Q2 2016 Earnings Call

Company Participants

- Eduardo Galanternick, Chief E-commerce Officer
- Frederico Trajano, Chief Executive Officer
- Roberto Bellissimo Rodrigues, Chief Financial Officer and Director of Investor Relations

Other Participants

- Guilherme Assis, Analyst
- Irma Sgarz, Analyst
- Luiz Cesta, Analyst
- Maria Paula Cantusio, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for holding, and welcome to Magazine Luiza Second Quarter Earnings Conference Call. We would like to inform you that all participants will be in listen-only mode during the company's presentation. After the company's remarks are completed, there will be a Q&A session when further instructions will be provided. (Operator Instructions)

Now I would like to turn the floor over to Mr. Frederico Trajano, CEO of Magazine Luiza. Please Mr. Trajano, you may proceed.

Frederico Trajano {BIO 17269235 <GO>}

Good morning, everyone, and thank you very much for participating in our results conference call for the second quarter of 2016. And we have here Roberto Bellissimo, Fabricio Garcia, Eduardo Galanternick, Marcelo Ferreira and Decio Sonohara. And they will all be available to answer your questions after this conference call.

So speaking about figures, it is -- there is no need to say that second half of 2016 had one of the most turbulent landscapes in our country. And this negatively impacted two of the most important indicators related to our country, consumer confidence and unemployment. Our segment is highly influenced by these indicators and posted a drop of 10% according to IBGE in the first five months of 2015. The only thing that we cannot mention in this context is that we were taken by surprise, because we knew exactly that we will -- we would face a very adverse scenario in 2016.

Therefore, our team worked very diligently in four fronts of work to put together a major plan to face the crisis of 2016 [ph] and that involves gains of market share without compromising our profitability, transforming our strategy into something digital, reducing admin and sales expenses, and also a control and improvement of our cash generation.

I will elaborate more on each item and then Roberto will give you more details about each information. In terms of the first item, which is market share gain with the maintenance of profitability. If the whole economic stake [ph] is shrinking, we have to try to get a bigger share of their package and so the focus of the company was to gain market share. The challenge was to get market share without compromising our gross margin, which was not an easy task. So we work together with McKinsey consulting company and we diligently raised all possible opportunities to gain more market share.

We looked at each category and each store location in order to map out, where we could have micro or granular opportunities to gain share and then we put together an activation plan to be able to capture all of these share gain opportunities by store and by category, by all of our marketing and pricing strategies and move. So in the second quarter, we gained market share in all relevant categories in our -- of our business. We gained market share in the white line telephone, image IT, so all relevant categories were very important, and they posted significant gains of market share considering the current scenario.

But certainly, the main highlight in terms of revenue in this quarter was E-commerce. We are the only -- the only store, the only operation and we have been saying that for the past few years because we are the only multi-channel company in the market. All of our market channels share those same operating platform of our brick and mortar stores, the same IT platform, logistic and financial platforms. With that, our E-commerce operation has some advantages when compared to other models from other peers.

We have some cost advantages and again, great price competitiveness, because we can also practice -- good online prices and we offer superior services because we can use the logistics of the brick and mortar stores to deliver at lower costs when compared to other players that do not have such a large grid of stores to use in logistics. And this was aggravated with the crisis because with the crisis and the consequent reduction of irrationality in the market, the market began to practice more sustainable prices in the long run, which was -- the rule of the game that we always applied. So, now there is more rationality on the online pricing and with all of that we were able to get important gains in the first half of 2016. E-commerce posted a growth of 30% when compared to the numbers of the previous year, which is quite higher when compared to the growth of the general market. We also deployed many different actions with the main focus related to mobile. There was an important migration of people towards mobile. And to that end, we made important investments together with our business team and Luiza Lab development lab.

So we deployed many improvements, especially regarding our new application, which is our new sales app and with that, as this accounts for more than 40% of the total public, we had a growth in terms of conversion rate, consumer traffic and also sales during the period. And this really helped us to increase our E-commerce sales in the first and the second quarter of 2016. In addition, I would like to add that we also deployed important projects that will be important to support the sales growth in the second half of the year. And in the next few years, our marketplace operation is already in place and it's started last June.

We are initiating the program with some retailers, they are already using those platform and we are ready to escalate that platform and this is something that we can refer to later on during the Q&A. And we also have the project well, buy online and do the store pick up. We have many stores already operating with pick -- or store pick up. And by the end of the year, we will we have more than 50% of our stores operating under that buy online and pick up in the store model.

These two projects are helping us with sales, to increase sales and also it's helping us to reduce expenses, especially logistics because we take advantage of the truck that is going to the store without having an additional cost. But sales growth will not be enough to generate increases in EBITDA because with inflation in two digits and an indexed economy whereby all of our cost like rental and working contracts, everything is indexed or attached to the inflation. Therefore, the company had to do a lot of work, very detailed and disciplined work to control expenses. We work with Galeazzi, another consulting company. And with them, we launched two projects ZBB or Zero Base Budget and also a GMD, Matrix Management of Expenses, and we also focus on rental, power -- or utilities bills, like power. We worked on several lines of expenses and this was a combined effort, including many of the -- many areas of the company and all of the teams together led us to despite 10% inflation, we had a nominal drop of 2% in our expenses in the quarter. And therefore, we had a dilution of SG&A, which makes us very proud because this was the result of some very diligent work. And finally, we worked hard to improve our cash management. We look at all of the purchasing or procurement terms and we are also very conservative in terms of our CapEx.

Now, I'll give the floor to Roberto to elaborate further on the financial aspects.

Roberto Bellissimo Rodrigues {BIO 17269312 <GO>}

Good morning, everyone, and thank you very much for joining us this morning in our conference call. So, I would like to start on page two, where we mention the first highlights of the quarter. Starting with sales, we grew almost 5%, with an increase in gross margin of 1.2 percentage points, in keeping with our expectation to grow but at the same time keeping our profitable margins.

E-commerce grew almost 34% reaching more than 580 million and sales approximately 23% of total sales. And this is indeed a very relevant operation for the company. Operating expenses, we were able to reduce them by 2% in nominal terms, despite inflation and payroll et cetera. We were able to lower expenses in percentage and nominal terms.

In percentage terms, we were able to post a reduction of 0.8%. And with all of that, we were able to grow EBITDA in almost 29%, reaching BRL163 million, which gives us a margin of 7.6% and a net income of 10 million or a margin of 0.5%.

Now speaking about our capital structure. One big highlight was a reduction in our adjusted net debt by BRL350 million in 12 months and that indeed is a significant reduction when you look at June of this year and June of 2015. And with a growth of EBITDA, we were able to lower net debt over adjusted EBITDA ratio to 1.5 times. Another important aspect related to the indebtedness reduction was the improvement in working capital.

We managed to operate with significant working capital levels since the beginning of last year. When we compare the current working capital performance with the performance of the year before, we also see a significant improvement, which directly reflects -- is reflected into our indebtedness level. And cash generation with EBITDA growth and improvements in working capital, our operating cash flow was almost BRL100 million in the quarter, which is much higher than the level of investment.

And finally, I would like to highlight Luizacred. In the quarter, we had BRL25 million of -- in net income and with ROE of 18%. And all of that also shows improvement in the short and long-term non-performing loan indicators.

On page three, we talk about the evolution of the number of stores. In the last 12 months, we inaugurated 25 new stores. In this half year, we inaugurated one, but we still have 24 more stores to be inaugurated along the year, until the end of the year, most of them in the Northeast. When we look at our investment level, we invested 50 million in the first half of the year. That was lower CapEx when compared to the year before, but our investment was mainly geared towards new stores, which should be emphasized in the second half of the year and also refurbishing. When we look at technology and logistics, all of the investments were in keeping with our strategic planning.

Turning to the next page, page four. We talk about our gross revenue evolution. We grew for the second quarter in a row. We grew slightly above the first quarter, almost 15% in the whole year, the growth is almost 4% in the first half of the year, which can be compared to the numbers from IBGE, which has anticipated a growth of 4%.

So if you look at a growth of 4% compared with a drop in the market of 10% of the IBGE figures, they also include E-commerce. Therefore, this means that our market share gain was quite significant, and it was more significant in E-commerce where we are able to grow 30% in the quarter when compared to data from EBIT in the quarter of about 5% in the half year.

In terms of brick and mortar stores or physical stores, there was a drop of 4% in the same-store sales line, but we also gain market share in the physical stores. Our comparison base was still relatively high when compared to physical stores, because despite a drop in -- of 15% in the second quarter of last year, that reduction was based on the growth of 2014, which was over 20%. So in 2014, we took advantage of the World Cup of the games. So we were able to grow same-store sales by over 20%. Therefore, the base for the second quarter in terms of physical stores was quite high. And despite this drop of 4%, we were still able to grow our market share in the physical stores.

Now going over to the next slide and talking about gross profit, we were able to raise our gross margin once again by 1.2 percentage points. It's worth mentioning that we are comparing oranges with oranges, we've reclassified the numbers of last year. I mean, the deduction of the payroll from taxes to expenses in order to facilitate this comparison. So, we reclassified from payroll taxes to selling expenses, so there is this effect when we compare the payrolls of last year and we were able to reduce the gross profit. I mean, we were to reduce that expense by 1.2%.

We also have a greater market share coming from smartphones. Now -- we are now charging for shipping and assembly, which was something that was introduced in the midst of last year. And this applies to the white line and furniture. And as Frederico said, the environment is less irrational and this favors the evolution in our E-commerce sales. That's why we see now a consistent growth margin in all categories, in all channels.

Now speaking about operating expenses, we were able to post a nominal reduction of SG&A as a whole by approximately 2% and this accounted for 0.8% of dilution over net income -- or net revenue and this was achieved despite the fact that the payroll had increases in terms of social contribution and with inflation around 10%. And high inflation when you compare a base of fixed cost in the retail industry and as you know this in the retail industry is quite high. So in order to increase sales and reduce expenses, we certainly did a lot -- we worked very hard and this is probably -- we would probably achieve good numbers because of ZBB and GMD.

And in terms of equity income, the Luizacred's and Luizaseg's net income were a bit lower when compared to the figures of the year before. But they still accounted for 0.7% of our net revenues, so we posted positive results and we see a positive trend when we compare the numbers with the second half of 2015. Further on, we will elaborate more on that when we speak about Luizacred.

Going to the next page, speaking about EBITDA. Our recurring EBITDA margin was 7.8%, one of the largest adjusted EBITDA margins posted in the last few years. That means that we grew approximately 27% year-on-year. And this was once again supported by a small sales growth, but also higher gross margins and tight expense controls.

Next slide, we referred to our financial results. Here, we still see growth in financial expenses that probably linked to growth of CDI and sales growth. Share of Luiza Card increased. Even though we had a reduction in physical stores, so Luiza Card increased and this means that our customers are becoming more loyal. This also had a slight impact in anticipation costs and with the growth of E-commerce, the growth coming from third-party credit cards also increased in our total mix. And that's why the level of receivable discount is a bit better -- it's a bit higher and also CDI quarter-on-quarter. The good thing is that this trend towards reducing CDI becomes clear to the entire market and as CDI begins to fall, also these lines should also directly benefit from those reductions.

Now, speaking about net debt. Here, we have a significant decrease from BRL1.2 billion to BRL854 [sic] million, so it's a reduction of 350 million in the last 12 months. We have been reducing it quite a lot and we've been maintaining that reduction steady since the end of last year. And the adjusted net debt over EBITDA ratio was down from 2 times to 1.5 times and this was mostly related to reductions in working capital. In this quarter, we were able to keep inventory turn in keeping with the numbers of the previous year and we were able to increase our average procurement term and this was due to some diligent work where we evaluated risk per category per vendor. And with that, we were able to increase our income coming from suppliers because they finance our inventories. So working capital and all of these other factors were crucial to lead to this improvement.

And finally, on our next slide we talk about net income. We see here a growth of 5 million in the first quarter and 10 million in the second quarter, still low considering financial expenses and also considering the current level of interest rates in Brazil. But at least, we see a positive trend when compared to the numbers of the year before, and we also anticipate drops in interest rates in the future.

Now, speaking about Luizacred. I would like to mention the growth in our total revenue, Tarjeta Luiza or Luiza Card grew both in Magazine stores and also in other stores. There was a larger number of activation of our cards and we increased our card base. Direct Consumer Credit came -- decreased by 58% due to a more conservative credit policy and a large part of that was also due to the growth of Losango, who is responsible for 5% of the growth in the physical stores and then we have overdue payments.

And usually, in the first quarter, we see a upward trend, but last year we had a change from 10.4 to 11, so it was an increase of 70 basis points and this year, in our long-term indicators there was a drop of 100 basis points from 11.7 to 12.7 and this reflects a -- the better mix of the portfolio and in keeping with a more conservative policy. And in terms of short term, we only have 3.9% coverage ratio. And this coverage ratio is also a reflection of the delinquency levels.

Finally, we speak about Luizacred net income. We have two charts. One, we show net income and the other chart shows operating income. When we look at the operating income throughout 2015, there was a drop quarter-on-quarter, especially due to increases in delinquency levels. And now we see a change in that scenario. The operating profit on both quarters was about plus BRL250 million, very similar to the second quarter of last year, but not yet in the same level of the first quarter of 2015, which was slightly higher, but we see a positive trend now.

And I would also like to mention that there was an increase in the tax burden from 40% to 45% on this operating profit. And even with increases in unemployment and a very difficult economic landscape, Luizacred has been very resilient. It went from 170 million profit in 2014 at the peak of its operation to 120 net income in early this year and now 50 million in profits with a trend -- with a positive trend in EBITDA positive delinquency profile. ROE was close to 9%.

These are my main financial highlights and now I would like to give the floor to Frederico.

Frederico Trajano {BIO 17269235 <GO>}

Thank you, Roberto. And to conclude, we believe that even though the trend is very, very incipient and there we see a slight recovery of the economy and that's why we see a pickup in consumption. And I would also like to emphasize that lower exchange rate may reflect in higher consumption, but despite all that we will maintain our focus in all of the projects mentioned before and also in the continuation of our strategy because we want to become a digital company with physical stores and a lot of human warmth.

With that, I conclude and we go to the Q&A.

Questions And Answers

Operator

Thank you very much. Now we go to our Q&A session. (Operator Instructions) Mr. Guilherme Assis from Brasil Plural has the first question.

Q - Guilherme Assis {BIO 16143141 <GO>}

Good morning, Fred. Good morning, Roberto. And thank you very much for taking my question. I have two questions. First on the excellent E-commerce performance of the company and we've been monitoring the competition as well. But I would like to hear from you, what is your opinion in terms of the outlook? There is a competitor, which is going through some disruption and there was a management turnover. They also had fraud problems, and they are trying to stand up again, even making changes in their capital structure. And there is another competitor that have problems with suppliers. We've heard in the first quarter results, and I think that still affects the company. Therefore, what we see now is an environment where two of the main competitors or maybe two of your largest competitors have problems this half year.

So I would just like to hear from you about what has been your approach considering all of those facts, whether you believe that now there is an easing in this pricing policy and whether this growth that you posted can be sustainable in the medium, long range? The market grew 5%, as you said and you grew 30%. Do you believe it's possible to this maintain growth or you think that competitive environment will become more challenging in the future? So this is my first question.

And my second question, you also posted a very high gross margin. You explained some of your gains that includes charging for shipping and handling and delivery and assembly and -- but you didn't talk much about the MP do Bem from that 120 basis points that you gained. What was the impact in the final numbers?

Could you say that about 30% of sales comes from smartphones and IT products that were benefited by the program MP do Bem so rounding up to 10% of our revenue. So this would cause an impact of 3 percentage point in your margins. I would just like to know whether this is a fair assumption and whether you know I'm right? And what is the outlook for this MP do Bem and we look at the results last week and they say that they expect to get an injunction for that as well? This is -- is there a trend that everybody will be benefitted by the injunction or people who lose that benefit from that temporary measure?

A - Frederico Trajano {BIO 17269235 <GO>}

Thank you. I will try to answer your question. About your first question, as you know, I don't really like to talk about the competition. And everybody has their own particular situation. I would rather speak about our own operation and also about something that I keep talking about and that refers to the rationality of the management of companies. There used to be a situation in the market that persisted for some time and most competitors that operate online, they were operating at very low margins and these margins were not enough to pay out for capital or to pay out for expenses, so they were growing but at a cost and that was a high cost.

And what I keep saying to you is that that was a situation that in the long run could not be sustainable. Internet can help us a lot. But when shareholders invest in our share, they want to get dividends, they want to make money and this can't happen if the operation is destroying the cash of the company. Therefore, what I see is that there is a trend all over the world and as well in Brazil. Even you know if you look at Internet outside the -- everybody is being pressured to generate profits. People were saying okay, we didn't have a good result in the last quarter.

So there is a concern all over the world because online operations have to post profits now. And to their end, they have to play the rules of the game, which is selling at the right price. You cannot provide free delivery or free shipping when that's not possible. So this is a trend that is here to stay. And so, I hope that the market does not pursue a path of destroying their cash, the way they were doing. We've always favored rationality and we are now benefiting from this model.

But I would also like to highlight that we have in -- a structural benefit in our E-commerce operation, because of our multi-channel approach, the fact that our operation shares all the fixed cost, as I described at the beginning, in terms of logistics, IT and even back office. We do not have many CFOs or CEOs, we have just one for everything. So, to have lower margins, it's very favorable and it is a good competitive advantage and also this gives us some strategic leverage.

And I am very comfortable and I'm sure that we will continue to grow above market levels. If you look at the five -- the past five years, we have been growing above market rates. The base of the first half of the year -- of last year, it was low. But the base of the second half of the year for E-commerce was higher. So probably, I don't know whether we will be able to keep that 30% growth going forward, but that's what we will aim at. We are doing quite well and July was a good month as well and we believe that it will be the same in the coming months. But I must emphasize that the basis of last year was better than this year. About physical stores, the basis last year was more favorable, so we have to balance this growth, but in general, we will continue to grow. Now, go ahead.

Q - Guilherme Assis {BIO 16143141 <GO>}

I understand that the fact that you don't want to talk about the competition, but I would like to understand how the dynamics of this market works. You talked a lot about trends and trends abroad [ph] but now, if you try to see what's happening in Brazil, I can see a disruption in terms of the competitors in the first half of the year. But after this half year and by looking at your results, and also looking at not every competitor, with a magnifying lens, but you see that in the market as a whole, there is a trend towards lower pricing, do you think is this sustainable, how do you see that?

A - Frederico Trajano {BIO 17269235 <GO>}

Well, as I said, there in an irreversible trend towards becoming more rational. Competitors will no longer apply the low cost prices. They're not, They can't afford to sell below cost, and I think this is a change that here to stay. Maybe we will see some changes here and there in terms of a policy that the trend in the medium, long range is irreversible. So it's good not only for Magazine to be more rational, but it's good for everyone. All of our competitors want to have sustainable and profitable companies.

Now speaking about your second question, I will give the floor to Roberto.

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

We do not disclose information about our mix or market share. Therefore, I'm not going to elaborate further in terms of our share in telephony or the mix in general. But what I can say to that end is that Brazil is a country that has one of the largest tax burdens in the world. We had last year and they were still more increases from last year to this year. And I think managers have a fiduciary obligation to advocating favor of shareholders and clients. And we are tackling that in two ways, legally and institutionally.

Legally, we are questioning increases that are not constitutional. So, we hire top legal officers and we also go to class entities. We have to fight absurd increases and so we have to demand more balance increases. We had several tax increases this year, the end of PIS and COFINS from this temporary measure called do Bem. And there were also changes in mobile charges.

And there is no legal basis to support these increases and that's why we are fighting hard against it. When there is some legal basis or technical basis to justify the increases, then it's okay, but it has to go through a series of approvals. We work with the best legal firms and that's what we've been doing. And particularly, in that specific case and we were successful at first. Several other companies were also successful in this first instance.

I don't -- I'm not going to mention companies per se, I can only mention (inaudible), which is an association and for all the members of the association were benefited. And they are now applying this benefits to their operations. I'm not going to disclose the amount. I did not do that before and I'm not going to do it now. But what I wanted was just to explain the rationale behind that, but I must say that we are now exercising a more stringent control in our company.

Good morning, Guilherme. I would also like to add that the margins that we published is comparable to the gross margin of 2015. Last year, there was no PIS and COFINS and not even this year. So then, we had to make adjustments in terms of the payroll. This increase of margin of 1.2 percentage points does not have any effect of PIS and COFINS -- PIS and COFINS which are excise taxes. And this is just a result of a better mix, shipping, assembly chargers and our multi-channel approach.

And as Fred said, we do not comment on the mix and the amounts related to PIS and COFINS we didn't comment on that last year as well. Well, the outlook is favorable as I said, and we also said the opinion from our legal advisors, both in-house and external, they are positive. I mean, there is a possible -- there is a possibility that we will lose the injunction, but we are looking on the positive side. Therefore, we will continue to monitor that very closely and also informing the market about it.

Q - Guilherme Assis {BIO 16143141 <GO>}

Thank you. By that one, Fred, I think that what I was trying to understand is whether -- I mean, today you have an advantage that not all competitors have thought [ph] in a way. This helps to boost your margins. I did a quick price survey and you are charging for mobile phone, for a smartphone the same thing that your competitor charges. So this is just a very empirical survey that I did.

Well, if you're not paying taxes, you get a better margin for that product. What is important for us to understand, I mean as I see that you are very comfortable with your lawyers and you were certain that you will be able to keep the benefits. I think it would also be correct for me to say that this benefit should be extended to the other companies.

And once you lose that advantage that maybe -- that may have an impact on your numbers in the future. I'm just trying to understand the situation as it is today. There is a difference when you compare your company to other players in the market, and this may not be sustainable. So I would think that either everyone loses or everyone wins it and this should have an impact on your margins. I would like to know whether this is the way you see it as well?

A - Frederico Trajano {BIO 17269235 <GO>}

Guilherme, adding to what I said before, the fact is, and as I said before, Magazine gain market share in all categories in the white line, imaging, IT, furniture and also telephony, so we gained market share in all categories. E-commerce performed very well, and as you said it, our pricing policy is not different from the market policy, we still have other things that are currently being evaluated. We can't do anything until we have a final outcome of the process.

But as we've been gaining market share in all categories, the performance in the first half of the year is due to the management approach of the company. Still speaking about the first half of the year, we also posted decreases in expenses and that's not related to tax benefits. I'm not familiar with all of the tax fees available in the market. There may be other benefits that are not available in other states like Rio, Bahia. There are competitors in the Northeast that have enormous benefits in certain taxes, even more significant that I see amass. It doesn't mean that in the future we won't be able to have that as well. Therefore, it's difficult to predict what can happen. Each retailer have their own tax planning, their accounting things. They have some advantages when compared to others. And I believe that the entire market will benefit from these -- from this benefit.

And this is good for the entire market, it's good to all consumers. And I honestly hope that all the other peers can also benefit from this, and once they go through all of the legal proceedings. I cannot predict what will happen tomorrow and I'm -- and I cannot answer that now. I cannot tell you what will happen to the market, but I honestly hope that everyone is able to legally host good results.

Q - Guilherme Assis {BIO 16143141 <GO>}

Thank you very much.

Operator

Ms. Maria Paula Cantusio from BB Investimentos has the next question.

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

Good morning, everyone. Good morning and thank you for getting my question. I would like to elaborate more on the growth in E-commerce. In your release, you said that you inaugurated the marketplace operation with good results this quarter. What we've seen and I don't know whether it's just a co-incidence that the operations that already have a more evolved marketplace, they haven't been able to plough such high growth as you were able to do it.

And the filtered tools are not maybe so efficient and maybe they still have to be adjusted and the delivery terms increased as well and this has been something mentioned by all retailers. They want to try to reduce shipping time and maybe some products may take up to 60 days to be delivered today and assembly also changed.

Do you believe that maybe part of the E-commerce growth came from some kind of migration from other websites into Magazine Luiza's website, because other websites were not so efficient because of marketplace? And how are you dealing with the bottlenecks from that marketplace operation that now so much so that your E-commerce operation will not be affected? So basically this is what I had. Thank you.

A - Eduardo Galanternick {BIO 20410320 <GO>}

Hello, Maria. This is Eduardo speaking. Thank you for your question. We believe that the marketplace strategy is just an additional strategy, it's complementary. We do not believe that we will see a deterioration in our sales growth, because we are including partners in our sales base once we maintain our competitive conditions and the industry conditions, our multi-channel strategy will add up -- bring up more benefits. Therefore, we believe that we will continue to post a very sound growth in terms of sales of our own goods.

Marketplace is just here to be an additional tool to add up to our growth and it's here to add up to our business. And even, it's important because it gives us more pricing options and more assortment. We do not think that marketplace will damage our sales. I cannot tell you whether there is a migration coming from the competition or whether that is caused by that marketplace strategy, I cannot tell you that. But in our view, we just think that marketplace is just an add-on.

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

And how -- thank you. And how are you registering new players, just to ensure quality and service and delivery time of Magazine Luiza?

A - Eduardo Galanternick {BIO 20410320 <GO>}

As part of our strategy, we are always very concerned with our brand. We are very rigorous in choosing partners, both in terms of the documentation and the history of the company. There are situations that may involve some hybrid products. We have brought the same products that our partners have and our conditions will not worsen because of that.

And in other products where we do not have in-house, but the partner does, the longer terms sometimes affect the conversion of that sale or they may not be converted into sales, but it does not eliminate our sale. It does not take away sales from us. Therefore, we want to have in the marketplace responsible and reliable partners that can also cater to the needs of our clients. These partners we have -- will have terms that will be competitive, maybe not as competitive as ours, because of our own structure, but they have to be competitive.

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

Now, Eduardo, do you want to grow your marketplace operation, at what pace, do you have any target?

A - Eduardo Galanternick {BIO 20410320 <GO>}

Well, we cannot give you any specific target, we just concluded our first phase, which is the stabilization of the platform where we are already operating. The website is totally integrated. We already have our E-commerce platform and now as indicated in our release, we will enter the expansion phase. We want to do everything in a very consistent and sound way to get to some sellers by the end of the year.

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

Thank you, Eduardo.

Operator

Thanks. Ms. Irma Sgarz from Goldman Sachs has the next question.

Q - Irma Sgarz {BIO 15190838 <GO>}

Good morning, and thank you and congratulations for your results. I have three very quick questions. First, still talking about marketplace, I would like to understand whether your focus would be more in establishing partnerships with large chains or whether you're also looking at smaller companies that may be even operate under the simplest regime or the simpler regime that may also have competitive prices as we see? Now some companies are trying to engage in partnerships with just large retailers that do not have their own operations or maybe they have their own operations, but they do not have such large traffic. And we see some other marketplace companies that are trying to capture mid-sized companies.

Therefore, my question is in terms of the focus of our commercial team. Also, could you please elaborate on the fee structure of the company for those sellers? What is the rate that you will charge and whether you were also thinking about offering additional services that can also be integrated in the sellers' offering?

And my third question is that I want to understand what you think about investment needs, not only this year, but also in the mid-range. Once again, we see some different strategies from different companies. Some companies favor an asset-light model, whereas others favor a model whereby they are becoming more verticalized and they are investing in IT platforms and in assets in the last mile delivery? So these are my three questions. Thank you very much.

A - Frederico Trajano {BIO 17269235 <GO>}

Good morning, Irma, and thank you very much for your questions. I will try to answer all of them and admittedly, my colleague will add up. In terms of our strategic focus, we do not want to exclude anyone from marketplace, but the focus in my view and I think the market of the future comes from the small ones, from the small companies. It's very difficult to convince a competitor to place products in your platform. Several have tried to place products in other existing platforms and we've never accepted, because obviously everyone wants to be predominant in this market. In my view the correct strategic approach is to focus on small companies. There are thousands of retailers that are already selling online in Brazil, they are becoming digital and the focus of Magazine Luiza will be directly in this market.

I think we will see a large increase in the number of even offline companies that will migrates to the online market in the future. They are now initiating to operate online and we were offline and we migrated to online. We know that there was a conversion in this process, so we wanted to convey our experience and our knowledge to these smaller companies, and we can certainly help these smaller companies to enter marketplace. Even though we do not want to exclude anyone, our focus is on the small companies.

And Luiza Trajano was chosen as our advertising girl. She -- for years, she has been talking to micro entrepreneurs, she gives lectures all over the country and so she is our major advertiser for Magazine Luiza. We are very excited and she is also very excited with this marketplace project.

Well, when you talk about fees, fee is something very complex, that's why it's very difficult for me to give you a very objective answer. It depends on the category and it also depends on the service level that you expect to get from marketplace. What we are trying to do is that, first of all, when we put together our marketplace project, we were very careful, we try to reduce all the costs along the process, because we know as a retailer how difficult it is to make money online.

We wanted our seller, not to pay a very expensive fee. And to that end, we did all we could to be more competitive and very competitive vis-a-vis the market offering lower fees, without compromising our margins as with E-commerce marketplace have to their profits, because it has a greater potential. We will try to be more competitive, lower our fees from -- when compared to the rest of the market. We are -- we already have a flexible fee approach. The seller can choose a simpler fee, it can be 5% or 6% depending on the category up to 15% if they choose to financing and 10 installments, non-interest bearing, if he wants media, we can acquire media for him. And the -- in the future, then down the line, we may also talk about fulfillment. We can use our stores. They could deliver the goods to our stores and the consumers will go and pick it up in our stores. So we want to be competitive with a lot of flexibility. This is a strategy of marketplace.

And to address your last question and speaking about CapEx, what we see now in this quarter is that the strategy is that in the future, a great part of our CapEx will be geared to logistics and IT. When we talk about logistics, we are talking about technology applied to logistics. Basically, the company will invest in platforms, automation and to deploy all of our digital projects.

Most of these projects, the bulk of the projects have great focus on technology. The trend in the future is that the business will be more asset light. But we will continue to open stores, we will continue opening stores, we still have that discipline of opening stores with a very low pass per square meters, strategically located. We believe that not only the store is a point of sale, but is also the distribution, it's a distribution of site.

And the store can give us a competitive advantage even when you look at E-commerce, because we can buy online and have store pick up. 50% of the stores will have store pick up. Until the end of the -- by the end of this year, most -- more than 50% of our stores will be operating with store pick up approach. And it's important that we have the physical stores. But to give you a more objective answer, the answer is, yes, so the company tends to be more asset light.

Q - Irma Sgarz {BIO 15190838 <GO>}

Thank you very much.

Operator

(Operator Instructions) Mr. Joao Pedro Gattai from Banco Votorantim has the next question.

Q - Luiz Cesta {BIO 15223262 <GO>}

Good morning. In fact, I'm Luiz Cesta from Votorantim. I would like you speak a bit more about expenses. We just noticed a very good evolution in this half year with all of the initiatives that you implemented with your partners. So to that end, what margins can be expected mostly in terms of additional gains? Do you think we could continue to expect expenses to reach nominal levels close to what you posted in previous quarters until this is annualized or you still see further margin improvements in the future? So could you elaborate more on that and what could we expect in the future in terms of additional expenses cuts?

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

Good morning, Luiz. Well, we cannot give you any expectations about expense evolution, but the matrix management of expenses is working quite well. We are very disciplined in monitoring expenses, in being accountable all of package managers and all BU managers in the Southeast, South, in E-commerce and everything else, they've been very disciplined. And so this matrix management of expenses has proven to work well and every month we stop to evaluate all of the expenses, we talk about all of our plans of action. We correct all the possible deviation and we evaluate not only looking at the average, but we look at the stores that are performing above average and stores that are not performing that well.

We try to improve productivity in all of our stores and improve our expense approach. But what I can say is that, we will continue to focus on that. We are now operating with Zero Based Budget and we are very much in keeping with that new plan with that expectation. And we will continue to work to have further improvements and improve efficiency. And in the year as a whole, we will decrease expenses and also, our objective is to have nominal and percentage reductions in expenses.

Now, out of the total expenses, I think those that were further reduced, I think I can say that we've -- we had gains in productivity, we increased sales per sales rep. We deployed ZBB, we had adjustments in our administrative expenses and also distribution center. There are several projects in the company to digitalize the physical stores. As we said, more than half -- in more than half of our stores, our sales reps are serving customers through the mobile phone. In the past, we used to serve customers in 40 minutes, now that time was shortened to five minutes, while at the same time, we are not compromising our service level.

We changed our marketing strategy. Our marketing is now more regionally focused, we are also tackling social media, we are reducing marketing expenses. Our logistics is quite efficient, it's very much integrated between E-commerce and brick and mortar stores, but there are still many projects in our logistics approach to enhance synergies, lowering the cost of logistics. One approach is the store pick up program.

Right at first, this new approach has proven to be very successful. We are renegotiating rental contracts, logistics contracts and all of the other expenses that are part of that matrix management of expenses, like Frederico said, rental, credit card, power bill, turnover, et cetera, et cetera.

So without giving any guidance about our expense expectation in nominal terms, I can say that we are firmly focused on continuing on this process of efficiency gains, without compromising sales and service. While at the same time we are gaining more efficiencies because of the digitalization of physical stores.

Q - Luiz Cesta {BIO 15223262 <GO>}

Thank you, Roberto, very much.

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

Thank you, Luiz.

Operator

We now conclude our Q&A session. I would like to give the floor back to Mr. Frederico Trajano for his final remarks.

A - Frederico Trajano {BIO 17269235 <GO>}

I would just like to thank all of you for participating in this call. Thank you and have a very good day.

Operator

Magazine Luiza's conference call is now concluded. I would like to thank you very much for participating and have a good day.