# Financial Statements

## Magazine Luiza S.A.

December 31, 2016 and 2015
with Independent Auditor's Report

**Magazine Luiza S.A.**

Financial statements

December 31, 2016 and 2015

Contents

São Paulo Corporate Towers
Av. Presidente Juscelino Kubitschek, 1.909
Vila Nova Conceição
04543-011 - São Paulo – SP - Brasil

Tel: +55 11 2573-3000
ey.com.br

**A free translation from Portuguese into English of Independent Auditor's Report on Individual and Consolidated Financial Statements prepared in Brazilian currency in accordance with accounting practices adopted in Brazil and with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB)**

# Independent auditor's report on the individual and consolidated financial statements

To the shareholders of
**Magazine Luiza S.A.**

## Opinion

We have audited the accompanying individual and consolidated financial statements of Magazine Luiza S.A. ("Company"), identified as Company and Consolidated, respectively, which comprise the statement of financial position as at December 31, 2016 and the statement of income of comprehensive income, of changes in equity and of cash flows for the year then ended, and a summary of significant accounting practices and other explanatory information.

In our opinion, the individual and consolidated financial statements referred to above present fairly, in all material respects, the individual and consolidated financial position of Magazine Luiza S.A. as at December 31, 2016, and its individual and consolidated financial performance and cash flows for the year then ended in accordance with the accounting practices adopted in Brazil and with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

## Basis for opinion

We conducted our audit in accordance with Brazilian and International standards on auditing. Our responsibilities, pursuant to these referred to standards, are described in the following section entitled "Auditor's responsibilities for the audit of individual and consolidated financial statements". We are independent in relation to the Company and comply with the relevant ethical principles set forth in the Code of Professional Ethics for Accountants and the Professional Standards issued by the Brazil's National Association of State Boards of Accountancy (CFC), and we comply with the other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to support our opinion.

## Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the individual and consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

**Repeal of benefits provided by the Tax Relief Law ("Lei do Bem")**

As disclosed in Note 20, the Company was awarded a favorable decision as early protection, which allows it not to collect the Contribution Taxes on Gross Revenue for Social Integration Program (PIS) and for Social Security Financing (COFINS) levied on revenue from sales of products eligible for the Basic Production Process. Due to the significance of the PIS and COFINS contributions on the Company's operations and the retail industry and the complexity underlying the understanding of the law under concern, and the arguments that support the conclusion that the benefits granted could not have been terminated, this was considered an important matter in our audit.

Our audit procedures included, among others, the use of senior members of our audit team, as well as the inclusion of indirect tax experts in our team to help us technically and legally evaluate the Company's and its legal counsel's arguments as well as to test calculations of the amount involved. We also verified the adequacy of the Company's disclosures with respect to this matter.

**Recoverability of goodwill generated in business combinations**

As disclosed in note 16, as of December 31, 2016, the Company had recorded in its intangible assets goodwill paid based on expected future profitability in the amount of R$ 350,683 arising from the acquisition of businesses.

The Company annually tests the impairment of these amounts, as required by CPC 01 (R1) / IAS 36 - Impairment of Assets. This process is complex and involves a high degree of subjectivity, and it is based on several assumptions, such as, among others, the determination of cash-generating units (CGUs), discount rates, inflation projection, growth rates and profitability of the Company's business for the coming years. These assumptions will be affected by the market conditions or future economic scenarios of Brazil, which cannot be accurately estimated. We consider the annual impairment test to be one of the key audit matters due to the high degree of subjectivity and complexity in the assumptions and calculations involved.

Our auditing procedures included, among others, the involvement of valuation experts to help us evaluate the model used to measure the recoverable amount and the assumptions, projections and methodology used by the Company, in particular those related to estimates of future sales, growth and discount rates used in the discounted cash flows and profit margin of the cash generating unit to which the goodwill was allocated. We also focused on the adequacy of the disclosures made by the Company on the assumptions used in the recoverability calculations, especially those that most significantly affected determination of the recoverable amount of the goodwill.

Building a better working world

## Other matters

### Statements of value added

The individual and consolidated statements of value added for the year ended December 31, 2016, prepared under the responsibility of Company's management, and presented as supplementary information for IFRS purposes, were submitted to audit procedures performed in conjunction with the audit of the Company's financial statements. For the purpose of forming our opinion, we evaluate whether these statements are reconciled with the financial statements and accounting records, as applicable, and whether their form and content are in accordance with the criteria set forth in Accounting Pronouncement CPC 09 - Statement of Value Added. In our opinion, these statements of value added have been properly prepared, in all material respects, in accordance with the criteria set forth in this Accounting Pronouncement and are consistent with the overall individual and consolidated financial statements.

### Other information accompanying the individual and consolidated financial statements and the auditor's report

Company management is responsible for such other information that is included in the Management Report.

Our opinion on the individual and consolidated financial statements does not cover the Management Report and we do not express any form of audit conclusion on this report.

In connection with the audit of the individual and consolidated financial statements, our responsibility is to read the Management Report and, in so doing, to consider whether this report is materially inconsistent with the financial statements or with our knowledge obtained in the audit or otherwise appear to contain material misstatements. If, based on our work, we conclude that there is a material misstatement in the Management Report, we are required to report this fact. We have nothing to report in respect of this matter.

### Responsibilities of management and those charged with governance for the individual and consolidated financial statements

Management is responsible for the preparation and fair presentation of the individual and consolidated financial statements in accordance with the accounting practices adopted in Brazil and in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the individual and consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company and its subsidiaries or to cease operations, or has no other realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's and its subsidiaries' financial reporting process.

**Auditor's responsibilities for the individual and consolidated audit of financial statements**

Our objectives are to obtain reasonable assurance about whether the individual and consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Brazilian and International standards on auditing will always detect material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

As part of the audit conducted in accordance with Brazilian and International standards on auditing, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess risks of material misstatements of the individual and consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than one resulting from error, as fraud may involve override of internal controls, collusion, forgery, intentional omissions or misrepresentations.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's and its subsidiaries' internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast substantial doubt as to the Companies' and its subsidiaries' ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the individual and consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company and its subsidiaries to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the individual and consolidated financial statements represent the corresponding transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the consolidated financial statements.

We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, of the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal controls that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those in charge with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

São Paulo, February 17, 2017.

ERNST & YOUNG
Auditores Independentes S.S.
CRC-2SP015199/O-6

Waldyr Passetto Junior
Accountant CRC-1SP173518/O-8

## Magazine Luiza S.A.

Statement of financial position
December 31, 2016 and 2015
(Amounts in thousands of Brazilian reais - R$)

| | | Company | | Consolidated | |
|---|---|---|---|---|---|
| | **Note** | **2016** | **2015** | **2016** | **2015** |
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | 6 | **562,728** | 590,400 | **599,141** | 617,465 |
| Securities and other financial assets | 7 and 28 | **818,984** | 497,623 | **818,984** | 497,623 |
| Trade receivables | 8 | **575,334** | 430,549 | **581,001** | 435,225 |
| Inventories | 9 | **1,587,299** | 1,343,741 | **1,596,743** | 1,353,092 |
| Related parties | 10 | **66,296** | 88,140 | **64,021** | 86,152 |
| Taxes recoverable | 11 | **210,657** | 333,475 | **212,151** | 334,344 |
| Other assets | | **47,013** | 35,531 | **47,802** | 36,614 |
| Total current assets | | **3,868,311** | 3,319,459 | **3,919,843** | 3,360,515 |
| | | | | | |
| Noncurrent assets | | | | | |
| Securities and other financial assets | 7 and 28 | **171** | 46,728 | **171** | 46,728 |
| Trade receivables | 8 | **3,570** | 2,595 | **3,570** | 2,595 |
| Taxes recoverable | 11 | **223,604** | 177,295 | **223,604** | 177,295 |
| Deferred income tax and social contribution | 12 | **241,089** | 228,602 | **242,010** | 229,347 |
| Escrow deposits | 20 | **292,187** | 248,450 | **292,189** | 248,450 |
| Other assets | | **49,671** | 51,977 | **52,273** | 54,291 |
| Investments in subsidiaries | 13 | **67,022** | 56,905 | **-** | - |
| Investment in joint ventures | 14 | **380,386** | 384,025 | **380,386** | 384,025 |
| Property and equipment | 15 | **559,320** | 577,811 | **560,067** | 578,571 |
| Intangible assets | 16 | **469,724** | 463,726 | **513,049** | 506,720 |
| Total noncurrent assets | | **2,286,744** | 2,238,114 | **2,267,319** | 2,228,022 |
| | | | | | |
| Total assets | | **6,155,055** | 5,557,573 | **6,187,162** | 5,588,537 |

| | | Company | | Consolidated | |
|---|---|---|---|---|---|
| | **Note** | **2016** | **2015** | **2016** | **2015** |
| Liabilities and equity | | | | | |
| Current liabilities | | | | | |
| Trade payables | 17 | **2,353,473** | 1,885,251 | **2,364,959** | 1,894,157 |
| Borrowings, financing and other financial liabilities | 18 | **837,878** | 568,220 | **838,016** | 568,350 |
| Payroll, vacation pay and payroll charges | | **184,789** | 150,419 | **188,390** | 153,903 |
| Taxes payable | | **38,613** | 29,497 | **40,132** | 30,605 |
| Related parties | 10 | **72,923** | 68,787 | **72,955** | 68,404 |
| Deferred revenue | 19 | **40,318** | 41,399 | **40,318** | 41,399 |
| Dividends payable | | **12,335** | - | **12,335** | - |
| Other payables | | **111,615** | 116,038 | **115,321** | 117,964 |
| Total current liabilities | | **3,651,944** | 2,859,611 | **3,672,426** | 2,874,782 |
| | | | | | |
| Noncurrent liabilities | | | | | |
| Borrowings, financing and other financial liabilities | 18 | **1,010,760** | 1,254,830 | **1,010,760** | 1,254,960 |
| Provision for tax, civil and labor contingencies | 20 | **275,054** | 230,010 | **284,126** | 243,412 |
| Deferred revenue | 19 | **509,155** | 550,910 | **509,155** | 550,910 |
| Other payables | | **-** | - | **2,553** | 2,261 |
| Total noncurrent liabilities | | **1,794,969** | 2,035,750 | **1,806,594** | 2,051,543 |
| | | | | | |
| Total liabilities | | **5,446,913** | 4,895,361 | **5,479,020** | 4,926,325 |
| | | | | | |
| Equity | 21 | | | | |
| Capital stock | | **606,505** | 606,505 | **606,505** | 606,505 |
| Capital reserve | | **19,030** | 14,567 | **19,030** | 14,567 |
| Treasury shares | | **(28,729)** | (9,574) | **(28,729)** | (9,574) |
| Legal reserve | | **20,471** | 16,143 | **20,471** | 16,143 |
| Profit reserve | | **89,663** | 36,199 | **89,663** | 36,199 |
| Other comprehensive income (losses) | | **1,202** | (1,628) | **1,202** | (1,628) |
| Total equity | | **708,142** | 662,212 | **708,142** | 662,212 |
| | | | | | |
| Total liabilities and equity | | **6,155,055** | 5,557,573 | **6,187,162** | 5,588,537 |

The accompanying notes are an integral part of the financial statements.

## Magazine Luiza S.A.

Statements of income
Years ended December 31, 2016 and 2015
(Amounts in thousands of Brazilian reais - R$)

| | Note | Company 2016 | Company 2015 | Consolidated 2016 | Consolidated 2015 |
|---|---|---|---|---|---|
| Net sales revenue | 22 | **9,371,169** | 8,872,845 | **9,508,745** | 8,978,259 |
| Cost of goods resold and services rendered | 23 | **(6,538,942)** | (6,369,372) | **(6,586,130)** | (6,399,630) |
| Gross profit | | **2,832,227** | 2,503,473 | **2,922,615** | 2,578,629 |
| Operating income (expenses) | | | | | |
| Selling | 24 | **(1,761,438)** | (1,711,504) | **(1,776,258)** | (1,720,799) |
| General and administrative | 24 | **(452,735)** | (431,100) | **(481,933)** | (458,479) |
| Doubtful account losses | | **(25,987)** | (30,462) | **(26,074)** | (30,462) |
| Depreciation and amortization | 15 and 16 | **(132,941)** | (125,333) | **(133,612)** | (125,801) |
| Equity in the earnings of subsidiaries | 13 and 14 | **73,266** | 88,948 | **62,702** | 75,605 |
| Other operating income, net | 24 and 25 | **9,740** | 15,187 | **13,505** | 20,233 |
| | | **(2,290,095)** | (2,194,264) | **(2,341,670)** | (2,239,703) |
| Operating Profit Before Financial Result | | **542,132** | 309,209 | **580,945** | 338,926 |
| Finance income | | **150,706** | 155,359 | **116,655** | 130,297 |
| Finance expenses | | **(618,760)** | (615,264) | **(620,504)** | (616,352) |
| Financial result | 26 | **(468,054)** | (459,905) | **(503,849)** | (486,055) |
| Operating income (loss) before income tax And social contribution | | **74,078** | (150,696) | **77,096** | (147,129) |
| Current and deferred income tax and social contribution | 12 | **12,487** | 85,091 | **9,469** | 81,524 |
| Profit (loss) for the year | | **86,565** | (65,605) | **86,565** | (65,605) |
| Profit (loss) attributable to: | | | | | |
| Owners of the Company | | **86,565** | (65,605) | **86,565** | (65,605) |
| Earnings/loss per share | | | | | |
| Basic and diluted (R$ per share) | 21 | **3.98** | (2.94) | **3.98** | (2.94) |

The accompanying notes are an integral part of the financial statements.

# Magazine Luiza S.A.

Statement of comprehensive income
Years ended December 31, 2016 and 2015
(Amounts in thousands of Brazilian reais - R$)

| | Note | Company and Consolidated | |
|---|---|---|---|
| | | **2016** | **2015** |
| Profit (loss) for the year | | **86,565** | (65,605) |
| Other comprehensive income (loss) deriving from previous years to be reclassified to profit (loss) in subsequent periods: | | | |
| Available-for-sale financial assets deriving from investments | | | |
| Available-for-sale financial assets | | **(2,959)** | (2,103) |
| Tax effect | | **1,331** | 841 |
| Total | | **(1,628)** | (1,262) |
| Other comprehensive income (loss) to be reclassified to profit (loss) in subsequent periods: | | | |
| Available-for-sale financial assets deriving from investments | | | |
| Available-for-sale financial assets | | **5,145** | (856) |
| Tax effect | | **(2,315)** | 490 |
| Total | 14 | **2,830** | (366) |
| Statement of other comprehensive income | | **1,202** | (1,628) |
| Total comprehensive income for the period, net of taxes | | **87,767** | (67,233) |
| Attributable to: | | | |
| Controlling shareholders: | | **87,767** | (67,233) |

The accompanying notes are an integral part of the financial statements.

## Magazine Luiza S.A.

Statement of changes in equity
Years ended December 31, 2016 and 2015
(Amounts in thousands of Brazilian reais - R$)

| | Note | Capital stock | Capital reserve | Treasury shares | Legal reserve | Profit retention reserve | Profit (loss) for the year | Other comprehensive results | Total |
|---|---|---|---|---|---|---|---|---|---|
| Balance at January 1, 2015 | | 606,505 | 10,103 | (20,195) | 16,143 | 143,173 | - | (1,262) | 754,467 |
| Stock option plan | | - | 4,464 | - | - | - | - | - | 4,464 |
| Treasury shares | | - | - | (15,582) | - | - | - | - | (15,582) |
| Cancellation of treasury shares | | - | - | 26,203 | - | (26,203) | - | - | - |
| Additional dividends proposed - 2014 | | - | - | - | - | (15,166) | - | - | (15,166) |
| Loss for the year | | - | - | - | - | - | (65,605) | - | (65,605) |
| Transfer to absorb profit retention reserve | | - | - | - | - | (65,605) | 65,605 | - | - |
| | | 606,505 | 14,567 | (9,574) | 16,143 | 36,199 | - | (1,262) | 662,578 |
| Other comprehensive income: | | | | | | | | | |
| Financial instrument adjustments | 14 | - | - | - | - | - | - | (366) | (366) |
| Balance at December 31, 2015 | | **606,505** | **14,567** | **(9,574)** | **16,143** | **36,199** | **-** | **(1,628)** | **662,212** |
| Stock option plan | | **-** | **4,463** | **-** | **-** | **-** | **-** | **-** | **4,463** |
| Treasury shares | | **-** | **-** | **(35,593)** | **-** | **-** | **-** | **-** | **(35,593)** |
| Cancellation of treasury shares | | **-** | **-** | **16,438** | **-** | **(16,438)** | **-** | **-** | **-** |
| Income for the year | | **-** | **-** | **-** | **-** | **-** | **86,565** | **-** | **86,565** |
| Allocations: | | | | | | | | | |
| Legal reserve | | **-** | **-** | **-** | **4,328** | **-** | **(4,328)** | **-** | **-** |
| Profit retention reserve | | **-** | **-** | **-** | **-** | **69,902** | **(69,902)** | **-** | **-** |
| Mandatory dividends | | **-** | **-** | **-** | **-** | **-** | **(12,335)** | **-** | **(12,335)** |
| | | **606,505** | **19,030** | **(28,729)** | **20,471** | **89,663** | **-** | **(1,628)** | **705,312** |
| Other comprehensive income: | | | | | | | | | |
| Financial instrument adjustments | 14 | **-** | **-** | **-** | **-** | **-** | **-** | **2,830** | **2,830** |
| Balance at December 31, 2016 | | **606,505** | **19,030** | **(28,729)** | **20,471** | **89,663** | **-** | **1,202** | **708,142** |

The accompanying notes are an integral part of the financial statements.

# Magazine Luiza S.A.

Statement of cash flows
Years ended December 31, 2016 and 2015
(Amounts in thousands of Brazilian reais - R$)

| | | Company | | Consolidated | |
|---|---|---|---|---|---|
| | Note | 2016 | 2015 | 2016 | 2015 |
| Cash flow from operating activities | | | | | |
| Net income (loss) for the year | | **86,565** | (65,605) | **86,565** | (65,605) |
| Adjustments to reconcile profit (loss) for the year to cash generated from operating activities: | | | | | |
| Income tax and social contribution expenses recognized in P&L | 12 | **(12,487)** | (85,091) | **(9,469)** | (81,524) |
| Depreciation and amortization | 15 and 16 | **132,941** | 125,333 | **133,612** | 125,801 |
| Interest rate accrued over borrowings and financing | | **254,466** | 252,910 | **254,514** | 252,958 |
| Yield on securities | | **(38,610)** | (28,361) | **(38,610)** | (28,361) |
| Equity in the earnings (losses) of subsidiaries | 13 and 14 | **(73,266)** | (88,948) | **(62,702)** | (75,605) |
| Changes in allowance for asset losses | | **98,489** | 137,072 | **99,209** | 137,072 |
| Provision for tax, civil and labor contingencies | 20 | **62,949** | (860) | **59,111** | (6,920) |
| Loss on sale, net of write-off of property and equipment | 25 | **476** | 710 | **476** | 710 |
| Appropriation of deferred revenue | 25 | **(40,646)** | (47,749) | **(40,646)** | (47,749) |
| Stock option plan expenses | | **4,463** | 4,464 | **4,463** | 4,464 |
| Other | 12 | **-** | 1,925 | **-** | 1,925 |
| Adjusted profit for the year | | **475,340** | 205,800 | **486,523** | 217,166 |
| (Increase) decrease in operating assets: | | | | | |
| Receivables | | **(188,960)** | 116,196 | **(190,038)** | 113,211 |
| Securities and other financial assets | | **-** | - | **(350,290)** | 62,991 |
| Inventories | | **(298,847)** | 57,005 | **(299,573)** | 54,839 |
| Related parties | | **5,338** | 6,906 | **5,409** | 6,988 |
| Taxes recoverable | | **76,509** | (109,088) | **76,104** | (109,567) |
| Other assets | | **(50,478)** | (24,632) | **(50,474)** | (24,040) |
| Changes in operating assets | | **(456,438)** | 46,387 | **(808,862)** | 104,422 |
| Increase (decrease) in operating liabilities: | | | | | |
| Trade payables | | **468,222** | 100,349 | **470,802** | 104,259 |
| Payroll, vacation pay and related charges | | **34,370** | (14,320) | **34,487** | (13,520) |
| Taxes payable | | **9,116** | (21,015) | **8,843** | (21,239) |
| Related parties | | **4,136** | (11,738) | **4,551** | (11,901) |
| Other payables | | **1,665** | 15,838 | **3,245** | 15,261 |
| Changes in operating liabilities | | **517,509** | 69,114 | **521,928** | 72,860 |
| Income tax and social contribution paid | | **-** | - | **(2,730)** | (2,556) |
| Dividends received from subsidiaries | | **72,123** | 70,898 | **70,892** | 70,898 |
| Cash flow deriving from (used in) operating activities | | **608,534** | 392,199 | **267,751** | 462,790 |
| Cash flow from investing activities | | | | | |
| Purchase of property and equipment | 15 | **(77,062)** | (98,259) | **(77,302)** | (98,472) |
| Purchase of intangible assets | 16 | **(46,297)** | (58,585) | **(47,046)** | (59,134) |
| Investments in exclusive investment fund | | **(2,244,734)** | (645,400) | **-** | - |
| Redemptions in exclusive investment fund | | **1,894,444** | 708,391 | **-** | - |
| Sale of exclusive agreements and exploration right | | **-** | 288,000 | **-** | 288,000 |
| Payment of exclusive agreement renegotiation | | **(11,182)** | - | **(11,182)** | - |
| Capital increase in subsidiaries and joint ventures | | **(1,000)** | (60,000) | **-** | (60,000) |
| Investment in subsidiary | | **-** | (9,545) | **-** | (9,545) |
| Cash flow deriving from (used in) investing activities | | **(485,831)** | 124,602 | **(135,530)** | 60,849 |
| Cash flow from financing activities | | | | | |
| Borrowing and financing | | **578,540** | 690,809 | **578,540** | 690,809 |
| Payment of borrowing and financing | | **(477,188)** | (738,264) | **(477,325)** | (738,396) |
| Repayment of interest on borrowing and financing | | **(216,134)** | (221,642) | **(216,167)** | (221,690) |
| Payment of dividends and interest on equity | | **-** | (33,484) | **-** | (33,484) |
| Treasury shares acquired | | **(35,593)** | (15,583) | **(35,593)** | (15,583) |
| Cash flow used in financing activities | | **(150,375)** | (318,164) | **(150,545)** | (318,344) |
| Increase in cash and cash equivalents | | **(27,672)** | 198,637 | **(18,324)** | 205,295 |
| Cash and cash equivalents at the beginning of the year | | **590,400** | 391,763 | **617,465** | 412,170 |
| Cash and cash equivalents at the end of the year | | **562,728** | 590,400 | **599,141** | 617,465 |
| Increase in cash and cash equivalents | | **(27,672)** | 198,637 | **(18,324)** | 205,295 |

The accompanying notes are an integral part of the financial statements.

## Magazine Luiza S.A.

Statement of value added
Years ended December 31, 2016 and 2015
(Amounts in thousands of Brazilian reais - R$)

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Revenue | | | | |
| Goods and products sold and services rendered | **10,735,506** | 9,910,096 | **10,885,587** | 10,022,062 |
| Allowance for doubtful accounts, net of reversals | **(25,987)** | (30,462) | **(26,074)** | (30,462) |
| Other operating income | **44,557** | 93,702 | **48,324** | 98,767 |
| | **10,754,076** | 9,973,336 | **10,907,837** | 10,090,367 |
| Inputs acquired from third parties | | | | |
| Cost of goods resold and services rendered | **(7,138,511)** | (6,941,230) | **(7,185,406)** | (6,971,641) |
| Material, electricity, outsourced services and other | **(902,118)** | (997,223) | **(928,413)** | (1,017,285) |
| Impairment of assets | **(55,289)** | (59,107) | **(55,740)** | (59,107) |
| | **(8,095,918)** | (7,997,560) | **(8,169,559)** | (8,048,033) |
| Gross value added | **2,658,158** | 1,975,776 | **2,738,278** | 2,042,334 |
| Depreciation and amortization | **(132,941)** | (125,333) | **(133,612)** | (125,801) |
| Net value added generated by the entity | **2,525,217** | 1,850,443 | **2,604,666** | 1,916,533 |
| Value added received through transfer | | | | |
| Equity in the earnings of subsidiaries | **73,266** | 88,948 | **62,702** | 75,605 |
| Finance income | **150,706** | 155,359 | **116,655** | 130,297 |
| Total value added to distribute | **2,749,189** | 2,094,750 | **2,784,023** | 2,122,435 |
| Distribution of value added | | | | |
| Personnel and charges: | | | | |
| Direct compensation | **705,982** | 716,681 | **718,272** | 728,383 |
| Benefits | **149,031** | 128,979 | **150,447** | 130,276 |
| Government Severance Indemnity Fund for Employees (FGTS) | **71,732** | 71,180 | **72,843** | 72,132 |
| | **926,745** | 916,840 | **941,562** | 930,791 |
| Taxes, fees and contributions: | | | | |
| Federal | **146,244** | 41,220 | **154,977** | 50,036 |
| State | **625,664** | 265,032 | **633,239** | 267,049 |
| Municipal | **37,880** | 37,366 | **39,484** | 38,798 |
| | **809,788** | 343,618 | **827,700** | 355,883 |
| Value distributed to providers of capital: | | | | |
| Interest | **581,024** | 537,271 | **582,440** | 538,134 |
| Rentals | **313,958** | 287,954 | **314,486** | 288,407 |
| Other | **31,109** | 74,672 | **31,270** | 74,825 |
| | **926,091** | 899,897 | **928,196** | 901,366 |
| Value distributed to shareholders: | | | | |
| Dividends | **12,335** | - | **12,335** | - |
| Retained earnings (losses) | **74,230** | (65,605) | **74,230** | (65,605) |
| | **2,749,189** | 2,094,750 | **2,784,023** | 2,122,435 |

The accompanying notes are an integral part of the financial statements.

## 1. Operations

Magazine Luiza S.A. (the “Company”) is primarily engaged in the retail sale of consumer goods (mainly home appliances, personal electronics and furniture), through physical and virtual stores or through e-commerce, with headquarters in the city of Franca, state of São Paulo, Brazil. Its Parent and holding company is LTD Administração e Participação S.A.

At December 31, 2016, the Company and its subsidiaries owned 800 stores (786 stores in 2015) and 9 distribution centers (9 distribution centers in 2015), located in the South, Southeast, Mid-west and Northeast regions of Brazil.

Magazine Luiza S.A. and its subsidiaries are hereinafter referred to as “Group” for purposes of this report, unless otherwise stated.

On February 15, 2017, the Company’s Board of Directors authorized the issue of these financial statements.

## 2. Presentation and preparation of the financial statements

### 2.1. Basis of preparation and presentation

The Company’s parent company and consolidated financial statements were prepared based on the accounting practices adopted in Brazil, which include the provisions of Brazilian Corporation Law provided for in Law No. 6404/76, with amendments to Law No. 11638/07, Law No. 11941/09 and Law No. 12973/14 and International Financial Reporting Standards (“IFRS”) issued by the International Accounting Standards Board (“IASB”) and interpretations issued by the International Financial Reporting Interpretations Committee (“IFRIC”), implemented in Brazil through the Brazilian Accounting Pronouncements Committee (“CPC”) and its technical interpretations (“ICPC”) and guidance (“OCPC”), approved by the Brazilian Securities and Exchange Commission (“CVM”).

All significant information pertaining to the financial statements, and this information alone, is being evidenced and corresponds to those used by management (in its activities).

## 2. Presentation and preparation of the financial statements (Continued)

### 2.1. Basis of preparation and presentation (Continued)

The financial statements were prepared based on the historical cost, except for certain financial instruments measured by their fair values. The non-financial information included in these financial statements, such as the number of stores and distribution centers, amongst others, were not purpose of an audit by our independent auditors.

### 2.2. Basis of consolidation and investments in subsidiaries

The consolidated financial statements comprise the financial statements of the parent company and its subsidiaries. Control is obtained when the Group is exposed or is entitled to variable returns based on its involvement with the investee and has the capacity to affect these returns through its power over the investee.

Below is a description of the Company's subsidiaries at year-end:

| Subsidiary | Main activity | Interest %<br>2016 and 2015 |
|---|---|---|
| Época Cosméticos | E-commerce of perfumes and cosmetics | **100%** |
| Luiza Administradora de Consórcios (LAC) | Consortium management company | **100%** |

The consolidated financial statements also consider exclusive investment funds in which the Company maintains part of its financial investments, as shown in Note 7.

The process of consolidating accounts in the respective financial statements is complemented by the following elimination adjustments:

- The Parent company's interest in the capital, reserves and retained earnings from consolidated entities;
- Balances of assets and liabilities between consolidated entities; and
- Balances of revenues and expenses deriving from transactions between consolidated entities.

In the parent company's financial statements, the financial information about the subsidiaries and joint ventures will be recognized by the equity accounting method.

## 2. Presentation and preparation of the financial statements (Continued)

### 2.3. Functional and reporting currency of the financial statements

The Group's functional currency is the Brazilian Real. The financial statements of each subsidiary, as well as the financial statements adopted as basis to measure the investments by the equity accounting method, are prepared in Brazilian reais.

## 3. Summary of significant accounting practices

The following main accounting practices described have been consistently applied to the reported fiscal years and to the parent company and consolidated financial statements:

### 3.1. Foreign currency-denominated transactions

If any, the monetary assets and liabilities denominated in foreign currency are translated into Brazilian reais by adopting the foreign exchange rate effective on the closing date of the related statements of financial position. The differences resulting from the currency translation are recognized as finance income or expenses in the statement of income.

### 3.2. Financial Instruments

i) Financial assets

The Company classifies the financial instruments according to the purpose to which they were acquired and establishes the classification upon initial recognition as per the following categories:

*Measured at fair value through profit or loss* - the financial instruments held for trading are recorded in this category to be sold in the short term. These instruments are measured at fair value and have their gains and losses recorded directly in profit or loss. Securities are classified into this category.

*Loans and receivables* - these are non-derivative financial assets with fixed or determinable payments not quoted in an active market. Loans and receivables are measured at the amortized cost by adopting the effective interest rate method, less any impairment loss. Escrow deposits, related parties and trade receivables are classified into this category.

## 3. Summary of significant accounting practices (Continued)

### 3.2. Financial Instruments (Continued)

i) Financial assets (Continued)

*Financial assets impairment*

On the reporting dates, the Company analyzes if there is any objective evidence determining the impairment of the financial asset, or group of financial assets. An impairment only exists if, and only if, there is an objective evidence of non-recoverability due to one or more events occurred after the asset's initial recognition with an impact on the estimated future cash flow of the financial asset, which may be reasonably estimated.

*Derecognition (write-off) of financial assets*

The derecognition of a financial asset only occurs when the contractual rights over the asset's cash flow are realized or when the Company transfers the financial asset and substantially all its risks and returns to third parties. In transactions where these financial assets are transferred to third parties, but without effective transfer of related risks and returns, the asset is not derecognized.

ii) Financial liabilities

The Group's financial liabilities were classified upon initial recognition as:

*Other financial liabilities* - these are initially measured at fair value, net of transaction costs and, subsequently, they are measured by the amortized cost adopting the effective interest rate method to calculate the interest expense. The effective interest rate method calculates the amortized cost of a liability and allocates interest expenses during relevant period. The following is classified herein: balances of trade payables, borrowings and financing, related parties and taxes paid in installments.

*Derecognition (write-off) of financial liabilities*

A financial liability is written off when the obligation is revoked, canceled or expired. When a current financial liability is replaced with another one from same lender under substantially different terms, or the terms of a current liability are substantially modified, such replacement or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in corresponding carrying amounts is recognized in profit or loss.

# 3. Summary of significant accounting practices (Continued)

## 3.3. Derivative financial instruments and hedge accounting

The Company uses derivative financial instruments to manage its market risks, deriving from mismatch between currencies and indices. Derivatives are initially recognized at fair value on the date of the agreement, and subsequently, measured at their fair value at the end of each fiscal year or period.

## 3.4. Allocation of goodwill balances

Goodwill allocated to each cash-generating unit is annually tested for impairment or more frequently, when there is any indication that the cash-generating unit shows lower than expected performance. If the recoverable value of the cash-generating unit is lower than its carrying amount plus goodwill allocated thereto, the impairment loss is firstly allocated to reduce the goodwill allocated to the unit, and subsequently, to other assets of the unit, proportionally to the carrying amount of each of these assets. Any goodwill impairment is directly recognized in profit or loss when it was identified, which is not reversed in subsequent periods, even if the factors which resulted in its recording no longer exist.

## 3.5. Investments in joint ventures

Based on the equity accounting method, the investment in a joint venture is initially recognized at cost. The carrying amount of the investment is adjusted to recognize changes in the Company’s share in the joint venture’s equity as of the acquisition date.

The statement of income reflects the Company’s share in the joint venture’s operating results. Any change in other comprehensive income of these investees is reported as part of the Company’s other comprehensive income. In addition, when there is a variation directly recognized in the joint venture’s equity, the Company will recognize its share in any variations, where applicable, in the statement of changes in equity. Unrealized gains and losses arising from transactions between the Company and the joint venture are removed to the extent of the interest in the joint venture.

The joint venture’s financial statements are prepared for the same reporting period as the Company’s financial statements. Adjustments are made when necessary to align the accounting policies with those adopted by the Company.

## 3. Summary of significant accounting practices (Continued)

### 3.5. Investments in joint ventures (Continued)

After applying the equity accounting method, the Company determines whether it is necessary to recognize any additional impairment on the investment in its joint venture. The Company determines, on each reporting date, if there is an objective evidence that the investment in joint venture is impaired. If so, the Company calculates the impairment amount as the difference between the joint venture's recoverable value and its carrying amount, and recognizes the loss in the statement of income. The Company did not identify any objective evidence to recognize impairment in 2016 and 2015.

### 3.6. Present value adjustment

Retail activities

Main transactions that result in adjustments to present value are related to the purchase of goods for resale in installments, as well as goods resale operations, whose balances the clients pay by installments at fixed interest rates. Purchases and sales are discounted to determine the present value on the transaction date considering the installment terms.

The discount rate adopted considers the finance charges effects on the end consumer, weighted at the default risk percentage assessed and already included in the allowance for doubtful accounts.

The present value adjustment of liabilities referring to the purchase of goods for resale is recorded under "Trade payables" (having "Inventories" as the corresponding entry). Its reversal is recorded under "Costs of goods resold and services rendered", as per enjoyment of maturity term.

The corresponding entry of present value adjustment of resale of goods in installments is the "Trade receivables". Their realization is recorded under "Revenue from resale of goods", also as per enjoyment of maturity term.

### 3.7. Monetary restatement of rights and obligations

The monetary assets and liabilities subject to contractual adjustments or foreign exchange and monetary variations are restated up to the end of the reporting period, and these variations are recorded in the statement of income for the year to which they refer.

## 3. Summary of significant accounting practices (Continued)

### 3.8. Provisions

Provisions are recognized for current liabilities or risks resulting from past events, where it is possible to reliably estimate the amounts and whose disbursement is probable. The amount recognized as provision is the best estimate of the considerations required to settle the liability at the end of each year or period, taking into account the risks and uncertainties related to the liability.

### 3.9. Statement of Value Added ("DVA")

The Statement of Value Added ("DVA") aims at evidencing the wealth created by the Group and its distribution during certain period. It is presented as part of its parent company financial statements pursuant to Brazilian Corporation Law and as supplementary information to the consolidated financial statements, since it is neither an estimated statement nor mandatory under the IFRS.

## 4. Significant accounting judgments and sources of uncertainties about estimates

When applying the Group's accounting policies, the management is required to make judgments and prepare estimates on the carrying amounts of assets and liabilities to which objective information is not easily obtained from other sources. Estimates and related assumptions are based on the historical experience and other significant factors. Actual results of these carrying amounts may differ from those estimates.

Below, the key assumptions concerning the future and other main sources of uncertainty in the estimates at the end of each reporting year, which may result in relevant adjustments to the carrying amounts of assets and liabilities in the next year.

a) Deferred income tax and social contribution

The management's judgment is required in order to determine the deferred income tax and social contribution assets that may be recognized, based on a probable term and level of future taxable income, along with future tax planning strategies.

b) Useful life of long-lived assets

The Group recognizes the depreciation and amortization of its long-lived assets based on their estimated useful lives, which are based on the Group's practices and past experience and reflect the economic life of these assets. However, the actual useful lives may vary due to several factors. The useful lives of long-lived assets also affect tests to recover its cost.

## 4. Significant accounting judgments and sources of uncertainties about estimates (Continued)

c) Impairment of assets

At the end of each year, the Group reviews the balances of intangible assets and property and equipment to check whether there are indications that these assets may have been impaired (the highest amount between the value in use and the fair value, less sales costs). If yes, management conducts a detailed analysis of each asset's recoverable value by calculating the individual future cash flow, discounted at present value, adjusting the balance of related asset and its market value, if necessary.

d) Provision for inventory losses

The provision for inventory losses is estimated based on the history of losses identified in the physical inventory of stores and distribution centers, and management considers it sufficient to cover probable losses at the end of the reporting period.

e) Provision for inventory realization

The provision for inventory realization is recognized based on analysis of current sales prices, less taxes and overhead incurred for the sales effort, plus historical percentage of margin recovery with suppliers, compared to the cost of purchase of the products. In addition, goods transferred to technical assistance were considered in the analysis of obsolete products.

f) Allowance for doubtful accounts

This allowance is recorded in amount management deems sufficient to cover potential risks on the loan portfolio and other receivables existing at the end of the reporting period. The criterion to record this allowance takes into account, in retail activities, the percentage of historical recovery of past-due receivables and the default rate for the amounts falling due.

g) Provision for tax, civil and labor contingencies

The Group is a party to several lawsuits and administrative proceedings, as described in Note 20. Provisions are recorded for all the risks referring to lawsuits and administrative proceedings representing probable and estimated losses with certain degree of safety. The chances of losses include an evaluation on available evidence, the hierarchy of laws, available former court decisions, most recent court decisions and their relevance in the system of laws, as well as the external legal counsels' opinion. Management believes that these provisions for tax, civil, and labor contingencies are fairly reported in the financial statements.

## 5. New standards, amendments and interpretations

The standards and interpretations issued but not yet adopted until the date of publication of the Group's financial statements are presented below. The Group intends to adopt these standards, if applicable, when they become effective.

| | |
|---|---|
| IFRS 9 Financial Instruments (Effective as of 01/01/2018) | It aims ultimately to replace IAS 39. The main amendments are: (i) all the financial assets must be initially recognized at their fair value; (ii) the standard divides all the financial assets into: amortized cost and fair value; and (iv) the concept of embedded derivatives was extinguished. |
| IFRS 15 Revenue from Contracts with Customers (Effective as of 1/1/2018) | It primarily aims at providing clear principles to recognize revenue and streamline the process of preparing the financial statements. The Company is already conducting studies to measure possible impacts from this standard. |
| IFRS 16 Leases (Effective as of 1/1/2019) | Unification of the accounting treatment of operating and finance leases under a model similar to financial lease, impacting property and equipment and financial liabilities. The Company believes that the implementation of this new standard will bring material impacts to its financial statements. |

According to the management's opinion, there are no other standards and interpretations issued, but not yet adopted that could have a material effect on the Company's P&L and equity.

## 6. Cash and cash equivalents

Accounting policy

The Company's management defines as "Cash and cash equivalents" the amounts held for the purpose of meeting short-term commitments rather than for investment or other purposes. The financial investments can be immediately converted into a known cash amount with the issuer and are not subject to a significant risk of change in value, recorded at cost plus income earned until the end of the reporting period, which does not exceed their market or realization value.

(Amounts in thousands of Brazilian reais)

## 6. Cash and cash equivalents (Continued)

| | Rates | Company 2016 | Company 2015 | Consolidated 2016 | Consolidated 2015 |
|---|---|---|---|---|---|
| Cash | | **36,063** | 31,646 | **36,069** | 31,651 |
| Banks | | **37,933** | 30,857 | **41,039** | 31,500 |
| Bank deposit certificates | From 70.0% to 105% of CDI | **488,084** | 527,316 | **499,493** | 542,893 |
| Non-exclusive investment funds | 102.0% of CDI | **648** | 581 | **22,540** | 11,421 |
| Total cash and cash equivalents | | **562,728** | 590,400 | **599,141** | 617,465 |

## 7. Securities and other financial assets

| Financial assets | Rates | Company and Consolidated 2016 | Company and Consolidated 2015 |
|---|---|---|---|
| **Securities** | | | |
| Non-exclusive investment funds | 98% of CDI | **10,069** | 6,319 |
| Exclusive investment funds: | (a) | | |
| Debentures | | **773** | 1,375 |
| Federal government securities and repo operations | | **789,366** | 387,394 |
| Time deposits and other securities | | **5,041** | 21,261 |
| | Note 10.a | **795,180** | 410,030 |
| **Total securities** | | **805,249** | 416,349 |
| **Other financial assets - at fair value through profit or loss** | | | |
| Swap receivable - Fair value hedge | (b) | **13,906** | 128,002 |
| **Total securities and other financial assets** | | **819,155** | 544,351 |
| Current assets | | **818,984** | 497,623 |
| Noncurrent assets | | **171** | 46,728 |

(a) Considers the exclusive fixed income investment funds. At December 31, 2016, the portfolio was distributed into the investment types described in the table above, which are linked to financial operations securities, indexed to the monthly variation of CDI rate, to return the average profitability of 103% of the CDI to the Company.

(b) Fair value hedge accounting, as detailed in Note 28.

(Amounts in thousands of Brazilian reais)

## 8. Trade receivables

Accounting policy

Trade receivables are recorded and maintained in the statement of financial position for the securities amount, adjusted to present value, where applicable, mainly represented by credits from installment resales and credit card and the allowance for doubtful accounts (Note 4-f).

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Trade receivables: | | | | |
| Credit cards (a) | **272,502** | 155,017 | **276,206** | 158,749 |
| Debit cards (a) | **11,474** | 8,061 | **11,474** | 8,061 |
| Own installment plan (b) | **118,171** | 106,252 | **118,226** | 106,305 |
| Additional warranty agreements and other insurance (c) | **60,155** | 104,274 | **60,155** | 104,274 |
| Total trade receivables | **462,302** | 373,604 | **466,061** | 377,389 |
| Arising from sales agreements (d) | **170,010** | 126,974 | **171,984** | 127,904 |
| Allowance for doubtful accounts | **(29,535)** | (46,640) | **(29,535)** | (46,640) |
| Present value adjustment | **(23,873)** | (20,794) | **(23,939)** | (20,833) |
| Total receivables | **578,904** | 433,144 | **584,571** | 437,820 |
| | | | | |
| Current assets | **575,334** | 430,549 | **581,001** | 435,225 |
| Noncurrent assets | **3,570** | 2,595 | **3,570** | 2,595 |

The average term to receive trade receivables is 14 days in the Company and Consolidated. Receivables were assigned to secure borrowings for R$109,445 on December 31, 2016 (R$109,588 on December 31, 2015), represented by credit card receivables.

(a) Refers to credit and debit card receivables, which the Company receives from credit card companies at the amount, term and number of installments, defined when the product is sold. At December 31, 2016, the Company had credits granted to financial institutions totaling R$1,587,544 (R$1,417,827 in December 2015), where a discount between 105.0% and 109.0% of CDI is applied, which is recognized in profit or loss under “Financial expenses.” The Company, through assignment of card receivables transactions, transfers to the credit card companies and financial institutions all risks of payment by customers and, therefore, does not recognize the receivables referring to these credits. The respective financial charges are recorded in profit or loss for the year upon derecognition.

(b) Refer to receivables from sales financed by the Company.

(c) These sales are intermediated by the Company on behalf of Luizaseg and Cardif. The Company allocates to its partner companies the extended warranty amount and other insurance, in full, in the month following the sale, as shown in Note 10, and receives from customers according to the transaction term.

(d) Refer to bonuses to be received from suppliers, due to the fulfillment of the purchase volume and agreements defining the suppliers’ percentage in the disbursements related to advertising and marketing (joint advertising).

(Amounts in thousands of Brazilian reais)

## 8. Trade receivables (Continued)

Accounting policy (Continued)

Changes in the allowance for doubtful accounts are as follows:

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Balance at the beginning of the year | **(46,640)** | (49,511) | **(46,640)** | (49,511) |
| (+) Additions | **(43,200)** | (72,265) | **(43,287)** | (72,265) |
| (-) Write-offs | **60,305** | 75,136 | **60,392** | 75,136 |
| Balance at the end of the year | **(29,535)** | (46,640) | **(29,535)** | (46,640) |

The aging list of trade receivables and receivables from sales agreements is as follows:

| | Trade receivables: | | | | Arising from sales agreements | | | |
|---|---|---|---|---|---|---|---|---|
| | Company | | Consolidated | | Company | | Consolidated | |
| | **2016** | **2015** | **2016** | **2015** | **2016** | **2015** | **2016** | **2015** |
| Falling due: | | | | | | | | |
| Up to 30 days | **76,846** | 81,197 | **77,492** | 83,487 | **56,032** | 29,395 | **58,006** | 30,325 |
| Between 31 and 60 days | **45,242** | 54,729 | **45,407** | 55,689 | **88,776** | 64,818 | **88,776** | 64,818 |
| Between 61 and 90 days | **26,308** | 44,619 | **27,117** | 45,096 | **11,740** | 30,609 | **11,740** | 30,609 |
| Between 91 and 180 days | **51,629** | 86,177 | **52,910** | 86,235 | **9,173** | 181 | **9,173** | 181 |
| Between 181 and 360 days | **233,649** | 67,184 | **234,507** | 67,184 | **3** | 18 | **3** | 18 |
| Over 361 days | **7,424** | 4,319 | **7,424** | 4,319 | **-** | - | **-** | - |
| | **441,098** | 338,225 | **444,857** | 342,010 | **165,724** | 125,021 | **167,698** | 125,951 |
| Past-due: | | | | | | | | |
| Up to 30 days | **5,979** | 7,223 | **5,979** | 7,223 | **3,138** | 714 | **3,138** | 714 |
| Between 31 and 60 days | **4,814** | 6,192 | **4,814** | 6,192 | **509** | 68 | **509** | 68 |
| Between 61 and 90 days | **2,650** | 5,991 | **2,650** | 5,991 | **29** | 310 | **29** | 310 |
| Between 91 and 180 days | **7,761** | 15,973 | **7,761** | 15,973 | **610** | 861 | **610** | 861 |
| | **21,204** | 35,379 | **21,204** | 35,379 | **4,286** | 1,953 | **4,286** | 1,953 |
| **Total** | **462,302** | 373,604 | **466,061** | 377,389 | **170,010** | 126,974 | **171,984** | 127,904 |

(Amounts in thousands of Brazilian reais)

## 9. Inventories

Accounting policy

Inventories are stated at the smallest amount between the average acquisition cost and the net realization amount. The average acquisition cost includes the purchase price, taxes and non-recoverable taxes, such as the ICMS ST (State VAT Substituition taxation regime), and other costs directly attributable to the acquisition, and trade discounts and rebates. The net realization amount corresponds to the estimated sales price of inventories, less all costs necessary for the sale and recorded under provision for inventory realization.

| . | Company | | Consolidated | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Resale goods | **1,616,710** | 1,362,818 | **1,626,787** | 1,372,169 |
| Consumption material | **11,483** | 11,314 | **11,483** | 11,314 |
| Provision for inventory losses | **(40,894)** | (30,391) | **(41,527)** | (30,391) |
| Total | **1,587,299** | 1,343,741 | **1,596,743** | 1,353,092 |

At December 31, 2016, the Company has revolving inventories assigned as guarantee in legal lawsuits in progress, totaling approximately R$2,353 (R$2,353 at December 31, 2015).

Changes in the provision for inventory losses also includes the provision for inventory realization and adjustment to net realizable value as follows:

| | Company | | Consolidated | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Opening balance | **(30,391)** | (20,828) | **(30,391)** | (20,828) |
| Provision | **(55,289)** | (64,807) | **(55,922)** | (64,807) |
| Written-off or sold inventories | **44,786** | 55,244 | **44,786** | 55,244 |
| Closing balance | **(40,894)** | (30,391) | **(41,527)** | (30,391) |

(Amounts in thousands of Brazilian reais)

## 10. Related-party transactions

a) Balances from related parties

| | Company | | Consolidated | |
|---|---|---|---|---|
| **Current assets** | **2016** | **2015** | **2016** | **2015** |
| Commissions on services | | | | |
| Joint ventures: | | | | |
| Luizacred (i) | **10,843** | 14,742 | **10,843** | 14,742 |
| Luizaseg (ii) | **28,722** | 34,233 | **28,722** | 34,233 |
| | **39,565** | 48,975 | **39,565** | 48,975 |
| Subsidiaries: | | | | |
| Luiza Administradora de Consórcios (“LAC”) (iii) | **828** | 757 | **-** | - |
| Costs with consortium draws | | | | |
| Consortium Group (“LAC”) (iii) | **146** | 249 | **146** | 249 |
| Dividends receivable: | | | | |
| Luizacred (i) | **-** | 1,235 | | 1,235 |
| Luizaseg (ii) | **2,830** | 3,317 | **2,830** | 3,317 |
| Luiza Administradora de Consórcios (“LAC”) (iii) | **1,447** | 1,231 | **-** | - |
| | **4,277** | 5,783 | **2,830** | 4,552 |
| Balance receivable from credit card sales and accounts receivable by CDC: | | | | |
| Luizacred - CDC (i) | **2,834** | 3,492 | **2,834** | 3,492 |
| Luizacred - Credit card (i) | **18,646** | 13,884 | **18,646** | 13,884 |
| | **21,480** | 17,376 | **21,480** | 17,376 |
| Other receivables: | | | | |
| Luizacred (i) | **-** | 15,000 | **-** | 15,000 |
| Total | **66,296** | 88,140 | **64,021** | 86,152 |
| Securities | | | | |
| Investment Funds (vii) | **795,180** | 410,030 | **795,180** | 410,030 |

(Amounts in thousands of Brazilian reais)

## 10. Related-party transactions (Continued)

a) <u>Balances from related parties</u> (Continued)

| Current liabilities | Company 2016 | Company 2015 | Consolidated 2016 | Consolidated 2015 |
|---|---|---|---|---|
| Transfers of receivables from services and accounts payable: | | | | |
| Joint ventures: | | | | |
| Luizacred (i) | **27,853** | 22,374 | **27,853** | 22,374 |
| Luizaseg (ii) | **38,605** | 43,432 | **38,605** | 43,432 |
| | **66,458** | 65,806 | **66,458** | 65,806 |
| Subsidiaries: | | | | |
| Consortium Group (“LAC”) (iii) | **1,087** | 806 | **1,087** | 806 |
| Campos Floridos Comércio de Cosméticos Ltda. (viii) | **-** | 383 | **-** | - |
| | **1,087** | 1,189 | **1,087** | 806 |
| Rentals payable and other transfers | | | | |
| Controlled by the Company’s controlling shareholders: | | | | |
| MTG Administração, Assessoria e Participações S.A. (iv) | **1,979** | 1,752 | **1,981** | 1,752 |
| PJD Agropastoril Ltda. (vi) | **43** | 40 | **73** | 40 |
| | **2,022** | 1,792 | **2,054** | 1,792 |
| Payables relating to advertising campaigns: | | | | |
| ETCO - Special Partnership (v) | **3,356** | - | **3,356** | - |
| Total | **72,923** | 68,787 | **72,955** | 68,404 |

| Profit or loss | Company 2016 | Company 2015 | Consolidated 2016 | Consolidated 2015 |
|---|---|---|---|---|
| Income from service intermediation commissions | | | | |
| Joint ventures: | | | | |
| Luizacred (i) | **118,979** | 130,820 | **118,979** | 130,820 |
| Luizaseg (ii) | **240,112** | 289,314 | **240,112** | 289,314 |
| | **359,091** | 420,134 | **359,091** | 420,134 |
| Subsidiaries: | | | | |
| Luiza Administradora de Consórcios (“LAC”) (iii) | **9,966** | 8,525 | **-** | - |
| Revenue from return on exclusive fund: | | | | |
| Investment Funds (vii) | **37,587** | 27,639 | **37,587** | 27,639 |
| Reimbursement of shared expenses | | | | |
| Joint venture: | | | | |
| Luizacred (i) | **50,630** | 66,837 | **50,630** | 66,837 |
| Total revenues | **457,274** | 523,135 | **447,308** | 514,610 |

(Amounts in thousands of Brazilian reais)

## 10. Related-party transactions (Continued)

a) Balances from related parties (Continued)

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Costs related to the acquisition of goods | | | | |
| Campos Floridos Comércio de Cosméticos Ltda. (viii) | **(3,752)** | (6,608) | **-** | - |
| Total costs | **(3,752)** | (6,608) | **-** | - |
| | | | | |
| Office building rental expenses | | | | |
| Controlled by the Company's controlling shareholders: | | | | |
| MTG Administração, Assessoria e Participações S.A. (iv) | **(20,056)** | (16,210) | **(20,080)** | (16,210) |
| PJD Agropastoril Ltda. (vi) | **(490)** | (445) | **(849)** | (445) |
| | **(20,546)** | (16,655) | **(20,929)** | (16,655) |
| | | | | |
| Freight expenses | | | | |
| PJD Agropastoril Ltda. (vi) | **(2,177)** | (2,333) | **(2,177)** | (2,333) |
| | | | | |
| Credit card anticipation charge expenses: | | | | |
| Luizacred (i) | **(153,244)** | (108,056) | **(153,244)** | (108,056) |
| | | | | |
| Advertising campaign expenses | | | | |
| Controlled by the Company's controlling shareholders: | | | | |
| ETCO - Special Partnership (v) | **(158,961)** | (269,375) | **(158,961)** | (269,375) |
| | | | | |
| | **(334,928)** | (396,419) | **(335,311)** | (396,419) |

(i) Transactions with Luizacred, a subsidiary jointly controlled with Banco Itaúcard S.A., refer to the following activities:

(a) Financial expenses on the advance of receivables from such cards;

(b) Receivables from sales of products financed to customers by Luizacred, received by the Company on the following day ("D+1");

(c) Commissions on the services monthly provided by the Company, which include the attraction of customers, management and administration of consumer credit transactions, control and collection of financing granted, recommendation of insurance associated to financial products and services. Access to telecommunication systems and network, in addition to storage and availability of physical space in the points-of-sale. The amounts payable (current liabilities) refer to the receipt of customers' installments by the Company's store cashiers, which are transferred to Luizacred on D+1;

(d) Balance receivable referring to Luizacred's dividend proposal.

(ii) The amounts receivable (current assets) and revenues of Luizaseg, subsidiary jointly controlled with NCVP Participações Societárias S.A., a subsidiary of Cardif do Brasil Seguros e Previdência S.A., arise from commissions on services monthly provided by the Company, relating to the sale of extended warranties and proposed dividends. The amounts payable (current liabilities) refer to the transfers of extended warranties sold to Luizaseg, in full, in the month following the sale.

(iii) The amounts receivable (current assets) of LAC, wholly-owned subsidiary, refers to dividends proposed and commissions and sales made by the Company as the agent of consortium transactions. The amounts payable (current liabilities) refer to the transfers to be made to LAC relating to the installments of consortiums received by the Company through the cashiers of its points-of-sale.

(iv) Transactions with MTG Administração, Assessoria e Participações S.A. ("MTG"), controlled by the Company's controlling shareholders, refer to expenses with rental of office buildings for the installation of its stores, distribution centers and head office.

(Amounts in thousands of Brazilian reais)

## 10. Related-party transactions (Continued)

### a) Balances from related parties (Continued)

(v) Transactions with ETCO, a special partnership which has as partner an entity controlled by the Chairman of the Company's Board of Directors, refer to advertising and marketing service contracts, also including transfers relating to placement, media production and graphic design services.

(vi) Transactions with PJD Agropastoril Ltda., an entity controlled by the Company's indirect controlling shareholders, refer to expenses with rental of commercial buildings for installation of stores and truck rental for freight of goods.

(vii) Refers to investments and redemptions, and income from exclusive investment funds (ML Renda Fixa Crédito Privado FI and FI Caixa ML RF Longo Prazo - see Note 7 - Securities).

(viii) Transactions with Campos Floridos Comércio de Cosméticos Ltda., a wholly-owned subsidiary, refer to the sale of products for resale by the Company.

### b) Management Compensation

| | **2016** | | **2015** | |
|---|---|---|---|---|
| | **Board of Directors** | **Statutory Board of Executive Officers** | **Board of Directors** | **Statutory Board of Executive Officers** |
| Fixed and variable compensation | **2,913** | **9,364** | 419 | 8,787 |
| Stock option plan | **2,454** | **863** | 386 | 2,930 |

The Company does not grant post-employment benefits, severance benefits, or other long-term benefits. Short-term benefits to the Statutory Board of Executive Officers are the same as those extended to other employees of the Company. The Company has an internal policy to pay profit sharing to its employees. These amounts are being provisioned on a monthly basis by the Company, in accordance with target achievement estimates, which is the substancial variation to the periods disclosed. On April 18, 2016, the Company's Board of Directors approved management's overall compensation for the fiscal year ended December 31, 2016, where a maximum limit for management's overall compensation is estimated at R$15,598.

(Amounts in thousands of Brazilian reais)

## 11. Recoverable taxes

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Recoverable ICMS (a) | **406,068** | 450,115 | **406,068** | 450,115 |
| Recoverable income tax and social contribution | **1,160** | 2,461 | **1,380** | 2,463 |
| Recoverable withholding income tax | **21,388** | 23,853 | **21,405** | 23,878 |
| Recoverable PIS and COFINS | **4,163** | 32,859 | **5,420** | 33,701 |
| Other | **1,482** | 1,482 | **1,482** | 1,482 |
| | **434,261** | 510,770 | **435,755** | 511,639 |
| Current assets | **210,657** | 333,475 | **212,151** | 334,344 |
| Noncurrent assets | **223,604** | 177,295 | **223,604** | 177,295 |

(a) These refer to ICMS accumulated credits and credits arising from the ST (“tax substituition”) regime deriving from the application of different rates in the inflow and outflow of interstate goods. Referred credits will be realized by refund request and offset of debts of same nature with the states of origin of credit.

## 12. Income tax and social contribution

Accounting policy

*Current tax*

Income taxes are recognized in profit or loss for the year. The provisions for income tax and social contribution are calculated individually by company member of the Group based on the rates effective at the year’s end.

*Deferred tax*

Deferred income tax and social contribution (“deferred taxes”) are recognized on temporary differences between the balances of assets and liabilities recognized in the financial statements and related tax bases adopted to calculate the taxable income, including the tax loss and social contribution tax loss carryforwards, not subject to statute of limitations. Deferred tax liabilities are usually recognized for all taxable temporary differences and deferred tax assets are recognized over all deductible temporary differences only when it is probable that the future taxable basis will be in an amount sufficient to absorb the deductible temporary differences.

The probability of recovering the balance of deferred tax assets is reviewed at the end of each year and, when future taxable bases are probably no longer available and allowing the full or partial recovery of these taxes, the balance of the assets is reduced to the amount expected to be recovered.

(Amounts in thousands of Brazilian reais)

## 12. Income tax and social contribution (Continued)

Accounting policy (Continued)

*Deferred tax* (Continued)

Deferred tax assets and liabilities are mutually offset only when there is a legal right to set off, when they are related to taxes managed by the same tax authority and the Group intends to settle the net amount of its current tax assets and liabilities.

a) Reconciliation of the tax effect on income before income tax and social contribution

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Income (loss) before income tax and social contribution | **74,078** | (150,696) | **77,096** | (147,129) |
| Nominal statutory rate | **34%** | 34% | **34%** | 34% |
| Expected income tax and social contribution credit (debit) at statutory rates | **(25,187)** | 51,237 | **(26,213)** | 50,024 |
| **Reconciliation for effective rate (effects of applying tax rates):** | | | | |
| Effect from government incentive (1) | **20,588** | 5,844 | **20,588** | 5,844 |
| Exclusion - equity in the earnings of subsidiaries | **24,910** | 30,242 | **21,319** | 25,706 |
| Other permanent exclusions, net | **(7,824)** | (2,232) | **(6,225)** | (50) |
| Credit from income tax and social contribution | **12,487** | 85,091 | **9,469** | 81,524 |
| Current | **-** | - | **(3,194)** | (3,301) |
| Deferred | **12,487** | 85,091 | **12,663** | 84,825 |
| Total | **12,487** | 85,091 | **9,469** | 81,524 |
| Effective tax rate | **16.9%** | 56.5% | **12.3%** | 55.4% |

(1) The Company has an investment incentive, granted by some government entities in which have an operation, in the form of presumed ICMS credits. Government incentive is recorded in the income statement for the year of the caption on "Net sales revenue". Up to the end of 2016, the Company complied with all requirements requested by the terms of the incentive, such as compliance with tax obligations, maintenance of agreed jobs, minimum billing and maintenance of logistics structure with appropriate physical space for inventories in the entity Governmental organization.

(Amounts in thousands of Brazilian reais)

## 12. Income tax and social contribution (Continued)

b) Breakdown of deferred income tax and social contribution assets and liabilities

| Company | Balance at 01/01/2015 | Recognized in profit or loss | Offsetting tax loss carryforwards with PRORELIT (1) | Balance at 12/31/2015 | Recognized in profit or loss | Balance at 12/31/2016 |
|---|---|---|---|---|---|---|
| Deferred income tax and social contribution assets: | | | | | | |
| Tax losses and social contribution tax loss carryforwards | 54,853 | 93,756 | (1,925) | 146,684 | **795** | **147,479** |
| Allowance for doubtful accounts | 16,834 | (977) | - | 15,857 | **(5,815)** | **10,042** |
| Provision for inventory loss | 7,081 | 3,252 | - | 10,333 | **3,571** | **13,904** |
| Provision for present value adjustments | 8,793 | (1,599) | - | 7,194 | **(1,304)** | **5,890** |
| Provision for tax, civil and labor contingencies | 80,099 | (1,896) | - | 78,203 | **15,315** | **93,518** |
| Foreign exchange variations | - | - | - | - | **14,895** | **14,895** |
| Other provisions | 5,324 | (503) | - | 4,821 | **(268)** | **4,553** |
| | 172,984 | 92,033 | (1,925) | 263,092 | **27,189** | **290,281** |
| Deferred income tax and social contribution liabilities: | | | | | | |
| Amortization of intangible assets | (27,548) | (6,942) | - | (34,490) | **(6,298)** | **(40,788)** |
| Escrow deposits | - | - | - | - | **(6,203)** | **(6,203)** |
| Other | - | - | - | - | **(2,201)** | **(2,201)** |
| | (27,548) | (6,942) | - | (34,490) | **(14,702)** | **(49,192)** |
| | 145,436 | 85,091 | (1,925) | 228,602 | **12,487** | **241,089** |

(Amounts in thousands of Brazilian reais)

## 12. Income tax and social contribution (Continued)

b) <u>Breakdown and changes of deferred income tax and social contribution assets and liabilities</u> (Continued)

| Consolidated | Balance at 01/01/2015 | Recognized in profit or loss | Offsetting tax loss carryforwards with PRORELIT (1) | Balance at 12/31/2015 | Recognized in profit or loss | Balance at 12/31/2016 |
|---|---|---|---|---|---|---|
| Deferred income tax and social contribution assets: | | | | | | |
| Tax losses and social contribution tax loss carryforwards | 55,657 | 93,438 | (1,925) | 147,170 | **737** | **147,907** |
| Allowance for doubtful accounts | 16,834 | (977) | - | 15,857 | **(5,815)** | **10,042** |
| Provision for inventory losses | 7,141 | 3,252 | - | 10,393 | **3,727** | **14,120** |
| Provision for present value adjustment | 8,793 | (1,599) | - | 7,194 | **(1,281)** | **5,913** |
| Provision for tax, civil and labor contingencies | 80,246 | (1,844) | - | 78,402 | **15,320** | **93,722** |
| Foreign exchange variations | - | - | - | - | **14,895** | **14,895** |
| Other provisions | 5,324 | (503) | - | 4,821 | **(218)** | **4,603** |
| | 173,995 | 91,767 | (1,925) | 263,837 | **27,365** | **291,202** |
| Deferred income tax and social contribution liabilities: | | | | | | |
| Amortization of intangible assets | (27,548) | (6,942) | - | (34,490) | **(6,298)** | **(40,788)** |
| Escrow deposits | - | - | - | - | **(6,203)** | **(6,203)** |
| Other | - | - | - | - | **(2,201)** | **(2,201)** |
| | (27,548) | (6,942) | - | (34,490) | **(14,702)** | **(49,192)** |
| | 146,447 | 84,825 | (1,925) | 229,347 | **12,663** | **242,010** |

(1) Offsetting of tax loss carryforwards, referring to the adhesion to the Program to Reduce Tax Litigation (PRORELIT), pursuant to Law No. 13202/15.

(Amounts in thousands of Brazilian reais)

## 12. Income tax and social contribution (Continued)

b) Breakdown and changes of deferred income tax and social contribution assets and liabilities (Continued)

The asset recorded is limited to the amounts whose realization is supported by future taxable base projections, approved by management. The expected realization of the deferred income tax and social contribution at December 31, 2016 is as follows:

| | Company | Consolidated |
|---|---|---|
| Year of realization | | |
| 2017 | **57,812** | **57,885** |
| 2018 | **34,490** | **34,490** |
| 2019 | **41,077** | **41,293** |
| 2020 | **46,466** | **46,466** |
| 2021 onwards | **61,244** | **61,876** |
| | **241,089** | **242,010** |

## 13. Investments in subsidiaries

Changes in ownership interest in subsidiaries, stated in the Company's financial statements, are as follows:

| | Época | | LAC | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Units of interest held | **12,855** | 4,155 | **6,500** | 6,500 |
| Current assets | **19,235** | 16,083 | **34,572** | 27,344 |
| Noncurrent assets | **6,803** | 6,618 | **3,967** | 3,368 |
| Current liabilities | **11,469** | 9,012 | **11,288** | 8,530 |
| Noncurrent liabilities | **8,473** | 13,062 | **3,152** | 2,731 |
| Capital stock | **12,255** | 11,255 | **6,500** | 6,500 |
| Equity | **6,096** | 627 | **24,099** | 19,451 |
| Net revenues | **60,177** | 45,674 | **53,530** | 47,234 |
| Net income for the year | **4,469** | 8,160 | **6,095** | 5,183 |

| | 2016 | 2015 | 2016 | 2015 |
|---|---|---|---|---|
| **Changes in investments** | | | | |
| Balance at the beginning of the year | **37,454** | 29,294 | **19,451** | 15,499 |
| Advance for Future Capital Increase "AFAC" | **1,000** | - | **-** | - |
| Dividends proposed | **-** | - | **(1,447)** | (1,231) |
| Equity in the earnings of subsidiaries | **4,469** | 8,160 | **6,095** | 5,183 |
| Balance at the end of the year | **42,923** | 37,454 | **24,099** | 19,451 |

## 13. Investments in subsidiaries (Continued)

Total investments in subsidiaries

| | 2016 | 2015 |
|---|---|---|
| Época Cosméticos | **6,096** | 627 |
| Época Cosméticos - goodwill | **36,827** | 36,827 |
| Consortium group ("LAC") | **24,099** | 19,451 |
| | **67,022** | 56,905 |

## 14. Investment in joint ventures

| | Luizacred (a) | | Luizaseg (b) | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Total shares - in thousands | **978** | 978 | **133,883** | 133,883 |
| Direct interest percentage | **50%** | 50% | **50%** | 50% |
| Current assets | **4,006,492** | 3,845,850 | **142,886** | 188,934 |
| Noncurrent assets | **441,504** | 484,162 | **320,370** | 272,202 |
| Current liabilities | **3,769,476** | 3,660,700 | **177,788** | 178,714 |
| Noncurrent liabilities | **127,566** | 106,052 | **75,650** | 77,632 |
| Capital stock | **274,624** | 274,624 | **133,884** | 133,884 |
| Equity | **550,954** | 563,260 | **209,818** | 204,790 |
| Net revenues | **1,669,580** | 1,834,284 | **364,902** | 383,592 |
| Net income for the year | **101,572** | 123,278 | **23,832** | 27,932 |

| | Luizacred (a) | | Luizaseg (b) | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| **Changes in investments** | | | | |
| Balance at the beginning of the year | **281,630** | 280,566 | **102,395** | 39,038 |
| Capital increase | **-** | - | **-** | 60,000 |
| Dividends proposed | **(56,939)** | (60,575) | **(12,232)** | (10,243) |
| Other comprehensive income (losses) | **-** | - | **2,830** | (366) |
| Equity in the earnings of subsidiaries | **50,786** | 61,639 | **11,916** | 13,966 |
| Balance at the end of the year | **275,477** | 281,630 | **104,909** | 102,395 |

(Amounts in thousands of Brazilian reais)

## 14. Investment in joint ventures (Continued)

Total investments in joint ventures

| | 2016 | 2015 |
|---|---|---|
| Luizacred (a) | **275,477** | 281,630 |
| Luizaseg (b) | **104,909** | 102,395 |
| | **380,386** | 384,025 |

(a) Interest of 50% of voting capital stock representing the contractually agreed sharing, the control of business, requiring the unanimous consent of the parties about significant decisions, financial and operating activities. Luizacred is jointly controlled by Banco Itaúcard S.A., the purpose of which is the supply, distribution and trade of financial products and services to customers at the Company's stores chain.

(b) 50% interest in the voting capital stock representing the contractually agreed sharing, the control of business, requiring the unanimous consent of the parties about relevant decisions, guarantees and operating activities. Luizaseg is jointly controlled by NCVP Participações Societárias S.A., subsidiary of Cardif do Brasil Seguros e Previdência S.A., the purpose of which is the development, sale and administration of extended warranties for any type of product sold in Brazil through the Company's stores chain.

## 15. Property and equipment

Accounting policy

Property and equipment are stated at the acquisition or construction cost, less related accumulated depreciation, except for land and construction in progress, plus interest rates incurred and capitalized during the properties construction phase, where applicable.

Depreciation is recognized based on the estimated useful lives of each asset or family of assets by the straight-line method, so that its residual value after its useful life is fully written off. The estimated useful life, the residual values and depreciation methods are yearly reviewed and the effect of any change in estimates is accounted for prospectively.

An item of the property and equipment is written off after being sold or when there is no future economic benefits resulting from its continued use. Gains or losses on sale or write-off are recognized in profit or loss when incurred.

The accounting policy related to the impairment of property and equipment is described in Note 4-c.

(Amounts in thousands of Brazilian reais)

## 15. Property and equipment (Continued)

Changes in property and equipment for the years ended December 31, 2016 and 2015 are as follows:

a) Company

| | Balance at 12/31/2015 | Additions | Depreciation | Write offs | Transfers | Balance at 12/31/2016 |
|---|---|---|---|---|---|---|
| Furniture and fixtures | 94,128 | 12,500 | (15,173) | (806) | 390 | **91,039** |
| Machinery and equipment | 64,057 | 5,868 | (4,584) | (377) | (203) | **64,761** |
| Vehicles | 17,349 | 444 | (3,968) | (29) | - | **13,796** |
| Computers and peripherals | 34,489 | 12,902 | (12,962) | (110) | 1,380 | **35,699** |
| Leasehold improvements | 322,730 | - | (54,347) | (946) | 63,567 | **331,004** |
| Work in progress | 35,770 | 40,851 | - | (159) | (64,631) | **11,831** |
| Other | 9,288 | 4,497 | (1,890) | (202) | (503) | **11,190** |
| | 577,811 | 77,062 | (92,924) | (2,629) | - | **559,320** |

| | Balance at 01/01/2015 | Additions | Depreciation | Write offs | Transfers | Balance at 12/31/2015 |
|---|---|---|---|---|---|---|
| Furniture and fixtures | 93,689 | 15,410 | (15,068) | (659) | 756 | 94,128 |
| Machinery and equipment | 58,704 | 10,799 | (4,087) | (282) | (1,077) | 64,057 |
| Vehicles | 24,870 | 826 | (8,202) | (100) | (45) | 17,349 |
| Computers and peripherals | 35,987 | 13,500 | (15,411) | (117) | 530 | 34,489 |
| Leasehold improvements | 288,951 | - | (40,246) | - | 74,025 | 322,730 |
| Work in progress | 56,929 | 52,850 | - | (89) | (73,920) | 35,770 |
| Other | 6,228 | 4,874 | (1,429) | (116) | (269) | 9,288 |
| | 565,358 | 98,259 | (84,443) | (1,363) | - | 577,811 |

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated depreciation | Net | Cost | Accumulated depreciation | Net |
| Furniture and fixtures | **179,215** | **(88,176)** | **91,039** | 169,399 | (75,271) | 94,128 |
| Machinery and equipment | **95,023** | **(30,262)** | **64,761** | 89,904 | (25,847) | 64,057 |
| Vehicles | **43,344** | **(29,548)** | **13,796** | 43,102 | (25,753) | 17,349 |
| Computers and peripherals | **158,887** | **(123,188)** | **35,699** | 148,058 | (113,569) | 34,489 |
| Leasehold improvements | **630,649** | **(299,645)** | **331,004** | 569,418 | (246,688) | 322,730 |
| Work in progress | **11,831** | **-** | **11,831** | 35,770 | - | 35,770 |
| Other | **22,722** | **(11,532)** | **11,190** | 19,061 | (9,773) | 9,288 |
| | **1,141,671** | **(582,351)** | **559,320** | 1,074,712 | (496,901) | 577,811 |

(Amounts in thousands of Brazilian reais)

## 15. Property and equipment (Continued)

b) Consolidated

| | Balance at 12/31/2015 | Additions (1) | Depreciation | Write offs | Transfers | Balance at 12/31/2016 |
|---|---|---|---|---|---|---|
| Furniture and fixtures | 94,128 | 12,500 | (15,173) | (806) | 390 | **91,039** |
| Machinery and equipment | 64,057 | 5,868 | (4,584) | (377) | (203) | **64,761** |
| Vehicles | 17,349 | 444 | (3,968) | (29) | - | **13,796** |
| Computers and peripherals | 34,489 | 12,902 | (12,962) | (110) | 1,380 | **35,699** |
| Leasehold improvements | 322,730 | - | (54,347) | (946) | 63,567 | **331,004** |
| Work in progress | 35,770 | 40,851 | - | (159) | (64,631) | **11,831** |
| Other | 10,048 | 4,737 | (2,143) | (202) | (503) | **11,937** |
| | 578,571 | 77,302 | (93,177) | (2,629) | - | **560,067** |

| | Balance at 01/01/2015 | Additions (1) | Depreciation | Write offs | Transfers | Balance at 12/31/2015 |
|---|---|---|---|---|---|---|
| Furniture and fixtures | 93,689 | 15,410 | (15,068) | (659) | 756 | 94,128 |
| Machinery and equipment | 58,704 | 10,799 | (4,087) | (282) | (1,077) | 64,057 |
| Vehicles | 24,870 | 826 | (8,202) | (100) | (45) | 17,349 |
| Computers and peripherals | 35,987 | 13,500 | (15,411) | (117) | 530 | 34,489 |
| Leasehold improvements | 288,951 | - | (40,246) | - | 74,025 | 322,730 |
| Work in progress | 56,929 | 52,850 | - | (89) | (73,920) | 35,770 |
| Other | 7,063 | 5,087 | (1,669) | (164) | (269) | 10,048 |
| | 566,193 | 98,472 | (84,683) | (1,411) | - | 578,571 |

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated depreciation | Net | Cost | Accumulated depreciation | Net |
| Furniture and fixtures | **179,215** | **(88,176)** | **91,039** | 169,399 | (75,271) | 94,128 |
| Machinery and equipment | **95,023** | **(30,262)** | **64,761** | 89,904 | (25,847) | 64,057 |
| Vehicles | **43,344** | **(29,548)** | **13,796** | 43,102 | (25,753) | 17,349 |
| Computers and peripherals | **158,887** | **(123,188)** | **35,699** | 148,058 | (113,569) | 34,489 |
| Leasehold improvements | **630,649** | **(299,645)** | **331,004** | 569,418 | (246,688) | 322,730 |
| Work in progress | **11,831** | **-** | **11,831** | 35,770 | - | 35,770 |
| Other | **25,218** | **(13,281)** | **11,937** | 21,317 | (11,269) | 10,048 |
| | **1,144,167** | **(584,100)** | **560,067** | 1,076,968 | (498,397) | 578,571 |

(1) Investments in renovation and adaptation of store facilities were substantially financed by the Brazilian Federal Savings Bank, as detailed in Note 18.

At December 31, 2016, the Company recorded R$2,979 (R$6,549 at December 31, 2015) referring to the borrowing costs capitalized to open new stores and acquire facilities and equipment. The average borrowing rate was adopted to calculate the borrowing costs that can be capitalized.

(Amounts in thousands of Brazilian reais)

## 15. Property and equipment (Continued)

c) Depreciation rates

Annual depreciation rates are stated as follows:

| | 2016 | 2015 |
|---|---|---|
| Furniture and fixtures | **10%** | 10% |
| Machinery and equipment | **5%** | 5% |
| Light vehicles | **20%** | 20% |
| Heavy vehicles | **14.3%** | 14.3% |
| Computers and peripherals | **20%** | 20% |
| Leasehold improvements | **9.1%** | 7.1% |

At December 31, 2016, the Group had property and equipment fully depreciated in operation at the amount of R$170,586 (R$130,064 at December 31, 2015). The Group has no idle items of the property and equipment or held for sale.

d) Asset impairment test

In the reporting years, we did not identify any event indicating the need of making calculations to assess any impairment of the property and equipment.

## 16. Intangible assets

Accounting policy

The intangible assets with finite useful lives, represented by the amounts paid in the acquisition of new points-of-sale (goodwill), have been amortized on a straight-line basis for 10 years, a period which reflects the management's best estimate of the minimum period of occupancy in the leased property.

Software refers to the acquisition cost of the corporate management system, which has been amortized on a straight-line basis for five years.

Research expenditures are recorded as expenses when incurred, and development expenses related to the technological innovation of existing products are capitalized, if they are technologically and economically feasible, and amortized in operating expenses during the expected period of benefits. While these developments are not concluded, the balances are recorded in the "Projects in progress" line.

(Amounts in thousands of Brazilian reais)

## 16. Intangible assets (Continued)

Accounting policy (Continued)

The intangible assets acquired in a business combination mainly refer to the goodwill verified in investment acquisition represented by store chains. In the consolidated financial statements, the intangible assets acquired in a business combination and recognized separately from goodwill are recorded at fair value on the acquisition date, which corresponds to its cost.

An intangible asset is written off upon sale or when there is no future economic benefits related thereto, being recognized in profit & loss when the asset is written off.

The accounting policies related to the impairment of intangible assets are described in Notes 3.4 (goodwill) and 4-c (other intangible assets).

Changes for the years ended December 31, 2016 and 2015 are as follows:

a) Company

| | Balance at 12/31/2015 | Additions | Amortization | Write-offs | Transfers | Balance at 12/31/2016 |
|---|---|---|---|---|---|---|
| Goodwill from the acquisition of new chains | 313,856 | - | - | - | - | **313,856** |
| Goodwill | 33,805 | 45 | (5,581) | (227) | 5,261 | **33,303** |
| Software and internal development | 83,266 | 472 | (34,392) | (26) | 70,560 | **119,880** |
| Projects in progress | 32,637 | 45,780 | - | (29) | (75,821) | **2,567** |
| Trademarks and patents | 58 | - | (44) | - | - | **14** |
| Other | 104 | - | - | - | - | **104** |
| | 463,726 | 46,297 | (40,017) | (282) | - | **469,724** |

| | Balance at 01/01/2015 | Additions | Amortization | Write-offs | Transfers | Balance at 12/31/2015 |
|---|---|---|---|---|---|---|
| Goodwill from the acquisition of new chains | 313,856 | - | - | - | - | 313,856 |
| Goodwill | 37,295 | - | (14,609) | (9) | 11,128 | 33,805 |
| Software and internal development | 62,020 | 11,264 | (26,237) | (8) | 36,227 | 83,266 |
| Projects in progress | 32,703 | 47,321 | - | (32) | (47,355) | 32,637 |
| Trademarks and patents | 102 | - | (44) | - | - | 58 |
| Other | 104 | - | - | - | - | 104 |
| | 446,080 | 58,585 | (40,890) | (49) | - | 463,726 |

(Amounts in thousands of Brazilian reais)

## 16. Intangible assets (Continued)

a) Company (Continued)

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated amortization | Net | Cost | Accumulated amortization | Net |
| Goodwill from the acquisition of new chains | **325,451** | **(11,595)** | **313,856** | 325,451 | (11,595) | 313,856 |
| Goodwill | **142,735** | **(109,432)** | **33,303** | 137,904 | (104,099) | 33,805 |
| Software and internal development | **262,123** | **(142,243)** | **119,880** | 187,923 | (104,657) | 83,266 |
| Projects in progress | **2,567** | **-** | **2,567** | 32,637 | - | 32,637 |
| Trademarks and patents | **211** | **(197)** | **14** | 212 | (154) | 58 |
| Other | **9,596** | **(9,492)** | **104** | 9,596 | (9,492) | 104 |
| | **742,683** | **(272,959)** | **469,724** | 693,723 | (229,997) | 463,726 |

b) Consolidated

| | Balance at 12/31/2015 | Additions | Amortization | Write-offs | Transfers | Balance at 12/31/2016 |
|---|---|---|---|---|---|---|
| Goodwill from the acquisition of new chains | 350,683 | - | - | - | - | **350,683** |
| Goodwill | 35,544 | 45 | (5,581) | (227) | 5,261 | **35,042** |
| Software and internal development | 84,307 | 1,221 | (34,810) | (26) | 70,560 | **121,252** |
| Projects in progress | 32,637 | 45,780 | - | (29) | (75,821) | **2,567** |
| Trademarks and patents | 3,445 | - | (44) | - | - | **3,401** |
| Other | 104 | - | - | - | - | **104** |
| | 506,720 | 47,046 | (40,435) | (282) | - | **513,049** |

| | Balance at 01/01/2015 | Additions | Amortization | Write-offs | Transfers | Balance at 12/31/2015 |
|---|---|---|---|---|---|---|
| Goodwill from the acquisition of new chains | 350,683 | - | - | - | - | 350,683 |
| Goodwill | 39,035 | - | (14,610) | (9) | 11,128 | 35,544 |
| Software and internal development | 62,740 | 11,812 | (26,464) | (8) | 36,227 | 84,307 |
| Projects in progress | 32,703 | 47,321 | - | (32) | (47,355) | 32,637 |
| Trademarks and patents | 3,489 | - | (44) | - | - | 3,445 |
| Other | 103 | 1 | - | - | - | 104 |
| | 488,753 | 59,134 | (41,118) | (49) | - | 506,720 |

(Amounts in thousands of Brazilian reais)

## 16. Intangible assets (Continued)

b) Consolidated (Continued)

| | 2016 | | | 2015 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated amortization | Net | Cost | Accumulated amortization | Net |
| Goodwill from the acquisition of new chains | **362,278** | **(11,595)** | **350,683** | 362,278 | (11,595) | 350,683 |
| Goodwill | **144,474** | **(109,432)** | **35,042** | 139,643 | (104,099) | 35,544 |
| Software and internal development | **265,071** | **(143,819)** | **121,252** | 190,123 | (105,816) | 84,307 |
| Projects in progress | **2,567** | **-** | **2,567** | 32,637 | - | 32,637 |
| Trademarks and patents | **3,598** | **(197)** | **3,401** | 3,599 | (154) | 3,445 |
| Other | **9,596** | **(9,492)** | **104** | 9,596 | (9,492) | 104 |
| | **787,584** | **(274,535)** | **513,049** | 737,876 | (231,156) | 506,720 |

Expenses related to the amortization of intangible assets are recorded under "Depreciation and amortization" in the profit or loss for the year.

*Impairment tests on goodwill and intangible assets*

Goodwill and other intangible assets underwent impairment tests at December 31, 2016 and 2015. Management prepared an estimate of recoverable values or amounts in use of all assets.

Impairment tests comprise the calculation of recoverable values of the Cash-Generating Unit (CGU), which corresponds to the group of all stores of the acquired chains, which totaled R$350,683 in 2016 and 2015 and have already been incorporated.

The value in use of each CGU is calculated according to the discounted cash flow method, before taxes, applying the following rates:

| | Rate (p.a.) |
|---|---|
| Discounted cash flow - discount rate | 14.5% (1) |
| Weighted average growth rate in the first 10 years | 3.8% |
| Perpetuity | 3.5% |

(1) CAPM rate (weighted average cost of capital).

The assumptions about the future cash flows and growth prospects for the geographical regions where each CGU is located is based on the Company's annual budget and business plans for the next five years approved by the Board of Directors, as well as comparable market data, representing the management's best estimate as to current economic conditions during the useful economic lives of the group of assets generating cash flows. From the tests performed, the Company did not identify any impairment of the goodwill recorded.

(Amounts in thousands of Brazilian reais)

## 17. Trade payables

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Resale of goods - domestic market | **2,375,873** | 1,907,626 | **2,383,961** | 1,915,222 |
| Other trade payables | **21,764** | 15,092 | **25,380** | 16,683 |
| Present value adjustment | **(44,164)** | (37,467) | **(44,382)** | (37,748) |
| Total trade payables | **2,353,473** | 1,885,251 | **2,364,959** | 1,894,157 |

The Company maintains agreements entered into with partner banks to structure with its main suppliers the operation of factoring of receivables. In this operation, suppliers transfer the right to receive the instruments to the Bank in exchange for the early payment of the instrument. The Bank, in turn, becomes the creditor of the operation, and the Company settles the instrument on the same date originally agreed with its supplier and receives a commission from the Bank for this intermediation and confirmation of the instruments payable. This commission is recorded as finance income.

The abovementioned operation is carried out by the Company and does not change the terms, prices and conditions previously established with suppliers and, therefore, the Company records it under Suppliers.

As of December 31, 2016, the balance payable negotiated by suppliers and accepted by Magazine Luiza totaled R$505,114 (R$452,092 as of December 31, 2015).

The accounts payable to suppliers are originally recorded at present value with an offsetting entry in “Inventories”. The reversal of the present value adjustment is recorded under “Cost of goods resold and services provided” during the realization of term.

(Amounts in thousands of Brazilian reais)

# 18. Borrowings, financing and other financial liabilities

**Borrowings and financing**

| Type | Charge | Collaterals | Final maturity | Company 2016 | Company 2015 | Consolidated 2016 | Consolidated 2015 |
|---|---|---|---|---|---|---|---|
| Working capital in foreign currency (a) | 1.43% p.a. to 6.41% p.a. + foreign exchange variation | N/A | Mar/18 | **333,503** | 590,491 | **333,503** | 590,491 |
| Working capital in domestic currency | 110.7% to 125.32% of CDI | Aval guarantees | Dec /19 | **362,558** | 163,606 | **362,696** | 163,866 |
| Finance leases (b) | CDI | Fiduciary sale | Dec /19 | **17,676** | 30,264 | **17,676** | 30,264 |
| Debentures - Restricted offer (e) | 108.8% to 125.9% of CDI | Credit card receivables | Mar/20 | **1,069,633** | 1,016,166 | **1,069,633** | 1,016,166 |
| Innovation financing - FINEP (c) | 4% p.a. | Bank guarantee | Dec /22 | **44,429** | 22,523 | **44,429** | 22,523 |
| BNB (d) | 7% p.a. | Bank guarantee | Dec /22 | **4,404** | - | **4,404** | - |
| | | | | **1,832,203** | 1,823,050 | **1,832,341** | 1,823,310 |
| **Other financial liabilities** | | | | | | | |
| *Swap payable - fair value hedge (a)* | | | | **16,435** | - | **16,435** | - |
| **Total borrowings, financing and other financial liabilities** | | | | **1,848,638** | 1,823,050 | **1,848,776** | 1,823,310 |
| Current liabilities | | | | **837,878** | 568,220 | **838,016** | 568,350 |
| Noncurrent liabilities | | | | **1,010,760** | 1,254,830 | **1,010,760** | 1,254,960 |

(a) A portion of the funds was contracted in foreign currency, over which fixed interest and exchange rate change are levied. In order to hedge its transactions against exchange rate change risks, the Company entered into swap transactions. The Company applies the hedge accounting for said operations. Further details are disclosed in Note 28.

(b) Refers to finance lease contracts relating to IT equipment and software, whose contracts expire in 2019.

(c) Refers to a credit facility agreement entered into with Study and Projects Financing Agency – FINEP, with the purpose of investing in technological innovation research and development projects.

(d) The Company entered into a R$68,103 credit facility agreement with Banco do Nordeste do Brasil S.A. (BNB), aiming at renovating the stores in the Northeast region and build a new Distribution Center in the city of Candeias (BA). Until December 31, 2016, the first installment was released, totaling R$4,383.

(e) The Company issued the following debentures not convertible into shares:

(Amounts in thousands of Brazilian reais)

## 18. Borrowings, financing and other financial liabilities (Continued)

| Issues | Guarantee | Principal Amount R$ | Issue Date | Final maturity | Outstanding securities | Financial charges | Company and Consolidated 2016 | Company and Consolidated 2015 |
|---|---|---|---|---|---|---|---|---|
| 1st issue - single series | Clean | 200,000 | 12/26/2011 | 6/16/2017 | 200 | 113.0% of CDI | **149,383** | 149,175 |
| 3rd issue - single series | Clean (ii) | 200,000 | 10/21/2013 | 7/21/2018 | 20,000 | 125.9% of CDI | **55,439** | 102,090 |
| 4th issue - single series | Clean | 400,000 | 5/30/2014 | 5/30/2019 | 40,000 | 112.0% of CDI | **402,451** | 402,262 |
| 5th issue - single series | (i) | 350,000 | 3/17/2015 | 3/17/2020 | 35,000 | 113.2% of DI | **362,492** | 362,639 |
| 6th issue - single series | Clean | 100,000 | 6/20/2016 | 6/20/2018 | 10,000 | 125.2% of DI | **99,868** | - |
| | | | | | | | **1,069,633** | 1,016,166 |

(i) The 5th issue of nonconvertible debentures has a credit card receivables guarantee, where, until the maturity date of debentures, should account for 30% of the issue's outstanding balance. See note 8.

(ii) On June 30, 2016, the Company acquired all 3rd issue Debentures for their market value (108.8% of CDI rate). On July 13, 2016, the Company changed the terms of the 3rd issue to extend its debt profile and, after said change, it sold the bonds.

Maturity schedule

The borrowings and financing payment schedule of the non-current portion is as follows:

| | Company | | | Consolidated | | |
|---|---|---|---|---|---|---|
| **Maturity year** | **Debt considering hedge accounting** | **Fair value hedge Notes 7 and 18** | **Debt not considering hedge accounting** | **Debt considering hedge accounting** | **Fair value hedge Notes 7 and 18** | **Debt not considering hedge accounting** |
| **2017** | **821,688** | **2,455** | **824,143** | **821,826** | **2,455** | **824,281** |
| **2018** | **667,401** | **74** | **667,475** | **667,401** | **74** | **667,475** |
| **2019** | **269,495** | **-** | **269,495** | **269,495** | **-** | **269,495** |
| **2020** | **57,804** | **-** | **57,804** | **57,804** | **-** | **57,804** |
| **2021** | **7,907** | **-** | **7,907** | **7,907** | **-** | **7,907** |
| **2022 onwards** | **7,908** | **-** | **7,908** | **7,908** | **-** | **7,908** |
| **Total** | **1,832,203** | **2,529** | **1,834,732** | **1,832,341** | **2,529** | **1,834,870** |

(Amounts in thousands of Brazilian reais)

## 18. Borrowings, financing and other financial liabilities (Continued)

Maturity schedule (Continued)

The Company maintains certain working capital agreements with covenants. The clauses relating to financial ratios refer to:

(i) *Brazilian Federal Savings Bank:* maintenance of the Adjusted net debt/adjusted EBITDA ratio below 3.0 times.

(ii) 5Th and 6 Th Issue of Debentures: maintenance of the Adjusted net debt/adjusted EBITDA ratio below 3.0 times.

(iii) The adjusted net debt is understood as the sum of all borrowings and financing, including debentures, excluding cash and cash equivalents, financial investments, marketable securities, credit card receivables not anticipated. The adjusted EBITDA is calculated in accordance with CVM Rule 527 of October 4, 2012, excluding non-recurring operational events (revenue/expenses).

The Company is found in compliance with the above-mentioned covenants at December 31, 2016.

## 19. Deferred revenue

| | Company and Consolidated | |
|---|---|---|
| | **2016** | **2015** |
| Deferred revenue with third parties: | | |
| Exclusive dealing agreement with Cardif (a) | **166,121** | 176,458 |
| Exclusive dealing agreement with Banco Itaúcard S.A. (b) | **134,000** | 146,500 |
| Other agreements | **2,323** | 4,234 |
| | **302,444** | 327,192 |
| Deferred revenue from related parties: | | |
| Exclusive dealing agreement with Luizacred (b) | **144,029** | 155,117 |
| Exclusive dealing agreement with Luizaseg (a) | **103,000** | 110,000 |
| | **247,029** | 265,117 |
| Total deferred revenue | **549,473** | 592,309 |
| Current liabilities | **40,318** | 41,399 |
| Noncurrent liabilities | **509,155** | 550,910 |

## 19. Deferred revenue (Continued)

(a) On December 14, 2015, Luizaseg entered into a new Strategic Partnership Agreement with the Cardif group's companies, aiming to extend the rights and obligations set forth in the agreements between the parties that expired on December 31, 2015, for an additional 10-year period, effective from January 1, 2016 to December 31, 2025. This agreement generated a cash inflow of R$330,000 into the Company. Of this amount, R$42,000 were allocated to the joint venture Luizacred, since it has exclusive rights over credit card insurance The Company's revenue recognition deriving from this agreement is recognized in profit (loss) over the term of the agreement, part of which is subject to the achievement of certain targets.

(b) On September 27, 2009, the Company entered into a partnership agreement with Itaú Unibanco Holding S.A. ("Itaú") and Banco Itaucard S.A., under which the Company grants to Luizacred the exclusive right to offer, distribute, and sell financial products and services in its store chain for a 20-year period. In consideration for the aforementioned alliance, Itaú group companies paid in cash R$250,000, of which: (i) R$230,000 relating to the completion of the negotiation, without right of recourse; and (ii) R$20,000 subject to the achievement of profitability targets in Luizacred. Said targets had been fully achieved at the end of 2014.

At December 29, 2010, the parties signed the first amendment to the partnership agreement with Luizacred, extending the exclusive right to offer, distribute and sell financial products and services at the chain of stores then acquired in the Northeast of Brazil (Lojas Maia) for a 19-year period. As consideration, Luizacred paid R$160,000 to the Company, which is recognized in profit (loss) over the term of the agreement. As part of this partnership agreement, the amount of R$20,000, mentioned in the paragraph above was increased to R$55,000.

At December 16, 2011, the Company entered into a second amendment to the partnership agreement with Luizacred, due to acquisition of New-Utd ("Lojas do Baú"). As consideration, Luizacred paid R$48,000 to the Company, which is allocated to profit (loss) over the remaining term of the agreement.

## 20. Provision for tax, civil and labor contingencies

Accounting policy

The provision for tax, civil and labor contingencies is recorded based on legal opinions and the management's assessment on the lawsuits known at the end of the reporting period, for the risks deemed as probable loss. See Note 4.g.

For labor, civil and tax lawsuits in progress, on which our legal counsel's opinion is unfavorable, the Company recognized a provision, which is the Group's management best estimate of future disbursement. Changes in the provision for tax, civil and labor contingencies are as follows:

(Amounts in thousands of Brazilian reais)

## 20. Provision for tax, civil and labor contingencies (Continued)

Company

| | Tax | Civil | Labor | Total |
|---|---|---|---|---|
| **Balance at January 1, 2015** | 206,211 | 17,122 | 22,892 | 246,225 |
| Additions | 22,821 | 7,857 | 13,245 | 43,923 |
| Reversals | (60,930) | - | - | (60,930) |
| Payments | (501) | (9,629) | (5,225) | (15,355) |
| Inflation Adjustments | 16,147 | - | - | 16,147 |
| **Balance at December 31, 2015** | 183,748 | 15,350 | 30,912 | 230,010 |
| Additions | 17,070 | 10,031 | 17,087 | 44,188 |
| Reversals | (500) | - | (477) | (977) |
| Payments | - | (8,276) | (9,629) | (17,905) |
| Inflation Adjustments | 19,738 | - | - | 19,738 |
| **Balance at December 31, 2016** | **220,056** | **17,105** | **37,893** | **275,054** |

Consolidated

| | Tax | Civil | Labor | Total |
|---|---|---|---|---|
| **Balance at January 1, 2015** | 223,113 | 17,329 | 25,249 | 265,691 |
| Additions | 22,821 | 7,959 | 13,315 | 44,095 |
| Reversals | (66,555) | (8) | (599) | (67,162) |
| Payments | (501) | (9,633) | (5,225) | (15,359) |
| Inflation Adjustments | 16,147 | - | - | 16,147 |
| **Balance at December 31, 2015** | 195,025 | 15,647 | 32,740 | 243,412 |
| Additions | 17,070 | 10,523 | 17,343 | 44,936 |
| Reversals | (4,232) | (57) | (1,274) | (5,563) |
| Payments | - | (8,716) | (9,681) | (18,397) |
| Inflation Adjustments | 19,738 | - | - | 19,738 |
| **Balance at December 31, 2016** | **227,601** | **17,397** | **39,128** | **284,126** |

As of December 31, 2016, the Company's main lawsuits classified by management as probable loss based on the opinion of its legal counsels, as well as legal obligations whose amounts are deposited in court, for which the amounts were included in the provision for contingencies, are as follows:

a) Tax lawsuits

The Company has administrative and judicial proceedings involving several tax claims classified as a probable loss, which are, therefore, provisioned. Said lawsuits involve federal taxes, totaling R$14,669 at December 31, 2016 (R$8,950 at December 31, 2015), state taxes, totaling R$30,273 at December 31, 2016 (R$25,262 at December 31, 2015) and municipal taxes totaling R$60 (R$60 at December 31, 2015).

## 20. Provision for tax, civil and labor contingencies (Continued)

a) Tax lawsuits (Continued)

The Company also records a provision for other lawsuits to which escrow deposits are made, as well as other provisions related to business combination, which involve federal taxes, totaling R$175,054 at December 31, 2016 (R$149,580 at December 31, 2015), state taxes, totaling R$7,545 at December 31, 2016, (R$11,173 at December 31,5). No provision of this type was recorded for municipal taxes this year.

b) Civil lawsuits

The provision for consolidated civil contingencies of R$17,397 at December 31, 2016 (R$15,647 at December 31, 2015) is related to claims filed by customers on possible product defects.

c) Labor lawsuits

At the labor courts, the Company is a party to various labor lawsuits, mostly claiming overtime.

The accrued amount of R$39,128 at December 31, 2016 (R$32,740 at December 31, 2015) in consolidated reflects the risk of probable loss assessed by the Company's management jointly with its legal counsel.

In August 2015, the Superior Labor Court (TST) issued a decision in which, in summary, changed the understanding on the monetary restatement index of labor lawsuits, whereby labor liabilities related to lawsuits filed as of June 30, 2009 are no longer restated by the Reference Rate (TR) but by the Special Expanded Consumer Price Index (IPCA-E). This decision, however, was suspended in October 2016 by the Federal Supreme Court (STF). The Company's management, supported by the opinion of its legal counsel that the obligation to settle such liabilities restated by the IPCA-E is not definitive and that, therefore, said liability is considered a contingent liability with a risk of possible loss, decided not to record the impact of the restatement by the IPCA-E, of R$3,882, and maintain the TR as the restatement index of labor liabilities. The Company will monitor de outcome of this issue so as to reconsider its conclusion at the end of each reporting period.

## 20. Provision for tax, civil and labor contingencies (Continued)

In order to deal with tax, civil and labor contingencies, the Company has a balance in escrow deposits of R$292,189 at December 31, 2016 (R$248,450 at December 31, 2015).

The Company is party to other lawsuits that were assessed by management, based on the opinion of its legal counsel, as possible losses and, therefore, no provision was recognized for such lawsuits. The amounts related to lawsuits involving federal taxes sum up R$603,615 at December 31, 2016 (R$320,062 at December 31, 2015), in relation to state taxes these amounts sum up R$186,278 at December 31, 2016 (R$168,142 at December 31, 2015) and as to municipal taxes these amounts sum up R$821 at December 31, 2016 (R$690 at December 31, 2015).

We highlight the following tax lawsuits assessed as possible loss: (I) administrative proceeding in which the Company and the tax authority are disputing the nature/concept of the bonuses/reimbursements of its suppliers for PIS/COFINS taxation purposes, in addition to the characterization of some expenses related to its purpose, such as inputs for PIS/COFINS credit purposes; (ii) lawsuit in which the Company challenges the breach of a number of legal principles by Law 13,241/2015, which extinguished the exemption of PIS and COFINS contributions on revenue from the sale of goods eligible to the Basic Production Process. The Company obtained a favorable interlocutory relief decision; (iii) administrative proceeding in which the Company is challenged by the state tax authority regarding a supposed undue ICMS credit due to the lack of the first copy of an invoice; (iv) administrative proceeding in which the Company challenges the state tax authority regarding tax-deficiency notices for collection of ICMS credits accrued on the acquisition of goods from suppliers subsequently believed not to be honest; (v) administrative proceeding in which the Company challenges the tax authority regarding the increase in the RAT rate; (vi) several tax-deficiency notices in which the Company challenges the collection of ICMS credits accrued on the acquisition of goods from some of its suppliers because they benefited from a tax incentive granted by another state. Moreover, the Company also declares that it monitors the discussion every quarter and, if the scenario changes, the Company will carry out net assessments of risk and losses.

The risks of lawsuits are continuously assessed and reviewed by management. Additionally, the Company also challenges civil and labor administrative lawsuits, with chances of possible loss, whose amounts are immaterial for disclosure.

Due to uncertainties regarding the outflow of resources for said provisions, management believes it is not possible to reliably plan a settlement schedule.

(Amounts in thousands of Brazilian reais)

## 20. Provision for tax, civil and labor contingencies (Continued)

Company as a plaintiff

The Company figure as a plaintiff in other various lawsuits, i.e., it filed several lawsuits against various tax authorities in order to recover taxes paid and/or unduly charged by these authorities. The amounts of these lawsuits are estimated at approximately R$648,802 at December 31, 2016 (R$607,786 at December 31, 2015) and have not been recorded in profit or loss and in assets.

## 21. Equity

a) Capital stock

At December 31, 2016, the Company's ownership structure is reported as follows, all shares are non-par, book-entry, registered, common shares:

| | **Number of shares** | **Interest %** |
|---|---|---|
| Controlling shareholders | **15,947,270** | **73.75** |
| Outstanding shares | **5,326,663** | **24.63** |
| Treasury shares | **350,000** | **1.62** |
| Total | **21,623,933** | **100.00** |

Shares held by controlling shareholders who are members of the Board of Directors and/or Board of Executive Officers are included under controlling shareholders item.

According to Article 7 of the Bylaws, the Company may increase its capital stock, pursuant to Article 168 of Law 6.404/76, by means of the issue of up to six million, two hundred and fifty thousand (6,250,000) new common shares.

On Wednesday, May 25, 2016, the Company's Board of Directors approved:

(i) The expiration of the Share Buyback Program created by the Company's Board of Directors on May 27, 2015 ("Program");

(ii) The cancellation of all treasury shares, i.e. 625,000 shares, without decreasing the capital stock;

(iii) The creation of the Company's new share buyback program. From this new program, the Company already acquired 350,000 shares, at an average cost of R$82.08.

## 21. Equity (Continued)

b) <u>Stock option plan</u>

*1st Granting of the Stock Option Plan*

For this Stock Option Plan ("Plan"), the Group's management, employees or service providers are eligible to receive stock options. In the first granting of the Plan, at January 5, 2012, 2,250,000 call options (281,250 options after the reverse split) were granted for the strike price of R$10.32 (R$82.56 after the reverse split) - "Plan 1" and 1,274,732 call options (159,342 options after the reverse split) for the strike price of R$13.60 (R$108.80 after the reverse split) - "Plan 2".

Both types of plans will have eight-year duration as of their grant date. The options may be exercised, fully or partially, provided that the beneficiary remains continuously binding as manager or employee of the Company, between the grant date and the dates specified as follows. For Plan 1, 20% of the options may be exercised upon granting and, from this date, other 20% of the options may be exercised every year the beneficiary is bound to the Company. For Plan 2, 20% of the options may be exercised as of March 1, 2012 and, as of this date, other 20% may be exercised every year the beneficiary is bound to the Company. These options when exercised will be settled through the delivery of the Company's equity instruments.

*2nd Granting of the Stock Option Plan*

The second granting of the Stock Option Plan was approved on October 25, 2013. At that occasion, 1,213,476 options (151,685 options after the reverse split) were granted and the strike price was defined at R$9.45 (R$75.60 after the reverse split). This plan will have a maximum exercise term of 12 years, as of the date of its signature, but the following grace period shall be observed: 25% of the options may be exercised as of October 29, 2015; 25% of the options may be exercised as of October 29, 2016 and 25% of the options may be exercised as of October 29, 2017.

*Fair value*

Until December 31, 2016, no stock option of the first and second granting was exercised. The fair value of each option granted is estimated on the granting date by adopting the Black & Scholes pricing model, considering the following assumptions:

(Amounts in thousands of Brazilian reais)

## 21. Equity (Continued)

b) Stock Option Plan (Continued)

*Fair value* (Continued)

| Assumption | 1st Granting | 2nd Granting |
|---|---|---|
| Expected average life of the options (a) | 5.5 years | 5.5 years |
| Average annualized volatility | 43.5% | 37.98% |
| Risk-free interest rate | 10% | 5.92% |
| Weighted average of fair value of options granted | R$6.65 | R$6.06 |
| Weighted average of fair value of options granted after the reverse split of shares | R$53.20 | R$48.48 |

(a) Represents the period when the options will be exercised and takes into account the average turnover of the plan's beneficiaries.

The effects of transactions with share-based payments were recorded in the profit or loss for the year, considering the fair value of stock options, resulting in an expense of R$4,663 for the year ended December 31, 2016 (R$4,664 at December 31, 2015). The following table shows the changes in the number of stock options and the strike price weighted average (MPPE):

| | Before the reverse split | | After the reverse split | |
|---|---|---|---|---|
| | Amount | MPPE | Amount | MPPE |
| Outstanding at January 1, 2015 | 4,354,120 | 10.88 | 544,265 | 87.02 |
| With right barred by law in the year | (73,193) | 11.83 | (9,149) | 94.63 |
| Outstanding at December 31, 2015 | 4,280,927 | 10.86 | 535,116 | 86.89 |
| With right barred by law in the year | (2,569,306) | 10.30 | (321,163) | 82.42 |
| Outstanding at December 31, 2016 | **1,711,621** | **11.70** | **213,953** | **93.60** |

The remaining weighted average contractual effectiveness for the remaining stock options at December 31, 2016 was 5.67 years (5.45 years at December 31, 2015). The weighted average fair value of the remaining stock options at December 31, 2016 and 2015 was R$6.27 (R$50.13 after the reverse split).

c) Legal reserve

At December 31, 2016, the Company has recorded R$20,471 under Legal Reserve (R$16,143 at December 31, 2015).

(Amounts in thousands of Brazilian reais)

## 21. Equity (Continued)

d) Dividends

The Company's Bylaws provide for the minimum mandatory dividend of 15% of adjusted net income pursuant to Brazilian Corporation Law. In the year ended December 31, 2016, management accrued R$12,335 referring to the mandatory minimum dividend.

e) Profit reserve

At December 31, 2016, the Company has recorded R$89,663 under Profit Reserve (R$36,199 at December 31, 2015).

f) Earnings/loss per share

The only financial instrument the Company has that may dilute profit/loss is the stock option plan. On December 31, 2016, the dilutive effects were not considered in the calculation of diluted earnings per share, given that there the stock option plan was not exercised.

| | 2016 | 2015 |
|---|---|---|
| Profit (loss) for the years attributable to the Company's owners | **86,565** | (65,605) |
| Weighted average of common shares | **21,740** | 22,290 |
| Basic and diluted earnings per share (Brazilian reais) | **3.98** | (2.94) |

## 22. Net sales revenue

Accounting policy

Revenue is measured at the fair value of the consideration received or receivable, less returns, discounts and rebates and sales taxes, as follows:

*Products resale* - Revenue is recognized when products are delivered and their legal ownership is transferred, also considering that the following conditions have been met:

(Amounts in thousands of Brazilian reais)

## 22. Net sales revenue (Continued)

Accounting policy (Continued)

*Products resale* (Continued)

- Transfer to the buyer of significant risks and benefits related to the ownership of products;
- No continued involvement in the management of products resold at level usually associated with the ownership, nor effective control over these products;
- Revenue can be reliably measured;
- It is likely that the economic benefits associated with the transaction may flow to the Company or to the Group; and
- Costs incurred or to be incurred related to the transaction can be reliably measured.

*Service revenue* - is determined by the intermediation of financial services to its joint ventures and other related companies of the Company and is recognized when it is likely that significant benefits to the service rendered will flow to the Company.

*Consortium management* - In the subsidiary Luiza Administradora de Consórcios, revenue from management fees of the consortium groups is monthly recognized upon effective receipt of installments from the consortium members, which, for the consortium management activities, represent the effective period of service rendered.

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Gross revenue: | | | | |
| Retail - resale of goods | **10,763,497** | 9,916,571 | **10,828,782** | 9,958,361 |
| Retail - services rendered | **457,179** | 469,261 | **484,800** | 488,375 |
| Consortium management | **-** | - | **58,062** | 51,578 |
| | **11,220,676** | 10,385,832 | **11,371,644** | 10,498,314 |
| Taxes and returns: | | | | |
| Retail - resale of goods | **(1,788,583)** | (1,450,198) | **(1,797,443)** | (1,452,922) |
| Retail - services rendered | **(60,924)** | (62,789) | **(60,924)** | (62,789) |
| Consortium management | **-** | - | **(4,532)** | (4,344) |
| | **(1,849,507)** | (1,512,987) | **(1,862,899)** | (1,520,055) |
| Net sales revenue | **9,371,169** | 8,872,845 | **9,508,745** | 8,978,259 |

(Amounts in thousands of Brazilian reais)

## 23. Cost of goods resold and services rendered

Accounting policy

Costs of resold goods and services rendered include costs related to the acquisition of goods and services rendered, less costs recovered from suppliers and recoverable ICMS tax substituition. Freight expenses related to transportation of suppliers' goods to the distribution centers ("DCs") are incorporated into the cost of goods to be resold.

| | Company | | Consolidated | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Costs: | | | | |
| Goods resold | **(6,538,942)** | (6,369,372) | **(6,562,328)** | (6,381,571) |
| Retail - services rendered | **-** | - | **(23,802)** | (18,059) |
| | **(6,538,942)** | (6,369,372) | **(6,586,130)** | (6,399,630) |

## 24. Information on the nature of expenses and other operating income

The Group's statement of income is presented based on the classification of the expenses according to their functions. Information on the nature of expenses recognized in the statement of income is as follows:

| | Company | | Consolidated | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Personnel expenses (a) | **(1,111,997)** | (979,084) | **(1,130,088)** | (982,829) |
| Service providers expenses | **(511,050)** | (637,860) | **(531,083)** | (646,589) |
| Other | **(581,386)** | (510,473) | **(583,515)** | (529,627) |
| Total | **(2,204,433)** | (2,127,417) | **(2,244,686)** | (2,159,045) |

(a) The Group provides its employees with benefits, such as health care insurance, dental care refund, life insurance, food voucher, transportation ticket, scholarships, in addition tothe Stock Option Plan for the eligible employees, as described in Note 21. Expenses arising from these benefits recorded in 2016 was R$116,326 for the Company (R$125,188 in 2015) and R$117,732 in consolidated (R$126,883 in 2015). Additionally, the Group offers supplementary pension plan for all its employees. This supplementary pension plan is included in the defined contribution category, not generating any actuarial responsibility for the Group. The Group's contribution corresponds to 0.20% of the salary of participating employees and may be suspended at any time, as long as with prior notice to the participants. In 2016 and 2015, the contributions totaled R$397 and R$450, respectively. Participants can make voluntary and payroll-deductible contributions, without any consideration for the Group.

| | Company | | Consolidated | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Classified by function as: | | | | |
| Selling expenses | **(1,761,438)** | (1,711,504) | **(1,776,258)** | (1,720,799) |
| General and administrative expenses | **(452,735)** | (431,100) | **(481,933)** | (458,479) |
| Other operating income, net (Note 25) | **9,740** | 15,187 | **13,505** | 20,233 |
| | **(2,204,433)** | (2,127,417) | **(2,244,686)** | (2,159,045) |

(Amounts in thousands of Brazilian reais)

## 24. Information on the nature of expenses and other operating income (Continued)

Freight expenses related to the transportation of goods from DCs to physical stores and the delivery of products resold to customers are classified as selling expenses.

## 25. Other operating income, net

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Loss on sale of property and equipment | **(476)** | (710) | **(476)** | (710) |
| Recognition of deferred revenue (a) | **40,646** | 47,749 | **40,646** | 47,749 |
| Provision for tax losses | **(4,761)** | (5,845) | **(1,043)** | (838) |
| Non-recurring expenses (b) | **(27,164)** | (27,886) | **(27,164)** | (27,886) |
| Other | **1,495** | 1,879 | **1,542** | 1,918 |
| Total | **9,740** | 15,187 | **13,505** | 20,233 |

(a) Refers to the allocation of deferred revenue from the assignment of exploration rights, as described in Note 19.

(b) Refers to store pre-operating expenses and expenses from the loss of tax relief.

## 26. Financial income (expenses)

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Finance income: | | | | |
| Interest on extended warranty sales | **41,232** | 54,878 | **41,232** | 54,878 |
| Income from short-term financial investments and securities | **47,456** | 37,692 | **13,405** | 12,617 |
| Interest on sale of goods - interest on delay in receivables | **4,366** | 5,724 | **4,366** | 5,724 |
| Exchange gains | **-** | 95 | **-** | 95 |
| Discount obtained and monetary restatement | **56,105** | 45,656 | **56,105** | 45,669 |
| Other | **1,547** | 11,314 | **1,547** | 11,314 |
| | **150,706** | 155,359 | **116,655** | 130,297 |
| Financial expenses: | | | | |
| Interest on borrowings and financing | **(272,733)** | (262,762) | **(272,777)** | (262,803) |
| Charges on credit card advances | **(308,291)** | (274,509) | **(309,663)** | (275,331) |
| Provision for interest losses on extended warranty | **(17,213)** | (41,803) | **(17,213)** | (41,803) |
| Exchange losses | **-** | (1,073) | **-** | (1,073) |
| Other | **(20,523)** | (35,117) | **(20,851)** | (35,342) |
| | **(618,760)** | (615,264) | **(620,504)** | (616,352) |
| Net financial result | **(468,054)** | (459,905) | **(503,849)** | (486,055) |

(Amounts in thousands of Brazilian reais)

## 27. Segment reporting

To manage its business taking into consideration its financial and operating activities, the Company classified its business into Retail, Financial, Insurance and Consortium Management operations. These classifications are considered as the primary segments for disclosure of information. The characteristics of these divisions are described below:

Retail - mainly resale of goods and provision of services in the Company's stores and e-commerce;

Financial operations - through the joint venture Luizacred, mainly engaged in the granting of credit to the Company's customers for acquisition of products;

Insurance - through the joint venture Luizaseg, mainly engaged in the offer of extended warranties of products purchased by the Company's customers;

Consortium management - through the subsidiary LAC, mainly engaged in the management of consortia to the Company's customers for purchase of products.

The Company's sales are fully made in the Brazilian territory and, considering retail operations, there is no concentration of customers, as well as of products and services offered by the Group.

Statement of income

| | 2016 | | | |
|---|---|---|---|---|
| | **Retail (*)** | **Financial operations** | **Insurance operations** | **Consortium management** |
| Gross revenue | **11,323,548** | **834,790** | **182,451** | **58,062** |
| Revenue deductions | **(1,858,367)** | **-** | **-** | **(4,532)** |
| Segment net revenue | **9,465,181** | **834,790** | **182,451** | **53,530** |
| Costs | **(6,572,294)** | **(117,136)** | **(28,303)** | **(23,802)** |
| Gross profit | **2,892,887** | **717,654** | **154,148** | **29,728** |
| | | | | |
| Selling expenses | **(1,776,258)** | **(303,256)** | **(123,815)** | **-** |
| General and administrative expenses | **(458,418)** | **(3,050)** | **(24,519)** | **(23,515)** |
| Result from allowance for doubtful accounts | **(26,074)** | **(303,189)** | **-** | **-** |
| Depreciation and amortization | **(133,248)** | **(6,025)** | **(4,738)** | **(364)** |
| Equity in the earnings of subsidiaries | **68,797** | **-** | **-** | **-** |
| Other operating income | **13,498** | **(7,935)** | **176** | **7** |
| Financial income (expenses) | **(507,107)** | **-** | **19,825** | **3,258** |
| Income tax and social contribution | **12,488** | **(43,413)** | **(9,161)** | **(3,019)** |
| Net income for the year | **86,565** | **50,786** | **11,916** | **6,095** |

(Amounts in thousands of Brazilian reais)

## 27. Segment reporting (Continued)

Statement of income (Continued)

| | 2016 |
|---|---|
| | **Retail (*)** |
| **Equity accounting reconciliation** | |
| Equity in the earnings of LAC (Note 13) | **6,095** |
| Equity in the earnings of Luizacred (Note 14) | **50,786** |
| Equity in the earnings of Luizaseg (Note 14) | **11,916** |
| (=) Equity accounting of retail segment | **68,797** |
| (-) Elimination effect - LAC | **(6,095)** |
| (=) Consolidated equity in the earnings of subsidiaries | **62,702** |

(*) Consolidated balance including results of Magazine Luiza S.A. and Época Cosméticos.

| | 2015 | | | |
|---|---|---|---|---|
| | **Retail (*)** | **Financial operations** | **Insurance operations** | **Consortium management** |
| Gross revenue | 10,455,261 | 917,142 | 191,796 | 51,578 |
| Revenue deductions | (1,515,711) | - | - | (4,344) |
| Segment net revenue | 8,939,550 | 917,142 | 191,796 | 47,234 |
| Costs | (6,390,096) | (134,730) | (27,975) | (18,059) |
| Gross profit | 2,549,454 | 782,412 | 163,821 | 29,175 |
| Selling expenses | (1,720,799) | (319,740) | (132,914) | - |
| General and administrative expenses | (434,951) | (3,267) | (24,102) | (23,528) |
| Result from allowance for doubtful accounts | (30,462) | (371,934) | - | - |
| Depreciation and amortization | (125,485) | (6,227) | (3) | (316) |
| Equity in the earnings of subsidiaries | 80,788 | - | - | - |
| Other operating income | 20,175 | (992) | 166 | 58 |
| Financial income (expenses) | (488,418) | - | 16,754 | 2,363 |
| Income tax and social contribution | 84,093 | (18,613) | (9,756) | (2,569) |
| Net income for the year | (65,605) | 61,639 | 13,966 | 5,183 |

| | |
|---|---|
| **Equity accounting reconciliation** | |
| Equity in the earnings of LAC (Note 13) | 5,183 |
| Equity in the earnings of Luizaseg (Note 14) | 61,639 |
| Equity in the earnings of Luizacred (Note 14) | 13,966 |
| (=) Equity accounting of retail segment | 80,788 |
| (-) Elimination effect - LAC | (5,183) |
| (=) Consolidated equity in the earnings of subsidiaries | 75,605 |

(*) Consolidated balance including results of Magazine Luiza S.A. and Época Cosméticos.

The “Financial operations” and “Insurance operations” segments are accounted for by the equity accounting method, since they are jointly-controlled operations.

(Amounts in thousands of Brazilian reais)

## 27. Segment reporting (Continued)

Statement of financial position

| | 2016 | | | |
|---|---|---|---|---|
| | Retail (*) | Financial operations | Insurance operations | Consortium management |
| **Assets** | | | | |
| Cash and cash equivalents | 565,327 | 2,999 | 107 | 33,814 |
| Securities and other financial assets | 819,155 | 6,020 | 162,017 | - |
| Trade receivables | 584,571 | 2,001,796 | - | - |
| Inventories | 1,596,743 | - | - | - |
| Investments | 404,485 | - | - | - |
| Property and equipment and intangible assets | 1,072,005 | 75,944 | 50,101 | 1,111 |
| Other | 1,132,712 | 137,239 | 19,403 | 3,614 |
| | 6,174,998 | 2,223,998 | 231,628 | 38,539 |
| **Liabilities** | | | | |
| Trade payables | 2,363,164 | - | 1,361 | 1,795 |
| Borrowings, financing and other financial liabilities | 1,848,776 | - | - | - |
| Interbank deposits | - | 900,241 | - | - |
| Credit card operations | - | 948,340 | - | - |
| Insurance technical reserves | - | - | 105,036 | - |
| Provision for tax, civil and labor contingencies | 283,527 | 43,549 | 709 | 599 |
| Deferred revenue | 549,473 | 20,122 | - | - |
| Other | 421,917 | 36,269 | 19,613 | 12,046 |
| | 5,466,857 | 1,948,521 | 126,719 | 14,440 |
| Equity | 708,141 | 275,477 | 104,909 | 24,099 |

| | |
|---|---|
| **Investment reconciliation** | |
| **Investments in subsidiaries** | |
| Investment in LAC (Note 13) | 24,099 |
| **Investment in joint ventures** | |
| Investment in Luizacred (Note 14) | 275,477 |
| Investment in Luizaseg (Note 14) | 104,909 |
| | 380,386 |
| **Total investments** | 404,485 |
| (-) Elimination effect - LAC | (24,099) |
| **(=) Result of consolidated investment** | 380,386 |

(*) Consolidated balance including results of Magazine Luiza S.A. and Época Cosméticos.

(Amounts in thousands of Brazilian reais)

## 27. Segment reporting (Continued)

Statements of financial position (Continued)

| | 2015 | | | |
|---|---|---|---|---|
| | **Retail (*)** | **Financial operations** | **Insurance operations** | **Consortium management** |
| **Assets** | | | | |
| Cash and cash equivalents | 591,223 | 3,810 | 231 | 26,242 |
| Securities and other financial assets | 544,351 | 8,708 | 148,243 | - |
| Trade receivables | 437,820 | 1,900,907 | - | - |
| Inventories | 1,353,092 | - | - | - |
| Investments | 403,476 | - | - | - |
| Property and equipment and intangible assets | 1,084,393 | 81,942 | 55,005 | 898 |
| Other | 1,165,675 | 169,639 | 27,089 | 3,572 |
| | 5,580,030 | 2,165,006 | 230,568 | 30,712 |
| **Liabilities** | | | | |
| Trade payables | 1,893,119 | - | 1,837 | 1,038 |
| Borrowings, financing and other financial liabilities | 1,823,310 | - | - | - |
| Interbank deposits | - | 971,644 | - | - |
| Credit card operations | - | 807,641 | - | - |
| Insurance technical reserves | - | - | 103,763 | - |
| Provision for tax, civil and labor contingencies | 242,942 | 31,921 | 428 | 470 |
| Deferred revenue | 592,309 | 21,000 | - | - |
| Other | 366,138 | 51,170 | 22,145 | 9,753 |
| | 4,917,818 | 1,883,376 | 128,173 | 11,261 |
| Equity | 662,212 | 281,630 | 102,395 | 19,451 |

| | |
|---|---|
| **Investment reconciliation** | |
| **Investments in subsidiaries** | |
| Investment in LAC (Note 13) | 19,451 |
| **Investment in joint ventures** | |
| Investment in Luizacred (Note 14) | 281,630 |
| Investment in Luizaseg (Note 14) | 102,395 |
| | 384,025 |
| **Total investments** | 403,476 |
| (-) Elimination effect - consolidated | (19,451) |
| **(=) Result of consolidated investment** | 384,025 |

(*) Consolidated balance including results of Magazine Luiza S.A. and Época Cosméticos.

(Amounts in thousands of Brazilian reais)

## 28. Financial instruments

Capital risk management

The objectives of capital management are to safeguard the continuous return to the Company's shareholders and benefits to other related parties, and maintain an ideal capital structure to reduce this cost and maximize its funds to allow for the opening and remodeling of stores, new technologies, process improvement and advanced management methods.

The Company's capital structure comprises financial liabilities, cash and cash equivalents, securities and equity. Periodically, management reviews the capital structure and its ability to settle its liabilities, as well as monitors, on a timely basis, the average term of suppliers in relation to the average term of inventory turnover. Actions are promptly taken when these balances ratio pose relevant imbalance.

The Company also adopts the adjusted net debt/adjusted EBITDA ratio, which in its opinion, represents the most adequate manner to measure its indebtedness, since it reflects the net consolidated financial obligations of immediate funds available for payment, considering its operating cash generation. Adjusted EBITDA means profit before income tax and social contribution, finance income and expenses, depreciation, amortization and non-recurring operating events.

The Company's capital structure is broken down as follows:

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Borrowings, financing and other financial liabilities | **1,848,638** | 1,823,050 | **1,848,776** | 1,823,310 |
| (-) Cash and cash equivalents | **(562,728)** | (590,400) | **(599,141)** | (617,465) |
| (-) Securities and other financial assets | **(819,155)** | (544,351) | **(819,155)** | (544,351) |
| (-) Third-party credit cards | **(272,502)** | (155,017) | **(276,206)** | (158,749) |
| (-) Related-party credit cards | **(18,646)** | (13,884) | **(18,646)** | (13,884) |
| Adjusted net debt | **175,607** | 519,398 | **135,628** | 488,861 |
| Equity | **708,142** | 662,212 | **708,142** | 662,212 |

(Amounts in thousands of Brazilian reais)

## 28. Financial instruments (Continued)

Categories of financial instruments

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Financial assets | | | | |
| Loans and receivables: | | | | |
| Cash and banks | **73,996** | 62,503 | **77,108** | 63,151 |
| Escrow deposits | **292,187** | 248,450 | **292,189** | 248,450 |
| Trade receivables | **578,904** | 433,144 | **584,571** | 437,820 |
| Related parties | **66,296** | 88,140 | **64,021** | 86,152 |
| At fair value through profit or loss: | | | | |
| Held for trading - Cash equivalents and securities | **1,293,981** | 944,246 | **1,327,282** | 970,663 |
| Designated - other financial assets | **13,906** | 128,002 | **13,906** | 128,002 |
| Financial liabilities | | | | |
| Amortized cost: | | | | |
| Trade payables | **2,353,473** | 1,885,251 | **2,364,959** | 1,894,157 |
| Borrowings and financing | **1,498,700** | 1,232,559 | **1,498,838** | 1,232,819 |
| Related parties | **72,923** | 68,787 | **72,955** | 68,404 |
| At fair value through profit or loss: | | | | |
| Held for trading – Borrowings and financing | **333,503** | 590,491 | **333,503** | 590,491 |
| Designated – other financial assets | **16,435** | - | **16,435** | - |

Fair value measurement

All assets and liabilities for which fair value is measured or disclosed in the financial statements are classified within the fair value hierarchy described below, based on the lowest level information that is significant for fair value measurement as a whole:

- Level 1 - market prices quoted (not adjusted) in active markets for identical assets or liabilities;
- Level 2 - evaluation techniques for which the lowest level information, relevant to measure fair value, is directly or indirectly observable. The company uses the discounted cash flow technique to your measurements;
- Level 3 - evaluation techniques for which the lowest level information, relevant to measure fair value, is not available.

The fair value measurement of the Company’s assets and liabilities is as follows:

(Amounts in thousands of Brazilian reais)

## 28. Financial instruments (Continued)

Fair value measurement (Continued)

| | Company | | Consolidated | | Fair value measurement |
|---|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** | **Level** |
| Financial assets | | | | | |
| At fair value through profit or loss: | | | | | |
| Cash equivalents and marketable securities | **1,293,981** | 944,246 | **1,327,282** | 970,663 | **Level 1** |
| Other financial assets | **13,906** | 128,002 | **13,906** | 128,002 | **Level 2** |
| Financial liabilities | | | | | |
| At fair value through profit or loss: | | | | | |
| Borrowings and financing | **333,503** | 590,491 | **333,503** | 590,491 | **Level 2** |
| Other financial liabilities | **16,435** | - | **16,435** | - | **Level 2** |

Liquidity risk management

The Company's management has ultimate responsibility for the management of the liquidity risk and prepares an appropriate liquidity risk management model to manage funding requirements and short-, medium- and long-term liquidity management. The Group manages the liquidity risk through the continuous monitoring of estimated and actual cash flows, the combination of the maturity profiles of financial assets and liabilities and the maintenance of a close relationship with financial institutions, with regular disclosure of information to support credit decisions when external funds are necessary.

The table below details the remaining contractual maturity of the Group's financial liabilities and the contractual repayment periods. This table was prepared using the undiscounted cash flows of financial liabilities.

Contractual maturity is based on the most recent date when the Company should settle the related obligations:

| | Less than one year | 1 to 3 years | Over 3 years | Total |
|---|---|---|---|---|
| Trade payables | **2,364,959** | **-** | **-** | **2,364,959** |
| Borrowings, financing and other financial liabilities | **838,016** | **937,141** | **73,619** | **1,848,776** |
| Related parties | **72,955** | **-** | **-** | **72,955** |

## 28. Financial instruments (Continued)

Considerations on risks

The Group's businesses mainly comprise the retail sale of consumer goods, mainly home appliances, personal electronics, furniture and financial services, consumer financing for purchase of these assets and consortium-related activities, created to purchase vehicles, motorcycles, home appliances and real properties. The main market risk factors affecting the Company's business are as follows:

*Credit risk:* arises from the possibility that the Group may incur losses due to non-receipt of amounts billed to their customers, whose consolidated balance amounts to R$466,061 as at December 31, 2016 (R$377,389 as at December 31, 2015). Most of the Company's sales are made using credit card model of payment, which are substancially securitized by the credit card companies. Other receivables risk is assessed by the Company as low due to the normal widespread sales, as a result of the large number of customers; however, there are no guarantees of actual receipt of the total balance of trade receivables due to the nature of the Group's activities. Even so, the risk is managed by means of periodic analysis of default rate and the adoption of more efficient collection measures. As at December 31, 2016, the Group recorded past-due or uncollectible balances under "trade receivables," whose terms were renegotiated, in the amount of R$4,672 (R$11,844 as at December 31, 2015), which are included in the Group's analysis on the need to recognize an allowance for doubtful accounts.

*Market risk:* arises from the slowdown of retail sales in the Brazilian economic environment. The risks involved in these transactions are managed by establishing operational and commercial policies, determining limits for derivative transactions, and constantly monitoring assumed positions. Main related risks are variations in the interest and foreign exchange rates.

*Interest rate risk:* the Group is exposed to floating interest rates tied to the "Interbank Deposit Certificate (CDI)", relating to financial investments and borrowings and financing in Brazilian reais, for which it performed a sensitivity analysis, as described in the following item below.

*Foreign exchange rate risk management:* the Company uses derivatives to meet its market risk management requirements, arising from mismatching between currencies and indices. Derivative transactions are carried out through the Finance Department, pursuant to the strategies previously approved by the Company's Board of Directors. Upon initial recognition of hedge, the Company formally classifies and reports the hedge ratio to which the Company intends to apply the hedge accounting, as well as the objective and the management's risk management strategy to materialize the hedge.

(Amounts in thousands of Brazilian reais)

## 28. Financial instruments (Continued)

Considerations on risks (Continued)

Documentation includes to identify the hedge instrument, the item or transaction purpose of hedge, the nature of the risk, the purpose of hedge, the nature of risks excluded from the hedge ratio, the prospective statement of effective hedge ratio and how the Company will assess the hedge instrument's efficacy for the purposes of offsetting the exposure to changes in fair value of item purpose of hedge or cash flows related to risks, purpose of hedge.

In this scenario, the Company raised foreign currency-denominated loans bearing interest, for which it entered into swap transactions to hedge against exchange rate variation, swapping contracted interest rate and foreign currency exchange rate for CDI plus fixed rate. For the purposes of hedge accounting, these instruments are classified as fair value hedge and initially recognized at fair value on the date the derivative agreement is contracted, and subsequently revalued also at fair value. Any gains or losses resulting from changes in fair value, both of the hedging derivative (swap) and the hedge purpose (borrowings) during the year are recorded directly in the statement of income, as finance income (expense).

Below, a description of agreements that affected profit or loss for the period ended December 31, 2016:

**Fair value hedge**

**Hedge instrument**

| | **Swaps** | | | **Average indexes** |
|---|---|---|---|---|
| | **Financial position** | **MTM adjustment** | **Fair value (a)** | |
| **Assets (Active tip)** | 329,823 | 3,680 | 333,503 | **US$ + 3.95%** |
| **Liabilities (Passive tip)** | 336,032 | - | 336,032 | **108.81% of CDI** |
| **Total** | **(6,209)** | **3,680** | **(2,529)** | |

**Hedged item**

| | **Working capital in USD** | | | **Average indexes** |
|---|---|---|---|---|
| | **Financial position** | **MTM adjustment** | **Fair value (a)** | |
| **Liabilities** | **329,823** | **3,680** | **333,503** | **US$ + 3.95%** |

**Reconciliation**

| | |
|---|---|
| Other financial assets (Note 7) | **13,906** |
| Other financial liabilities (Note 18) | **(16,435)** |
| **(=) Fair value of derivatives** | **(2,529)** |

(a) The fair value of derivatives is determined by using a methodology normally used by market players; the present value of payments is estimated by using market curves disclosed by Bloomberg, which uses forwards of BM&FBOVESPA.

(Amounts in thousands of Brazilian reais)

## 28. Financial instruments (Continued)

Considerations on risks (Continued)

There were no transactions, in the reporting period, no longer classified as hedging transactions and no future commitments subject to cash flow hedge.

Sensitivity analysis of financial instruments

As of December 31, 2016, management carried out a sensitivity analysis, taking into consideration a probable scenario and scenarios with 25 and 50 percent increase in the expected interest rates. The probable scenario of increased interest rates was measured based on future exchange rates disclosed by BM&FBOVESPA and/or BACEN. The expected effects of interest expenses net of finance income of financial investments for the next three months are as follows:

| | **Probable rate** | **Probable Scenario I** | **Scenario II (+ 25%)** | **Scenario III (+ 50%)** |
|---|---|---|---|---|
| Interest to be incurred exposed to: | | | | |
| CDI | **12.75%** | **(41,144)** | **(51,430)** | **(61,716)** |
| Impact on financial result, net of taxes | | **(27,155)** | **(33,944)** | **(40,733)** |

As discussed above, the Group's management understands that there is no market risk arising from foreign exchange fluctuations since all significant financial liabilities recorded in foreign currency are pegged to swap transactions, so that the accounting and financial treatment of these loans is denominated in domestic currency. Accordingly, changes in swap derivative financial instruments and loans and borrowings are offset.

## 29. Leasing commitments

Accounting policy

Assets acquired through finance lease are initially recognized as property and equipment at their fair value when lease starts or, if lower, by the present value of the minimum lease payment. The corresponding liability to the lessor is stated in the financial statements as an obligation with finance lease.

Assets held through finance lease are depreciated by their estimated useful lives likewise own assets or for a shorter period, where applicable, pursuant to the terms of the lease agreement under consideration.

Payments referring to finance lease are distributed between financial charges and liability reduction, so that to achieve a constant interest rate in relation to the liability's remaining balance.

(Amounts in thousands of Brazilian reais)

## 29. Leasing commitments (Continued)

Accounting policy (Continued)

Payments referring to operating lease are recognized as expenses by the straight-line method during the effectiveness period of the agreement, except when another system is more representative to reflect when the economic benefits from leased assets are earned. Contingent payments arising from operating lease are recognized as expenses in the year or period in which they are incurred.

Operating lease - lease agreements

The Company has several property lease agreements with related parties (MTG Administração e Participações S.A. and PJD Agropastoril Ltda.) and with third parties, whose average term is five years, renewable for another five years. Management analyzed these agreements and concluded that they are classified as operating lease.

These agreements establish fixed or variable lease amounts, based on a percentage over net sales, in accordance with the contractual forms. At December 31, 2016, the Company had 800 stores (786 stores in 2015) and 9 leased Distribution Centers (9 leased Distribution Centers in 2015). For these lease agreements, expenses of R$313,380 were recorded in the year ended December 31, 2016 (R$287,953 at December 31, 2015).

Future commitments deriving from these adjusted agreements amount to in the following five years:

| Year | Amount |
|---|---|
| **2017** | **337,166** |
| **2018** | **354,975** |
| **2019** | **370,523** |
| **2020** | **386,620** |
| **2021** | **404,155** |
| **Total** | **1,853,439** |

Finance lease agreements

| | Minimum payments | |
|---|---|---|
| | Company and Consolidated | |
| | **2016** | **2015** |
| Within one year | **11,529** | 16,501 |
| Between two and five years | **8,321** | 16,305 |
| Over five years | **-** | 862 |
| | **19,850** | 33,668 |
| Less: financial income not incurred | **(2,174)** | (3,404) |
| Present value of minimum payments | **17,676** | 30,264 |

(Amounts in thousands of Brazilian reais)

## 29. Leasing commitments (Continued)

Finance lease agreements (Continued)

Below, the amount of assets, net of accumulated depreciation, acquired through finance lease:

| Type of assets | 2016 | 2015 |
|---|---|---|
| Computers and peripherals | **2,404** | 4,263 |
| Vehicles | **2,271** | 4,285 |
| Software | **11,736** | 16,862 |
| Machinery and equipment | **7,471** | 7,908 |
| Other | **267** | 316 |
| Total | **24,149** | 33,634 |

In the reporting years, we did not identify any event that could indicate the need for making calculations in order to assess any impairment of these assets.

## 30. Statement of cash flows

Below are the changes in equity that did not affect the Company's cash flows:

| | Company | | Consolidated | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| Dividends proposed by subsidiaries and joint ventures and not received | **4,278** | 5,783 | **2,830** | 4,552 |
| Dividends declared not paid in the year | **(12,335)** | - | **(12,335)** | - |
| Other comprehensive income (losses) | **2,830** | (366) | **2,830** | (366) |

## 31. Insurance

The Company has insurance contracts with coverage determined following the advice of experts, taking into account the nature and degree of risk, in amounts considered sufficient to cover any losses on its assets and/or liabilities.

As of 2016 and 2015, insurance coverage is as follows:

| | 2016 | 2015 |
|---|---|---|
| Civil liability and D&O | **42,000** | 41,000 |
| Sundry risks - inventories and property and equipment | **2,014,174** | 1,905,145 |
| Vehicles | **17,285** | 16,696 |
| | **2,073,459** | 1,962,841 |