

Q2 2019 Earnings Call

Company Participants

- Eduardo Galanternick, Executive Director of E-commerce
- Frederico Trajano Inacio Rodrigues, Chief Executive Officer & Member of Executive Board
- Roberto Bellissimo Rodrigues, Chief Financial Officer, Investor Relations Director & Member of Executive Board
- Unidentified Speaker

Other Participants

- Joseph Giordano, Analyst
- Luiz Felipe Guanais, Analyst
- Richard Cathcart, Analyst
- Robert Erick Ford Aguilar, Analyst
- Ruben Couto, Analyst
- Thiago Bertolucci, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen, thank you for waiting. Welcome to Magazine Luiza's Conference Call referring to the Second Quarter of 2019 Results. At this time, all participants are connected in listen-only mode. And afterwards we will have a question-and-answer session when further instructions will be given for you to participate.
(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 Rodrigues {BIO 17269235 <GO>}

Good morning, everyone. Thank you very much for participating in our call about the results of the second quarter of '19. Here I have all the executives of the Company, as traditionally we do in our calls. And we will all be available to answer your questions at the end of my presentation and Roberto Bellissimo's presentation. Exceptionally, in this call, we have the presence of [(inaudible) from Netshoes and he will be available as well to answer questions about the operations, based on the results of the second quarter that will be incorporated into the balance sheet of Magazine Luiza.

Now, turning to the second quarter, a lot of the good results that the Company has been delivering in the last few quarters comes from clarity from strategic consistency together with a disciplined execution and this was what happened in the cycle of digitalization of Magalu, and it will continue to be so. And in this quarter we see the beginning of this new strategic cycle as well.

And our focus is the construction of the platform and popularly known as marketplace, and due to the dynamic of the platform itself we have a non-linear growth, I would say a Chinese type growth since the beginning of the year because with a platform, you do not grow all by yourself. We are talking about thousands and thousands of companies, small, medium and even large companies, and that have their products shown to millions of clients through the platform. So I'm very happy to see in the first, but especially in the second quarter, very consistent indicators of progress in this new strategic cycle that we announced at the end of last year, even more so because I usually say that the main competitor of Magalu in 2019 is Magalu 2018. Our comparison base of last year was extremely strong.

No retail company in Brazil has a comparison base as strong as Magalu of 2018. And especially, the second quarter of 2018, in which we had maybe one of the best quarters in our whole history, which had the World Cup with a campaign, a successful campaign and in this quarter we showed 1 million TVs, more TVs, over 20% market share at the time. So it was a big challenge to grow at Chinese levels on a very strong comparison basis as the second quarter of '18.

And the strategic pillars of this new cycle are, as we have been saying in our cause, as well as in the last two calls, Chinese growth, mainly in active clients and frequency of purchases, both of Marketplace and those services rendered to the sellers, which is the second pillar. Both in our client base and the app, we are focusing a lot on our app as a universal remote control, as a center for universal control of this platform, which is our super app.

And very good evolution. They are new categories, fast delivery, efficient delivery. Besides the best level of service and retail and a very strong work on big data as well, which are the pillars that we mentioned at the beginning of the year. And in this quarter we delivered in all fronts. We will be talking about some figures in order to evidence this delivery and to make the delivery more tangible to you.

But I would like to stress two relevant points in this delivery, which are Marketplace, the second pillar of our strategy that our core platform, but it goes much beyond because it has to do with taking your whole infrastructure and deliver this as service to sellers. And this is a construction that is achieved in the long run, but we have already had significant deliveries and we are growing the number of sellers and sales. And this was really brilliant, outperformance and it was even beyond our internal or in-house expectations.

And new categories is the second one, most of the time of our executives and my time was invested here in order for us to conclude, one of the most emblematic acquisition in our history, which was Netshoes, and it was fundamental for us because we have 70 years

of history in one specific category to really get into this business as a new category and do a very strategic move such as the conclusion of the Netshoes acquisition.

It was a very competitive process, a very complex one, because it involved a company that was built in Cayman, listed in New York and operating in Brazil. So you can imagine one of the most complex deals and totally complex deal and it took quite a lot of our time. And it started in the first quarter, but April, May and June were taken and Marcio [ph] and the whole team of Netshoes, they worked very hard in this process in this quarter.

So we delivered on these fronts and I will start the presentation on Page number 3 now with the first pillar of our new strategic cycle. Our client base already incorporating Netshoes client. We have about 10 days of Netshoes balance sheets, but already incorporating the client base of Netshoes. We have 22 million active customers in our base, 53% increase vis-a-vis 2Q '18 and even without Netshoes, it would be a 30% increase. A very sound one. And the comparison base had the World Cup.

And in spite of that, we had a growth of 20% vis-a-vis the previous year. And we are focusing on fairly lower average ticket products as well because it's important for us to increase the number and the frequency of clients. And with the growth of Marketplace and exponential growth, we were able to evolve the client indicators at the same time. This is a huge challenge, as you have less control over this base than on your own.

So the RA1000 seal in the Reclame Aqui. We do not separate e-commerce from Marketplace. We contemplate both in the same mitigator and most of our competitors separate 1P from 3P. 25% of our total sales is Marketplace and e-commerce, but we kept them together here in this analysis, and we evolved, for instance, the growth of 23% in first call resolution in our call center. A significant reduction of Procon complaints and civil complaints as well. So a very significant evolution in all fronts.

And physical stores and e-commerce and also a very positive NPS for -- well, not at 1P level, but higher than our expectations, original expectations and growing. So, client indicator, satisfaction indices that are very important for the compensation of our team. All this evolved quite a lot in the last quarter.

E-commerce specifically had a significant growth in the client base. The MAU of the super app with the Netshoes base, which has a very high monthly frequency, which is the monthly average users, MAU, reached 12 million in this quarter. In recently, we had three apps among the top three of the most downloaded ones, Netshoes, Magalu. Last week, we did the net app in all our apps, so we have three of the top 10 apps in Brazil in terms of downloading, Netshoes and Magalu continue this week as well showing the strength of the combination of these companies.

And I would like to highlight the logistics work of Magalu. We got to an indicator of 40% of deliveries being last mile deliveries. That is to say, in a couple of days in the consumers home. If you consider the click and collect, we are talking about 70%, 75% of deliveries of Magalu today being carried out in up to two days. And these numbers are already compatible with US operations and Chinese operations.

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And most of these deliveries we are already doing in one day, in up to one day because of a huge endeavor made by our whole logistics team and with the acquisition of our Uber like deliveries, Logbee and helped us to have those participation and we already deliver in over 100 cities. And another highlight, 10% of all the products sold by e-commerce they are done by e-commerce, but they use the brick and mortar stores' inventories. We have been talking about that and conventional stores instead of distribution centers. And we want to make this available and roll this out as much as possible to Netshoes, ship from store and click and collect.

So we are evolving in e-commerce and one of the main highlights of the app and the logistics level that is much higher than the market average due to the fact that we work with our own network, driven by Logbee now.

And undoubtedly the major highlight in the quarter was Marketplace. And as I said before, it was higher than the market expectation and higher than our own in-house expectations, 289% growth year-on-year. And I would like to remind you that it took us over 40 years to reach BRL1 billion in 1P and in Marketplace less than two years to reach BRL1 billion. So it's an exponential growth in a way that we have never had before in our history, 583 million GMV.

And one thing that we mentioned in our message, 100% of our sales with issue of invoices, 100% of transactions have invoice system. So we do not encourage informal activities and we have much more control over all those actions and they are much more formal nowadays and much more formal than we see as the pattern in the market. So we believe that there will be a very strong regulatory initiative and operators will have to sell original products and will have to take care with their quality of service. So our growth is not based on informal "operations" or non-original products.

And as I said before, we are talking about over 8,100 sellers that play according to the rules of the game and we want to stimulate sellers that do not have any informal operations because we believe that this is the only way a company can grow in an organized country such as is the case of Brazil. What we are trying to do in Brazil and at every two client, one buys at the marketplace, growing a lot in lower ticket product and this helps e-commerce to gain new clients.

And I would like to mention also our brick-and-mortar stores, we did a lot of work in this quarter because the exchange of TV was a very big highlight and 27% same store sales driven by these promotions that happened. And the focus was on physical stores. If we exclude the TV or smart TV line, in spite of that, we were able to grow at double digits, not 10% in this quarter, excluding one category, which is smart TVs and all the other categories grew and we already see our physical stores with a strong base in the third quarter. So the level is already similar to the other quarters in July and August and we expect to publish these figures at the end of the third quarter.

But it was a great work. We grew 20% our active client base, and I would like to highlight the quality and the sales higher than expected in the stores that were opened last year in Maranhao, which has all the stores that we opened in other states and very big success

and sales higher than our forecast for these stores that were opened in the last 12 months. So a very good job done. We are very successful in these new markets and we are about to get into Para, as has already been announced and very encouraged with the state as well as Mato Grosso and Brasília.

And we will be opening stores by the end of this year. So we are very much enthusiastic with the expansion of our physical stores and the remodeling that is being done in the stores. We launched the Smartphoniza Brasil, the exchange of smartphones, and we give a certain amount for the exchange of your mobile phone, your smartphone. And we launched this campaign at the end of May. So now we're in the third quarter, it will be three months as a comparison page and a very successful campaign, as successful as the other one that we did last year in which we exchanged smart TVs. And now we are exchanging smartphones. And this buyback system was not popular in Brazil before. And these benefits our physical stores as well, because people come and they exchange and it's frictionless.

Now, let's talk about Luizacred. We continue to grow significantly our financial operation 50% in the second quarter, credit portfolio 44% year on year, almost BRL10 billion. It's already the biggest independent consumer finance company in the market in terms of credit portfolio. The Luiza card base grew 24%, reaching 4.6 million in 2Q '19. We are selling the Luiza Card also by Internet and the Netshoes card also with a very good performance. And the highlight here is that our card is co-branded, issued by a JV with Itau, it's a MasterCard Luiza. And the frequency of use the Magazine Luiza card is 7 times per month. So this is a very strong figure. And it shows that it's the first card for most of the clients and they use not only inside Magazine Luiza, but they use the card very often in supermarkets and drugstores, et cetera. Sales outside Magalu represent 75%.

Netshoes, we have a ready highlighted the strategy. And Eduardo and Marcio will be available to you to talk about integration. Marcio will be talking about the situation in Netshoes. We cannot talk about quantities, we can talk about quality, quantitatively no, but qualitatively okay.

Now I give the floor to Roberto. And then I will be opening for the Q&A.

Roberto Bellissimo Rodrigues {BIO 17269312 <GO>}

Good morning, everybody. Starting with the highlights of our results, total sales growing by 24% on the 43% base, very strong, reaching BRL5.7 billion. We have already talked about the sales in Marketplace, e-commerce, in gross profit. Marketplace very, very strongly and giving already a very good competition, and the gross margin dropping 0.8 percentage because of the end of May operating expenses, we kept at the same level around 22% of our net revenue in spite of an increase in the level of service and the acquisition of new clients and services, and faster logistics.

With that, we were able to deliver an EBITDA of BRL304 million, 7.2% margin, a pro forma net income of BRL108 million, 22.6% [ph]. Operating cash generation from operations continues to be very strong, BRL700 million, ROIC 17%, and 23% in the last 12 months. We

continue to have a strong return and very good cash generation at the same time. And we closed the quarter with adjusted net cash BRL800 million, even considering all the investments made in the acquisition of Netshoes and the payment of the Netshoes debt and the net cash position of BRL2 billion, based on receivables from credit cards as well.

And then we show the evolution of the user base. Fred has already referred to this. It's growing. Number of stores, over 100 stores opened in the last 12 months, with 27, 28 in the last quarter, with a Shoestock store and opening about 50 new stores in this half year with the Para State coming on board. We are increasing our investments according to our strategic plans, over BRL200 million in first quarter.

Highlighting technology and logistics that are the fastest growth areas. Then we go to sales performance once again, accumulated 26% growth vis-a-vis the market of around 3%, so an extremely high market share gain. In e-commerce, 56% growth in the quarter vis-a-vis the market -- much higher than the market. And Marketplace reaching BRL1 billion already in this quarter and total e-commerce by almost BRL5 billion in this quarter with just a few days of integrated operation with Netshoes.

Then we show the evolution of our expenses from 21.7% to 22%, a small variation and totally in line with the strategy of increasing our level of service, the Luiza Card, the app and the focus on our clients.

Equity income from BRL10 million to minus BRL3 million, basically because of Luizacred and will be because of the IFRS 9 and BRGAAP, but with a good result, BRL35 million in the quarter.

Now, the EBITDA margin going from 8.5% to 7.2%. And with the non-recurrent effects, IFRS 16, they were positive and the total EBITDA margin was 8.8%. Financial results, from 2% to 2.3% financial expenses, basically due to the growth of sales via Cartao Luiza. In line with our growth strategy for Luizacred, working capital continues to have a very good performance in the quarter. It continues to be negative by BRL600 million.

Inventory turnover very well balanced, around 72 days, very much similar to the same quarter last year and 92 days similar to the third quarter of last year. So this variation in our cash position is totally related to the acquisition of Netshoes, as I said before. And then we give you more details in this breakdown of our cash flow and the total cash position. Once again, we maintained practically BRL1.9 billion, almost BRL2 billion in total cash, with cash generation, all the investment that we mentioned, including the acquisitions as (inaudible) last year and Netshoes this quarter.

So the net income was BRL231 million pro forma in this quarter, BRL108 million in the quarter considering in IFRS, it would be BRL130 million the pro forma Luiza. And talking about Louisa continues to grow very consistently, reaching 4.6 million cards, almost 600,000 downloads of the app, expense BRL6.4 million Luiza Card growing over 30%.

And the net revenue of Luizacred has been growing consistently, and in this quarter we had most of the growth of the net revenue in the last five years. So, growth of over 50%

year-on-year. And also because of that, the efficiency ratio has been improving quite a lot from 46% to 40% in this quarter, one of the lowest ever level of operating expenses in the last few years and with a downward trend, together with growth in our sales.

And still talking about the Luizacred, we talk about the evolution of the portfolio. The over 90 days past due went back to the level of two years ago, basically because we have many more new clients than we had a couple of years ago or one year ago even. And as you know, the new clients usually have 10% compared to the older clients. 7%. And today our portfolio has much more new clients than two years ago.

So delinquency continues -- we continue to have a very good expectation with these new clients and short term delinquency, very low. 3.2%, very much under control, and coverage ratio 78% of the portfolio. So with that Luizacred had BRL8 million in net loss in IFRS, to very high provisions, also due to limits granted to the best clients in our portfolio. There was a rise in provision because of the IFRS 9. So we expect to have a very good result for the full year.

So, these were the main remarks that I had regarding the financials of Magazine Luiza. So, I will give the floor back to Frederico.

Frederico Trajano Inacio Rodrigues {BIO 17269235 <GO>}

Before opening for the Q&A, I would like to give you a highlight about the third and fourth quarters that we are starting. We will still have a very strong comparison base in the third and the fourth quarters, but it will not be like the second quarter. So I believe that this will be reflected in our growth indicators for the third quarter and the fourth quarter as well. In the fourth quarter, we had an exceptional Black Friday and we intend to continue now to plan our Black Friday so that it may be very strong in the fourth quarter.

I would like to make a highlight, a winning team has to be very good, everybody, and we have very good players in our legal department and a big gain regarding the intermittent employees. This was a new legislation that was enacted and there was dispute and we had some defeat in the first level, the first court, the lower court and our team was excellent as well as our legal advisors and everybody in retail was turning their eyes to us because they all have intermittent workers, intermittent employees. So this was a big victory on our part and on the part of -- labor legislation show that we continue to have the right people that we need them at the peak of retail.

And we continue to grow along the marketplace team and all the old lads [ph] and with a team of Netshoes, we have over 1000 people in four different locations, Sao Paulo, Franca, Uberlandia and San Carlos. So, we need to have these four locations because we dilute the risk, because I feel not only at the lab, but well the economy is not growing still. But the labor market is growing and our professionals, our leaders are being contacted by many people. And we wanted to set up a very robust team for the long run.

We have over 50,000 people, 250 people in Magalu are partners of Magalu. We have already attributed shares of Magalu to the main leaders of Netshoes and we want to go

more in-depth in this program and considering other levels and to be contemplated by the program. And we had only just a handful of people leaving the Company during these months.

We have almost 40 Directors of Magalu, 15 in Netshoes that we maintain. We want to count on them so we kept the team and they are important for our development, for our growth. And so this was a very big concern on my part and we are very well protected now. I don't mean that there will be a few changes, but we are very well protected.

And I would like to highlight the integration for Netshoes. We started and the officers of Netshoes will be talking about that. In the second half year, we will be planning this. And the heavier systems integration will be after Black Friday and the end of the year. It wouldn't be prudent to accelerate this. And there are many things that they will be talking about during the Q&A. So now we would like to open for questions.

Questions And Answers

Operator

(Operator Instruction) Our first question comes from Robert Ford from Bank of America.

Q - Robert Erick Ford Aguilar {BIO 1499021 <GO>}

Good morning. Congratulations. Thank you for the question. Could you talk about the changes being carried out in the 1P inventory?

A - Unidentified Speaker

Good morning. We made provisions for the sale that we will be doing in the second half in order to sell the products that have a slow turnover. We want to accelerate the turnover of our inventories and the turnover is already good. It has always been good. That is to say, 60, 70 days, but we want to have more campaigns in the second half for these goods that have a slower turnover. So this was a provision that we built for that specific purpose with the objective of moving these products faster from now on. I don't understand the second part of your question. You talked about changes in the assortment. What was your question?

Q - Unidentified Participant

Your use of technology in order to optimize your inventory situation?

A - Unidentified Speaker

Well, there are many fronts of technology here. They are proprietary algorithms that we are creating to forecast demand and we also use external information, Google and other kinds of information for a forecast and also the assortment and the forecast of demand. And for the stores, we use information from our website, searches for products. And we are being more assertive in this assortment. And the algorithms of replenishing and the process of replenishing is more and more automated, no human factor, involved. So most

of these algorithms are very recent. They were developed with a commercial team and the e-commerce people and the labs team and the physical store team. And at the lab, we have a team fully devoted to that. Because of that, we believe that, well, we will take advantage of these sales, special sales. And we have one holiday coming in September, and we want to use this provision made in order to move these products in a more assertive fashion than in the previous model.

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Q - Robert Erick Ford Aguilar {BIO 1499021 <GO>}

Thank you, Fred. Growth in credit continues to be high, provisioning even higher. How do you think about Luizacred and the sustainability of the growth rates that you have today?

Luizacred has a very specific factor. All the consumer finance companies are under IFRS 9 now, which is a different accounting method than the Brazilian GAAP.

It's another model. And the IFRS 9 is a peculiarity, so to say, and we and Carrefour and everybody, or a company or a retail company that has a consumer finance company has to follow this model. So it has to do with the provision. It anticipates or brings forward long-term provisions. And the disadvantage is that when you grow a lot, you have to make a lot of provision, but when you project the result to two, four, five years, you see that in the third, fourth year, your income will be much higher. So no surprises there. So from the viewpoint of our projections, the future results are very healthy.

And as we said at the beginning of the year, this is a strategic definition. We want to grow even if it comes to the detriment of the short term. We want to grow our portfolio, 40%, 50%, not very much concerned with the results of the fourth quarter being affected because this is only an accounting factor. And if you analyze our results, the results of Luizacred is very sound. And the EBITDA margin could be better, but I will continue to grow our client base because this increases loyalty and frequency. And I'm not going to stop doing that because of the short-term results.

So we're very happy with that, and Itau is very much enthusiastic about this operation. They even want to accelerate this further. So we will continue to grow at Chinese pace in all products and services that we are selling through Luizacred. And also the digitalization of Luizacred, the app of Luiza is one of the biggest downloads of financial apps. Over 600 million clients are using this app, and with a very strong in the process of sale of cards in the stores as well.

So Luizacred is becoming more and more digital. And this will help us to continue to have our clients using the Luiza Card as their main -- we are talking about preapproved clients. They are old clients, whose activation is improving the portfolio. The frequency is improving as well, and operating expenses are improving. We are improving the efficiency of Luizacred. This is just a temporary situation and it is just an accounting point.

Operator

Joseph Giordano, JPMorgan.

Q - Joseph Giordano {BIO 17751061 <GO>}

Good morning. Some qualitative questions here regarding Netshoes. I would like to understand in the short run which are the main measures regarding the gross margin of 1P of Netshoes and understand also the relationship with suppliers during this process in which there was a sensitive financial situation. And when we think about Black Friday and Christmas, maybe this is the focus for Netshoes, could we think about driving Netshoes in the Magalu, the Luiza network?

And now about Magazine Luiza, you said about investments in new clients. When we look at Magalu, will we continue to see investments emerge in improvement in logistics and in Luizacred, you have the app in order to do the card, but I would like to know why this is not integrated into the super app of Magalu yet?

A - Unidentified Speaker

Thank you for the question. And the first one will be answered by Marcio. He will be talking qualitatively.

Q - Unidentified Participant

Thank you for the question. I will give you a general overview here. I would like to mention that Netshoes Brazil came to Magalu. Netshoes Brazil, we had some other M&As before the M&A in Brazil and Magalu acquired the business units that were more mature and more profitable of Netshoes, mainly sports and fashion. And secondly, and most importantly, we gained this confidence during our negotiations and we saw that the cultures of the companies were very similar and we were very well received by the Magalu executives and that very quickly got into a Chinese rate growth together with Magalu.

And the other step that was given by Magalu was the payment of net debt. And trust, of course, was very quick to come. You have payment of the debt, a favorable environment in the process, that was very tough during April, May and June and very quickly, Net came back, and we were working in two great fronts. One is the integration. We have four areas focused: operations, technology, back office and businesses. And focusing on a super planning for 2020 is systemic execution -- systems execution. But we can already reap some fruits because we have expenses more under control. Our base is smaller and everything was published in our last releases. So the work of integration is being done. The two teams together with a consultancy company focusing on the full systems integration as of 2020.

And on the other hand, thinking about the business acceleration, Net had already the level of suppliers. We have a 100% of the base already understanding this moment and the inventory level of Net continues to be under control. And I would say just that the best moment we have never had before in our recent history of Net, such a wonderful level of inventory. And with that, we resumed our growth pace and of course, a lot remains to be done. And we have a joint campaign with Magalu. And as Fred said, 22 million clients, we're already working on this client base together. And everything is okay with our

suppliers. The inventories are under control, at excellent levels and we have already resumed a very good pace, higher than the market, 10%.

In a very friendly environment, building things together from now on. Would you like -- well, some highlights about integration. We divided this into three stages. The stage one was the zero moment. And with a very clear communication, a second stage, in which we're capturing -- coming from negotiations of contracts and understanding of the back office structures and we have a team that is supporting us. Also, tapping into joint business opportunities and the Black App is very important. It was done hand in hand with Netshoes and with very good results here in the last few days. And we are also focused on designing very clearly and detailedly, the coming together of the two companies operations, logistics and customer service.

Regarding the use of the Luiza Network for Netshoes during the Black Friday, probably not, because it requires a lot of systems integration and we don't want to risk anything at this important moment. But execution will happen in early January and as soon as possible during 2020.

A - Unidentified Speaker

I would like to add that we have one characteristic when we do acquisitions. The best process must prevail. We want to tap in to Net's advantages as a whole. We have a long haul work like a aircraft that we didn't have, the transfer of goods from one side to another. They have last mile in some city, some even better than ours. All the automation is more developed than in our case. So, they have quite a lot of things. And it's important for us to learn from them as well and choose the best process, if the best process in a certain area is Magalu's, this one will remain, and likewise Net and Magalu.

Regarding investment and clients et cetera, our focus has been very strong in service level, mainly in express delivery. And we need investment because we are increasing our major DCs and their inventories and expanding to other cities, the number of people who work in DCs. And we are making a lot of investments in automation. And we're focusing our investments in as H&A. It's more an effect of the Lei do Bem, the effect on our gross margin.

We are not traditionally aggressive price wise, but we simply did not transfer this. It was a strategic decision. Our investment is very strong in our client service and we invest a lot of in order to grow our client base, mainly in the app and also the Luizacred client. Investments in terms of awards given to employees to sell the card, et cetera, because the app -- because GMV is higher and it's an intelligent investment in the long run, not in the short run.

So, what interests us is the future frequency of use, not only in our client -- not only the size of our client base, but also their frequency. And the super app integrates now the Netshoes catalog, and (inaudible) catalog. And the sellers of Marketplace are coming on board with new products and we are very much focused on the #netmagalu, to have a wider category array in financial services and cards will be added to the process of the app. Our app is a shopping app. And the other ancillary services will help the daily

frequency of use and the monthly frequency of use, but our objective is to have the best shopping app in Brazil. And you cannot do everything at the same time.

Q - Joseph Giordano {BIO 17751061 <GO>}

Thank you very much.

Operator

Richard Cathcart from Bradesco.

Q - Richard Cathcart {BIO 16457807 <GO>}

I have two questions. What is the speed of your -- speed to sellers across base [ph], the cross docking? Are you going to roll this out to all sellers? And the second question, would you talk about the dynamics of Marketplace vis-a-vis the 1P operation of Magalu? The growth of Marketplace, is it totally incremental or is there some cannibalization level from 1P to 3P?

A - Unidentified Speaker

The first question -- well, good morning. Thank you for the question. We are focusing now Magalu Intgras -- Magalu deliveries in a more standard operation where you use the carriers in the market and not the Luiza network. So this is a big systems development to integrate the delivery of third parties in to Magazine Luiza's Network. We started with Logbee, which has already had very good participation. We want to roll this out, including the click and collect over to net support. I am not giving you any guidance or mentioning any quarter, but what I can say is that this is one of the main targets of the lab people, the business people and the logistics people shared by some people in our brick and mortar stores. This is a very big target, important one.

We have a very big participation of express delivery of 1P, and we cannot deliver this yet to 3P, and this will be the big difference for Magazine Luiza in the next few years. This is very complex because we have to create a different legal entity in logistics in order to operate this. We have already done this. But over the next few quarters, I will be able to talk about the progress in this area.

A - Eduardo Galanternick {BIO 20410320 <GO>}

Thank you for the question. This is Eduardo. Regarding 1P and 3P, naturally, what we expect is to implement not only the number of categories and products, but also in the categories that we operate in the long tail. This is what we have been seeing in the last few years, so much so that in 1P we continue to have a very sound growth, and say that there is no cannibalization. Well, I cannot guarantee this to you, but we try to deal with that in order to minimize any degree of cannibalization focusing mainly on distribution and products and lines that are more complementary and the sales coming from these increments.

Q - Richard Cathcart {BIO 16457807 <GO>}

Perfect. Thank you very much.

Operator

Luiz Felipe Guanais, BTG Pactual.

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

Good morning, everyone, I have two questions. One has to do with new clients in the platform. Could you give us some more color, Fred, about how many of these clients that go directly to market base? And still along these lines, do you already see any cross-selling among the clients that come to the Netshoes platform and those who buy 1P and 3P from Magazine Luiza?

And another question about logistics. You said that Magalu Interras is already delivering to 60% of sellers on the platform. So what is the penetration of Logbee for these same sellers right now?

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

Well, first, regarding Magalu Integras, of these 60%, we have two modalities. 25% already go through our network, and growing. Growing because of the expansion of Logbee. In relation to cross-sell between Net and Magalu, we started by analyzing the bases said we identified, what part is common to both and we are working on our business plan and how to do this legally in order to tap into a better results. And this is still in an embryonic phase. And new clients, we have the participation of new clients in the Marketplace. And in the beginning, Marketplace was working for recurrent clients, and this has already changed. We have already had new clients, a higher number than we have in 1P. So overall...

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

Thank you very much.

A - Unidentified Speaker

22 million are the single client. That is to say, we did not include the repeat clients. So this base is already clean and this already gives you the very good perspective.

Operator

Ruben Couto from Santander.

Q - Ruben Couto {BIO 20636571 <GO>}

Going back to investments in new clients, can you give us some color about marketing expenses and your selling expenses? How much of your marketing expenses is divided between online et cetera? Could you compare the marketing activities of Luiza and Netshoes?

A - Unidentified Speaker

Today, over half of our marketing investment is online because the online base is growing a lot. We have contacts with Telso [ph] in commercial TV. We have contracts with Baisa and Paru [ph]. We are very strong in online, growing proportionally, but brick-and-mortar store stores capturing more of this participation, but online. And this number is stable in spite of this growth. We are not -- it is not diluting because we keep a very good focus. Marketing investment in order to increase sales, but it's different from the marketing ROI return on investment.

We are focusing on client base and we have to further integrate this in terms of our marketing decisions. But to bring new clients to our base and it's very difficult to compare because they come from another category. And in fashion, for instance, it is higher than electronics, the consumer electronics or home appliance. So you cannot really make a comparison here, but their catalog is already in Magalu. This will be generating sales and we are going to improve our algorithms, And we are going to increase their sales. So this will generate many new clients for Netshoes, but our consumer electronics and home appliances have a higher ROI. So there will be a cross selling between the platforms and not really increase investments in Netshoes.

Well, I believe we will accelerate investments there, yes. In the last year Netshoes decreased investments in marketing because of cash situation. And there was a very good campaign for the marathon and the Black App, and full banner in Wow [ph] et cetera. So it was great to see Netshoes back and deliver sales through these media. But you don't have to do one to the detriment of the other.

We want to grow at Chinese levels based on synergy, then also standalone and the channels. But of course, we want to get new clients. We have 22 million clients, and 150 million consumers that are active. So we still have a lot to include in our base. We only have 2% of the online/offline retail in Brazil. It was 15% durables and online/offline retails, as I mentioned. So we have a lot of room to gain space and we have a huge avenue for growth and we will tap into that, because our focus, the focus of Magalu for the next two years is growth. And I will be repeating this all the time during the next few quarters. This is our top priority, growth.

Operator

Thiago Bertolucci, Goldman Sachs.

Q - Thiago Bertolucci

Good morning, everyone. We have three questions. Non-recurring volumes in the quarter, could you talk about this? There is some tax effect there. And how could we think about the evolution of this line for the year? The second has to do with Netshoes. Could you give us an update about the model of store that you are thinking? And In the opening remarks, Fred talked about the regulation that he sees coming in the future regarding informal operations. So what do you see there, and how this shift could materialize over the next few months?

A - Unidentified Speaker

Good morning, Thiago. First, the non-recurrent. So they are non-recurrent. So there is nothing to be said about that for the next two quarters and the main thing is the tax credit that is related to winning a suit, excluding the ICMS from the calculation base of the PIS and COFINS taxes. We had a gain of about BRL1 billion in those lines, and we talked about the provision and tax expenses and compensation regarding these gains. Expenses regard the acquisition very complex. Involving foreign lawyers and Brazilian lawyers and banks and auditors, et cetera. So, expenses related to the acquisition, and some result of Netshoes in these 14, 15 days. And in this case, we left this out of the result because otherwise we wouldn't be able to compare this to the second quarter '18.

So these were the main effects and the adjustments in the financial results line. And some non-recurring effects, the tax effect -- tax credits were restated, so the restatement of these credits is included in the BRL1 million that I mentioned posted to the financial revenues line and the PIS and COFINS central themes that I mentioned. So there is financial expenses related to the acquisition, mainly swap and hedge operations that are in US dollars, and the pre-payment of cards that in order to pay the debt, 14th of June, at the closing day and other smaller expenses.

And the tax effect on all that between positive and negative, this BRL281 million positive for the total results of the company. But they are non-recurring events. And we published our results focused on the recurrent result. And of course, they are non recurrent events, they are positive -- these tax credits will become cash over the next couple of years or three years, so there is a positive impact on our cash and in terms of cash generation for the next few quarters as well.

About the regulatory risk when we launched Marketplace, we made the decision of anticipating any regulatory risk because we believed there would be a huge volume in terms of revenues in Brazil with a very high penetration in the total transactions carried out by the Brazilian. Retail, online and offline, you see all the marketplace operations growing a lot, and we thought that most probably governments, the authorities and regulatory agencies would not accept for a long time operations that didn't have control over the sellers in terms of their issuing an invoice or not. So obliging them to issue the nota fiscal or the invoice and demand the sellers to be formal in all of their operations.

So I do not have any privileged information about that. There is a lot of debate going on at the level of many agencies that deal with tax collection. We are talking here about the executive branch and the judicial branch as well. And this is going to be more. This will be increasing over time because Marketplace is growing a lot. And the agencies, the regulatory agencies will not allow this.

Amazon until a while ago, did not collect that tax in the US, it became too big and the state saw that and now they are obliged to collect this tax. And in the US, you know that this situation is not very easy. And this happened around 2011, 2012. And more than doubling the net.

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In Brazil, we will see a similar situation and in Magazine Luiza we wanted to set up an operation already imagining that this regulation will be coming and being proactive in this regard. So we do not want to be worried about that in the future.

Should this regulation come, we will be ready and we will have a structure already prepared for that. And besides regulations, it has to do with ethics. So it would not be ethical for you to offer products that are being put on your platform by smugglers or by people who do not pay the due taxes. We have always grown being a very formal company, paying all the taxes and only offering products that are from ethical companies, so to speak. And our Board would not ever let us do anything differently regardless of any legislation.

About Net, the main focus is that we will become a super seller together with Magalu. Integrations will start next year, as we said, but the ones that we already have in our hands, we're already executing. So our focus is to accelerate and place Net in a position such as it had in the past and strategically, we will be discussing new business models, new stores, new possibilities. But now we are reaping the fruits of what we have in our hand, the integration that already exists between Magalu and sellers.

Operator

The Q&A session comes to an end. I would like to give the floor back to Mr. Frederico Trajano for his closing remarks.

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

Once again, thank you very much for participating in the call. Magazine Luiza's call comes to an end. Thank you very much for participating. Have a good day.

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