

## Q1 2018 Earnings Call

### Company Participants

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

### Other Participants

- Fabio Monteiro, Analyst
- Guilherme Assis, Analyst
- Joseph Giordano, Analyst
- Maria Paula Cantusio, Analyst
- Richard Cathcart, Analyst
- Tobias Stingelin, Analyst
- Unidentified Participant

### Presentation

#### Operator

Good morning, ladies and gentlemen and thank you for waiting. Welcome to Magazine Luiza's First Quarter of 2018 Earnings Conference Call. At this time, all participants are connected in listen-only mode. Afterwards, we will have a question-and answer-session, when further instructions for you to participate will be given. (Operator Instructions).

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

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

Good morning, everyone. Thank you very much for participating in our earnings conference call. I'm here practically with the whole Executive Committee of the company and they will all be available to answer your questions at the end of our introduction. I would like to start by talking about the first quarter a few words, and then Roberto will be getting into details about that.

I think the result come from three main aspects. We had a very positive first quarter because of these three aspects. And the first one is the business model that has been very much proven after all these quarters with consistent results, positive results. So this is

the model that we call physical presence and human touch platform, we are already reaping some fruit especially in this quarter coming from the seed that we planted over the last 17 years and the last 2 years implementing our strategy for digital transformation.

So this is the business model that has been very successful and it is really a structural aspect, which means that it will continue to bear fruit. It's not (inaudible) in the multichannel model of a digital platform in marketplace and multichannel. It's a model that we believe is the most adequate in order to work with the Brazilian economic, the traders especially retail and e-commerce. This is a winning model for us to grow and also tap into the opportunities of e-commerce towards profitability.

And the second point, I would like to mention is the first line execution by our team. We had very good result in all departments, in all units of the company and our team exceeded the very high level that they had already before in terms of the focus and energy that they had last year. In the last call, I said that, I reinforce this. The biggest competitor of Magazine Luiza this quarter is Magazine Luiza's performance last quarter showed the execution of this team makes me very happy and all areas in the company had a medium performance. Everybody really exceeded in delivering their indicators, their objectives and this execution brought about this result.

And the third one, although it's not as heavy as the other one is, although lower than the initial expectations that we had at the end of last year, the economic scenario. While we did improve in fact, but below our expectations than the market expectations. But I really have to say that inflation is lower, interest rates are lower, so there is more confidence on the part of consumers vis-a-vis the previous quarters. And more important to our business is higher credit supply and our sector is discretionary, although we have many other categories in our platform, we still have a very big weight of the discretionary categories, which are very much impacted by the economy. When you have a slowdown in the economy, we are impacted more than the average of retail, and likewise the opposite is true. So this economic cycle now tends to be more positive for our kind of retail than other kinds of retail because we are still -- while we have a high participation of high ticket products and high value and related to credit, okay.

So having said that and afterwards Roberto will get into detail about the first quarter and the results, I would like to reinforce the message that I had already given you in our last call and also we gave the same message in the release of this quarter, which is the following. Our focus for the year is to -- well it's a new strategic pillars and it is more focused on the significant increase and the improvements in the level of service delivered to our clients. And as a consequence, a significant increase in the active client base that we have. We will start to adopt a group of 20 indicators in our incentive plan with targets that are very challenging. In this direction, that is to say, in order to improve the service of level that we deliver to our clients, so this is not just words, it's fact and also increasing the base of active clients of the company.

So improving indicators like NPS, which is a universal indicator for satisfaction vis-a-vis the clients experience with their shopping activities or the clients experience with the product itself or the service. So we're very expressive and increasing NPS. And from logistics viewpoint, the percentage of product delivered in up to 48 hours, we have to increase

significantly the number of products that we deliver in up to 48 hours. So you know that this is much, much shorter than the average of our competitors and bringing this experience to international levels in terms of delivery terms and Brazil is lagging behind and we really want to push this forward and give this to Brazilian consumers.

Of course, deliveries on-time -- on-time deliveries and our logistics in Brazil are not very much based on IT, but we will get into details about that because we are going to increase the number of products delivered on-time and significantly increase. And also the new clients and clients that come back show focusing on the active client base and not total GMV, because this perceives [ph] GMV in fact as an indicator. And when we talk about the active client base, we talk about the total value on the client brought to present value and not the standard of the industry. So it's a more sophisticated calculation and we will be talking about that later if you wish.

Other indicators, more specific ones are physical resolution and the call center facility to exchange and cancel orders, level of satisfaction. A group of 20 indicators that we calculated and that obviously have very high targets. And this was established from the CEO of the company and this has to be delivered from the CEO down to our field people and putting a higher weight on the incentive model that we have in place.

And as we said, we calculated and we spent a lot of time in the first quarter defining trade offs, so that we may reach and deliver all these improvements in service level. You cannot make a normal at the -- without breaking your egg. So we will be investing in better technologies and the call center, more people in the stores by means of the intermittent modality. So we will be making investments and we calculated very carefully with a strategic consultancy service in order to make investments not destroying value in the long run. Although, there might be some trade-offs in the short run and we will be getting into that without giving you a (Technical Difficulty).

We are informing the market that we will be making investors [ph] very much focused on activation of clients, calculating how much we will be investing in each area to reach these goals and a more intensive implementation, as of the second quarter and also, the second half of the year. The fact that we calculated very carefully and with the support -- well with a lot of support to see if these investments would be bringing value to our shareholders. This makes us very comfortable in the sense that we will be -- intensify the investments as of this quarter.

I would like to mention a few just to tell you. The acquisition of Logbee is another one that will be materialized in the second half and Decio Sonohara, Logistics Officer will be talking more specific about that. But the focus today, it already delivers much of our deliveries and this is a platform that we use to deliver up to 48 hours, especially in Sao Paulo. So responsible for 90% of deliveries in Sao Paulo and we -- we will be rolling this out to other places as well with this acquisition. This is a very good example of investment in the sense of improving the indicators.

And secondly, the expansion of our physical presence in important market, where we have no presence almost (inaudible), so Fabricio will be here at the end of the

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presentation to clarify this further. And I would like to remind you that the expansion of brick and mortar stores not only helped us increase our client base, but also helped our e-commerce market that had no option of the in-store pick up, now they will have this opportunity with the presence of our brick and mortar stores. So this benefits e-commerce as well. So this is a virtual cycle in fact and we are intensifying our investments in brick and mortar stores, and then readaptive [ph] of the existing stores in order to give a good level of service with our project of stores being like a mini distribution centers and Fabricio will be talking about that. We inaugurated two last week, and we are going to roll this out to an additional 100 stores. So we can also talk about that, but this is further investment being made in the same strategic cycle that we are intensifying.

And I would like to say that we have the expansion of marketplace that was very healthy. We have been reporting this ever since the last quarter of last year. So a very expressive growth. But I would like to add that we don't focus only on GMV. Although, this is the figure that the market tracks, but this helps us in one of the main indicators of this strategic [ph], which is the active client base and categories that have a higher frequency of purchase, they are more recurrent and this is a niche that we must address here in order to be able to reach the goal of doubling the active client base in the next two years to three years.

So marketplace undoubtedly is fundamental for this purpose. And so in our strategic purpose, this is not just GMV that is important, but it's important to make clients more active and make Magazine Luiza more relevant to our clients in their daily purchases because the frequency used to be low because of the high ticket. So the marketplace has a very big importance in this strategy. And I would like to remind you that we will not weigh service level because of that.

Today, we are the only company with RA 1000, then the Brazilian e-commerce and putting together the experiences of 1P and 3P, so this shows that we want to deliver the same level of service in 3P that we have in 1P and this is not just words. We have many initiatives in-house in order to increase the number of sellers in our base and so that they also have the level of service that we have been delivering the last 60 years to our clients.

So in this context, I would like to highlight that the first quarter already reflect all the work done so far and a better visualization of what we will be doing will be perceived over the next few quarters. And we are very much pleased with the results obtained so far with the validation of the model, with our performance, but we are still far from being comfortable.

We are already channeling our efforts and our energy to what we believe will give a higher sustainability to our business in the long run, which is to make our clients extremely happy and gaining a higher share in the Brazilian consumers, we only have 10% of the total Brazilian consumers. So we have a lot of room to grow and to increase this number and our relevance in the Brazilian consumer product scenario online and offline as well.

So now, I would like to turn the floor over to Roberto to talk about the indicators for the first quarter, then Decio will be talking about the acquisition of Logbee and my -- everybody will here -- will be available to answer your questions.

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

Thank you very much for participating in our call. I would like to go to page number four, the highlights. The first highlight was the total sales growth 34% increase over a base that had already been very strong, 24% growth in the first quarter of last year and we grew 34% in the market that according to the IBGE, the beginning of the year grew only 2%. So this means that our market share gain was extremely high in physical stores, we grew 21%. And I would like to highlight same-store sales, 16%. The contribution of 5 percentage points by the new stores in the total growth was a very good performance as well. E-commerce growing by 65% over a base of almost 60% last year, reaching 35% of our total sales. And according to EBIT, the market grew only 11%, so again, we grew much more than the market.

Gross profit, we saw a reduction of 80 bps mainly because of the mix effect. As happened in the last few quarters, e-commerce growing more than brick and mortar stores, but all this is more than offset by the level of operating expenses. Once again, we had a dilution of operating expenses of one percentage point, very high and this brought our SG&A, as a whole to the level of 21% of the net revenue. So the lowest ever level of operating expenses. So we have been diluting all these expenses and improving our efficiencies and because of that our EBITDA grew by 30% reaching over 300 million, keeping a margin 8.3%. And we reduced our net -- we multiplied net income to BRL148 million, growing 152% vis-a-vis last year.

We had focus on cash generation. In the last 12 months, the cash flow from operations reached BRL1 billion. Working capital helped a lot. We improved our working capital at over BRL200 million. And with all that in the last 12 months, we were able to reduce our net debt by 1.7 billion going to a net cash position. And we closed March with a cash position of over BRL2 billion, the best position for a first quarter in the whole of our history.

On page five, we go into details about our investments. Investments will be intensified over the next quarters as well. And in the same quarter, we already have this estimate of opening over 30 new stores according to our investment plan and also the funds that we raised in the follow-on that we had last year.

On page six, we show the evolution of our quarterly sales. In the first quarter, we sold more than the fourth quarter of last year, which is normally the best one for retail overall and we are accelerating our growth. And e-commerce, we sold 1.6 billion in the first quarter, much more than we sold than the first quarter last year.

On the -- on page number seven, we show the evolution of our gross margin, the dilution of operating expenses. This was very strong mainly in G&A, as you can see on the slide and our operating leverage of the company and a very strict control of our expenses. And also in fixed expenses, as a whole rental expenses, for instance, in this quarter compared to the first quarter of last year, we had a difference of 6% basically 4% coming from new stores and 2% coming from adjustment in this line. And equity income, as you can see a lot of contribution to our result 23 million, basically the same level of last year, 0.6% of our net revenue. And then we can go into Luizacred afterwards. Luizacred had a very good result as well.

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EBITDA quarterly evolution, as you can see on this slide, a very consistent one 8.3% margin, 30% growth, very much impacted by our sales. And on slide number nine, we show reduction in financial expenses, you can see that we got a reduction by 57% in our financial expenses. Financial expenses, as a whole lower than 20% of the EBITDA, which was one of our goals. And if we look at financial expenses in detail, you can see that it comes from accounts receivable and net of accounts receivable, we had financial revenue, which leads to our net cash position.

As you can see on the next slide, we will show 1,300 million [ph] including receivables. And when we look at the adjusted working capital, we maintained a very healthy level between 65, 60 days of turnover and our e-commerce has a turnover even better than that. And as we are multichannel and fully integrated and all the DC service, all the channel, so we continued to improve our inventory turnover and a very high result here 85 days. So difference between the average term and the turnover of 20 days, which gives a lot of contribution to our cash generation and the more we grow, the more cash we will be -- generated as working capital as well.

On the next slide, we show the reduction in our indebtedness from 1,600 million to 800 million and our cash position from 1.1 billion to 2.1 billion net income growing consistently as well. We increased our net margin by two percentage point from 2.1% to 4.1% and again, the highlight here is the ROE (sic) and the ROIC. Here we have 29% of the quarter ROIC with return on invested capital of over 30% -- 31%. So finally accelerated growth with high return on the invested capital.

Then Luizacred on the next page with a very good contribution to our bottom line. Total revenues growing by over 30% in Luizacred and especially in Magazine Luiza inside our stores, it grew over 50%. The participation of the Luiza Card and the physical stores increased by six percentage points in this quarter vis-a-vis the same quarter last year, and our clients of Luiza Card is the most valuable client for us. This is the client, where we have been investing a lot and they are very loyal. So we increased our client, our card base. The sale of new cards practically doubled vis-a-vis last year. So we have been carrying out improvements in the model and the process here as a whole and this has been allowing us to well, what was evident over last year, becomes even more evident this year, which is the growth in the revenues of Luizacred, the card base and with the lowest level of delinquency dropping from 8.1 to 7.1. Non-performing loans over 90 days past due and with a portfolio, which is even more provisioned with the coverage ratio of a 158% in a very comfortable way, as you can see.

On slide number 12, we show the quarterly evolution of Luizacred's net income comparing to the first quarter last year, there was a slight drop, but basically it was due to the reduction in the interest rate, mainly in the past due and the revolving one. So it's good for our clients because they have more money left to buy at Magalu and in spite of a reduction in interest rate, we were able to get the performance, which was similar to the other quarters, where we had already talked about the reduction in interest rates. So the result of Luizacred had a very good improvement and 27% return, a very interesting one as well.

And with that, I would like to give the floor to Decio, who is our Logistics Officer, who will be talking about the Logbee acquisition.

## **Decio Sonohara** {BIO 21479277 <GO>}

Thank you for participating in the call. Yesterday, we signed the acquisition of Logbee. Logbee has a IT platform and they deliver or they manage deliveries and they track all the orders and we can monitor via GPS, where the driver is located at all times and also the driver has a laptop and they know exactly the route and all they can do everything in real time. They work with a concept in which they offer and the drivers can pick up the products to deliver to our clients. And the selection of drivers is very strict and we are extremely careful with that because the drivers go to the client homes and they deliver.

And the company has no vehicle that is to say only third-party vehicles are used, so the company has asset light [ph] as Frederico shared and the integration of technologies we can integrate with Malha Luiza with over 1,500 micro carriers using this Luiza delivery or logistics base in order to deliver the light product and also integrated with Magalu Entregas with the 3P delivery -- the delivery of the 3P product. Beside the platform, Logbee has their own operation because they deliver light product. They have been working with us for a long time for over eight months. And it is very important in terms of our strategy of express delivery not only promising delivery within 48 hours, but be able to deliver on-time and the express delivery in the greater Sao Paulo already represents 35% of sales and the orders realized. And of the -- of any deliveries, 90% of the whole volume in the greater Sao Paulo area.

The company has the best delivery service measured by us and with our tracking criteria and we intend to expand this increasing the coverage of deliveries in the greater Sao Paulo and other large cities of Brazil. Beside it's going to be fundamental for our strategy for shipping from store, the whole platform will be helping us in order to pick up the product at the stores and delivering this to the client like a mini DC and Logbee is the strategic part to reach or accelerate Magalu deliveries, not only delivering 1P, but also 3P from marketplace.

## **Frederico Trajano Inacio Rodrigues** {BIO 17269235 <GO>}

Thank you, Decio, Roberto, And with that we would like to open for questions.

## **Questions And Answers**

### **Operator**

Ladies and gentlemen, now we will start our Q&A session. (Operator Instructions) Richard Cathcart, Bradesco.

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

Good morning, everyone. Fred at the beginning and also in the release, you said that now you want to significantly increase the active client base and also the frequency of

shopping by these clients. So maybe this is difficult to answer, but which are the strategies that you believe are the most important in order to allow you to reach this objective. And the second question about the pickup -- store pickup. Can you update us about the store pickup and the plans for the remainder of the year?

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

Of course, the initiative of increasing the client base -- the active client base (Technical Difficulty) many initiatives, it's not like a super bullet, but it has to do mainly with, well, we must have this indicator as the focus of the company instead of looking only at the GMV. We have to put to our whole team with more emphasis in the incentive system, the activation of the base, so clients that shop more frequently and that come back and expanding the client base by conquering new clients. Otherwise, you feel very comfortable in the old model selling a very high ticket to less clients. So this is a very relevant target in our incentive program.

And then we have many other points. I think the most relevant is to increase the offer of products to our clients and the base of our offers is established with high average ticket durable product. So the most relevant strategy in this sense is marketplace, the introduction of sellers that sell products that are different from the one that traditionally we have in our stores and 1P and this is already increasing our active client base. This is not the only initiative. I will give the microphone now to Eduardo and then I can come back and go more into detail, but just to show you how the marketplace helped us in this initiative and increasing our base.

Good morning. Well, the growth in this quarter was even more accelerated in our business in the -- these categories. 64% growth overall in our business and in terms of [ph] products almost a 100%. So this is the major challenge. We have to generate traffic and relevant to the new categories. Some of them are already gaining relevance, which is the case of (inaudible) Magalu, very significant already to our business and also toiletry et cetera. And we have the opportunity for new categories, they are still in the embryonic phase, but we have -- we can bring many other clients to our base and we will be getting into session [ph] in the short run and we already even looked in. 30% of the new clients that we had brought marketplace -- marketplace items, if we compare this to 8%, which is the participation. This shows how significant the marketplace is already in our client base, accounting for growth, for the overall growth of our business.

And there are other points as well, maybe less relevant than the marketplace, and also the impact on our offers and it's not really less relevant, but by improving your level of service, you can deliver much faster than the others in the market. And we have a very high bar here in our target and the clients will become loyal in your ecosystem. If you have a higher penetration of cards, the card clients is more active than the non-card clients. And this is one of the most expressive goals that we have in this new cycle to increase our card base. And also the loyalty platforms we are starting many alternatives and we already have the older program, but we have other programs in the pipeline in order to incentivize our clients to participate in our ecosystem.

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In terms of the store pickup that was the gist of your question. As we said in the release, it's already at 25% of the total. We talk about the total that we sell and what is the participation of this. And we depend on the light product delivery and Logbee will be fitting this gap perfectly because it is much more adequate today for high ticket than the shipment store. We have more inventory in the stores of light products and heavy products that are usually in the DC. So Logbee will help us a lot as you said in the expansion of this area and we consider this number, which is over the total of our sales are not eligible products. Thank you.

## Operator

Joseph Giordano from JPMorgan.

### Q - Joseph Giordano {BIO 17751061 <GO>}

Good morning, everyone. I would like to -- could you talk about this mix issue and how this has been impacting the -- you talked about the NPV of the client and I would like to know if you already see an evolution in the rate of repurchases mainly through the app because I know that the app is doing very well and same-store sales 16% was very relevant in your overall result. So can you identify higher correlation between the online and the offline clients maybe the social classes are different? So are you already seeing an symbiosis there?

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

Well, if we already see an increase in the frequency, yes. Eduardo will be going back to that in order to further emphasize your question. But I believe that the bulk of this increase will happen later on because the participation of these new categories is not so big, yet. We launched the marketplace at the end of 2016, so we are talking about one year and a half. So we went from 40,000 items available to almost 2 million items available to our clients. So it's a very big, but we still have a long way to grow.

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

Eduardo is talking now. He has already talked about the two points that influenced the frequency, it was a very stable frequency up to 2016 and after we made this investment in the ecosystem and the marketplace, this curve is going upwards every single month, we see that people have been buying more and more frequently and more than in the other platforms and marketplace more and more a part of the consumers' basket. I would like Fabricio to take the floor now, but I would like to add that since the second half of last year, we have been seeing a very positive performance on the part of the brick and mortar stores, everybody helping that. And also in terms of credit recovery, we have been increasing the limit significantly for the clients' of (inaudible) Luiza, Luiza Card, increasing the number of cards that we are selling and the cards are very important to improve our sales in the brick and mortar stores. So Fabricio, could you talk about the same-store sales of the first quarter?

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

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Thank you for the question. This is Fabricio. As he said, credit is important and this is a very positive point that we had. But our performance in many categories have -- has improved, 2017 was very good in all the categories. And now in 2018, we are going very well in white line and with a very good recovery in the furniture category. And the great highlight here is the smart TV line, we are growing three times more than the market and this is of course, because of the World Cup that we launched the campaign encouraging our consumers to exchange their old smart TVs to -- for new ones and we are giving them discounts and by means of an agreement with our -- one of our partners and also in terms of smartphones. So this is really driving our growth quite a lot. And I think the big highlight are the smart TVs, but furniture and white line have been helping us a lot as well with a very good alignment with our suppliers and a very good selection of products and with promotions et cetera. So I think this is the big highlight in my area.

**Q - Joseph Giordano** {BIO 17751061 <GO>}

Thank you very much. Have a good day.

**Operator**

Fabio Monteiro, BTG Pactual.

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

Good morning everyone. Still about growth and I think my question has more to do with how we should think about Magazine Luiza in the medium run? We believe that there is still quite a lot of room for you to grow in e-commerce and retail sales and you are certainly one of the companies that are leading this initiative, occupy market and the growth of your e-commerce is much higher than the sector of e-commerce overall? And you have already given us many inputs regarding new categories and being freeze and the number of orders. And my question is the following, what do you believe would be possible to grow in the more long run? Or in other words, do you believe that the market will start to see or the companies that are the winners in this game, a growth of 30%, 40%, 50% growth for 10 years. So I would like to know what you think about that?

And still along the same lines, how do you see marketplace or your marketplace because you have been very much concerned or very much focused on the quality of service being a top priority for you to achieve a very good level of service? So I would like to understand how or how much the marketplace could represent in your e-commerce business from now on, thinking about let's say 5 years to 10 years. So two questions, one about growth in the medium and the long run. And if you believe the evolution will be as strong as what I've described then what about the -- how much marketplace they will represent?

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

Good morning, Fabio and thank you for your question. Well, you know that we don't give guidance, okay. So I will try to answer your question as best as I can. Well, talking about more theoretically that is to say if a Brazilian company could grow 30% to 40% in the next 5 years to 10 years, I would say undoubtedly today, we have an e-commerce in Brazil with a penetration of about 5% of the overall retail operations. So retail was practically stagnant in the last few years with a very low growth rate. And this penetration is even

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lower because this is the average, and it is even -- in other categories are -- that are so important all over the world for instance, fashion. So if you analyze this very carefully, you can see that there is a huge potential for e-commerce growth in Brazil.

And also in the categories, where we already have a high penetration, the more traditional category of durables, which is our case, so it is of course certain that it is going to go to 10%, then 15%, 22% and it will be a bad mistake, a bad mistake on the part of investors and companies to (inaudible) against this growth. And our participation in e-commerce is already slightly higher than 10%. So we have a lot of room to gain additional share and this will consolidate its impact. We are able to implement this whole cycle focused on service level.

If we can reduce significantly the delivery times and facilitating exchanges and cancellations and giving the client a very flawless experience in deliveries, no delays et cetera, always on-time and facilitating credit for the clients' that buy online, for clients that already has credit this is easy, but those who don't have credit yet, the brick and mortar stores are the best option. So we are doing this in many fronts and our model is omnichannel. And now it is even more focused on delivering the best possible service level and even higher than the international standards, if we execute them in a diligent fashion.

So if we do all that, we can gain share and be one of the big players in e-commerce. Of course, this is very hard and the agenda is very complex, it requires investments in logistics and the frequency of inventory with management and the (inaudible) lab team and the delivery teams will have to be involved and are involved. But I think this is totally possible and feasible marketplace is totally relevant because it has a very big strategic importance in these categories that I mentioned. So it would be very difficult for us to do a very expressive e-commerce in 1P only in these new categories. They are very new sectors and they're fundamental. And for future growth, this will be totally relevant always respecting the level of service, which is the standard that we want to give our consumers. We are not going to have a marketplace with a low service level and it has to do with ethics as well in our part. In terms of informal market, we only accept sellers that pay all their taxes that issue invoices and that, so true product and we are not going to have any trade-off in terms of ethics. And in terms of service level, just to grow GMV in the marketplace. No, we will do this ethically with the same ethical standards of quality and that we do with 1P.

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

Great. Just a follow-up question. Okay. So there are many trade-offs for the growth of marketplace and you mentioned a few of them. But I would like to understand in your agenda today, what you're discussing today? What are the most critical points on your agenda? Is it the integration of platforms with the sellers or the profile of the sellers that you're filtering so to say or is it a level of service that you have established as the minimum and that you will not go below that? So if it will not for all that, well just to understand what (Technical Difficulty)

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

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Our marketplace is higher than our target in fact not lower. So we took some time to launch it. It is just a matter of timing of the launch and not having to do with anything difficult in terms of the implementation or execution. We decided to launch it at the end of 2016 and many of the platforms have been in the market for five years. So our growth curve is much faster than many of our competitors had in their first years. And we decided to come later because we wanted to be absolutely sure that our omnichannel model of Magazine was ready in order to expand after we had 1P totally lucrative. We didn't want to have a marketplace at all costs or any cost. First, we wanted to have a model, a tested model, and then launch a 3P. And it will be tapping into the same platform that we had with 1P and with Magalu Entregas and it had more to do with the timing of the launch and not because of difficulties. And the challenges in the marketplace are one going from 40,000 items to 2 million, the user experience is much more complex and the search and the recommendations. So all this involves a reinforcement in our team that deals with big data algorithms. You have to do this with algorithms. They are no longer with people only. So it's much more sophisticated and you have to invest in machine learning and transform non-structured data into structured data, all this requires from our team. A very big challenge, it's a big challenge.

And secondly, it is logistics, investments such as the one that we made in Logbee and the roll-out of Magalu Entregas and the expansion of the network because there are so many DCs and we have to open more DCs as well and also increasing the number of stores as mainly distribution centers, so that they may receive products from sellers. So you have to invest in physical assets so to say. But GMV is on, according to our plan and it went from zero to almost 10% in 1.5 years. So no other channel has grown so fast. We had already a very big participation of 1P and this is still growing. So our metrics is not share of marketplace in the total of e-commerce, so the share of e-commerce is the total of our company focuses MDS and GMV of course and active clients.

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

Very clear. Thank you.

**Operator**

Guilherme Assis from Brasil Plural.

**Q - Guilherme Assis** {BIO 16143141 <GO>}

Good afternoon. Thank you for the question. There are two things I would like to ask. First Fred, could you talk about the performance of the stores, not the performance, but the operation of the five stores that you opened like distribution centers and how this works in the integrated network or chain of Magazine Luiza. And the second one is the following.

Yesterday, you -- well, you talked about Logbee and you have already signed and you have already talked about the purpose and what Logbee does and the roll out. But I would like to know if in the plan of improving the service level to consumers and rolling out the offer of products, do you think there is part of the platform that is still missing and that you could eliminate by means of new acquisition adding this to your platform?

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

Well, about your first question, well, thank you for the question. Your first question was about the stores and we opened. Well, we have been opening stores. Well, it was Friday, so last Friday. So it's a little bit too early to say anything, but I would like to mention a few factors.

First we have a bigger area and it is better distributed in order to have this inventory of products in the store, so or the products that arrive in order for clients to pick up their products. So the space for the client is also more adequate. We had a -- we believe that the NPS could be better for the client that buy on the website, and then they pick up the products at the store. Beside the physical improvements and we are improving the spaces and better equipment for service for the clients and also for replenishing the inventories, we are also investing in the technological platform because I manage, what we call the mobile stock.

So we have to have this inventory control in the store products that people buy in the website and they pick up at the store and not promising a product that is not in the store, whether there was a mistake in the calculation or a shrinkage. So we have a digital system to count all the items and it receives and locates the product in the stores, it receives the order and checks the replenishing and we have to check the truck more fast or fastly. Many functionalities that we have in the application that we have in our back office and these are being made available to our people. So we are increasing the store back office and of course, we do not want any lines, we want to remove lines. So we are improving all that by means of our back office. And the store is going to change the reality with more products with new categories and you have to be prepared, you have to review your processes, so that the client gets there and has a user friendly experience and we are making all our processes digital. We want to get to the level of the client picking up the product in two hours after the order is placed.

A client that goes to one of the new stores, unfortunately, I have not been able to go to one of them yet, but the client that comes to one of these stores, the traditional store that we know very well how it works and what the environment is, well the client goes to in the area that looks like DC, it's a different area than a traditional store. Yes, in fact it's very beautiful, and you can visit one of these stores, as you want and the space is very beautiful and visually speaking it's very pleasing. Well, if you want to buy, you can go to the (inaudible) store, one of the pilot stores and you can make your purchase and pick up your product there and then you will go and see that store by yourself if you make a purchase.

And about the second part of your question. There are still gaps in our ecosystem. One of them was already eliminated with Logbee and last year, another one. So we still have a universal payments that we have to fill in the gaps either developing internally or acquiring a startup in logistics another opportunity that might arise. So we are always looking around and checking opportunities. And as you saw in our release, part of that would be to acquire companies such as Logbee and this is the plan that we are executing with a lot of discipline.

## Q - Guilherme Assis {BIO 16143141 <GO>}

Very clear. Thank you.

## Operator

Lucas (inaudible) from Credit Suisse.

### Q - Tobias Stingelin {BIO 18290133 <GO>}

This is Tobias. Fred, you talked about investment in services two pages in the release, and now a lot you talked about the first phase. But could we see a margin that is negatively impacted in the short run, but the consequence will be an acceleration of growth. Could we see a stronger top line in spite of a lower margin. Is this what you mean?

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

No, I'm not giving you any guidance whatsoever. But what I can say is that, we are going to make investments in OpEx that impacts margin and CapEx as well. In order to achieve this better level of service, the increase in the frequency of delivery, the number of people in the DCs increasing in order to process the bigger loads more efficient. DC management, the increase in headcount at the stores to increase NPS, the increase in investment of the call center to increase the number of first-call resolution and also to reduce the call waiting time. So there are many metrics, and our objective is not to bring down our margin. However, we have to make investments that are -- have already been guaranteed to our team so that we may deliver these indicators. And the trade-off is to increase the number of active clients, the clients that really deliver customer value. It's not a trade-off of investments in OpEx vis-a-vis GMV in the short run. It has to do with OpEx and CapEx in order to increase the active client base that will in the long run generate value for the company. All the calculations are made very carefully.

With no trade-offs, such as we see some times in internet companies, but the potential margin that we gain with high growth, we will be reinvesting this to activate clients and mainly to have a significant increase in the level of service, so we have over 20 indicators, as I said. But there could be a change in the margins of the company, but all this focusing on returning value to our shareholders. So we are calculating the CLV [ph] and it has to do with that. So I wouldn't -- we are not going to destroy value to our shareholders, but we must increase our investments to improve our ecosystem and we can only do this by making investments.

Of course, you have many objectives for the short and the medium and the long run. But by the end of 2019, what will be different in the consumers' experience in the ideal world. Most of our deliveries in up to 48 hours twice the number of active clients, a totally user friendly exchange system, better call center service, we will have a much higher number of categories available to our clients with the higher penetration of our credit insurance both in our stores and in e-commerce, so these are some indicators of the 20 that we have.

So it's a lot of hard work on our part and we are not staying in our comfort zone and everybody in the company is totally outside their comfort zone, so there are many aspects for us to be recognized by our clients as the best option on and offline.

### Q - Tobias Stingelin {BIO 18290133 <GO>}

And one last question. Of course, you have to improve on an ongoing basis, I understand but do you have a time line?

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

Well, we are no longer talking about project because when I say a new strategic cycle, it's because in the last two years, we did all the ground work to achieve that. We had marketplace and we unified Luizalab for the whole company because now Luizalab develops for the co-company, and all the teams working in a very agile fashion. We created our app and with it all the ground work show that we could have what we have today, and we reduced our debt. We're cash positive, margins are higher, so we can do that in a comfort zone financially and operationally speaking. So this is another project for two years or three years. This is the part of the strategy to be consumer centered, no it's not something for one years or two years. This year, we are giving a major focus of that -- to that having more operating indicators, which are consumer centered, they are not only financial indicators, but this is not for only a couple of years.

### Q - Unidentified Participant

(inaudible) Itau BBA. Good morning. Thank you for the question. What about your geographic performance in your physical stores, one region pushing this upwards or downwards? And the second question about the acquisition of Logbee. How do you see this acquisition helping your company develop fulfillment?

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

This is Fabricio (inaudible). About the same store sales, it's quite well balanced. The Northeast growing a little bit faster, but also growing in the Southeast and the South of the country. Since last year, in 2016, the Northeast was better growing quite well now, but the Northeast with a very good performance, but growing a lot in the South and the Southeast regions. And also in our virtual stores, very aggressive growth.

In relation to Logbee, it was a startup that started with a platform delivering when the project gets to Logbee, they deliver on the same day or the next day. Totally consolidated with significant gains for the level of service. So it has everything to do with what we want, we want to have a bigger and bigger coverage in terms of delivery up to 48 hours and we are opening new distribution centers, we are increasing our team, our logistics team and the level of service, not only regarding the delivery, but also what we offer -- offering and selling and delivering in up to 48 hours.

So Logbee now delivers 1P of Magazine Luiza, 90% of the deliveries in the Greater Sao Paulo area, and we want to put this together with Magalu Entregas and then we will be offering this to the sellers, the marketplace sellers. We will be integrating this platform in order to manage the whole Luiza network, the over 1,500 small carriers that work exclusively for Magazine Luiza and being able to have the platform of Logbee helping us in the routing activity and tracking via GPS. So this is a platform, it's an operation that will be helping us quite a lot not only in 1P, but 3P as well.

## Q - Unidentified Participant

Thank you.

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

Maria Paula Cantusio, BB Investment. Good morning and congratulations for the result. Thank you for the question. I have three questions in fact. You said at the beginning of the call that the CEO of the Company is very much focused still on discretionary items and that you intend to dilute this mix. Along these lines, what have you been learning with the sale of the marketplace products at the stores and that to consider maybe placing one of these categories in house and working -- or operating in 1P.

And at the beginning of the call, you said that you will be increasing the frequency and the level of service. What about the impact on the working capital of the company? Can you offset this with improvement of another line or do you believe that e-commerce will help you? And what about the situation of Magalu Pagamentos platform?

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

Thank you very much for your question, Paula. About the first question, in terms of the marketplace in the stores we launched at the end of 2017, so we took the first quarter to understand the impact of that in the store operation (inaudible) we have seen some improvement that we will have to make in order to give the store support, to the consumers that buy there. So it would be useless for the client to buy in the marketplace and then have a problem when he get to the store. So we are extending this pilot to other stores, increasing the number of sellers and improving our support. And by the end of the year, we believe that all the stores will be ready to sell marketplace product.

Regarding migration, from 3P to 1P, this is what we see. In some categories, we decided to start together -- we started from scratch and like toiletries and (inaudible) Magalu, the Magalu market and this is something that we see all the time. And as we see the benefits for the company, then we will choose whether we will bring this inside or not with the new categories that we have, like Vox, passion that is in the pipeline. The trend is our focus on 3P and very specialized categories. And these categories will probably seeing the 3P for the time being.

About the frequency, the most frequent is the purchase, the less inventory you have sitting there. So we have to synchronize this with the industry et cetera and it does have an impact on the working capital and the cost of credit because you have more trucks going in and out. We have been improving our working capital management. What could have an impact on the working capital is the increase in the availability of products in the regional DC. This is the gap that we have and with a very strong concentration of the main products in the two DCs in Sao Paulo and Minas. So we have to have a better distribution in the 10 CDs. This could generate an increase in inventories, a momentary one, but you will have an increase in conversion that will offset that. So I do not see major changes in our working capital in the short run. I don't see any significant impact there.

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



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Maria Paula, this is Roberto. About Magalu Pagamentos, this is one of our main project, corporate project and in our financial area in marketplace et cetera. So we already have a pilot of that, with one of our sellers in our marketplace and the results are very good so far. And for the next few months, we have this first phase in where we will be able to tap into these gains related to the marketplace and also encouraging a lot of pre-payment of receivables. We do quite a lot of prepayment of receivables of suppliers of IP and we want to make this available as well, and we are already building this in our platform to do this in a large scale, in a digital fashion for our sellers -- marketplace sellers. And most of them are small, they tend to adhere to that. So it's going very well.

And then we will have a second phase, the first one is okay and the second is the launch of a digital portfolio, not only regarding the management of payment, but also with a partner in the banking system also offering services such as loans and investments and other product. So we have a very good opportunity there in order to give a better service to our sellers and increase the profitability of the marketplace, as a whole, I would say in the medium run.

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

Thank you. Very clear. Have a good afternoon.

**Operator**

The Q&A session is closed. We would like to give the floor to Mr. Frederico Trajano for his closing remarks. Mr. Trajano?

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

I just want to thank you very much for participating, I wish you a very good week.

**Operator**

Magazine Luiza's conference call is closed. Thank you very much for participating. Have a good afternoon.

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