Local Conference Call
Magazine Luiza (MGLU3)
4Q20 Earnings Results Call
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Operator: Good morning ladies and gentlemen and thank you for waiting. Welcome to Magalu's videoconference referring to the fourth quarter of 2020 results. We would like to inform you that this event is being recorded and simultaneously translated. All participants will be in listen-only mode during the conference and during the company presentation. Afterwards, we will have a Q&A session and questions should be asked by telephone. Questions received via webcast will be answered afterwards by the investor relations team.

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

Mr. Trajano, you may start.

Mr. Frederico Trajano - CEO
Good morning everybody, thank you for participating in our results video conference, this is my 20th as the CEO of the company.

This is a very special call given the fact that we had a very non typical year in 2020. As we said before, the message of the executive committee was that we lived many years in one last year, and of course, we are keenly aware of the situation of Brazil as a Brazilian, as a citizen, and I'm very sad about everything that happened in Brazil and in the world, but ultimately, from the viewpoint of the company, our team was able to overcome all the hurdles that existed in this period and we had a very fast reaction, we were very agile, and we work with human warmth and with all the care with our 40,000 people, with millions of clients, and thousands of suppliers, and thousands of sellers as well, and this is an epic event and with extraordinary results.

During all this COVID crisis, we had longer calls, as the message from the executive committee was a longer message, and during this call I would like to take the opportunity to talk about two subjects: the first point, in relation to 2020, I would like to mention that it was not by accident, 2020 was another good result in a sequence of excellent results that Magalu has been delivering, and of course, the pandemic accelerated the digitisation of Brazil and it worked as a catalyst, but the process was already happening historically, so in the fourth quarter we grew 66% over a growth of 50% in the previous quarter ,and 35% in the previous one, and 31% in the previous one, so we have been delivering consistent results and our results last year were not by accident, if you compare Magalu to the other companies in the market, the other players, mainly online players, we grew 325%

since 2018, we grew significantly in 2020 and during 18 to 20 we gained over 13 percentage points of market share.

And if we look at that in relation to my third fourth quarter as the CEO, which was in 2016, Magalu increased tenfold the GMV, 900 to 9 billion. So, this is a very consistent work being done in these five years, and even more, we grew 10 times twice the second ranking among the major players, so this growth is consistent year on year, and the base of e-commerce, specifically the last quarter, grew quite a lot in relation to the previous quarter, which was one of the best results of the company.

But I believe that more important than that was the fact that we redefined growth based on sustainability. If you look at our historical base since 2016, you can see 2 billion in accrued net income, the only company in e-commerce that had consistent results all year, every single year, 3 billion cash, 2 billion in the last quarter vis-a-vis 1.5 in 2019, 1 billion before, so we generate cash and we deliver consistent results every single year because of the superior business model and the focus on a very efficient execution so that you may grow your sales exponentially not to the detriment of your growth and your profit generation, of course, we have a trade off in margin, but very far from representing any losses ultimately or cash consumption or cash burn. So, we do a very consistent project.

In relation to sales, we reached almost 44 billion in sales last year in spite of the fact that many of our stores were closed in comparison to the previous year or to March last year. From March to August, we operated with sometimes 100% stores closed and we grew 60% year on year and 66% in the quarter. So, we were able to deliver a fantastic, extraordinary year in spite of going through one of the most difficult situations I have ever faced, which was the closing of 100% of our stores on March 2020, and in fact, this is driven by our online operation, which already represents 2/3 of our business, we grew 120% in the last quarter and over a base for comparison, and I really wanted to show you, 93% in 2019, so we grew 120 over 93%.

So, everybody asks me “So, what about 21? Because you had such an accelerated growth in e-commerce”. We grew 120% online over one of the best quarters ever in our history, which was 92% in the fourth quarter of 19, 7 percentage points of market share being gained, and another quarter in e-commerce that grew the most in Brazil.

We are consistent with sustainability, which is our focus, and if I show you here 1P and 3P, we grew 122% in 1P, extraordinary the growth of 1P was higher than we could possibly imagine when we started the year, and we expected an exponential growth in 3P, but not 1P, and in 1P we are reaping the benefits of our superior logistics, our multi-channel operation and half of what we sell go through the stores and store pickup or ship-from-stores. So, our operation is really the best.

It's very difficult for anybody to have the same level of service, the NPS that we have and the short lead time, so we are gaining a lot of market share even in the B operation, which is growing more than we expected, but not only in 1P, we set up our marketplace four years ago and we had a spectacular year, evolution of sales, 120%, the biggest in the market, it had already been like that in the second and third quarters, and we made an extraordinary launch last year, the first platform to help the offline vendors to sell online, we launched the Parceiro Magalu (Magalu Partner) one week after the closing of commerce in Brazil at the end of March last year, we went from 15,000 to 47,000 sellers and many of these sellers were saved literally by the *Parceiro Magalu* platform that we rolled out to the whole country.

So, in a few hours, they uploaded their catalogues and they issued their invoices online, everything online, and they got their authorization, the end-to-end platform developed, and the Luizalab that saved many companies, and what I'm the most proud in 2020 was the fact that we are having this digital inclusion being rolled out, we went from 13 million to 26 million offers, and today it's almost impossible to look for a product in our app and not find it, and you will see that we have already achieved to extend our assortment base and the number of categories that we offer. And one thing that makes me very proud in the process is the fact that our sales did not grow to the detriment of physical stores, we continue to have a very strong growth base from our physical stores. We grew last year 10% same-store-sales in the last quarter, 11%, the biggest growth that we had during this period, and in spite of the reduction of the Coronavoucher from R$600 to R$300, we got this increase.

And I would like to mention in relation to this growth of the fourth quarter specifically that we were not able to have the Black Friday in our physical stores, so it was in spite of that the very positive year.

Ok, let’s continue. The growth in physical stores is extraordinary and I would like to highlight that it was not to the detriment of stores and we had record online growth as I said, 120%, and we grew in the total of the company 66% in the quarter and the NPS is an all-time-high for the company, 75 in November, the Black Friday month, and an extraordinary figure, and this shows that all our investments in service level are already having a return and keeping a high level of service in spite of all the problems that we faced having all this growth is a heroic achievement on the part of our team.

And I would like to talk about the categories now. We had a very big highlight here for the non-core category of the company, so as you can see, sports 166, fashion 436, beauty 293, market 300% (the big highlight of the company), and books 276%, smartphones 149% growth, so you can see significant growth in all the category in a year in which we wanted to show this diversity and we delivered exceptional, outstanding results.

And I would like to mention our Super App, we have been working very hard on

this strategy, 76% of our online sales came from mobile, 33 million MAU through our app in the last period, so you can see consistent growth, and we also launched – and I will be talking about that – MagaluPay in the Super App fully integrated to the Super App, and we are the only digital wallet that is not separated from the Super App.

In June last year we had 2,700 million accounts opened, so it's really incredible, and I will be talking later about this opportunity, but having the Super App in the core of all our ecosystem makes a huge difference.

And so, I talked about 1P, I talked about service level, and let's talk about logistics. Logbee, we have the fastest logistic in Brazil, 45% of all the products we delivered in one day and this number was 5% in 2019 from 5 to 45% of all the products delivered in one day, it's a fantastic job and we acquired Logbee some years ago, it was a start-up and today it represents almost all our deliveries in 1P, and when we look at the reason behind this growth of fast delivery it's because we use the store differently from the monoline competitors that have one single channel, we have all the power of the stores and half of everything that we sell goes through a store, or either store pickup or ship-from-store, and the store is a central point of our platform, our sales platform, our digital system, and this helps us to have very fast deliveries, over 1,200 points scattered through cities in Brazil.

And the objective this year – and later I will go into detail, but – this is the year of logistics, everything that we did to have this very high level of service for 1P transporting this to 3P, so the focus of Magalu this year, such as was the case last year with 1P, the focus is 3P. we want to invest in logistic and reduce even more the lead time from 24 hours to a few hours and increasing the 3P and we have already started, of course, to put in place all these initiatives. In 2020, 32% of all the orders from sellers already over 10 billion GMV, 1,400 already use cross docking, when we collect the product and it goes through our network, and 324 stores are already enabled for the client to buy from the seller and pick up from store.

And this is a significant evidence of our superior logistic and what we do for the sellers, and we made two acquisitions this year, GFL and Cintilog, because we wanted to drive this, and we should be extending and increasing our investments in this area as well.

Now I would like to give the floor to Beto so that he may talk about the financial results of the fourth quarter, and I will be coming back to talk about the future.

Roberto Bellissimo – CFO and IRO

Good morning everybody, thank you very much for participating in our video conference. I would like to start by our financial highlights. We have already talked about the very strong growth in sales, 66% of total sales growth, over 120% in e-commerce, 16% in physical stores, in the quarter we reach almost 15 billion in

sales, total sales, and a cash generation of R$2.1 billion in operating cash flow, and the adjusted net income of 232 million and 2.3% margin in the quarter and growing in this quarter 40% in relation to the same quarter last year, or an year on year growth, so to it was a great growth in all the parameters.

When we look at the year as a whole, we grew 60%, e-commerce over 130% in the year as a whole, physical stores growing in spite of so many stores closed for a long time, and we reach 43,5 billion in sales with over 3 billion in cash generation, and the adjusted net income of 378 million, a very robust one, especially if you consider the first quarter where most of the stores are closed.

And now, explaining the evolution of our EBITDA margin as a whole, our EBITDA margin went from 7.8 to 5.2% and the gross margin going down 3.9% because of the very fast growth of our e-commerce. So, we always explain that in e-commerce our gross margin is lower than in the physical stores, but due to the model multi-channel fully integrated we offset most of this difference, most of this gap in the level of operating expenses, logistics, marketing and all the expenses are diluted with the e-commerce.

And I would like to remind you that last year our e-commerce went from 45% total sales to 65%, 20 points increase, and today practically it represents 2/3 of all sales of the company. So, this has an impact on the gross margin, but we offset this in our operating expenses and in this quarter, we had a level of operating expenses that was the lowest ever and the lowest in the market.

SG&A lower than 20% in this quarter and it was 19.7% to be precise, much lower than the market average, and also, administrative expenses lower than 3 percentage points in a very efficient level.

Now, let's go to… oh, one detail: and the reason why we didn't have an additional dilution of operating expenses is because, as we have been repeating very often, we increased our investment in service level and faster deliveries and in service in general, so we improved our operation and we showed our NPS at the highest ever level in our history, so an all-time-high.

So, all these investments that we're making are helping us grow and go to the next level in sales, and in spite of that maintaining or net income with 5% of EBITDA margin, for instance, in the quarter we diluted our financial expenses, and we had a net income that was 40% higher year on year.

On the next slide we talk about our capitals structure, and I would like to mention that the financial expenses went from 2.9% to 1.2% of our net revenue and coming from not only the drop of the CDI, but the strong cash generation of the company and we showed the evolution of the working capital that has improved over the year, and in the last quarter inventory turnover 70 days, improving inventory turnover 90 days purchase time and the difference from 70 to 90 allows us to

generate cash and grow by generating cash.

And other accounts in the working capital were very positive, accounts receivable, recoverable taxes and other assets and liabilities, short and long term. So, a very efficient management of our working capital, and with that we show that our adjusted net cash increased by 1 billion going to 7.3 adjusted net cash.

On the next slide we show the total cash that went from 7 billion to 9 billion, and we closed the quarter with the best ever cash position in our history, an all-time-high started with an operating cash flow of 3 billion, we made 600 million in investments and we paid interest and leasing and we had share buy back and we paid dividend, we raised 100 million at the beginning of the pandemic and we increased our total cash by 1.8 billion-1.9 billion. So, this is the breakdown of our cash flow.

And on the next slide we talk about Luiza Cred. During the last call we said that we recovered our growth, and we were selling more cards every year, the base of Luiza Card reached 5.3 million cards at the end of the year, billings growing, reaching 9 billion in the quarter and 29 billion in the year, growing inside and outside Magaly.

And lastly, the result of Luiza Cred, which was spectacular, over the quarters we talked about the level of collection, and receiving, and the indicators of past dues dropped to the lowest levels in our history, dropping here from 2.4 to 1.4, 8.4 to 2.6 and the coverage ratio increasing at the same time. So, you can see that the portfolio performance reached over R$12 billion, and this is outstanding, exceptional really, and the net income of Luiza Cred grew over 50% in the quarter reaching 53 million in the quarter and over 200 million in the year, one of the best results ever for Luiza Cred.

So, these were the best results.

Frederico Trajano – CEO
Thank you very much, Beto. When we prepared the material, the message from the executive community, I think it was very important to really highlight the opportunities that we had, I saw the market only looking at 2021 and very much concerned with the consequences for the e-commerce companies in the post-pandemic world, and I would like to make something very clear: I know that it's very obvious, but I think we should emphasise this, the pandemic accelerated and it worked as a catalyst in the digitalization of the Brazilian companies, but on the other hand, when we compare the Brazilian market to any other economy in the world in terms of digital maturity, even in the post-pandemic world we are at a very low level.

So, I would like to highlight the markets that we are addressing and also Magalu in spite of the fact that the cash position is excellent, 7.3 billion, much better than we were at the beginning of last year, the pre-pandemic world, although we are very

strong there, we made 11 acquisitions during this period, and the 11 acquisitions our for a strategic purpose: we want to set up a strategic world and a platform, but to address certain markets.

So, I would like to make it very clear that everything that we do we do based on our strategy. Of course, I'm not going to talk about our strategy in detail, but I would like to emphasise the markets that we are addressing, and we want to be the operating system within the Brazilian retail. In terms of opportunities in the Brazilian retail, the opportunity of 1 trillion and 200 billion reals, it's gigantic, it's one of the biggest retail markets in the world, and even in post-pandemic world, only 10% of that is online, so a little bit more than 100 billion online. So, this means that there is a gigantic opportunity to grow participation.

So, if we apply the penetration of China to Brazil, the market if even if it doesn't through anything (the previous slide, please) even if it doesn't grow at all, it will go to 300 billion. So, if we apply the potential of China to Brazil, this is the number, and even if retail does not grow, only with digital maturity and more people buying online, the potential of the market is 300 billion. So, you can see that we only have a very small fraction of this business and we see a major opportunity.

Which categories have bigger opportunity? And one of the main ones is the market categories, food, hygiene, cleaning products, and if you take half of the Brazilian retail, they sell food, beverages, hygiene and cleaning products and penetration in Brazil is 1% only, even after the pandemic. So, the penetration is very low, it's not a very well penetrated market in the whole world, there is a small penetration because of logistics and costs of freight, etcetera, but any creative team, intelligent team in any multi-channel operation could solve. There is nothing whatsoever that human beings are not able to solve.

If you take the China penetration and you put it to Brazil, in Brazil, it's a 64 billion potential in Brazil. So, I see a major opportunity here, Magalu started organically in this market last year and we had the launch of the category to help the consumer that didn't want to leave home, and today we already have the same policy of all the categories. If you take the GMV of 1P that we launched in the fourth and annualize the run rate, you reach 1 billion. So, in a little bit less than one year we already have a very relevant operation.

If you take the 1 billion over 64, you can see that is still too little, so the opportunity is huge. Of course, our view is platform, it is growing not only in 1P, but 3P as well, and for that we made a super strategic acquisition last week: we acquired VIP Commerce, which is a technology company that helps supermarket owners online, and today the companies that operate online they don't have many supermarket clients, and one of the major players in the market, although very incipient, is VIP Commerce itself, it is one of the only players with 100 market chains and 450 million GMV annually, and we are going to make this grow.

And besides going 1P in the dark store format that we launched, we are going to grow in 3P as well. And another major market that we have is the beauty market, the fashion market, R$223 billion…

Please, remain connected.

Ladies and gentlemen, please stay connected.

Ladies and gentlemen, please stay connected. We will resume shortly.

Please, stay connected.

Ladies and gentlemen, please hold.

Please, stay connected.

So, let us resume now. Is everything alright? Okay.

Another important market – once again, we apologise for this connection problem – so the other market is the fashion market addressing 220 billion in Brazil, a very low penetration, around 5%.

If we apply the same penetration process considering markets for instance like China in Brazil, the total addressable market is 67 billion in Brazil. Magalu has already been in the market, we have Zattini, Época as acquisitions in the past and also Hub Sales with digitizers fashion hubs. Actually, we'll have a huge opportunity, we only have 5 billion of the total potential market. So, we still have a lot of room to grow and tap into this market.

On the next slide we can see another opportunity, this time in the food delivery market. Approximately true 200 billion GMV on an annual basis in the market. Penetration rate or potential penetration rate of 24 billion. Using the same rationale, considering percentage of a developed country, and applying to Brazil, developed in terms of digital maturity it's the total addressable market of 24 billion, we acquired AiQFome last year and this operation already has 1 billion as GMV with 20,000 restaurants in 44 cities. So, it's a huge opportunity.

AiQFome the focus this year is integration with the company Super App, it's growing on its own right now with an independent app and now connected to the system we believe there will be a greater potential for growth. What about Retailtech MaaS services for seller? We have a huge opportunity ahead, 5,700,000 retailers in Brazil only 47,000 are in our base, around 100,000 selling online, so it's a huge opportunity for growth in this context as well.

And as for restaurants, 1,600,000 restaurants. Our estimate tells that only 300,000 restaurants today use delivery apps, and we only have 20,000 of the markets. So,

it's a huge opportunity to digitalise these companies and doing the same as we did in Magalu this time for third parties.

Now we also have a huge potential when it comes to financial products. By far we have the greatest opportunity in terms of market size and also opportunity to be profitable and to monetise our sales, our GMV everything we do is either inside the ecosystem and payment is very much related through the surrounding areas of retail as well. If you think about everything about debit and credit cards in Brazil, we're talking about R$2 trillion and although we have one of the greatest credit card portfolios in Brazil, we launched an account, a digital account last year, and we only have 41 billion of the total market.

So, last year we acquired Hub Fintech at the end of the year to tap into these processes and boost the service we already have: Magalu Pay, Magalu Pagamentos and Luiza Cred.

Just to give an idea what Hub can bring and deliver, I would like to breakdown the opportunities now. Magalu Pay is the digital account for the end client, we have a digital account in charge of all the digital account operations, and it's embedded into the app 2,700 million points, and we also have Magalu Payments (Pagamentos) focused on sellers, 47,000 sellers and it is a sub-acquiring with speed of payments, receivable, prepayment with 7 billion TPV.

So, what does Hub have to add to this digital ecosystem? First of all, it's a payment institution integrated to SPB with a licence for Pix, so it adds value to bring something to our digital account, cashback, offline, online, payment of consumptions, so it adds a number of functions, TED, DOC, prepaid card, payment, bank slips, and also including lottery stores, and recharge transportation adding to accounts we already have, and also payroll services which can also be good to our sellers, Magalu Pagamentos, tax payment, expense, management, meal voucher, and even a licence for acquisitions. So, it's a very strategic acquisition, this company has millions of cards processed and 7 billion as well with a very strategic acquisition.

So, just to close, before we move into our ecosystem and opening for questions, we also have a huge potential to monetise and have our profitable GMV with a digital media, so the total media market in Brazil drives 48 billion, a potential to be 34 billion digitally considering digital media, and we only have 19 million last year with ads, so we acquired 2 strategical companies to address the market: Canatech with more than 20,020,000 hits, and expanding our assets also helping us with e-commerce; and we brought Inloco Media, one of the unique platforms in Brazil with media service, a great player in the segment in order to launch Magalu Ads, which will be powered by Inloco Media. With the technology and the team, we'll make available of very user-friendly tool to our sellers so they can perform their sales and have digital operations.

So, we believe these are huge addressable markets, potential growth it will all depend on our execution ability, but like I said, we have a very strong track record with execution, so I'm very confident that we'll be a relevant player, not necessarily we're going to be leader in our markets, that's not the idea, the idea is to be a relevant player in all these markets, and why not leader in some of them? But maybe we can start with the model we chose, which is the most common in China: being a digital ecosystem.

There is a lot of synergies here, for instance, AiQFome on its own would never have the same capacity to grow compared to Magalu ecosystem, and the same goes for Hub Sales, Canaltech, they already benefited from relationships with our suppliers, so that's a systemic concept, an ecosystem, an integrated digital platform. The goal and the mission are to go digital in Brazil and particularly in retail, and naturally, bring fruit to our shareholders via monetisation in these opportunities.

So, that's what I wanted to say, I just wanted to show the highlights of the business and now I'd like to open for the Q&A session. By the way, we have all the executive management here available to take your questions, and we are here for you.

Question & Answer Session

Operator
Thank you. Ladies and gentlemen, we are beginning now the question-and-answer session. If you want to ask questions using your phone, please press start 1, or you can send via chat.

Our first question comes from Mr, Joseph Giordano, with JP Morgan.

Joseph Giordano – JP Morgan
Hello, good morning everyone. First of all, congratulations on the earnings.

Fred, you gave a lot of detail on the ecosystem strategy of the company involving several growth fronts which are very robust, and we believe the company in the future will be standing out, but what about the platform? The company today has a lot of M&As in the platform in order to strengthen some capabilities.

If you look at your current ecosystem, where do you think you should dedicate and allocate more capital to speed up the process? And I would like to have a better understanding of the next steps within Fintech and its integration with Magalu as a service in the connection, particularly with small retailers that are essentially digital today. Thank you.

Frederico Trajano - CEO
Joseph, first of all, thank you for your question. Well, I believe our strategy is multidimension. Actually, it's hard for you to… well, we don't have a silver bullet in

terms of where to invest, we want to diversify our options, our opportunities, sometimes you dilute risk by having several opportunities, so all the addressable markets that are mentioned will be our focus. We want to increase digitalization in Brazilian retail based on the opportunities I mentioned.

I'm not saying that we don't have opportunities in core categories, but big opportunities are underpenetrated, and we believe we can be a key player in the delivery of food, for instance. So, this opportunity both in Fintech and also in adds that's a big opportunity, and we have to invest on this, and also, become relevant in these categories.

We had a move in Hub, and I'll tell you more about it later on, but naturally, the development of systems and more money in Luizalabs, in developing more people, and we have outstanding IT programmes to have more opportunities.

Now more specifically about penetration in new categories and digitization in Brazilian retail, there is a means for that and one of the possibilities is logistics. We described in our earnings release, as you mentioned, that we expect to invest heavily in logistics, this is the logistics year, so we'll improve capillarity with new stores, new DCs, new cross docking operations, increase in frequency of supply, and new technologies.

Anyway, we expect to keep on significantly investing in logistics in order to work more in lower tickets, high-frequency categories, it's a competitive edge, so transfer from 3P what we already have in 1P.

More specifically about Fintechs, opportunities are endless. Now our focus is on trying to have the approval by CADE and the Central Bank to absorb the Hub and managed to implement all the functions I mentioned before, both for Magalu Pay and Magalu Pagamentos.

Fatala, Robson they're also here to take your questions about Fintech, we're working on that and we are just launching in March Pix in the account, we managed to have the approval indirectly to operate Pix in the month of March in our account, and we accept Pix on our sales checkout as well starting with e-commerce and also brick-and-mortars later on. We believe Pix is going to bring bank slips to an end, and it will be a very key tool in order to grow the digital accounts and bring in at the same level the new accounts with established operations.

And we also launched a card. Remember we have 5 million credit cards today, one of the best credit card portfolios in Brazil, much higher than Fintechs in the market, about 12 billion of credit card portfolio in our Luiza Card. But this is not so relevant on the web, it was launched for brick-and-mortars. We expect to launch in April the credit card Magalu Card fully integrated with the app purchase experience and also integrated to the purchase, no annual fee, and I think it will expand a lot. We

already have 160,000 cards for month, and with Luiza Card we expect to see a higher relevance.

Beto or Robson, would you like to make comments on Fintech and elaborate on that?

Roberto, would you mind opening your camera, please?

We cannot hear you.

Why don't we take the next question and then we go back to Roberto?

Operator
The next question is from Robert Ford, with Bank of America. Please, go ahead, Sir.

Roberto Ford – Bank of America
Thank you. Congratulations on the earnings and thank you for taking my question.

Fred, what are your thoughts about this long-term balance between 1P and 3P? and what about pinpoints for 3P this year, what about the response on demand?

Frederico Trajano - CEO
Bob, I've been talking a lot about this. First of all, thank you, thank you for your question, good morning. We talked a lot about the focus on 3P and marketplace and the operating system of the Brazilian retail trying to help retail to go digital. In the last cycle, we increased on our own and now we want to grow by supporting the others and being supported by them being basically an enabler of retail in Brazil. So, in the long term the big opportunity undoubtedly lies on 3P.

1P is really surprising us during the pandemic, actually, they are the greatest sellers, those who have a structure 1P operation that have the ability and a high inventory to deliver, but once we go back to normal, the future of retail will necessarily go through 3P. It happened worldwide, Amazon for instance boomed after it started 3P, the same happened to China. So, the future necessarily for big digital platforms will come from 3P.

As for the balance, I really like to work in an integrated manner. So, first point: why is it we still want to have a strong 1P? in my opinion, 3P, our 3P is somebody else's 1P So, 1P supports you to work on logistics, operations, and support you in several aspects in terms of understanding the economics of the categories to deliver services. So, if I want to deliver services to a seller, well, many 3P started with 1P and they learn from us to create interesting platforms and services to sellers.

I believe 3P's economics, well, naturally, we cannot destroy this economics, so I can see many operations exaggerating their input to 3P in terms of take rate,

shipping. We grew at 1P, well, we became leaders of 1P in Brazil without concessions, with a sustainable operation, and for many years we had very irrational competition.

So, when I started e-commerce at Magalu everybody was losing money, most 1P lose money in Brazil up today, but we never put aside sustainability in a long-term view, we want to do the same for 3P, we want to have a rational structure, a sustainable structure for the future.

A secret for that, Bob, lies in multi-channel. One of the changes we made last year – and by the way, in the organisational structure is the following – what supported our 1P, what helped it to be unique? It was brick-and-mortars. Like I said, 50% of what happens, or the volume in 1P goes through brick-and-mortars, and I'd like to make brick-and-mortars relevant to 3P as well, but we also have hunting and farming, so benefiting from the synergy of multi-channel is one of the doors to have a sustainable 3P in the future.

Naturally, it will take a huge additional capacity, but we intend to keep on opening stores. What they meant by logistics investments also includes investments in more physical points of sale, a geographical performance, and that's also important to sustain 3P. So, having this is one of our strategies to have a sustainable 3P in the long run.

Roberto Ford – Bank of America
Thank you, Fred. And like you said, if you think about this huge supermarket, but nobody cracked the code, what is different from the way you want to do with e-commerce?

Frederico Trajano - CEO
Well, I believe… first of all, in terms of VIP Commerce, Bob, we have 1P operations, and our 1P operation increased a lot without a huge impact on our bottom line, we even increased our net profit, last quarter we had an annual GMV that was very interesting with no impact on net profit, so its breakeven in our business, which is difficult worldwide, and we increased this category basically with the ex-door model, so we have 1,300 stores and last mile with a low cost. So, when it comes to 1P, that's a sustainable manner, and obviously, in order to have a huge impact on the market, we have to support from the 5 million retailers mostly they are grocery merchants, so 50% of them sell food and this type of product, so I need to bring this inventory to our platform and one of the possibilities is by acquiring a company that is an expert on this.

Vip today works with small and big retailers, but they also can help smaller ones, just as we did at Magalu with other categories, so supporting online and platform operations, and in our Super App where these products will be available from these partners the consumer buys locally, they can check the filters, geolocation, buying local products and then the last mile is shorter.

So, this is very important this inventory distribution I mean, having the inventory close to consumers, and that's why we need to bring the higher number of local sellers into our platform, and Vip Commerce is going to help us tremendously.

As for categories, the grocery category is not going to improve our profit that much, but it's very strategic because it will improve our frequency. So, with digital platform if you consider why all retailers in the world are investing in groceries, they're doing that because it brings frequency. In China from zero to 600 million customers basically owing to grocery categories, so this kind of product is absolutely key for those who want to run recurrent customer base. You cannot be a dominant digital player if you only have high ticket categories.

So, there are other strategic components and not only generating margin to the company.

Roberto Ford – Bank of America
Very clear, Fred, thank you.

Operator
The next question is from Luiz Guanais, with BTG.

Luiz Guanais - BTG
Good afternoon everyone. Thank you, Fred. I have two questions. And adding to what you said before about diversification, on the one hand, the average ticket goes down owing to the new categories or at least the majority of them, there are two impacts: engagement and frequency. So, can you tell us more about what to expect to see in these indicators in years to come?

And the second question about multi-channel, could you tell us more about the role of brick-and-mortars now in 3P? I think you have been evolving in the latest quarters moving in that direction, a natural evolution from ship-from-store rollout last year. So, could you tell us more about it, Fred, please?

Frederico Trajano - CEO
Luiz, thank you for the question. With regards to the average ticket and frequency, naturally, like I said before about addressable markets, in the long run the trend in Brazilian e-commerce is to grow in lower ticket categories. It happened in all markets, started with electronics, home appliances or media products, like books, for instance, or music, and it even turning to streaming, and it also added to lower ticket categories.

So, that the digital maturity level of market, so the trend in the future if you want to grow online you have to grow in lower ticket categories. The thing is that in the short term, Luiz, owing to the pandemic and people are staying home more often or not travelling that much, they're investing more in what they do at home, so

durables, for instance, traditional categories they had an outstanding year last year and they keep on delivering very well this year because lockdown measures continue and they are expected to continue for a while, at least in the first half of the year or maybe until the year end depending on how the pandemic evolves.

So, in the short term, we don't expect to see major changes and not because the smaller categories or lower ticket categories are not growing, as you can see, they're even growing more, but because other traditional categories are also growing at very high rates, 150% for mobile phones, for instance, and they have a high share in GMV.

So, I believe this will happen later on. And what was the second question, Luiz?

Luiz Guanais - BTG
It was about multi-channel. Now, for 3P with brick-and-mortars, Fred, you are evolving in recent months. So, could you tell us more about how you imagine seeing this evolution going forward?

Frederico Trajano - CEO
Well, I don't want to share too many things because that's a strategy for us, but conceptually speaking, like I said before, the store is very important for 1P, and it was the decisive driver for an operation that posted growth above the market and so profitable, which is very rare in recent years, so we want to replicate this model for 3P, we want to turn the store into a logistic support point to the seller, but also do other services for sellers. We have a very strong regional footprint, and we want to benefit from that not only for 1P, but 3P as well.

I'm sorry, I'm not going to disclose too many details on this strategy.

Luiz Guanais - BTG
Okay, this is great. Thank you, Fred.

Operator
The next question is from Thiago Macruz, with Itaú.

Thiago Macruz - Itaú
Hello everyone, good afternoon. Thank you for taking my question and congratulations on the earnings for 2020.

You talked about some generation results, Magalu Pay with recurrent frequency, but once again we would like to talk about the app. It's reasonable to assume that the track record of Super App, which is what we want to see in Brazil and Latin America, should include opening a platform for third party and partners. What about the next steps? Fatala is already involved in that, so would like to understand if it's still on your radar and the next steps for this initiative. Thank you.

Thiago Macruz - Itaú
Hello, Thiago. Thank you for your question. Totally on our radar. I think we have platform-oriented mind, not only the techniques, but technology as well. We expect to see the first experiences involving the companies acquired and we want to connect via mini apps we're going to integrate the companies to be connected.

Fatala, are you with us? Could you share more detail on this, how we can move forward? If you could give us your input.

André Fatala – VP of Platform
Good morning, thank you for the question, Thiago. Like Fred said before, since last year we've been working on a change in the app architecture to allow us to develop third parties developing solutions into our app, and actually, we already started putting into practise last year when we brought Luiza Card into the app and now we're going to expand it to our partnering companies, and this will allow us to have a lot of feedback from developers, including companies on how they use our solution, an SDK, that's what we're doing now, which is a small development kit, you develop it once and then you can post and have it on the web on the Super App and then you won't need to have a native development for Android or iOS, which simplifies the operation.

So, like Fred said, we'll start with the partnering companies getting feedback and evolving with this internal development community and then our strategy is to open as a second moment.

Thiago Macruz - Itaú
Perfect, crystal clear, Fred and Fatala. Thank you for your answer.

Operator
The next question is from Irma Sgarz, with Goldman Sachs.

Irma Sgarz – Goldman Sachs
Good morning, good afternoon. So, I`d just like to ask you about purchase frequency. I don't know if there is any data that you can disclose, and in the past, you also showed us, for instance, that there are some people who download the app and never use it again, they even delete the app, but I imagine this scenario is changing a lot considering the number of MAUs and also all the new categories and everything they're adding. So, anything that you can share with us so we can have a better understanding of this journey, the customer journey over 2020.

And the second question has to do – and I apologise if I missed something here, but – the CDC, I know that is a small part of the portfolio, but I know there was a dramatic drop. Is it right to assume this product is migrating into other lines, in financial services? Or what is actually happening? Well, maybe this is related to managing risk in the whole portfolio. So, I would like to have a better understanding about this move because there was this drop in the portfolio. Thank you.

Frederico Trajano - CEO
Irma, good afternoon. Thank you for your questions. When it comes to frequency, it's very hard if you consider your company that is growing so much in the customer base to check the number, the total frequency based on an indicator alone. Last year we doubled the number of annual sales based on a very low base. However, we still have a number which is behind what is the number of Alibaba, which is 80 purchases per year with one customer. So, that's a key indicator to the company.

However, for a company that is growing with a new customer base, many new customers kind of pollute the average of annual purchases, some purchased for the first time last year owing to the pandemic, so you should cheque *cohorts,* I already have *cohorts* of customers who buy significant groups, they buy 25 times per year, and we already have this kind of product, this cohorts, and I can see that's a trend.

So, in the long run we want to have more and more of our customers moving into this type of segment of very high annual frequency. Today we have the right products and categories for that, and naturally, grocery, beauty, fashion they boost this frequency, and the same goes for food delivery, the frequency of AiQFome is 3 times per month, which is way above our standard.

The idea of acquiring the platform and integrate the Super App is precisely this. So, we already have cohorts, which encourage us and allow us to have high expectations about the future. So, that's a very significant goal for all the management at the company in terms of increasing the annual purchase and frequency.

I'm sorry, I cannot disclose too much in addition to what I said before or how we want to achieve that, but that's a big strong focus at the company.

As for CDC, Beto, can you help us?

Roberto Bellissimo – CFO and IRO
Good afternoon. Can you hear me? Good afternoon, Irma, thank you for your questions. With regards to CDC, there was a mixed effect actually. CDC was always… well, it was only relevant and only available in brick-and-mortar stores and with a very fast growth in e-commerce, the total share brick-and-mortars became smaller compared to total sales, and consequently, CDC compared to the rest also got smaller.

If we check CDC only in brick-and-mortar stores, it increased a little, nothing significant because our focus is Luiza Card, which for us is far more important and it is a long-term relationship tool bringing many benefits those who are more loyal to Luiza Card. CDC is a secondary product in our strategy for customers who don't necessarily want to have a Luiza Card or have not been approved to use Luiza

Card, so our strategy is to have the card in brick-and-mortar stores and when you check the total of the card, apparently it decreased a little owing to the mix of stores because on the web the card is not so relevant and then Fred told you about the next card, and with the new card we want to be more relevant in e-commerce as well and therefore increase this relevance in the total sales, adding particularly Luiza Card and the new card plus CDC and brick-and-mortar stores.

So, that's about the strategy. And if I may, just adding to something about Fintechs from a previous question by Joseph, with Magalu Pagamentos, which we launched last year with sellers, the result was outstanding, more than 100 million net profit with sub acquiring, prepayment or receivables and the whole processing of sellers' payment, and the beauty with Hub is that we can pay sellers in a Hub account.

So, the question is how to get to sellers, oh, it will get to sellers naturally, we're going to make the money available in a Hub account, and today we make it available in Magalu Pagamentos account that doesn't have a minimal for sellers, so actually, they transfer to a different account, and now with a simple payment in a digital account at the Hub our cash flow will be very high in the account with a lot of services at Hub and also others to be developed in the future, and naturally, the seller is going to use the account a lot to make payments, to work on payroll and cards, etcetera. So, that's also a strategy behind Magalu Pagamentos and Hub Fintech very finetuned for sellers as well.

Irma Sgarz – Goldman Sachs
Thank you very much.

Operator
Rubem Couto, from Santander.

Rubem Couto - Santander
Good morning everybody. I apologise if I have lost something. What could we expect in terms of Capex and Opex in order to be able to deliver all that? Is the idea to maximise the use of these two assets in the company now? And a follow-up on the previous question: how much could we expect for the service line or the revenue from services in about three to five years' time I would say?

Frederico Trajano - CEO
Good afternoon and thank you very much for your question. Differently from the logistics, the idea is the follow: we have already had three acquisitions: log Logbee, GFL, that have similar business models, and Cintilog, a tech platform for logistics. So, three acquisitions, they are fantastic and the people there are fantastic and the platforms are fantastic, and the idea, well, of course, we could consider new acquisitions, but we already have a very robust platform over which we're going to make investments, and the focus will be to accelerate the organic investments, and significant one, and this acceleration will be in the increase and the penetration when you open a store in the format that we work, we increase logistics and new

cross dockings, for instance, which is a model of Logbee and GFL, and new distribution centres as well. in 2022 we're always also going to do this.

So, it's a significant expansion of this network of frequency of supply and investment in teams that are going to develop algorithms and geolocation systems and transactional systems as well, so investment mainly organic.

In relation to lines, as you know, our style is not to give any kind of guidance in this regard, we are showing the potential of the market and the Fintech and the potential of retail as a whole when that should explore mainly on 3P, but we do not like to give the market any kind of estimate I would say.

Rubem Couto - Santander
Okay, thank you.

Operator
Gustavo Oliveira, form UBS.

Gustavo Oliveira - UBS
Good afternoon everybody. Thank you for the question. Still talking about logistics in your 3P strategy, I would like to better understand the hypothesis that is adjacent or that underlined. It seems to be a little bit different from the other players in logistics approach. Mainly you talk about the educational aspect of the stores in the process, and the store pickup and delivery and the assortment being located in the stores. What I would like to understand is the following: as you grow the long tail with smaller retailers coming onboard, or 3P becomes more and more localised and you were talking about the geolocation development that you are carrying out, have I understood it correctly, or is it a desire on your part because this is going to facilitate your cause and the delivery of local services and your matches between buyers and sellers?

So, what is your idea about geolocation? Because I think this is where the big difference lies between what you are doing and what the other players are doing. Everybody is taking the products to the fulfilment centres so they imagine that the seller has a more nationwide presence, and you're doing something different because maybe you're thinking “Well, I already do this very well and I can refine it locally”, or do you believe that the local approach is much more important? Could you clarify your approach, please?

Frederico Trajano - CEO
Thank you very much for your question. Well, more than a hypothesis, this is a bet that we are placing. We like to think with our own heads, and we understand that we know Brazil in depth, and we know everything regarding logistics, we are great 1P operator, so logistics is no mystery to us, and we know the cost of operating a system, and I believe that many operations in Brazil they replicate the Amazon long-haul system, but Brazil is not the US. You do not have very high frequency of

flight and lots of airports, and you don't have the same structure, you only have a few airports and they're very concentrated in the capitals. When you go to a small city in the interior of Brazil the long-haul is very expensive and very slow.

So, the ideal having 10 centralised distribution systems and having fulfilment for the whole country it is not feasible for the situation that I have just described about Brazil. We want to address opportunities of having short-haul deliveries, more short-haul deliveries, and bringing the inventory of the local vendor to our platform and having the local delivery this is our bet.

I'm not saying that I'm right and the market is wrong, or the other way round. Only the future will tell. What I can tell you is that having a logistics operation for sellers totally long-haul with gigantic distribution centres and making the goods travel a long-haul, the cost is unfeasible, the cost is huge, and companies will have a very serious problem in terms of results and cash generation.

When I placed my bet on multi-channels way back then, you know that it's very difficult for me to place my bets on any system that I cannot see a light at the end of the tunnel. I don't see the economic feasibility in the other system.

Gustavo Oliveira - UBS
Well, this is very interesting, but when you look at your data, you already have a big critical mass, you have 14,000, you went from 14,000, I don't know how many are companies or individuals, but do you have enough data to show this?

Frederico Trajano - CEO
Well, we're scratching the surface, as I said before. We have 5,700,000 retailers in Brazil and I only have 40,000 on our platform, so since last year I have been talking about the Chinese growth and it's very important for us to gain scale, and the company has to grow a lot and much much more than the market in all aspects, so we need to continue to focus on growth, on GMV, top line, scale gains provided there is an economic rationale that really makes sense in terms of ROE, and so, of course, we cannot waive that.

But you have to gain scale, you have to have more sellers, you have to have more inventory here and the digital platform is operating large figures. If you are small or if you grow just a little bit or less than your competitor, you have no chance or don't stand one chance in this market. So, growing scale and addressing these opportunities and being ambitious and making big investments is imperative so you cannot just start, you know, and be small.

Gustavo Oliveira - UBS
Thank you, Fred. And I have one last question if you allow me. The impact of the AiQFome on your result, I believe that you are going to accelerate quite fast because there is a learning curve, the first year is slower, but I believe you are already accelerating GMV and that opportunity that due to the pandemic it even

becomes bigger in the short run.

But what is the impact that we could see? As you accelerate your GMV, what is the impact on your take rate, how much of the GMV is converted into take rate, and what is the impact on your profitability?

Frederico Trajano - CEO
This is a 1 billion operator GMV, profitable, they are outstanding entrepreneurs, they have a fantastic technology, the commercial people are great, and the business model is great, it is similar to some Fintechs that work with local strategy, and they operate in a very efficient fashion, and this is a business that is good by nature. Of course, we know some companies that have a lot of cash burn, but the beauty of our model is the ecosystems; when you integrate the AiQFome in this app this is going to go down, you already have clients.

When you have a local operation for hunting seller helping not only to bring on board new sellers or even restaurants or whatever, I see synergies in the front, that is to say in the integration with the Super App, and also in the hunting and the farming teams there is integration, so the economics will be even better.

This is a market that is still very difficult, mainly in the big cities, so the smaller and the medium-sized cities have a lower cost of operation, so we're going to follow this line. We acquired Netshoes that was the only company that we acquired that was in the red, and the price was very good. All the other businesses that we acquired they are sustainable, and they are lucrative when we acquire them.

Gustavo Oliveira - UBS
Thank you very much.

Operator
The next question is from Guilherme Assis, with Banco Safra.

Guilherme Assis - Banco Safra
Hello, Fred, good afternoon. Good afternoon everyone. Thank you for taking my questions.

Fred, I would like to go back about economics in new categories. I think you just announced this acquisition Vip Commerce, and like you said, this segment has a very big potential, maybe higher the size of the e-commerce potential or retail, I mean, in Brazil with a low penetration even though it is expected to increase. We can see there are many players including food retailers and also players in the market, and we also decided to be part of it during the pandemic.

So, we can see fierce competition, we can see a lot about vouchers being used in order to attract consumers, so now, now that we have this platform and you are going to deliver services to physical retailers, so if I understood you correctly, your

strategy is to use the platform as a seller.

So, what about the economics? I think it is similar to Gustavo's question about AiQFome, but what about take rate and acquisition cost, specifically in the grocery, grocery segment?

Frederico Trajano - CEO
There are several different manners to answer your question. First of all, good afternoon and thank you for your question. We run 1P grocery category, and this category if you think about new categories, you are only considering groceries, right? Or are you relating to all new ones, like fashion, for instance?

Guilherme Assis - Banco Safra
Groceries only.

Frederico Trajano - CEO
Okay. Groceries, well, that's a worldwide challenge. If you think about online e-commerce operations, it entails a challenge because the average ticket is low, and the price is high. Logistics is price over weight, or price over cubic metre, so groceries are hard to be profitable.

So, let me go back to the question before. Geolocation is key or have to have a logo inventory with fast delivery, very high frequency, high level of use of the frequency capacity in order to have a lower cost vis-à-vis the purchase basket, both in 1P and 3P. for 1P we're using brick-and-mortar, like dark stores in order not to travel so much, we have 1,300 stores, all of them have a grocery inventory and we are improving our algorithms to identify which product should be in all markets.

Naturally, I'm not going to have full basket everywhere, it has to make sense for 1P, but in order to have a higher capillarity, it's important to have the 3P modality, and that's the rational about Vip Commerce; it has to be integrated with local small grocery stores or local networks to help them sell directly online, and then you have a direct participation in the system or selling via the closest marketplace. It's not that they're only going to sell at Magalu, but they'll keep on selling directly via their own website as well, and we're going to support them with IT systems or logistics and payments.

So, locally, I believe there is a good opportunity for the business to be relevant. It's growing worldwide, all companies are investing in this category and I see it with good eyes. As for the economics, it's a matter of choice. Historically speaking, like I showed for the last five years, if you check the historical series, we always try to work in areas with economics that make sense for us, it doesn't necessarily have to be profitable, but it delivers good frequency. Not all categories have to be a cash call, maybe there is a different strategy that is important for you.

For grocery is not necessarily it has to have a wonderful economics or be a great

cash call, all it has to do is not to burn cash that much, but if it adds frequency it meets another strategical need.

So, you have to have a global systemic view. Overall speaking, you have to grow a lot, generate cash, and as much as possible improve profitability in order to bring return on invested capital. That's always on our radar, we are a rational player, we'll continue to be that in the future, but not all categories have to deliver the same high margin of contribution.

Guilherme Assis - Banco Safra
Fred, just a follow-up question about this, and not only about groceries categories, but also about marketplace in general. We know marketplace is the kind of business that brings higher margins. Naturally, you have the support that you mentioned. You talked about logistics and how efficient you are, and you don't have the long-haul model, which in my opinion allow you to have a smaller average cost to get to the last mile in an integrated system.

So, when we talk about marketplace and take rate, the idea is that we have a high margin business, unlike 1P. Sometimes you have more fierce competition and sometimes you need to move away from margin. So, we have seen competitive moves in marketplace that are very aggressive. Now if we think about a long-term view, do you believe marketplaces economics will be accretive for margin as we expect, or considering the circumstances of the market it is something that will make economic sense, but maybe the margin is not much higher or as good as we expect? So, how do you see that Fred?

Frederico Trajano - CEO
Guilherme, first of all, marketplace, intrinsically speaking, should be or could have better economics compared to 1P. you need to deploy less capital and you grow with somebody else's assets. So, conceptually speaking, okay, but think about a bank. Bank has a huge profit pool, it is one of the best segments, highly profitable. Think about the number of banks that went broke in Brazil.

So, even in an intrinsically good segment, you can have a poor operation. You can lend to somebody else that you shouldn't have, and maybe you'll have a higher cost in the end, so including marketplace which has a good economics, maybe you can have mediocre circumstances, and I saw that in 1P, I've been for 20 years in 1P and many companies went broke in 1P because they wanted to grow without being profitable.

But we have a profitable 1P, and if you can do that with 1P, I can't see why you won't do it with 3P. So, it depends far more in the company. Naturally, in my case, 1P I competed with extremely rational companies that would burn cash. At that time, not only had the Stock Market to subsidise consumer, at that time it was VC2C, venture capital to consumer. VC2C rather than B2C, and today is IPO2C; the company gets the money for consumers does subsidize.

So, we managed to grow in the past even though we had to compete with this kind of companies. So, maybe in another quarter we're going to play the game and we might slow down, etcetera, but in the long-term I trust our business model, I trust our rationale, our capacity of execution, and when I show that we have 5 million retailers, the majority is not even online yet, I believe competition has been overrated because that's such a new market.

I think competition is more related to mature companies. If you think about price, take rate, mature markets you have more issues related to that, but when the market is in the first steps, 10% of the Brazilian market, 1 trillion and 200, only 100,000 sellers online, so there is plenty of opportunities.

So, I don't waste my time that much looking to the side. I think we have to focus on blue oceans and opportunities. That's we want the market to see so we can move away from this dilemma of looking to the sides.

Guilherme Assis - Banco Safra
Great, it's clear, thank you.

Operator
Richard Cathcart, from Bradesco.

Richard Cathcart- Bradesco
Good afternoon everybody. I would like to ask two questions. The first one is about the fashion category. Are you going to accelerate this category still during this year? Maybe you need a little bit more marketing or maybe you already have everything you need in place.

And the second one is about the 24 hours. What was the role played by the market category? Was it this category that drove the faster lead mark? Thank you very much.

Frederico Trajano - CEO
So, fashion, we talked about market quite a lot, but we should really consider this fashion because it is even abroad, it is more consolidated than other markets in developed countries, and the economics are better than market. For instance, you have many operations that are going very well online, and we made a very high investment there when we acquired Netshoes that came with Zattini, one of the biggest in our life as a company, and then Época Cosmético that had a brilliant performance last year.

So, you have sports, for instance, which is also a gigantic operation, but fashion and beauty you have a penetration that is very low in Brazil still, much lower than other countries in the world, and they are good, they have a good gross margin, they have a good average ticket, and we invested quite a lot in infrastructure

already ,we created two departments in Magalu last year, one for sports, Júlio Trajano, known for fashion, Silvia Machado, who came from previous experience in Arezzo as COO, she is setting up a fantastic team from product development going all the way up to marketing, and everything exclusive and dedicated to this category, and the M&A already happened, which was Zattini, and we have Shoestock, which is one that we will be developing as our private label, and Época Cosmético I have already mentioned, and Hub Sales that operates B2C models.

And our objective is to have it in… well, it is in Franca, which is where most of the footwear in Brazil is produced, but we want to take this to other places in Brazil. So, we are investing both organically and inorganically in the case of Hub Sales in order to be able to take advantage of the opportunity. It's a big investment mainly now investing in teams and talents, we are attracting fantastic people that are bringing know how to this category that the company didn't have before.

Of course, we have people that came from Netshoes, but it was more focused on sporting goods and there is a very big opportunity here for the team to work.

And your other question, could you repeat it?

Richard Cathcart- Bradesco
So, about 24 hours lead time.

Frederico Trajano - CEO
No, no, it was not driven by market. Smart phones, mobiles, TVs, and other categories are being operated with the store inventory. Market does help, but it's not limited to market.

Richard Cathcart- Bradesco
Excellent, thank you very much.

Operator
Next question comes from Daniela Eiger, from XP Investments.

Daniela Eiger – XP Investments
Thank you for the question. Congratulations for the result.

My question has to do with profitability. You said that many competitors are very aggressive in terms of incentives, etcetera, but looking at your margin, what we see is that there is a major pressure, even higher than your peers although they already have significant gains coming from the digital channel. So, I would like to understand the dynamic. You are having a stronger pressure on your gross margin than your competitors, I understand that you are offsetting this with lower operating expenses, but you said you're making major investments in service level and logistics, but what are the main drivers? Does it have anything to do with categories, or some incentive that would make sense in the short run?

You said that it's important for the operation to be sustainable, but it must have scale. So, this investment should make sense in the short-term because your company becomes more robust to face the future, so I would like to understand the dynamics of the past and how you see this for the next year. Should we continue to expect this pressure? Maybe it will be smaller because digital is already there and maybe it should flatten out, but what is the trend for your gross margin and EBITDA for this year?

Frederico Trajano - CEO
Daniella, thank you for the questions. Gross margin, it has to do with mix and mix alone. We are the company that has been growing the most digitally, we went from 1/3 to 2/3 of our sales coming from digital, nobody has this kind of share online, 2/3 of the sales. So, nobody has that.

If you look at the online operations, they will be working with a low gross margin, all of them. In operation that is mono channel is easier to compare, so you can see that the gross margin of digital channels is always lower than the gross margin of the offline channel. On the other hand, the digital operation has lower expenses, so although the gross margin is lower, our expenses are much lower.

But I believe that the major point here about the margin is the following: your margin is my opportunity. We talk a lot about Amazon, for instance, Jeff Bezos, and he says that the consumer will always want to pay less and receive faster. This was the only certainty that he had in his life. So, it's important to have an operation that is profitable and generates cash, and including last quarter, our expenses are the lowest in the market by far, and if you can have this level of expense you can have lower margin and grow more than the rest of the market.

So, we have been growing more than the other players and I reemphasise, Daniela, the importance of scale: this is a business of big numbers, no medium-sized platform can be a player in this market. So, having a growth much higher than the market and having a high GMV annually is fundamental for a successful business. So, we have to look for scale and, well, Chinese growth is one of our strategic pillars.

So, this is very important for us to grow, so we do not believe that having a high margin is a competitive advantage. Quite the opposite. And our decisions have nothing to do with the market. We grow online because this is where Brazil is growing. I know that the company is only based on the mix.

Daniela Eiger – XP Investments
So, if you can add to what you said, what do you expect for the year? Do you see a fiercer competition, do you see this as an additional challenge for Magalu, or do you believe that your position protects you enough, or should you do something in order to help the seller further in this more competitive situation?

Frederico Trajano - CEO
Daniela, I have already said that to Guilherme when he asked the question. Our decisions are all made for the long run, we never make a decision for this current quarter or anything like that. So, 44 billion GMV, when I look at the position of 1 trillion and 200 billion in the market, I see that this is a multiple opportunity, multiple categories, multiple fronts, and in each one I have a different competitor. So, it's Fortnite, it's not a World Cup; you compete with many in many different categories. So, it's very difficult to map this.

I don't spend a lot of time looking at that, the financial market does, but we focus on the on the opportunities and the level of service that can be improved and trying to be sustainable at all times, and this is what we have been doing in the last few years. So, I'm not very much concerned with the short run, it could happen in one month or one quarter.

The company has 7.3 billion in cash, we generate quite a lot of cash, we have a profitable operation, and we can accelerate should it be necessary. We have 20% operating expenses; this allows us to be more aggressive than any other player in the market. So, we are very comfortable that we have a superior model, we have a proven execution, we have fuel, which is cash, and we have an ambitious view for the future, so it doesn't make sense to be looking to the sides.

Daniela Eiger – XP Investments
Congratulations for the results.

Operator
The next question will be in English, Razi Jain, with HSBC. Please, go ahead.

Razi Jain - HSBC
Morning, Fred, thank you for the questions. The first one is probably for you and maybe Fatala as well. Digging deeper into Magalu as a service, if you can give us some colour on your initial focus, what kind and size of merchants are you going to look at? What services would you prioritise in the near term for the smaller retailers?

And the second question is on fresh. Maybe, Fred, you can lay out your vision for groceries, what is the mix going to be? Is it going to be driven mainly by the 3P picking and delivery services, specialised 1P fulfilment centres, or something like a community group buying that you have seen in China? That well be really helpful. Thank you for it.

Frederico Trajano - CEO
Razi, thank you so much for your question. Let me begin talking about Magalu as a service, Fatala can also add to that. Our vision is very focused on small and mid-sized, we have a purpose which is to generate digital inclusion in Brazilian retail.

Usually, larger networks and chains have their own digital initiatives. Big grocery networks they have their own digital teams, they don't depend so much on Magalu compared to small and mid-size, so we want to develop technology for those who need it.

When we moved to the small and mid-sized business universe, there is a broad range of necessities, some can be very basic including education, that's why we acquire ComSchool. ComSchool is a digital business school allowing businessman to do basic things in e-commerce, so we acquired an education company to support SMEs to go digital.

You also have to, for instance, have an online invoice, you have to know how to do that and you need approval by some federal agencies to do that, or cataloguing, or inventory control, or logistics, payments, anyway, go to market strategy and some options, and in all of them the idea is to develop applications our own, or like Fatala sat before, plug other in the markets in our ecosystem to meet the needs of SMEs.

But these are broad opportunities, nothing that we haven't done before to Magalu, so we are making everything available for them according to their size, in their segments, and categories they are.

Fatala, anything to add?

André Fatala – VP of Platform
Yes, Fred. Fatala speaking. Thank you for the question, Razi. One of the points in order to address at first Magalu as a service has to do with providing several services which allow us to have a digital seller, and from the beginning bring this catalogue geolocated in our platform, and with that, help consumers to find the needs that are closer to them.

Like Fred said, it's part of the strategy of logistics deliver what is closer to the customer. So, we need to try and support them with the right tools, very friendly tools. Many of them, like Fred said, are not familiar with marketplace and sales on the web, they don't know how it works. So, we're trying to remove complexities of issuing an invoice, or logistics, delivery to consumers who are close to them. So, are the main first tools that we are considering Magalu as a service.

And based on the information that we are going to send about these merchants, we will learn a lot about other services that we can also deliver, this time involving other pillars of the company, like for instance, the financial areas, what are the main financial services that are a pain to these people and how can we help with the current tools we have without having to contract or use others so we can benefit already from the services we have.

And other things we have, for instance, about advertising and publicity, we also want them to have a simple operation to make it easier for them to have publicity

on the web and drive more traffic to the products they have on the list and also support them in one of the points that we learned to do, which is to drive traffic to the point of sale, physical point of sale, trying to boost revenues. So, these are the first steps.

As for the size of the super small business up to an average size, which is already a small network, for instance, or a small merchant chain. Well, we had an acquisition of Stoq, which is a little bit more robust, and we want to use this solution as a channel to deliver these services as well.

Frederico Trajano - CEO
As for groceries – Fred speaking now – I think I made many comments about 1P, back store and 3P with Vip Commerce, and you mentioned the Chinese model, which is community group, and it has similar characteristics to Magazine E Você. This is an operation that we are watching very closely.

To tell you the truth, Razi, nobody in the world managed yet to be ultra-relevant. Like I said, penetration is lower compared to any other category, including US and China. It's great in Brazil, but it's too very low. So, there is a lot of opportunities. China is tapping into new territories, particularly now with the model you mentioned and we're keeping our eyes open. We have similar tools of social commerce and I believe they can be alternatives for the future.

So, we will be running tests, we will be experimenting several opportunities and see the best to scale. considering our characteristic, we always test, experiment, run, make mistakes than we learn and scale up whatever makes sense to us.

Operator
This concludes the question-and-answer session. We'd like to give the floor back to Mr. Frederico Trajano for the final remarks. Over to you, Mr. Trajano.

Frederico Trajano - CEO
Thank you very much, thank you all for being with us.

We apologise for the technical glitch, and I'd like to say… well, actually, we want to thank you, particularly our team, 40,000 employees, our leaders, our direct people who have been with us in this extraordinary year. Like I said before, I'm so sad about what we have been living in Brazil right now, it seems to us we went back to zero when it comes to the pandemic. However, we are happy with our team's ability to react to all those difficulties, to make a difference, to support other businesses, and take care of our peers and our customers.

My admiration, my gratitude to the team is absolutely huge, and also to investors who still have confidence on us, and stakeholders, and sellers who were growing with us. Obviously, finally, our customers. And once again, we have to think about the highlights, upsides; Brazil is relentlessly generating negative news since I was

a little boy, I started e-commerce in the year 2000 and I wonder about all the difficulties, so many sad news throughout this time, but we continue to be a huge country with plenty of opportunities, amazing companies, they see the glass full and keep on flourishing.

So, many entrepreneurs, many companies with good cash generation. I don't believe bad news will come to an end, they'll always be here, but we will focus on what we can do, what it's up to us to do based on our talent, our ability, and always have a bullish view.

Opportunities for us who are digital are huge, addressable markets are huge as well, there will be obstacles ahead, difficulties, now we have 800 stores closed out of 1,200, last year we had 1,200 closed. Obstacles will come and it will depend on our ability to react, to be firm on our purpose, our mission, and obviously, I would just like to close like saying that we have to do the right thing and fight for formal retail in a sustainable manner. I think that's what Magalu has been delivering successfully with no pathways, but just trying to do the right thing.

Thank you very much, enjoy lunch. Thank you.

Operator
This concludes Magalu's conference call. Thank you all for being with us, have a good day.