

Q1 2019 Earnings Call

Company Participants

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

Other Participants

- Joseph Giordano, Analyst
- Pedro Fagundes, Analyst
- Robert Ford, Analyst
- Rodrigo Cuestas, Analyst
- Ruben Couto, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Magazine Luiza's conference call referring to the first quarter of 2019 results. At this time, all participants are connected in listen-only mode. Afterwards, we will have a question-and-answer session. (Operator Instructions).

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

Frederico Trajano Inacio {BIO 17269235 <GO>}

Good morning, everyone, and thank you very much for participating in our conference call about the results of the first quarter of this year. Once again, we are with the whole team, our executive team and I would like to make my presentation first and then we'll both -- we'll give you some additional information and then we will be opening for questions.

I would like to start by saying that we got into this first quarter with a new strategic cycle, a very promising one that we committed ourselves with some pillars, with some drivers of the strategy, among them the accelerated growth of the company, its financial growth, in fact, Chinese style growth and the leverage of our platform, Magalu as a Service, growing the marketplace platform of Magazine Luiza with the services that we deliver to the company itself, to third parties, that is to say, to other companies, very much focused on this pillar and so that third parties may operate at the same level that we operate with 1P and the superapp, our digital platform, as the main point of contact with our clients, our app; extension of new categories, improved experience in retail, fast delivery, both in

stores and at home and a culture of data and innovation. So these were the seven pillars that we detailed in our Investor Day last year as well as in our annual report referring to the results of 2018. So of course we are already executing this new strategic cycle. And in practice, our theories followed. Magazine Luiza became digital and now we want to have the whole retail of Brazil also in digital form. And specifically now in this moment, we want to bring digital inclusion to consumers and also to small and medium retailers over the companies that might wish to learn or tap into the advantages of these investments that we made over these years in the very successful digital transformation process in Magazine Luiza.

But this quarter, we found some challenges ahead of us. In the first quarter, we had a very high comparison basis, the first quarter of last year, already counting on sales that had already been brought forward February and March mainly last year. We already had a higher than normal sale of smart TVs because of the World Cup and we had the end of the Lei do Bem, that is to say, the law regarding benefits, the fiscal benefits given to technology products and mobile, smartphones and some other products of other lines as well. And in my opinion, what was really a broken rationale part on the part market and some non-transfers benefits of the Lei do Bem and the economy that really was lower than we expected. So in spite of all these challenges and taking into account the fact that we are in a phase that is very much focused on growth, accelerated growth, exponential growth, as we said about, but without making any concessions regarding the level of service, we want to improve the level of service and not go into the detriments of that and neither making concessions regarding trade-off of margin. We want to do it provided it does makes sense in the long run and not just like free shipping for everybody and with no long-term rationale and like concepts like failure analysis and also maintaining our ethics with everybody forming with the chain guaranteeing that all the sellers in our platform deliver high level of services.

And with all these challenges, I can say that in the first quarter, we were able to have a very good performance. And I will give you some figures to show you how we have evolved during this quarter with indicators and bullet points that are very significant in order to address each one of these points. First, the client base. When I talk about the exponential growth, I mean the growth of the client base because you can increase by increasing your average ticket only, but we want to have a bigger base and a more faithful client base or more clients buying over the year and more clients buying frequently over the year. And in that sense, we had a very good evolution. The client base was 18 million active clients, 34% growth year-on-year. Highlighting the website, 78% growth vis-a-vis the previous year. But also, the brick-and-mortar store that had a significant growth of 23% year-on-year.

So we are able to grow both channels and not grow, as we always say, one channel to the detriment of the other. And I consider this growth a very significant one and I'm very happy about it because our client indicator is not only in terms of frequency and purchases, but also the level of service. Today, we continue to be the only large retailer with the RA1000 seal in the Reclame Aqui website, and we were able to achieve this in spite of the 240% growth in marketplace that still operate with a slightly lower level of service than our 1P. And the marketplace already represents about 28% of total clients that buy in the website. So even with this very relevant marketplace, it barely has this

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weight and we were able to maintain the RA1000 seal when we were working to have the same level of service at the marketplace as good as we have in the traditional chain, that is to say, selling the merchandise that's in our inventory and from the client. Therefore, we had a reduction of 60% in complaints, a very good work on the part of our team. 26% improvement in first call resolutions. And we are improving the cancellation process as well with the client tracking of orders integrated in WhatsApp. And many -- there is no bullet -- or silver bullet. It is work being done by the whole team.

And though in the level of service, that is to say, raising the bar for the Brazilian e-commerce, we are not going to wait for a foreign player to come to Brazil. As domestic players, we are going to raise the bar of retail as a whole. And we are doing that in spite of the accelerated growth that sometimes brings about some stumbling blocks. And talking specifically about e-commerce, we grew 68% client base, 50% in sales, and we grew less sales than the client base because we are obviously wanting to sell more different items. We doubled the number of listed items sold year-on-year, lower average ticket. And we launched the books category we have with Mercado Magalu and we continue to invest a lot in e-commerce and the app. And for the app, we have the strategic objective that to make it a superapp and the first step has to do with the expansion of the sellers base and the number of items sold and category and then getting to payments, et cetera.

But our first phase of superapp has to do with expanding the category of products and the launch of books, and I will be mentioning this afterwards and I know everybody wants to hear this, Netshoes is very much focused on that as well, so that we may expand the category base. And we made 33 million downloads and average users now 6 million, a very expressive growth vis-a-vis last year and 33 million net downloads. And then beside the marketplace that grew 240% in the quarter, this helped a lot the overall growth of e-commerce and also the level of service of logistics. And the logistics team is working very well, delivering in up to 48 hours in express delivery, reaching 33% of the total e-commerce sales, a very major number. And together with the store collections, we can collect 60% of our sales -- total sales in e-commerce already being received or collected in less than 48 hours. And it's very difficult for competitors to beat this kind of service that we are delivering. And this is a very positive result from e-commerce, already very much impacted by the accelerated growth of marketplace. We reached 5,000 sellers already and 5.4 million SKUs in our platform.

So we already started to have the network effect, users attracting more sellers. And ultimately, we have more products that attract more consumers and gaining scale with this Chinese growth mode. And we already have this first time that this is materializing already. And in marketplaces we work a lot, we have two clients, we have the seller and we have the end customer. And when you work with an ecosystem, you have to understand that this is a market of two clients. And we're responsible to deliver service to the seller as clients, not only catalogs, et cetera, and bringing clients via our platform, via our app, but we are rolling out Magalu Pagamentos and Magalu Entregas. Magalu Entregas already has 53% of sellers that use the standard contract of our website at much lower shipping fees than they have negotiated directly with the carriers, but also rolling out Logbee for instance to deliver for the sellers and even lower shipping fees. And in this case, the growth of Magalu to 20 sellers that we are piloting now and many adjustments have to be

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carried out to allow us to roll this out, the top quality, both the level of service with sellers sharing what we have in 1P Magalu low fee, and we want to pursue this to the sellers by means of the cross docking platform. In Magalu Pagamentos as well that already has 3,750 sellers. And in this case, we're already prepay -- having prepayments of receivables which are collecting or charging low fees. And it's super important for them to work with a sound working capital in our payment strategy there to help the seller to be successful and grow with sustainability. We always have this view that our platform wants to be the best option for the seller and not only for the end customer. I'm talking about the physical stores.

We had another very good quarter and a very big challenge because we already had a same-store sales last year which was very high because of the World Cup. And we were able to grow 16% at the stores with 8% same-store sales, over 16% without the World Cup. And this is an extraordinary work that we do in all the regions and all the categories in the first quarter with all the difficulties of the Lei do Bem that is the bigger stumbling blocks in terms of profitability. And in spite of that, we were able to grow it. I would like to say that we look at same-store sales, but we grew the total store base. We accelerated our expansion. We opened 102 new stores and the new stores already contributing 9 percentage points helping the overall growth of brick-and-mortar stores. At this moment of a challenging economy, this is very positive. And I think the participation of new stores in growth already indicate that these stores are operating with a level of sales even higher than the ones that we estimated at the beginning. And I would like to mention the announcement that we made last week, which was the purchase agreement of some commercial point-of-sale from the company that owns front of the Armazem Paraiba stores in the North and the Northeast, 48 stores in Para and Maranhao inaugurating our presence to the North, a very promising region. And I believe that they are under-assisted from the viewpoint of retail.

And in our model of multi-channel, this will help us not only gain clients, but also this will help our e-commerce as well to improve penetration in the North. And I would like to remind you that many people carry out campaigns of free shipping in e-commerce, and they all exclude the North. And Magazine Luiza will not exclude the North region in the free shipping mode. We will bring benefit to these consumers with our other distribution centers and the support of our physical stores for a major part of the SKUs that we have available in the region, another plus both for physical stores and for e-commerce. And in this call, I would like to highlight Luizacred as well. We generate -- make an -- give an expectation about Luizacred from the financial viewpoint, but I would like to reinforce the figures, the more operating figures of Luizacred just to explain what is going on with this company. Two years ago, we decided to expand Luizacred, accelerate it and it's super important for us in Luizacred is delivery in growth of fintech. And the growth of Luizacred's portfolio, a private portfolio was 48% in the credit portfolio year-on-year, 8.8 billion in credit portfolio as Luizacred. And we believe that now this is the biggest credit card company in Brazil, exceeding other names that are very well known in the market and with a very fast growth pace.

And the card base went to 4.4 million cards in this quarter, growing by 26% vis-a-vis last year and 50% of the whole sale that we have in the brick-and-mortar stores come from Luizacred. But I would like to mention that 70% of the expenditures are outside Magazine

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Luiza, they are off-store and we have an average of the use of Cartao Luiza around seven times per month. So this card for those who already have the Cartao Luiza, the Luiza Card, this is already the first option. This is very positive. And based on the new ways that we post the result of the finance company, such as no longer in retail finances since the IFRS 9 and not by saying that which is what banks reported, we have a volume of provision that is much higher than the Brazilian GAAP at the first moment and the profitability goes down a little bit and we see this in the equity income. But in the long run, it's a very good insurance for us because in the past when we grew the finance company a lot, the profits were high at the beginning and then they went down. And in our case, we are having this result now that I described, but the future will be very positive because we have a much higher position than a bank consumer finance company. And we are reporting both models about same GAAP and the IFRS 9, so that the market may analyze this very clearly. From the strategic view of the company, this does not change even if this means a lower result in IFRS 9. We will accelerate the growth of Luizacred. And the clients that use the Luiza credit card, they buy five times more than the others. And we want to have this level of loyalty and shopping frequency. And in this case, we are making a long-term decision. It's very consistent with our strategy.

Okay. Now Netshoes, the big news of last week. And I believe that this will be the biggest source of questions from you during this call, from analysts and afterwards from journalists. And of course, we are very happy with the announcement of the acquisition agreement that we signed last week. And we consider Netshoes a major asset. And as this is not a purchase, it's just a purchase agreement because it is subject to the shareholders' meeting that will be held in 30 days and we need two-thirds of approval. And we will have to make the regular comments and I anticipate that I will not be able to answer many of your questions because this purchase has not materialized yet. We still have 30 days ahead of us, and the approval by CADE, the consumer finance agency, an addition of 45 days, probably, even if we get a fast track. And we are very happy with the acquisition. The figures of Netshoes were published recently, but they are the biggest online players of sports, clothing, footwear and sporting goods with outstanding high value brands, Netshoes and Zattini, and Shoestock itself, which was an asset that they recently acquired. 24 million users, almost 7 million active customers in marketplace, 1,000 sellers in marketplace and assortments of 250,000 SKUs that supplements ours, and we practically do not work in this category and GMV, 2.5 billion and marketplace already with 15% share in the business.

The acquisition is totally in line with our strategy that we have described to you, the adding new categories, increase of the active customer base, increase in purchasing frequency. But I would like to mention talent in the wholesale because a company that has a Chinese-type growth has to hire very good people in retail and this becomes more and more difficult because there is a possibility of the Brazilian economy soaring or at least taking off. And we need talented people and at Netshoes, there are many, many good people. So this is a big asset for us in case the transaction is approved. And I apologize for the fact that I will not be able to answer many questions because of the reasons that I have just described, and this is the recommendation on the part from lawyers and bankers.

Now I would like to give the floor to Roberto, and he will get into the financial details.

Roberto Bellissimo Rodrigues {BIO 17269312 <GO>}

Good morning, everybody. And I would like to mention the highlights first. We talked about the sales growth and accelerated total sales growth, we had a reduction in the gross margin 0.9 percentage point, very much concentrated with the Lei do Bem -- the end of the Lei do Bem. Our marketplace contributed a lot, practically offsetting the growth of e-commerce. And with 1P that continues to grow a lot as well, over 30% in this quarter. We were able to dilute our operating expenses because of the operating leverage diluting expenses and growing much higher than inflation. And even with the increase in the level of service and investments in new clients in line with what we said last year and with that, we were able to grow our EBITDA in nominal terms BRL318 million in EBITDA. And even considering the zero to zero result of Luizacred, if we were to consider in BRGAAP, the EBITDA would be BRL236 million with a margin of almost 8% or 7.8%.

And net income pro forma net of the effects of IFRS 16 was BRL139 million would be BRL156 million considering Luizacred in BRGAAP and ROE 23%, it would be even higher. We continue to generate quite a lot of cash. We continue to have a very high ROIC, 20% in the quarter, 27% in the last 12 months. Net cash vary about BRL1.4 billion and net cash position BRL1.8 billion.

On the next slide, we show the evolution of active users of the app from 2 million, 3 million to 5 million, 6 million, active customer base from 14 million to 18 million. Then they have the number of new stores, over 100 new stores in the last several months and increasing investments. We more than doubled our investments in the first quarter and highlighting technology and logistics here. Then we show the quarterly evolution of our sales. You can see that we sold in the first quarter almost at the same level of the last quarter last year, which is usually much higher than the other ones. And another highlight here is e-commerce with 2.4 billion in sales in the quarter. In annualized terms, this is already almost 10 billion in sales and representing over 40% already of the total sales without Netshoes. And including Netshoes, it will be even higher.

Then we show the gross profit, expense evolution concentrated in selling expenses and dilution of fixed expenses. Equity income is actually 0.0% vis-a-vis last year. We had 0.6 percentage point drop. And on the next page, you can see that it has an impact on our EBITDA, so the pro forma EBITDA BRL319 million. In IFRS 16, almost BRL400 million with a margin of over 9 percentage points. Then we have the financial expenses. This was very similar to last year, 1.7 to 1.8 percentage point and due to the growth of Cartao Luiza. Net of prepayment of receivables, we had net financial revenue. And on the lower part, we show you the working capital. We continue to improve our working capital position, the net one. And by that, we improved our net income increasing practically BRL100 million from BRL1.3 billion to BRL1.4 billion. Then we show cash generation, the evolution of net income that we have already mentioned.

Then some data about Luizacred. In 12 months, we increased almost 1 million cards in Luiza Card base almost 500,000 here in the app users of Cartao Luiza that relaunched about six months ago. And penetration in new accounts is almost half. So more and more, our clients will be taking advantage of the Cartao Luiza app with an even better experience. Luizacred grew a lot, selling BRL5.7 billion. Highlighting growth inside

Magazine Luiza, participation of Luizacred increased even more, reaching almost 50% of sales of brick-and-mortar stores and 40% total. Then we talk the evolution of the portfolio past due, practically stable at a historically low level, 7.7% of the total portfolio, one of the lowest in the market. And with that, we had the evolution of the quarterly net income with IFRS 9. And we had the loss of BRL900,000 and in BRGAAP, the net income of BRL36 million, which continues to be very strong, ROIC 17%. And there are the contribution to our strategy as a whole.

Now we would like to open for questions. Thank you very much.

Questions And Answers

Operator

Ladies and gentlemen, now we will start the Q&A session. (Operator Instructions) Our first question comes from Bob Ford from Bank of America.

Q - Robert Ford {BIO 1499021 <GO>}

Thank you. Good morning, and congratulations for your growth. Could you talk about your credit operations? You're adding many new users with default risk. And with the IFRS 9, are you happy with the performance? Is it according to your plan? Or how are you thinking about the growth in the number of users from now on?

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

Good morning, Bob, and thank you for the question. In fact, we have a very low level of approval. We continue to be very conservative with this regard. And we are not facing more risky clients in the Luiza base. What happens is that we have a higher number of new clients. And they usually bring about a higher position in the short run, but then they bring about a higher return in the medium and the long run. So the risk profile of the portfolio at the level of Luizacred is totally under control. And we are yes, very happy with the operation. We are further accelerating, we want to accelerate. We want to grow even more. And this year, we will be selling much more card than we sold last year. And the result of these cards in the medium and the long run tend to be very positive for retail and for Luizacred as well. So there has not been any change with the risk profile. We look at the rate of activation delinquency per graphic for period of sale very consistent once. So the operation is very well balanced. And the IFRS 16, unfortunately has this impact to bring forward provisions. But this is only an accounting factor and a very conservative one. And Bob, I would like to add two things, the efficiency ratio of Luizacred is all time high, which means that lower expenses of the operation of the revenues 36%, 38% by the end of the year, one of the most efficient consumer finance companies in the whole market. And with this kind of scale, we are able to dilute this. And we are capable of increasing revenue per user. So they are using the card more often inside and outside and also consuming personal loans and also installment purchases. And so we are able to bring or to make in front of the users more profitable and this is very positive in practice. Although, the numbers of the short one don't look like that, it is very positive in terms of the revenues for Luizacred for the next two years, very, very clear. Thank you.

Q - Robert Ford {BIO 1499021 <GO>}

There are many hardline assets available in Brazil for sale. Are you more willing to do this kind of business? Could Fred ask him to repeat the question? It was not clear. There are many hardline assets for sale in Brazil now. Are you more willing to accept a leasing contract?

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

At the Armazem Paraiba, the sectors left the crisis, but it was much weakened and many regional operations had very bad sequels of this economic crisis in the country. So there are companies that are giving up acting in this category. But as far as we are concerned, the acquisition of this point of sale is decided in a -- on a very rational basis. We bought only the point-of-sale and not the company. And the amount is in line with the amount that we pay in terms of inaugurating each store. It's less than BRL1 million per point of sale. And this is what we achieved in the negotiation. And for me, it's very important because I will always give preference to expansion with a very sound rationale from the commercial viewpoint. And if it is a shoppable distribution center, we must have this value of rentals and the investments made, which may be compatible with that. It would be nonsense to pay high premiums for point of sale. And so we have been following this rationale for a long time regarding the value that we take for each unit. So I believe that we will still privilege organic growth because we have even more vacant point of sale. And in the case of Para, for instance, the Para state maybe the better alternative is to carry out a negotiation in the wholesale, not only in retail. And it's just a case like we say then, we will never waive rationality in terms of investing because the trend is to have a digital platform with some physical points of sale. And if you make a large investment in these physical stores, you will not have the necessary return on the capital.

Operator

Joseph Giordano, JP Morgan.

Q - Joseph Giordano {BIO 17751061 <GO>}

Good morning, everyone.

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

Good morning.

Q - Joseph Giordano {BIO 17751061 <GO>}

Good morning, Roberto, Fred. Thank you for the question. I would like to talk about the top line of e-commerce because it continues to be very strong. I would like to understand two major factors, diversification of categories, such as Netshoes. So these new categories and the lower frequency categories maybe, are they contributing to the growth in e-commerce stores and brick-and-mortar stores? And how should we see the evolution of marketplace? It's slightly higher than you estimated in terms of short-term penetration. So what is your target for the end of this year and for next year? And what about fulfillment by Magalu for this seller base, which is growing very strongly?

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

Joseph, well, first, good morning and thank you for the question. I will answer very quickly and then I will ask Eduardo Galanternick to answer about this quarter and the outlook. I believe that the major driver of e-commerce growth in the first quarter, well, they were two. One was marketplace going from 4 million to 5.4 million SKUs and increasing the seller base. You have a much bigger number of items available in our digital platforms. And you end up converting a sale that you even have the category before because very often, the clients come through a search engine looking for a certain category or a certain product. And more items bring about more customers that bring about more sellers and then consume more products as we said. And marketplace, as we said in the past, this will be the big driving force of e-commerce growth in the future and in an exponential phase that we did have in 1P. This is very important, and we are very much focused on this in the current year, client base and not only GMV. You have to look at the GMV and the active customer base and the number of categories and the nature of a lower ticket in Marketplace and some other categories. As you said, all this helps bring growth. 1P continues to grow on the base of last year. And the major driving force besides a very good was being done by Edu's team, you have an outstanding work being done by logistics. And the level of deliveries is much better than our competitors, so much so that we already have 33% of our deliveries in up to 48 hours and over 95% of deliveries in 1 day in the greater Sao Paulo and the greater Belo Horizonte. We will probably reduce this to one-day delivery time for Sao Paulo and Belo Horizonte for some broader categories this week because logistics, they are doing an outstanding job from the delivery viewpoint. And this helps us convert more sales and delivery time even more relevant than price in conversion of e-commerce and this means that the growth is sustainable. And we are not doing this by increasing our free shipping. We are doing this with an economic rationale, which is what we have always done in Magazine Luiza.

A - Eduardo Galanternick {BIO 20410320 <GO>}

Just adding to what he said regarding the growth of sales and the positive network effect, the major driver is traffic generated by this expansion and assortment, 75% increase in traffic year-on-year. And when we see the number of items sold with GMV up 50%, it was over 90% items sold. And they buy the new products and they buy the traditional products. And regarding marketplace, as Fred said, we will continue with the growth phase that we have. That is to say (inaudible). And one of the major drivers of marketplace sales is the number of sellers and our capacity of onboarding sellers that are getting into the platform. And this is growing consistently. And we already have a much higher pace of seller entry than we had initially. And in relation to Magalu deliveries, we have two modalities. We have the concept that we said 50% of the sellers already in this mechanism growing on a monthly basis. Today, we have a higher figure than we had at the close of the quarter. And the pilot for the (inaudible), we made many adjustments, physical ones and operational ones and ready to scale at the end of this quarter and beginning of the next, when we do the scaling app, the Magalu Entregas.

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

Joseph, thank you very much.

Operator

Ruben Couto, Santander.

Q - Ruben Couto {BIO 20636571 <GO>}

Good morning, everybody. Could you give us some color about the performance of gross margin because there was a sequential drop vis-a-vis the last quarter and mainly regarding merchandise? Was it because of the product mix and also the Lei do Bem end? Or is it mostly because of the increases of e-commerce in terms of sales? And what could we expect for gross margin in the next few quarters. I know that the first quarter is more difficult in terms of comparison. But how are you thinking about gross margin for this year?

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

Good morning, Ruben. Thank you for the question. I will start and then I will give the floor to Roberto if he wants to add something. Here's the deal. The major impact on the margin, as we said in the release was the end of Lei do Bem because you have to collect PIS and Cofins. Both are super relevant category revenues, mainly the main one, which is smartphone. So there is a very significant impact on our margins. And you see the results published by the market. You see that there was a huge impact on gross margin of everybody that was with this important category. And this will continue to happen. And this was offset by some positive things on our side. We already won one suit, one claim, which was the PIS/Cofins over the ICMS. And in the first quarter, this has a very mitigated PIS and Cofins over the smartphone category and a major part of that. And it tends to continue because this is recurrent. And we want this because we recognized last week -- no, not recognized. We published a communique of BRL170 million and we gained or we won a suit at the Supreme Court. And we will be recognizing this over time, reducing the PIS and Cofins, which is -- this is an accrued amount of the previous years. And in the first quarter, this -- it was a recurrent one. And the next quarters, we will be debating the correct way of posting this. And this will offset the PIS and Cofins in the smartphone category. But in the first quarter, shifting to the recurrent part of the PIS/Cofins over the ICMS has already mitigated this increase in part. We could say we have other things that we get here, the growth of marketplace, increase the tax rate. And this growth help generate revenues that offset the trend of marketplace, where we (inaudible) the gross margin of the company and we have already offset this. And so we have services and other sources and the expansion of margin of other categories in order to further mitigate this smartphone situation. The long-term dynamic, well, I don't see quite a lot of room in the market to absorb the non-transfer of the smartphone PIS and Cofins, such as was the case in the first quarter. This is not sustainable. And the market over time will be obliged to transfer this because we see margins that are not positive in the market. So we will not transfer this to prices if the market does not transfer this to prices. And we have this (inaudible) victory in this PIS/Cofins claim. But if the market continues to be irrational, we will not waive growth and we will continue to play the game.

Q - Ruben Couto {BIO 20636571 <GO>}

Very clear. Thank you very much. Between offline and online, do you see any changes in terms of absorbing this impact? Does it generate a level of competition between the channels? If you exclude the market base effect, was the impact similar between offline and online? I would like to understand the dynamics.

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

Yes. We sell online and offline as well. There was no adaptation of prices because of the return of this tax.

Operator

Pedro Fagundes, Bradesco BBI.

Q - Pedro Fagundes {BIO 20029197 <GO>}

Good morning, everybody. Thank you for the question. Yes, I would like to understand a little bit better the expansion of your assortment. Do you have any bottlenecks that might prevent you from scaling up faster in these new categories that are underpenetrated online, maybe integration warehousing because some have a shorter replacement cycle? And the purchase of Netshoes, the acquisition of Netshoes, would help you if you do have these bottlenecks?

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

Good morning, Pedro. Thank you for the question. Any category that is added to your base brings about some necessary adaptation both in your systems and in logistics and even in shopping experience because there are many changes that you have to make in the filters and the search engines and the media. And they are marginally different. We have not gotten into perishable products or regulated products yet. So there are many points that, well, we have not entered any categories that are very different from the supply chain viewpoint. We have some that have a different life cycle, but nothing that is not adaptable by us. And the major point is the delivery cost for lower ticket categories because they have a lower penetration in e-commerce because the traditional dynamics of the large delivery companies, carriers, et cetera. This becomes very expensive. If you have a BRL15 delivery for a product that costs BRL20 or BRL10, so there should be a fee or the delivery fee is higher sometimes. So when you have the lower ticket, the cost or the weight of the delivery prices becomes bigger versus if you buy powder soap, the delivery price will be higher. And this is the reason why you have this situation. But this is the beauty of our multi-channel model. This is why we have a very big competitive difference. Magalu Books, Magalu Livro has been growing a lot in the click-and-collect mode. 80% of our purchases are through the physical stores and Magalu also starts to pick up -- the store will pick up with a marginal cost because they already have a truck going into the store every single day from our DC. So we can have a big advantage over the purely digital platforms, the delivery channels. The delivery cost via the click-and-collect is much lower. So the problem of the market as a whole is a very big competitive advantage like we have being in our favor.

Q - Pedro Fagundes {BIO 20029197 <GO>}

Okay. I understood. One last question. Do you work with a target of -- number of SKUs?

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

No, no. Our target is the active client base and that's it. Thank you.

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Operator

Rodrigo Cuestas, Goldman Sachs.

Q - Rodrigo Cuestas

When you think about the expansion cycle in your brick-and-mortar stores and as these stores are taking on the function of distribution centers and more integrated with e-commerce, what about the correct density or maybe catchment area that would be correct for each one of the stores? I imagine that it varies according to the size of the city, et cetera. But maybe you could help us understand omnichannel (inaudible) a different mix of stores, how this impacts your plan for opening new stores on the short and maybe the medium term as well?

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

Rodrigo, thank you for the question. Well, the answer is quite simple. We still have a long way to go. We're getting to 1,000 stores with the Para stores, almost 100 -- 800 cities in Brazil. We have 5,000 municipalities. So the potential of opening new stores in Brazil is still quite high. And we are able to open a store in a very small town, 20,000 inhabitants with a virtual model and in the large capitals, we have formats for stand-alone and mall stores, and we have a whole array of formats and this is very flexible. And this gives us the return in the whole market. So we want to cover most of the Brazilian municipalities. And we give preference to new regions. This is why we got into Para. And last year, we got into Goias. And there are other states where we are not present, the Federal District, Espirito Santo, Rio and other states in the North, Mato Grosso. And there are many places in Brazil and many municipalities in the current states that we have no stores. We have not opened a new store in the same district, in the same neighborhood. They are distant from other and they generate totally new client base and automatically helping us have a better level of e-commerce. But we still have a long way to go. This is a very simple decision, where we want to open where we do not have stores or many neighborhoods and other cities.

Q - Rodrigo Cuestas

A quick question now. Can you give us some figures about the marketing campaigns that you're airing now that has Magalu? Because I believe this is to associate Magalu with the higher mix that you're building. So how should we think about the campaign? Do you have some initial figures that you could share with us about the results? Or how much this has been helping in bringing new traffic or new client base?

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

One of the focuses -- in the last few years, (inaudible) our institutional marketing endeavors online and offline. And the focus of the last few years was on the app. We worked on the app for long time in the mass media. And I think this is what you're referring to. In the social networks as well, we worked a lot. And we will continue to do this with marketing on the app for the app. And added to the fact that we have a user-friendly app, the #Magalu, is a big endeavor that we are making now that we have a huge diversity of categories. And frankly so through customers that they can buy much more than a refrigerator, or a piece of furniture, or a smartphone, that they can buy, well,

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exceptionally to perishables and some regulated markets. We want to -- well, I cannot give you any figures now, only the figures that we have already published. We grew twice in distinct items in the first quarter in e-commerce. And we grew the number of items sold in the brick-and-mortar stores. And we are selling through more people, different people and different categories. And these are concrete figures already. But we have this institutional campaign (inaudible) program -- TV program and talking about beauty product in some 30-second spots and some campaigns, one-minute campaigns. And we are talking about many different products in our communication endeavors and the marketing endeavors. We need time, but the short-term indicators, what I can tell you is that they are very positive.

Operator

Now we close the Q&A session. And we would like to give the floor back to Mr. Frederico Trajano for his closing remarks.

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

Once again, I would like to thank you very much for participating in the call. Thank you.

Operator

Magazine Luiza's conference call is closed. We thank you for participating, and wish you a very good day.

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