab, which is the area that is going to be most in terms of our payroll or in terms of our team. And all this consumes cash and it requires our cash. So this is the focus of the company in terms of investment technology, logistics, increasing the number of clients and improvements in the service level that I mentioned. I have already mentioned that part of the investments are in OpEx and part in CapEx. So this is the line that we wish to continue. We did have an M&A, we acquired Logbee this year. And solutions like Logbee that might complement our ecosystem, we continue to look for alternatives in the market, and we have been

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mentioning this consistently since our follow-on last year, but we have a lot of discipline involved, and we are following our strategy with a lot of discipline.

**Q - Fabio Monteiro** {BIO 3711690 <GO>}

Thank you. Excellent. Thank you.

**Operator**

Richard Cat, Bradesco.

**Q - Richard Cathcart** {BIO 16457807 <GO>}

Good morning. I have two questions. The first one has to do with our app. And could you give us an update of the penetration of the app in e-commerce? You maybe you can give us the figure also of the previous quarters and the gross margin? There was a decrease because of their channels as you described and there was a slight decrease also because of the mix, as you said in the release. So as you 1 million TVs, how were you able to deliver a gross margin that only dropped a little bit in this quarter?

**A - Eduardo Galanternick** {BIO 20410320 <GO>}

Richard, this is Eduardo. I will start and then Fabricio will talk about the TVs. In terms of the app, we placed this bet on 2015, at the end of 2015, and we were very happy to see that in this quarter. We became really an app-based company. This is the channel that represents the most traffic in our business reaching almost 30% of the B2C. Not only investing a lot in terms of download but one of the most important targets is the more active users, and we want them to download, but also we want them to interact with the app.

And push is very important in the sale of the app. Well, we believe that we are on the right track and we will continue to invest. So that the app becomes more and more important because the experience, the user experience is very good there.

As I said before, I think what helped us in terms of our margin was the categories. We did a very professional work on TV, as we said, but the growth in white line, for instance we grew sixfold the market in smartphones also and furniture as well with the higher two-digit and three times more than the market in high margin products. And we grew very much in all categories and not only in TV's. We had an excellent performance in all categories. And this was the reason why our margin was not very much hindered. And about margin, I would like to mention our services sale.

We have been doing an outstanding work in the sale of insurance and warranty. We launched digital services and both the control plan as well as the installation and maintenance and they increase their share even more than sales and they bring about a very big contribution. It is not just the price increase, we are talking about the penetration of our sale of services, that helps a lot in terms of maintaining our margin.

## Q - Richard Cathcart {BIO 16457807 <GO>}

Thank you.

## Operator

Felipe Cassimiro, HSBC.

## Q - Felipe Cassimiro {BIO 20321618 <GO>}

Good morning everyone and thank you for taking our questions. Still about the strong performance in the quarter in the brick-and-mortar stores. Fred talked about that in the answer to the first question. But we would like to understand how much the each channel initiatives, personalized by means of the app, of the app, \$16 million downloads in the first half. How much this helped increase client traffic in the brick-and-mortar stores beside the marketing campaign of course.

And the second question is the following. Could you give us an update about the timing of the rollout logistics for marketplace. So these are my questions.

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

Thank you for the questions, Felipe. About the first question. As we said in the release, the app today, well, the focus of the app is to generate sales for the e-commerce, although it does have features of multi-channel and with one click, you can buy and you can do the click and collect. This sale get into the digital channel, so the growth in the download of apps and the marketplace strategy contributes a lot to the growth of the e-commerce growth. And not so much of the brick-and-mortar stores, although we have already approved.

We have already proven that, there is no cannibalization because the channels grow in specific context, but the ones that you mentioned specifically give a contribution to the growth of the digital channel and the brick-and-mortar stores were mostly impacted by the promotions that we carried out, with focus on the brick-and-mortar stores. For instance, the exchange of merchandise and the client comes to the store to exchange the old TV for a new one. So because of that, we attracted a lot of consumers to the brick-and-mortar stores. Beside that, you have the use of the Luiza Card and the better terms for the use of the Luiza Card. And all that ends up, helping all the other channels. But at this level, of course this helps for channel. But we are investing a lot in marketing campaigns in Facebook and digital platforms in general, in order to attract clients to the stores to the brick-and-mortar stores with growing results.

And the second question? Oh, the Magalu delivery. We're extending in the modality that we have today. We already have over almost 20% of the sellers, adhering to this modality. In relation to the click-and-collect model, we have a pilot for the third quarter and we believe that over half of these sellers will be included in the first modality that we mentioned.

### **Q - Felipe Cassimiro** {BIO 20321618 <GO>}

A follow-up to the last question. Given the growth of GMV and looking on annualized terms, it should be close to 1 billion. Do you already have the structure in place for that by the end of the year?

### **A - Frederico Trajano** {BIO 17269235 <GO>}

Where we'll be launching the pilot by the end of this year. So, of course, we are going to change whatever is needed in the structure vis-a-vis the adherence of the sellers. We are not building capacity much before a good assessment of the pilot and how much the area will do. And we can do this very quickly. So we would rather do this, just in time than building a lot of capacity before -- because this will have an impact on profitability. So we're going to look at the pilot and see how it performs and what area it requires, what infrastructure. And based on that, we will be increasing our DCs and our focus is always to have a very quick turnover because having merchandise in the DCs is not good for us and it's not good for the sellers.

### **Operator**

Olivia Petronilho, JP Morgan.

### **Q - Olivia Petronilho** {BIO 19090195 <GO>}

Good morning. Thank you for the question. I have three questions. The first one -- are about the brick-and-mortar stores. When you look at the categories net of TV, could you give us an idea of what you have been seeing at the beginning of the second half and what you expect from now on and what we saw in the first quarter could be considered as more normalized? Secondly, the productivity of the new stores. It seems to me that this is very strong as the expansion in area was 6%. So is the profile of these stores different? What about the maturation of these new stores? Is this maturation in line with what you expected? And in terms of e-commerce, the new distribution centers, you already have some pilots, and I would like to know the results in terms of productivity for e-commerce in terms of the delivery terms, et cetera? Thank you.

### **A - Frederico Trajano** {BIO 17269235 <GO>}

I will start and maybe somebody will add to that. About your first question, as I said, at the beginning of the call, we do not have a World Cup every quarter. And I believe that we will be seeing figures more similar to a quarter without the World Cup, such as the first quarter. And you can see that the comparison base is much stronger, and you have to take this into account. This is a major challenge from the viewpoint of generating growth post World Cup because we do not have any external factors coming into play, such as the World Cup in order to generate more. So this is what I can give you as guidance, so to say.

The second question about the new stores. We are totally, totally satisfied with the maturation curve of the new stores in Sao Luis and Goias, in Maranhao, Goias and these two states and also all the other stores in the other states, I would say, that in over 95% of the new units, we have original estimate being exceeded and the IRR of the stores has

been exceeded and also the payback. So we are super satisfied with the performance of the new stores, and we will continue to accelerate the opening of stores because the initial figures are rather encouraging.

#### **A - Marcelo Ferreira** {BIO 16849609 <GO>}

I would like to add some. Well, the strategy was very good. We chose the right locations. We got into new -- two new locations. And the main point is the discipline that we are having. We are being very rigid in terms of the occupancy cost and the choice of the location. And this all helps the store to reach breakeven. So our discipline is a major difference, and they have very good performance. And the third point, as I said, we have the perspective by the end of '19, having, all are delivered in 48 hours. And of course, we will have to continue to rollout our investments in technology and in distribution, because this is very important to reach this indicator.

So we have to have a lot of discipline and a lot of competence in the execution. And of course, this is not easy because if you talk about remodeling a store and making it a mini DC, this is not very easy.

#### **Q - Olivia Petronilho** {BIO 19090195 <GO>}

Thank you.

#### **Operator**

Guilherme Assis, Brasil Plural.

#### **Q - Andres Estevez** {BIO 20806759 <GO>}

No, this is Andres talking. Fred, could you talk about the increase of account receivables, because it's slightly higher than your historical levels. Is this related to online sales or other specific factors? And could we expect with the growth of online, the increase in your receivables as well?

#### **A - Frederico Trajano** {BIO 17269235 <GO>}

Good morning, Andres, thank you for the question. This is totally related to the growth in sales and we do not want to discount as much card receivables as we did in the past because of the better capital structure. If you talk about mix, the participation of Luiza Card is increasing and the participation of the Luiza Card, most of it, we discount with Luizacred, that is to say it's not in the balance sheet.

The third-party cards tend to grow with the growth in sales and mainly with the growth of e-commerce, because the participation of third-party cards in the brick-and-mortar stores is very low, comparatively, because Luiza Card is very high indeed, e-commerce it's very high and it tends to go down as we increase the participation of Luizacred in e-commerce. This is one of our major objective, so -- but sales in third party credit cards will continue and they will more or less accompany the growth of the company and the decision of discounting or not discounting is tactical. It is whether we want to transform this into cash

or not. And we have to consider the fact that there is a daily settlement possibility and this is a very cheap way of us financing ourselves. So to say. But the trend is very similar to what we see today. As we continue to generate cash, we do not have to discount all the receivables, such as was the case in the past.

**Q - Andres Estevez** {BIO 20806759 <GO>}

Okay, understood. Thank you.

**Operator**

Franco Abelardo, Morgan Stanley.

**Q - Franco Abelardo** {BIO 17416219 <GO>}

Good afternoon. Congratulations for the results. I have two questions. The first one has to do with selling expenses. Can you quantify or at least qualify the level of investments in terms of services in the quarter of the 35% increase in selling expenses. How much came from growth in sales and logistics and how much has to do with the acquisition of clients and the improvement in services? And what was the penetration of free delivery in the total online sales in this quarter? Because you had the campaign that was called it's worth waiting for it to minimize the impact of the strike. And what about this free delivery and how should we see this penetration in the second half of the year?

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

Thank you for the question. We do not give this level of disclosure about variable expenses. We do not disclose this. But the fact is that a major part of the increase in variable expenses came from our investment in express delivery, which involves having more people in the DCs handling the items and the merchandises and having more shifts in the DCs and also increase the frequency of routes. So this involves quite a lot of investment in logistics. And we, I believe we have added about a 1,000 people in the overall logistics operations of the company over these quarters. So this is very significant, and once again this shows that we were talking very seriously when we said that we had the commitment of having the fastest delivery in Brazil and having high indicators. So and other investments as well more call center operators in order to reduce the time and other investments as well. More investments for instance in the Luiza Card and marketing to activate the Luiza Card. So there is a major part that was offset by a higher contribution margin due to the World Cup.

And I really cannot get into details, but your reasoning is correct. If it were not for these investments the company -- well, this would be much higher in the quarter. So I think it's important to add this. It would be higher in the quarter, not a lot higher, okay, so this is all I can say. Well, the delivery, the free delivery was 1 week in 12.

**A - Eduardo Galanternick** {BIO 20410320 <GO>}

This is Eduardo. It had to do with the free delivery for all the purchases made through the app, higher than BRL99, and the promotion of free delivery has been decreased and the campaign that we carried out it is worthwhile to work was practically 5 days or 7 days after

the strike, and it had no relevant impact on the consolidated results for the quarter, but the click and collect comes out very clear.

**Q - Franco Abelardo** {BIO 17416219 <GO>}

Congratulations once again for the result.

**Operator**

Maria Paula Cantusio, BB Investment.

**Q - Maria Paula Cantusio** {BIO 18652439 <GO>}

Good morning and thank you and congratulations. Thank you for the question. How do you see your competition? Do you think most of the competitors are little bit fragile because of the market situation? Do you see any recovery on the part of your competitors? And how do you see competition for the second half because of the promotional event that will be carried out?

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

Maria Paula, good afternoon, in fact, because it's already past 12. Thank you for the question. We have been talking about competition in the last calls and I do not see a material change in the competitive scenario from the first to the second half of the year. I think it's more related to the macro situation. And I say that our biggest competitor is Magazine of the previous year. So our major difficulty is surpassing our own achievements. So I still see the market in a rational position because Brazil is still in a crisis. We still see a slowdown in the economy and investors are very cautious in terms of investing in companies via equity or debt. So nobody has money, a lot of money to invest without caution.

So I do not see significant changes in the market for the second half and I imagine that it will continue as such. The challenge that we will have in my opinion are more -- well they will come more from the macro situation than the micro situation, online and offline. So I do not see major changes for the next half or this present half year. In micro-economy, I don't see any major changes, maybe for 2019, and what about your second question?

**Q - Maria Paula Cantusio** {BIO 18652439 <GO>}

What about the performance of the marketplace product in your brick-and-mortar stores?

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

It's still too incipient. We had some situations in which in the pilot we had worse results than we expected and we are correcting. We're fine tuning these issues. So we still see no impact on same-store sales in brick-and-mortar stores. We believe that there is a big opportunity there to increase sales in brick-and-mortar stores. But we still have to fine-tune the technology involved and the whole process involved in order to deliver a better experience and be more successful with the sale in this channel.



## Q - Maria Paula Cantusio {BIO 18652439 <GO>}

Thank you Fred and congratulations again.

## Operator

Now we close the Q&A session and we would like to give the floor back to Mr. Frederico Trajano. You may proceed.

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

I would like to reinforce my happiness with the results delivered and I would like to congratulate the over 20,000 employees of Magazine Luiza for the outstanding result, in spite of all the difficulties that we faced over this period. And I would like to reiterate my confidence in the long-run and the strategy of the company and the measures that we are taking and reinforce the fact that we would -- we're facing a more challenging macro situation in the second half or compared to last year. And I would like to thank all the investors that have placed their bets on the company and that have supported the company in the last few months. Thank you very much and good afternoon.

## Operator

Magazine Luiza's conference call is closed. We thank you for participating and wish you all a good afternoon. Thank you.

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