Q3 2018 Earnings Call

Company Participants

- Eduardo Galanternick, Executive Director of E-commerce
- Fabricio Bittar Garcia, Vice President of Operations
- Frederico Trajano Inacio, Chief Executive Officer
- Roberto Bellissimo Rodrigues, Chief Financial Officer and Investor Relations Director

Other Participants

- Franco Abelardo, Analyst
- Joseph Giordano, Analyst
- Luiz Felipe Guanais, Analyst
- Maria Paula Cantusi, Analyst
- Richard Cathcart, Analyst
- Robert Ford, Analyst
- Rodrigo, Analyst
- Thiago Macruz, Analyst
- Tobias Stingelin, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, thank you for waiting. Welcome to Magazine Luiza Conference Call to discuss the results of the third quarter of 2018. Right now, all participants are in listen-only mode and later, we will hold the Q&A session when further instructions will be given.

(Operator Instructions) Now, I would like to turn the floor to, Mr. Frederico Trajano, CEO of the company. Please Mr. Trajano, the floor is yours.

Frederico Trajano Inacio {BIO 17269235 <GO>}

Good morning, everyone. Thank you very much for participating on our conference call, regarding the third quarter of 2018. Here with me, I have all the executive management of Magazine Luiza, me and Roberto Bellissimo, our CFO will be doing the presentation. I will hold a brief introduction and then Roberto will go into the details.

In my opinion, we had very positive results considering a challenging scenario that we had forecasted -- I had forecasted that, this challenging scenario in our last call. Post

World Cup, we always have a World Cup hangover as we see it. It was a very strong growth quarter and sometimes we even anticipate sales from the second half of the year to the first half of the year, especially on TV sets.

We also had a net FX pressure scenario, which was a major concern for me about the second quarter. Because of the elections and all the uncertainties surrounding elections and because of all that I should highlight our sales growth.

Considering the fact that the third quarter of past year was one of the best quarters in the company's history, we had a growth in the offline, as well as in the online last year. So, to grow on top of that basis and facing a challenging scenario, really is something that the company should celebrate and it was even higher than my expectations, we have grown 24% the brick-and-mortar stores with an expressive share of same-store sales 16%. We are already reaping the benefits of an expansion program, we started accelerated last year of opening new stores, we have over 80 stores opened and by the end of the year, we should continue on that pace of growth.

And also, I should highlight growth of the e-commerce, both in 1P and operation that is growing on top of high growth already and with a result that is very significant of marketplace is that we were already expecting in the range of BRL 1 billion. So that is a very significant growth when we compare to last year. And we'll talk more about that shortly.

We had a new sellers coming in, now in October we are already with 400 new sellers, that is a record for new sellers in a month, showing that we are improving our on-boarding process and we are still being very selective about the entry of new sellers. We are, by far, the company that is most selective, most strict because for us the service level of 3P has to be the same, as the service level of 1P, that is very good, very high. But, what I am celebrating the most about this third quarter results is the performance of our customers indicators, we committed ourselves and we emphasized that since the beginning of the year in all our conversations with investors in all our releases that this would be the year of the customer.

And we raise the bar and raised very much regarding the growth of our client base and especially the growth of the customer service level. So, we were committed to put together real operation, in fact, operation that would be guided towards consumers and also customers, because anything that we can have -- that is most important is to have a loyal customer base. That would have no reason to leave us.

We have been doing that and for this time and this release, and I would like to invite you to read the release, the message that we have sent, we are showing some indicators that we did not disclose to the market before, we'll be talking about those because, I believe that is crucial for you to understand the quarter of vis-a-vis the significant growth of these indicators.

We have added these customer indicators at a high bar, so that you could see any organization in Brazil or in all over the world, but many of them are not really focused on the customer, sometimes they lose market and they do not have our situation. So some of these indicators are qualitative and some are quantitative, I think it's important to grow our customer base.

We had an increase in the average ticket and this year we wanted to grow the number of our active customer base. We have grown 31% of the active customer base with the highlights to e-commerce that has grown 71%, a very significant figure, much higher than any other operations, in the market. And I would like to emphasize that we are not growing e-commerce and not growing brick-and-mortar stores, brick-and-motor stores have grown 21%. So, we are really gaining market share, not only in sales, but especially, share and client base, both in the online as well as in the offline.

For the online, I should highlight our efforts to increase not only the increase of our client base, but also the loyalty and we are working on the app, over 75% of our access already by these new digital options, the app and also on the website, we have the total of 19 million of downloads on the app. And the brick-and-mortar stores, I should say that the app customer will buy more frequently, they're more loyal to the base as we provide them more advantages such as free freight, so that they can have the delivery -- free delivery of products over BRL 100, this is a better purchasing experience. We can buy in up to 10 seconds, we are one of the best evaluated apps both in the app store, as well as in the android store.

So we developed an app that we are always improving and it is generating a constant relationship. And also hey, it's a visit and our tracking of both sales and the app has improved a lot. Therefore, we are very happy about the customers that are using the app. And the app for brick-and-mortar stores, we consider to be the credit card because then we have a relationship with the customer that is not one time off to be more frequent. And in addition, to increase our client base, we want to have a more frequent relationship with those customers. And this is a challenge, because we were a company that we're very much turned to low frequency products of a high average ticket. Now, we are improving the share the participation of the light products.

And the credit card customer buys more, we decided in the beginning of the year to accelerating investments and bringing in customers by selling the Luiza card, we are selling 150,000 cards a month, 86% more than last year, and that involves investment discounts for those customers that buy with a credit card, the financial dynamics of accounting, the results of the credit card, has -- that has an impact in the short term, by the IFRS 9. But, what time this credit card since this is a very profitable, it will improve the company's results in the long term.

In the short term, we do have an impact in Luizacred, but in the long term, we will have a very positive result. both were Luizacred, as well as for Magazine Luiza, because, since this cardholder has a higher credit limit, they will buy more products and they have that profile of the customer lifetime value, that is more positive. So the investment on the app shows that, we are investing that something that in might translate a little bit less in the short term, but in terms of value generation for the long term, makes sense and we are making that constant decision of doing that right now, because it does have a trade-off to give you an idea, 50% of everything that will sell in the brick-and-mortar stores. We sell, especially by the Visa credit card. This is a sound figure and it turns very resilient, the results of the brick-and-motor stores because the credit card, the Luizacred is still those customers are loyal to the channel and a good part of the growth of brick-and-motor stores has to do with the increase of penetration of credit card in the channel.

I talked a little bit about numbers. Now I want to talk about quality service level. We invested a lot in post sales, especially in delivery. We opened two new DCs and we invested a lot in the express delivery today over 30% of what we sell online. We promise and we deliver in up to 48 hours. I think this is an average that is much higher than the market and good part of the online growth has to do with a higher conversion of products that we promised at a shorter period of time sometimes, those customer privileges lower delivery time rather than price or any other KPI that you might provide and since we are giving lower delivery times in 160 cities where we have the express delivery. We have had higher conversion rates and this express delivery model, not only is bringing a higher NPLs to our customers, but also we are converting more sales and growing more at a very accelerated level on top of a high base.

We should highlight and congratulate our logistics team, they are doing a great work. We also have the Magalu deliveries, this is a pilot we are running. We want to transfer what we have in 1P to 3P, we've tested with 10 sellers. And with the pilot project, we reduced that time in 60%. We want to work more on that to make that available to our sellers. But this is a promising storage for our pilot project and as we always do, we have a strong ability to roll out pilots at an expedited rate as we have been showing you consistently.

I also I should highlight indicators that are very relevant for any retail operations (inaudible) our client or customer satisfaction to customer service that has increased the waiting time also is in less than one second, sometimes 30 seconds. When they call customer service, 60% delivery time reduction when you buy in the website. They (inaudible) the complaint site and (inaudible) all of those complaints have decreased 40% at every 1,000 orders.

So we are -- with a service level with delivery level that is much better than the market average. We are improving and we are very happy about it. So we are the only ones that have the CORA-1000. We also have that CO for our brick-and-mortar stores. We have -- our website also CORA-1000. These are very sound indicators and all the efforts we have dedicated to improve the service level to customers to increase the number of active customers and frequency of purchase, all of that is showing positive results in our stores NPS improved, our e-commerce NPS is still there, and it's growing.

So I am especially happy about the teams' work regarding all of these indicators and how we have been able to consistently grow. We always have trade-offs to reach those indicators. We have invested BRL 36 million and that brought our margin down and one percentage point vis-a-vis the prior quarter.

We invested in logistics, with the two new DCs, we increased the supply of stores and also for delivers to be able to promise 48 hours. We increased the number of people working in logistics, handling the goods. We also increased our stores capacity, the capacity of customer service. We invested in tools, technology, some of them in the OpEx, some of them in CapEx.

We also have taken actions to bring in more customers to our app to work hard base all of those investments are crucial, so that we can go forward and protect the company against any market threat and also maintain this company as one of the companies that tends to have a share gain, the market share gain that is relevant. These investments were all planned and our conversations that we have already mentioned that, and I would like to say that based on what we see, especially in other online operations, these are not very high investments, other companies that had to grow a little bit more, they had a trade-off that was much higher than ours, showing that our growth is extremely healthy, and we are very much focused in generating value to our shareholders.

The return on invested capital, it's on a base of 30% that's very high. Yes, we are letting go little bit of percentage, but in absolute results. We are growing EBITDA, cash generation, net income. So I believe this is an operation that has been proven to be sustainable, healthy and the way to tap into growth with a greater potential of value generation to shareholders is this one. Yes, we do have a trade-off there and I I want you to interpret it in a positive fashion, knowing that the company has that discipline of generating value to shareholders and there's always has been our motto for the online and offline operations.

Now closing my remarks and before I turn to Roberto for the financial results, I would like to tell you a little bit about the fourth quarter. In terms of -- well, I am not as much concerned because my concern, as I have said in the prior call, was the FX pressure because that makes it difficult to negotiate with suppliers. This was what happened and part of this third quarter and now at the end of October, beginning of November, we have a better overview of the FX, it's more positive. We were able to close our deals for Black Friday for the last quarter and we will start negotiations already for the first quarter of next year.

So we are already in a situation where we have more visibility and obviously, it will depend on our execution capacity because if you have a good quarter in retail, you have to execute well the next quarter and now on a comparison basis is getting worse, because we were very good in the quarter -- third quarter of last year and we did extremely well in this quarter.

So as I usually say our main competitor is the result that we had in the prior quarter of the past year. So we have to execute it very well with very little error margin. So that we can provide you better results than the quarter of the past year, but I should highlight, it's always a challenge for our operations. But in terms of the macroeconomic scenario, the indicators show a good situation that is at least a little bit more predictable than what we had in the third quarter and now we can plan ourselves, both for the past quarter -- for the last quarter as well as for the quarter that comes ahead.

I will turn the floor to Roberto and then we'll be available for your questions.

Roberto Bellissimo Rodrigues {BIO 17269312 <GO>}

This is Roberto. Good morning and I will start with some highlights on page five, we have grown 34% on top of 30% growth last year. So, in fact, our highest growth last year and we sowed [ph] BRL 4.6 billion, the same level of the second quarter where we had the World Cup. It was really an outstanding sales performance. Same-store sales 16% in brick-and-mortar stores and new stores had a contribution of 8 percentage points in this growth, very positive since the beginning. Marketplace and e-commerce has grown 55% also reaching highest level of 36% of our total sales and has grown 55% on top of 65% as compared to last year.

Marketplace also has grown reaching annual sales of BRL 1 billion rials in September. Our gross profit was down a little basically because of higher share of e-commerce that increase 5 percentage points when we compare last year to this year, but we diluted operating expenses and a half percentage point, considering the investment of 1 percentage point in operating expenses. So this dilution could have been 1.5 percentage points, but it was 0.5 considering all investments Mr. Trajano talked about. We grew EBITDA in 11%, and net income in 29%. Our operating cash generation and ROIC also very high.

In the next page, we have the performance. There are number of stores, we have 83 stores that were opened in the last 12 months. We have investments that we have already started for more dozens of stores that will be opened in this quarter. Our CapEx has increased a lot. It has more than doubled in the third quarter when we compare it to last year, reaching BRL 234 million more or less of that 50% in new stores and remodeling. And the remaining in IT and logistics. And that's our strategy.

On the next page, we have our quarterly sales performance, our e-commerce performance, the sales growth, IBGE discloses our segment as Franc and we did have growth in this quarter. So we gained a lot of share in the different channels.

In the next page, we have margin performances. For expenses, you can see that we have diluted administrative expenses that are essentially fixed expenses for the company's management offices, DCs and we have not diluted sales expenses by the investments in service level, no customers and so on.

And the equity income, the profitability of Luizacred decreased a little bit. We'll talk more about that, but also because of the growth effect and the IFRS 9.

On the next page, our performance for EBITDA, once again we have grown our EBITDA because of sales growth. The profitability of e-commerce dilution of expenses even considering all investments and customers. And the financial results on page 10. We can see that we continue diluting a lot of our financial expenses. We were able to reduce those in 1 percentage point not considering prepayment of receivables.

We have financial revenue and we also show you here the cash generation starting on working capital. And I highlight here, we continue having an average term of inventory turn that's very high. The purchasing period of 90 days and also 70 days for selling. So that's very healthy. And something that we already said in the second quarter, we've increased inventory a little bit. We anticipated purchases taking advantage the prices that had no effect of the FX increase or appreciations. So anticipated some of the purchases of the third quarter to the second quarter since we have 90-days to pay.

We anticipated those purchases and so we have more payments in the third quarter. So we should have less payments to be made in the fourth quarter. The working capital is seasonal. But this effect has decreased a little bit. The cash generation for the third quarter, but that will favor the cash generation for the fourth quarter. And even considering these anticipated purchases, we've have now increased any investments in fixed assets and everything else. We were able to maintain our net cash position at BRL 1.3 billion, considering BRL 700 million of cash and BRL 1.2 billion of receivables. So I believe that we still have a sound capital structure and a cash generation and a return that is high as well.

On page 11, we have the capital structure. We have reduced BRL 1 billion in debt in the last 12 months. We increased our cash variation of BRL 1.3 billion in the last 12 months. We have the net income margin of BRL 3.3 million in the quarter, even with all the investments on customers and on ROIC of 31%.

And then on page 12, we talk more about Luizacred. We are still investing on Luiza card increasing our card base. We reached almost 4 million credit cards in September and growing at an annualized pace of almost 1 million cards. We should grow around 1 million cards this year.

We are selling, as Fred mentioned, 150,000 cards a month. And it's important to say that 95% of our base is active and that means that they are either buying or they have a balance to be paid. They're receiving the balance. And 65% do use the credit card every month in average and seven times a month in average. So in fact this is the main card for most of our customers. And this is very important for the bottom chart that shows the credit card sales increase inside ML and 54% also improving the growth of brick-and-mortar stores. And with the highlight for e-commerce that started having the use of that share. The use of the credit card and e-commerce is lower, but it's growing. Total revenue of Luizacred went over BRL 5 billion in the quarter, a portfolio of BRL 7 billion with all the conservative approach that Itau Unibanco has.

And in the next page, we show that NPL 90 went from 8.3% to 7.4%, one of the lowest levels in the NPL for 15 to 90 days, also is at the lowest level for the third quarter at 2.8%. So we have been able to grow a lot with a very healthy portfolio, very conservative approach and levels of provisions that are also conservative.

We show here, the coverage ratio at 189%. With the IFRS 9, we have strengthened our provisions. The impact in the short-term was on the results. If you show the results in BRGAAP, you see that this is still growing. It's over BRL 115 million over the year. And as Fred also mentioned, the trend is a potential of the Luiza Card, as well as the profitability of this portfolio in the mid and the long run is very good. And it makes all sense both for retail as well as for Luizacred to have this strategy.

These were the main highlights. So now we would like to open the floor for the Q&A session.

Questions And Answers

Operator

Ladies and gentlemen we will now start the Q&A session. (Operator Instructions) Our first question is from Luiz Felipe BTG Pactual.

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

Good morning, everyone. I think the investments made in platforms and the purchasing experience are very clear, but on the side of the seller, how can you expect that the performance fulfillment initiatives for the next quarters. And the second question, can you share with us out of these new customers, the active customers, what is the percentage that is going straight to the marketplace? Thank you.

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

Good morning, Luiz. Thank you for your question. As I said in terms of fulfillment and the use of our logistics for sellers, we started the pilot project with 10 sellers with very positive results. Now we are in the rollout process. We have a version 1.0, which is the one that we use third party contracts for sellers and we have an advanced version when we use our own network. We are already running tests with Logbee that now is considered our own network because we acquired it.

So, we are still in a pilot stage. We intended to roll it out to start the rollout in this fourth quarter and to accelerate it over next year, but I will not provide you guidance in that sense. We are being very careful to do that, we have to do it very consistently and to maintain that positive consumer experience. What I can tell you is that we will be doing it very fast, but this year logistics were concentrated on express delivery and next year we will also concentrate on taking in the volume of third parties. So we are confident that we will be able to bring that, which is one of the main differentials of 1P then bring that to 3P.

We are still -- not even providing this major differential and considering that basic model where the sellers are taking care of logistics even then we are having significant results regarding sales curve. I think the growth curve of the marketplace is even higher than operations with public figures that this is an exponential growth showing that marketplace is a greenfield, we have a lot of market to be used. The penetration is still less than 5%. So I believe that e-commerce is an area that can be explored by everyone, we have room for people to come in and the growth there in the marketplace shows that we have room to grow in Brazil.

About the new customers, that's around, I think Roberto can tell us.

A - Eduardo Galanternick {BIO 20410320 <GO>}

This is Eduardo. Luiz, let me tell you about the impact of marketplace on the customer base of e-commerce. We have two main impacts; one impact in the entry of new customers. First when we look at the participation of marketplace of 13% when you talk about the number of customers much more because the ticket of the marketplace is lower, and in fact that contributes to the entry of new customers, but it also has a significant contribution for the increase of purchasing frequency. If you compare those that bought an item from marketplace for those that didn't, that level is higher and if you compare that to an active base, you see that you're not losing customers not going to the details or figures, I should tell you that this is a significant impact more than sales in itself.

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

Thank you very much.

Operator

Our next question is from Robert Ford, Bank of America Merrill Lynch.

Q - Robert Ford {BIO 1499021 <GO>}

Thank you very much. Good morning, congratulations on your results. People seem to think that the pressure on the margin -- on the quarter is over. How would you address that?

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

Hello. Bob, can you please repeat your question. I did not understand very well, there was a connection problem?

Q - Robert Ford {BIO 1499021 <GO>}

Of course, people seem to think that the margin pressure on the quarter means that, that story is over. How would you respond to that?

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

Well Bob, I think this is only the beginning. A fewer -- digital operation and we are a digital company with brick-and-mortar stores. We have to be totally focused on indicators for our digital operations. If we consider Amazon operators, Google indicators, Ali Baba indicators, all of them are interactions indicators, growth indicators, indicators for our active customer base. They are not totally focused in maximizing percentage. So if you want to be a digital operation, you have to play as all digital operations play.

We make a decision this year, for a few years, we haven't started the digital operation and to help that game, we have to talk about the exponential growth, not linear growth to grow exponentially and you cannot grow exponentially any platform in the world in the ramp-up. No platform in the world can grow with the margin percentage. We are very clear, since the beginning of the year about that and we have shown that we can grow, but significantly above the market with a trade-off that much lower in terms of margin more than what we have seen the online operations in Brazil.

So I should emphasize that if there is a vehicle that can replicate the online growth in Brazil with some level and in our high level of return on invested capital, 30% and this company is Magazine Luiza, but we chose to be a digital company, not a traditional company and to be a digital company, we have to have exponential growth both at the base, interaction with customers as well as service level and loyalty from these customers. So the operation is just beginning. And also, same store sales were extraordinary.

Q - Robert Ford {BIO 1499021 <GO>}

How do you explain that growth and what do you think about same-store sales growth over time?

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

Thank you for your second question. And I will turn now for Fabricio our officer for operations to talk about brick-and-mortar stores. But a quick remark -- our strategy brick-and-mortar stores they have a crucial component for the experience. The multichannel customer is better than the single-channel customer, so we are opening new brick-and-mortar stores, we're renovating them and we are also -- some stores we're renovating, the whole stores. But we have been investing a lot in implementing in technologies that turned the experience of the consumer and the brick-and-mortar stores much better than in other stores in the market that you can buy in two minutes.

Now we are also developing the digital credit card, so you can have a new credit card in Magazine Luiza that takes only two to three minutes rather than 25 to 30 minutes that we had in the prior model. Today you do that through mobile sales with a seller or a sales person in the store, all of that in the store environment using the tech process in the store and also we have our team, the work of the team, the motivation, our commercial team is working a lot. We have the stores well supplied.

We are working on the very basics of the supply as retail very well done. Because we do have a digital operation. We are also stressing, reinforcing our traditional basis. Therefore, we have a significant same-store sales growth and also we have some stores with an even higher performance. We are gaining a lot of share in brick-and-mortar stores. And I'll turn to Fabricio for more details and some categories in which we are growing.

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

Good morning, Bob. Thank you for the question. This is is Fabricio. As Fred mentioned, I think the same-store sales are growing also because of operations, our service level and the stores is very good. We take advantage of all these investments, the customers are also benefited, management of categories also is going very well. Not only this year, we operate well -- all the categories in this quarter.

Now, for instance, the Whiteline in furniture this year are higher than the store growth, mobile phones are growing again. TVs did not take a strong hit after the World Cup. We have other categories such as IT, imported, and games that are growing above market rates. So the focus on the category, as Fred mentioned, and the promotional assertiveness is really making the difference. And is growing our base not only the credit, which is also driving force for our business, it's a whole set of actions.

Q - Robert Ford {BIO 1499021 <GO>}

Thank you very much.

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

Thank you Rob.

Operator

Our next question is from Joseph Giordano, JP Morgan.

Q - Joseph Giordano {BIO 17751061 <GO>}

Good morning everyone and thank you for answering my questions. I want to talk about the growth of Luiza Card which is amazing. But in a way, it is replacing the payment slab especially on the online, we see a relevant growth. I would like to understand how much of this Luiza Card today already represents something in the online world. I would like to understand if you want to really work with this loyal customer of Magalu or if we are still have any relevant growth in new customers that were not traditional customers of Magazine Luiza and second, I want to understand that fulfillment initiative. I would want to know if this is an exclusive process that is fulfillment is only done in the marketplace to Magazine Luiza sales and how integrated those logistics will be with the sellers if they will have the inventory in their own DC, how is this model the store will work as they drop off location, how can we consider that and how this going to work from now on?

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

Well, thank you for your question, I'll turn to Bittar for the first question on the Card and then I'll talk about the fulfillment.

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

Hello, Joseph, about Luiza Card, so far most part of the growth comes from brick-and-mortar stores, also new cards that is happening in the brick-and-mortar stores. We reported that we increased the IPP, the share of Luiza Card in the sales of Luiza Card is 7 percentage points, so when we compare the third quarter of '18 to third quarter of '17 and just the card itself, we have more or less 50% of share of Luizacred, credit card in brick-and-mortar stores. The card is over 40% of those 50% and then direct credit to consumers is the 50% of sales in brick-and-mortar stores.

Of those that -- the share in brick-and-mortar stores and credit card -- with credit cards and the Internet, it was 4% and this year it's already at 6%, turning to 7% and 8% and this is a constant growth month-by-month. And we do have a lot to do, we are working hard a lot of things that will be available in the e-commerce very soon, improving customer experience with customized offers for pre-approved customers with experience, promotions, discounts. So they will be able to purchase right there and then with a discount with no interest, with a series of benefits for the e-commerce customer as well. This card is started for our brick-and-motor stores, we are adapting that for the e-commerce customer.

We believe that we do have a potential to increase the share of this card in the e-commerce and we are also considering developing a new card focusing on the e-commerce customer specifically, so there are several opportunities to be tapped into and the e-commerce we expect to have the same success for Luiza Card that we have on the stores.

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

Okay, Joseph, now -- Joseph, what I would like to say is that, once again one of the assumptions of our marketplaces strategy is that everything that we do for 1P, we will be doing for 3P everything all functionalities for pickup all of that we are working on. We see the store is a shoppable distribution center. We're adapting all the stores, we are adding all the stores. We have already renovated 44 stores up to September, we will be renovating 100 up to the end of the year, and we roll it out for the new stores. All the new stores are being opened witness this new capacity 30% of the area for storing and inventory handling.

And all of that will be available to sellers, that is to buy on the website and pickup at store, will work for 1P and 3P and the stores in the future. We also be collection points that is the seller will be able to deliver a product in a store, then it will be directed to the DC, so that it can be sent to another store or even to the home of the final consumer. So in our almost 900 stores, now we are seeing those as distribution centers that sell and they will be in full operation for a marketplace, that is a long-term view. Obviously, we have the rolling out process, which we are executing very carefully, this is a goal, this as an objective also of our logistics and pack a team our operation back office, legal. Everyone is working to turn that into something real, we already have the go ahead of our legal department to be able to operate for third parties, because that also requires an approval.

So we are working at full speed and we will not give you a guidance of those roll-out, but as every other roll-out that we have made, we do have a great capacity to accelerate and grow once implemented this view and what I always has advocated about the omni vision for our retail and 1P, it will be just as strong and powerful for 3P and will give us a competitive advantage for pure marketplace operations, if it is not the most competitive advantage, at that point then we will have, it will be a great one.

Q - Joseph Giordano {BIO 17751061 <GO>}

Perfect, thank you very much, one more question if I may. And you involve the seller and involve the customer and we already see a digitization for consumer credit, I would like to understand the company, understand you have a lot of services for sellers, but now we start to extend credit for the sellers and probably broad -- bringing these two sides together in the payment term and in an payment, I mean?

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

Well of course, now we are in the first stage of Magalu Pagamentos, prepayment of receivables. There are no risks for the company here and at the same time, this is very important for sellers, because the need of credit is there on receivables, and in our new processes frictionless for the seller, and also it has a better rate than the average of the market, because we have also as an assumption for the marketplace as the better option for the seller.

We will not tie the seller with logistics or with payment, we will be the best option for them; for me, the seller is a client, so we are in the market here with two clients, we have the final consumer, we have the filer, I see the seller as a client. Our mission here is to provide the best option to the seller, I don't want to tie the seller to me, but I want these sellers to make sure that the best operation to work with is the Magazine Luiza, one of the digital companies in the world that I like the most are the ones that have an open mind set in China, in the US, it's not the limit the sellers options on the contrary and the short period what I can tell you is that we are doing the rollout of Magalu Pagamentos or payments that are at full speed, we will be accelerating that very soon, most of the sellers will be operating there, but we will not make anyone to work with that.

So it's up to them, this is we're not tell them not to work with the competitor, we want to provide them the best option, and that's how we are working, that's our strategy, that's Luiza's way to do.

Q - Joseph Giordano {BIO 17751061 <GO>}

Perfect, thank you very much.

Operator

Next question from Thiago Macruz, Itau BBA.

Q - Thiago Macruz {BIO 16404924 <GO>}

Hello, thank you very much for answering my question. It has to do with investments that you have made in customers, you did have a positive reaction in all your KPIs, you mentioned four points; logistics, Luiza Card, customer service, and I want to understand the growth in them considering that also part of this investment will be diluted in the next quarter, we will not see all of them in the same magnitude, that's my question?

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

Hello, Thiago. We are not just rebidding this investment, we are not break that down this information is not open and the release and it's not published by the company, but I can tell you that the most part of this investment is in logistics, especially in quick delivery, express delivery because we believe that this is the differential that is most competitive in the market. The investment in new DCs, investments in capacity investments, investment in automation and Logbee an increasing Logbee and supply frequency all investments and converting the stores and shoppable distribution centers. So logistics is being benefited from these investments, Decio and his team because in fact that's what, where we believe that the structural bottleneck of Brazil is higher. The market average operations are difficult. So, I would say that our main investments are guided to better logistics, express delivery, better level of return, better experience and the store pickup. We are already working with inventory in the stores for store pickup.

So we are focusing very much in these logistics investment that really require investments, so it is not as much in marketing, which is an investment in which you spend one year, next year you have to spend again in marketing. For logistics, if you develop the route and create frequency, we start at lower capacity and also at a lower density, and while you provide the customer lower delivery time, you have to increase the delivery time and you decrease the idle time of our drivers.

So now we are promising a due date and when we have a growth in orders, all of that is optimized. So in terms for the next quarter, we will be maintaining focus on these investments, we will not give you guidance on percentages, but I can tell you that this operation is going to focus on growth of absolute numbers and less in margin percentage. This is what's guiding the company, high growth, accelerated growth, less percentage in margin, because in fact the better digital operations in the world are guided by the same KPIs.

So we will be disciplined on that, without losing sight in our case. The discipline on return on invested capital, so lower margins, but absolute growth in the sales and margin mass in results. Okay.

Q - Thiago Macruz {BIO 16404924 <GO>}

Thank you very much for your answers.

Operator

Our next question is from Maria Paula Cantusi, BB Investments.

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

Good morning, everyone and thank you very much for answering my question. I still following this prior question, how these levels of investments will be for the next year? Next year, we already have a pressure on gross margin because of the lei do bem; the law of good, so what do you foresee for next year. Also, I would like to talk more about exponential growth and that's what you're focusing on from now on, and in my opinion the marketplace would be very important there. So, I want to understand how do you see the criteria to bring sellers into a marketplace? Will you be able to reach these exponential growth even being a strict or when you have a complete platform of services, will you be able to bring down the bar, so that you can bring more sellers to your platform? Thank you.

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

Good morning. Thank you very much for your question. About guidance, we will not provide anything. We will continue emphasizing that the company's focus will be the growth of our customer base, interaction with customer service level for customers, also with the discipline of cash generation and return to shareholders, less focus on margin, but focus on general growth.

You are right, that the main driver for growth in this company will be marketplace. That's right, because of all the channels, that's where we have more exponential potential to grow because we have, there are investments in other areas. So, this is really a market that has a platform dynamics and in everywhere in the world, it tends to represent larger growth and we are growing that on the established investment phase logistics as I mentioned, that we will be sharing there and it has better dynamics of ROIC both for 1P as well as 3P and I think this will be maintained, there is possibility of growing, generating value to shareholders in a very clear fashion.

Once again, even with all the selective process that we have to taking new sellers, the last month, we had a record 400 new sellers. We have a lot to improve in all processes. This is just a 2-year old platform, we have reached in the quarter and the year already 2 billion with less than 2 years and the operations in the platform. We have a lot of process to improve, the on-boarding, the sellers approval, which can be improved. We were able to reduce the period of time to introduce a new seller.

We believe that there are a lot of people that are not in the market yet and they will be more mature operations, you're talking about 16,000 new sellers, 35,000 millions and millions of tax ID numbers here in Brazil they have to sell, could be selling with those. And so we have a huge market to grow and our ambition about having sellers and the platform is huge. But those sellers have to be formal, they have to follow all legal and ethical issues in Brazil and they have to provide the same service level that we provide to our customers.

We are not going to grow, if we have to lose service level and once again the indicators for customer levels are just as high as sellers growth and also goals for active users. So, we have no shortcuts here. We'll be growing at a very high bar for a service level and obviously sometimes the seller does not provide a good service level, because they don't have a good logistics to provide that. But, if they can use ours, they can benefit from us, but I will not tie the seller to my logistics process. I will give the sellers, the option to choose because we believe that a platform company has to be an open company. So if I have addressed your question, that's it.

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

Thank you Fred. So for next year, you will continue investing in service level as you did in 2018?

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

Yes. We'll continue investing in the service level and the impact of that in the P&L will depend on the level of growth and the sales that we will have. So we will not give any specific guidance for profitability percentage, but customers are not one year investment. We will maintain that focus because once again, we do believe the companies, digital companies and that's how, how we see ourselves today a digital platform with the brick-and-mortar store. These companies have to be evaluated using those criteria and increase of the client base interactions, investments and cash generation as well. We'll be focusing in maintaining cash generation, but with less focus on margin percentage, which is how the traditional retail market works and a digital company cannot be assessed as a conservative or average retail company.

Operator

Our next question is from Mr. Richard Cathcart from Bradesco.

Q - Richard Cathcart {BIO 16457807 <GO>}

Good morning. I have two questions, first one is around about Logbee. I want to understand your opinion about the end of the tax rate for next year? And second question, analyzing the growth of e-commerce and marketplace and also, retail company that has the low penetration, e-commerce. We know this is a category that is difficult to operate. How are you preparing the company and the company's logistics to seize the potential of this category in the future? Thank you.

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

Hello Richard. Thank you very much for your question. Actually, good afternoon, right. About your first question, what is that again. Okay, the lei do bem: law of good, it's very difficult to understand what's going to happen because this is going to change for the whole market, everyone that would benefit from this tax break now is going to transfer those new tax cost, to prices. Historically, what I see is that usually the market ends up transferring that because if you look at the results of our market operations. I don't think anyone can like little margin right now.

So from what I see and the competitors and the market and everyone that has published the results, I believe that everyone will need margin. No one will be able let go margin. Therefore, I believe that we'll see those taxes being transferred almost totally, but we have no guarantees there. So again, conservatively, I think that this transfer will not be over 100%, especially in the first quarter of next year, this will be a stabilizing quarter. We -- that's where we have our main concerns in our budgets. We probably are contemplating a non-food transfer prices. I think in the first half of the year, we'll have a normal situation. But once again, I have no crystal ball. I don't know what's going to happen, how the market is going to react. We'll have to be following the situation up and closely and as much as possible we'll be working on that.

And in our calls and public interactions with the market, we will be making it very clear, how we're going to deal with that. But, what I want to say is that, no one today is able to take in. Our margin is above the markets average, is much higher. We were very -- one of the very few profitable operations both in the on and the offline.

In the online, I think we are the only one. So, I don't see any one with that capacity of taking in that margin drop, but we never understand the market and its competitor has a different strategy. So, I cannot anticipate anything about the lei do bem; law of good.

Now, on fashion, is a sector that has low penetration in Brazil, but it has great potential. It had great representation and other countries in the world in China 20% is one of the main sales channel. I think this has a huge potential and we want to be an operation of co-categories. We want to operate in all categories. We want to have the develop competences such as we have already developed for consumer good products. And so, this is on operations to be full commerce, two categories.

Therefore, we will be preparing ourselves to go into different categories and they are very important, if we consider that increase consumption frequency. They increase our indicators for frequency, customers and Logbee was an acquisition that allowed the company to do the last mile for the lowest added value products, because Logbee was very good at higher item of, but we're higher ticket volume. So, it with provided that type of category. It is a specific in this story, but it's nothing that we have not faced before with other challenges.

Q - Richard Cathcart {BIO 16457807 <GO>}

Thank you very much, Fred.

Operator

Next question is from Franco Abelardo from Morgan Stanley.

Q - Franco Abelardo {BIO 17416219 <GO>}

Hello, good afternoon. Congratulations on the results. Two questions. The first is about the gross margin. I want to understand the drop in the margins. This was because of mix or did you have an investment of gross margin per channel in brick-and-mortar stores and your online? And my second question. Should we see a positive contribution from marketplace and the gross margin or if you had, does it help to offset the drop of the gross margin that you have seen on the quarter? This is the first question.

The second one is about working capital. We have seen it lower inventory levels as well as in payment terms. Roberto mentioned that there was purchase prepayment in the third quarter and should we see this working capital going back to regular rates in the fourth year or fourth quarter, I'm sorry or we should see any different movement ahead?

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

Thank you for your question; about the gross margin, the main factor here for the quarter obviously is the exponential growth of e-commerce. Growing on top of a high base already and we always say that the gross margin of e-commerce is lower and it is more than offset by a lower expense. And in this case, we did not see the stable EBITDA margin, because in fact, we had investments especially in logistics and as I mentioned in the quarter, but e-commerce went against market share and the company. It reduces the gross margin of the company, but it offsets it with the lower expenses, providing us a stable EBITDA since we invested in all these factors that we mentioned, new DCs, higher purchasing frequency, we had also a reduction in our EBITDA margin.

But obviously, this was as planned, maintaining a high level of return on invested capital. We also had a little bit of transfer of the FX rate. We did -- you have the impact of those 15 days of July for the World Cup. But within the category, the margins are well behaved. I think the main impact is the e-commerce mix, but this time it was not as much offset by expenses dilutions, because we had Investments in consumers, which is part of our strategy.

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

Good afternoon, Franco. About the working capital, it's like I explained. The inventory in the last 12 months has increased around 35% and if they had grown at a same pace, we had a difference of BRL 200 million that the suppliers accounted to be high and why it's not because these BRL 200 million we purchased in July and paid in September.

If we had purchased in July and August, we will be paying in October or November. Therefore, what should be happening now is that we have the right levels of inventory, seven days of turnover. That's the average, e-commerce is even better than that. We are very much prepared for the increase of sales in the fourth quarter and the average purchasing time is right, is of around 90 days.

What happened specifically is that, we anticipated purchases from third quarter to the second quarter and so payments went from the third quarter to the third quarter more or less in BRL 200 million. So, what you will see in the fourth quarter is that in theory in average in this quarter since we have 90 days term are balance of suppliers there of what we had in September since it was lower, because we already paid for that.

The cash generation of this quarter should be BRL 200 million higher than it would be and the cash generation for the fourth quarter, which is already good usually and this is going to be better because of this anticipation and for the end of the year that we do not foresee any changes. We will have the same inventory turnover and the average purchasing time that we had estimated. And this is really a one-time off thing, because of the dollar rate in the middle of the year. We took advantage of that. It was a one-time off situation in the quarter. In the year, that -- it will not change and the focus on the working capital and also on the cash managing -- management is still there, as Fred has mentioned. It has not changed.

Q - Franco Abelardo {BIO 17416219 <GO>}

Okay, very clear, Roberto. If I may, a follow-up on the gross margin. When the marketplace gains a share of total sales, should we see an improvement in this gross margin or not? Maybe because of this, a lot of good and e-commerce in 1P growing faster. We should see more pressure on the gross margin from now on?

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

Franco, yes, I forgot to mention that. Once again, lei do bem, law of good, we don't know, we don't know how the market will behave. Let's consider that if the market transfers 100% of that tax to prices. In theory, we would not have a margin pressure and I'm sure that the ramp up of the marketplace should improve the gross margin of the company, especially for e-commerce.

When the e-commerce gains share and the company as a whole, it tends to help the total margin to drop less. But, obviously, next year, we'll see other factors we have at gross margin, which is a mix of e-commerce vis-a-vis brick-and-mortar stores, that's one. And the level of the transfer that the market will be doing because of this loan of good. All of that will have to be part of the equation, if we consider the variables and consider the marketplaces specifically we operate marketplace in a very profitable fashion, this is a positive business, we are not holding takeaway promotions. Since we have always operated with 1P, the marketplace is a rational operation. We have trade-offs that makes sense for the long-term cash generation for the company, not otherwise. So this is already added to our gross margin, if it were not the marketplace or gross margin would not be as good.

And as it gained share in the e-commerce and in the company as a whole, the trend is that we should have a better result. And -- but I, once again should say that we cannot forecast what will happen with this law of good.

Q - Franco Abelardo {BIO 17416219 <GO>}

Thank you, very much.

Operator

Next question from Tobias Stingelin from Credit Suisse.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Good afternoon, Fred and Roberto. I know you had several questions especially about the margin. First, congratulations on the results. I think your strategy is right to focus on growth. Now, my question is what is the fair growth, but in order for us to understand, Fred, how can we think about it considering that you have capitalized -- you could improve your growth. So how are you going to drive that cash generation break evencash generation, I'm trying to bring in the conditions, so that we can better understand this trade off vis-a-vis growth vis-a-vis profitability. For getting the margin, I'm thinking really about the growth here?

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

Well. To be -- it's very difficult to address your question without providing guidance. So I'll have to be very cautious and we'll try to be more qualitative here. In order to give you a general overview, so about those overview, once again, I want to make it clear and since the beginning of this year, we saw that we were adopting a strategy of growing above the basis with, at the same time, an increase of the service level and growth not only focused in GMV, but also driven to the increase of our active customers. Because, we were from 2010 to 2014, we did not grow our active customers, we had 10 to 11 active customers, those years.

So we understood that, in order to be a digital operation that was significant, we had significantly increased our base of customers, not only GMV, active customer base, we had to increase interactions with these customers the number of times, we have a relationship with them both financially, as well as the number of uses MAU and so on. All investments we have made -- were made analyzing the customer lifetime value, we invested heavily, we worked with a consulting service in the first quarter. We identified the investments that will give us more return in the long term.

So this is the customer lifetime value, we saw that credit card, the customers that have the credit card that have the app and other segments that I'm not mentioning here. These are segments and profiles of customers that tend in the long term to be more profitable customers for the company. They tend to have a buyback profile that is better, we accelerated investments in these customers. So I'm sure that over the year, the results of the company will explain these investments and will maintain a high return on invested capital. Because, if we compare what we are investing to what the markets invest, then we have a higher return, we have additional sales to what has been invested. The CapEx and everything else, today we have a machine that is producing a growth at a cost of investment that is much lower than what we see in the market.

So this is the way we are going, but guidance in terms of margin percentage and all these impacts, we cannot provide you. I can tell you that, we do believe that in Brazil, you cannot say -- so what we will not accept at all a higher indebtedness level, return on invested capital that is not something out of the rationale. We do not accept operating at a loss. So, the company has always focused on a very rational growth. And so now we are considering on the long-term, not only in the short term, that's how the best operations in the world work.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Okay. Thank you very much.

Operator

Next question is from Rodrigo from Goldman Sachs.

Q - Rodrigo {BIO 19272736 <GO>}

Good afternoon, everyone and thank you for answering my question. About brick-and-mortar stores, I see that you have very good returns in terms of technology. But in terms of new stores, I see that you had less productivity gains, so, does it make sense to have maturity curve from those stores that are -- for the stores that are opening from now on. And also, if you have a more cards in these stores.

And my second question is about customer service. When you had another quarter with results still consider the impact of the IFRS 9. So we see a change in the more normal level and the results, when will be able to see that next year? And when you see that maturation of this new batch of credit cards? Thank you.

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

Thank you for your question Rodrigo. This is Fabricio. About new stores, in fact the, yes. The first thing that have happened to new stores this year that they are not performing very well. The strategy was right. We are very good in the execution. So we identified the market who was going in, the investment in the stores, occupation and so I knew, we went very well in different markets, we went in new markets offering digital operation very good service level, we opened 2 DCs to cater to these markets, promotions, new products that is the strength of the brand.

But, in fact that these stores performed above our expectations, but they do have a maturation time. I'm sure that next year, they will have a better performance than this year. So we do have a great opportunity to grow in these stores, because we are into two new markets, Maranhao and Goias. We are starting our market share in these two areas, that is lower than what we have in mature markets. So, considering that, we have a great growth opportunity and I believe that we will be maturing with 2 or 3 years of these stores. And also we are having good sales on these stores, as part of the strategy.

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

Good afternoon, Rodrigo. About credit cards, all card portfolio -- when you grow a lot in the beginning, usually you have some problems, you'll suffer a little bit, both because of sales cost, because they are relevant and the number of cards is also relevant. And also now because of the IRFS 9, you have to make provisions and sometimes the customer is not using the full credit limits of this credit card. And that's why, our older customers are more profitable. So we have portfolio that is new, this year we have more customer debate, that's why they are less profitable. But once again, in terms of customer lifetime valuable, it is very profitable.

And we are adding a lot of new clients maintaining delinquency at very healthy levels and it was as you know is very conservative in this approval rate, their approval rate is very strict, less than 10% actually. So we expect that -- well, this year was a year where we accelerated growth. We are selling 150,000 cards a month much more than past year, which was around 80,000, 70,000 a month, so we doubled the expansion here. So the issuance costs are affecting the results in the IFRS 9 and the BR gap and also the new provision criteria for the limits and the trend for the results is to have a convergence and also to improve in the mid term and then the long term with the maturation of the portfolio. And we will continue investing in increasing a lot of this base of cards. Because of the strategy we already talked about this new credit card, it has two benefits, it's retail and Luizacred, but it makes all sense in terms of return on invested capital in the long term. So investments I'm sure are profitable.

Q - Rodrigo {BIO 19272736 <GO>}

Thank you very much.

Operator

We now end the Q&A session. I would like to turn the floor back to Mr. Trajano for his final remarks. Please Mr. Trajano, the floor is yours.

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

I would like to thank you all for participating on this call. Thank you also to the team and to our partners that helped us have a positive quarter and despite of all uncertainties of the market. Thank you very much.

Operator

The conference call of Magazine Luiza has ended. Thank you very much for your participation and have a nice day.