Local Conference Call
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Vanessa Papini: Good morning, everyone! Thank you for waiting. Welcome to Magalu's quarterly earnings conference call.

For those who need simultaneous interpretation, simply click on the Interpretation button via the globe icon at the bottom of the screen and select your preferred language, either English or Portuguese.

Please note that this event is being recorded and will be available on the Company's Investor Relations website at ri.magazineluiza.com.br, where you can also find the earnings release and the presentation, both in Portuguese and English. The link to the English presentation is also available in the chat.

During the presentation, all participants will have their microphones muted. We will then proceed to the Q&A session. To ask questions, click on the Q&A icon at the bottom of your screen. Please include your name, company, and the language of your question. When you are announced, a prompt to unmute your microphone will appear on the screen, and you can then activate your microphone to ask your question. Questions submitted in writing will be answered later by the Investor Relations team.

I would now like to hand the floor over to Fred Trajano, CEO of Magalu. Fred, please go ahead.

Fred Trajano: Good morning, everyone. Thank you very much for joining us for Magalu's 2Q24 earnings call.

Once again, I'm here with our entire leadership team—our executive directors are present and will be available to answer your questions at the end of the presentation. We aim to keep the presentation concise to allow ample time for the Q&A session.

Despite challenging market conditions, particularly with unfavorable interest rates, we have delivered another exceptional quarter. In 2Q24, we recorded our third consecutive quarter of net profit, and this quarter, we reached a historic EBITDA operating margin of 7.9%. This margin was initially projected by the company consensus for next year—just to give you an idea of how we have accelerated this timeline.

As I've communicated in several calls since the end of last year, the company's focus has been on returning to profitability and growing our results, and that is precisely what we've achieved over the past three quarters, especially in this 2Q. We reached a 7.9% EBITDA margin and grew our absolute EBITDA by 62%. This growth wasn't just in margin; we increased sales while also expanding our margins, leading to a 62% increase in our EBITDA.

This strategy has proven to be absolutely correct because, at the beginning of the year, both we and the market were projecting a much steeper interest rate curve than what actually materialized. I think I made a promise to myself after what happened in 2021 that I would never again be caught off guard by interest rate fluctuations or by Central Bank decisions that differ from what was forecasted in the FOCUS report and the consensus.

Back then, in 2021, I remember the FOCUS report was projecting rates at 4.5% per year, but the final interest rate ended up being over 10%. You build your entire agenda to aggressively accelerate growth and investments, and in the end, financial expenses turn out to be much higher than what was projected.

The 7.9% margin now shields us from any bad news regarding interest rates. That's exactly what happened this quarter. Even with interest rates at a high level and not so positive outlooks, we are delivering profits and strong results, proving our team's ability to deliver results regardless of the external environment.

I want to make it very clear that this was the right strategy, a correct one, and it was even intensified by our team in the first half of the year, particularly in the second quarter. To put it in perspective, the last time we reached this level—7.9%—was back in 2019, before the pandemic. So, we're certainly celebrating the 7.9% EBITDA margin, the 62% EBITA growth, and, of course, the BRL 37 million in net profit, even amidst this challenging environment.

On the next slide, I want to highlight two important points. What drove this margin increase? It's very clear in our financial statements—we had a 2.1 percentage point increase in gross margin. This increase was mainly due to the improvement in our 1P margin.

The primary channel contributing to the rise in our gross margin was 1P, with a 3 percentage point increase. Since 1P represents about half of our overall 1P sales—excluding stores—it contributed nearly 85% of the increase in our gross merchandise margin, leading to the overall gross margin improvement this quarter. Additionally, the growth in service revenue, which also contributes to gross margin, was significant, particularly in financial products like insurance. We finalized the Cardiff agreement last year, as we announced to the market, and had an extraordinary quarter in insurance sales and other financial products, which performed very well. The marketplace take rate, which is included in this service line, also grew 11% above total GMV, contributing to the 2.1 percentage point increase in our consolidated gross margin.

So, 1P and the growth in service revenues were the primary drivers behind much of this margin increase.

Another key point to highlight is that Luizacred is accounted for using the equity method in our consolidated results, above the EBITDA line. Last year, Luizacred's performance was a drag on our EBITDA margin—we posted a BRL 66 million loss in 2Q of last year. However, this year, we reported BRL 71 million in profit from Luizacred, a positive delta of BRL 137 million.

Regarding Luizacred, I also want to emphasize that this result was achieved without any credit expansion initiatives. All of this performance came from improved delinquency indicators and healthier rollovers, which continue to look favorable into the third quarter, setting a positive outlook for the second half of the year. In other words, all the financial results we achieved this quarter were not driven by credit expansion, which underscores the solidity of these results.

So, Luizacred has returned to delivering positive results, with BRL 71 million in profit this quarter. In fact, this is one of the best quarters in Luizacred's history.

Finally, I want to emphasize a crucial point because a significant portion of the questions and pushbacks we received from the market last year concerned our short-term debt and the maturities we had in the first half of this year, totaling BRL 3 billion. I want to stress that the company successfully settled BRL 3 billion in debt during the first half—just under BRL 1 billion in the first quarter and a little over BRL 2 billion in the second quarter.

We are closing our 2Q balance sheet with zero short-term debt. Our next maturities are only at the end of 2025 and 2026. Importantly, we achieved this without resorting to judicial or extrajudicial recovery. We did this with our cash, by improving our margins, our financial results, and the cash flow from our operations. This demonstrates the company's financial strength and positions us with a much lighter agenda moving forward.

On the next slide, I'd like to emphasize our sales performance. Even with our focus on gross margin growth—2 percentage points in consolidated gross margin and 3 percentage points in 1P gross margin—the company was still able to deliver growth. Expanding margins by 2 points while simultaneously growing the top line is a herculean task, extremely challenging.

Anyone who operates day-to-day or manages a company with the complexity of Magalu, or any retailer in Brazil, understands how difficult it is to simultaneously pursue an agenda of increasing margins at this level while also growing sales. Yet, that's exactly what we delivered for another quarter, with 4% total growth.

The standout in our sales this 2Q was our physical stores. We achieved the best same-store sales growth for a quarter since 3Q20, which was when stores had reopened and there was pent-up consumer demand, along with the billions from the Corona Voucher program. So, 16% same-store sales growth is a historic figure.

Whenever we face a counter-cyclical period, as we have over the past two years, there are always market questions about the future of physical stores. Yet, whenever the economy shows even slight improvement—and it's undeniable that the economy is improving; we've seen it in the financial statements of banks, retailers in general, and in our own results—our physical stores become a significant macroeconomic indicator. We know things are getting better because we achieved 16% growth in this quarter.

I'd like to highlight some specific regions within this figure. These are highly important areas for Magalu, particularly because we expanded into them during the counter-cyclical period—specifically, Rio de Janeiro and the Federal District. These stores, which were not yet fully mature, grew by more than 20% in 2Q and boosted our average same-store sales. We are now reaching a breakeven point in these two markets, Rio de Janeiro and the Federal District.

We had an exceptional performance in Rio Grande do Sul, despite the tragic events that occurred in the state in May. The results were extraordinary—families are restocking their homes, and Magalu has been very present in the state, providing significant support through donations and other initiatives. I believe our brand emerged even stronger from this experience. We even created a special product label for sellers and suppliers from Rio Grande do Sul on our app, reflecting the sensitivity our brand has shown during this difficult time. The people of Rio Grande do Sul have reciprocated by choosing our stores to rebuild their homes during this period.

We're very pleased with these results, and they continue to be strong as we move into the third quarter. Additionally, the Northeast region once again boosted our overall same-store sales average for the Company.

So, it's a very positive moment for the stores with a 16% growth—a number worth celebrating, and this momentum is expected to continue into the third quarter.

Regarding online sales, we grew by 1% in total, with the marketplace continuing to grow at 4%, along with an increased take rate during this period. The focus of our online operations has been to contribute to the Company's EBITDA margin improvement.

We achieved a 3 percentage point increase in gross margin for 1P, as mentioned earlier. We have now reached an EBITDA margin level of 7.9%, which was initially projected for next year. This provides us with a comfortable position, even with a potentially less favorable interest rate environment, and gives us the flexibility to focus on growth in the second half of the year.

So, increasing your margin by 3 percentage points while simultaneously focusing on accelerated growth is challenging. The team needs to have a clear focus—our commercial, sales, and marketing teams delivered what they committed to for the first half of the year, and now we'll balance that with growth for the coming year.

We don't want our 7.9% margin to decline; we aim to maintain and build upon this level. I will discuss additional leverage points, such as Ads and Fintech, to further improve our EBIT margin. Our goal is not to grow at the expense of margin but to continue evolving and enhancing our margin going forward.

However, we will be more focused and will also reap the benefits of initiatives we launched in the first half of the year, which will support our growth in the second half. I will discuss these in more detail later, but certainly, the partnership with Aliexpress is a major highlight among these growth pillars as we look ahead.

I'd like to highlight our fulfillment operations. An important growth lever for the marketplace is advancing our fulfillment agenda. When a seller migrates to Magalu's fulfillment system, conversion rates increase, service levels improve, and shipping costs decrease, resulting in better economics, even for lower-ticket items. This quarter, we reached 21% of total 3P orders through Magalu's fulfillment in less than a year.

We now have 8 distribution centers, with operations in São Paulo, Minas Gerais, and the Northeast, and we are also expanding our operations in the South. Our fulfillment in the Northeast has been an absolute success, with inventory turnover even higher than our 1P operations in the region. Products are coming in and going out with great availability.

It's important to note that our fulfillment is different from the market's fulfillment models. Once a seller's product is in our distribution center, it benefits from the same multichannel advantages as our 1P products, such as store pickup. In our 1P operations, 50% of items are either picked up from the store or shipped from the store, providing a variety of options. Similarly, once a 3P seller enters our fulfillment system, they also benefit from these features, with around 20% of 3P orders utilizing store pickup.

We're very excited about continuing to advance this agenda. We have plans to expand further in the South and are in the final stages of negotiating to bring fulfillment operations to Rio de Janeiro as well. Our fulfillment operations are progressing very well, with over 3,000 sellers storing inventory with us, more than 1 million items in stock, and 60,000 unique SKUs.

On the next slide, I'd like to discuss initiatives that could drive our already historically high margin to even higher levels, one of which is Ads. We have completed building our Go-To-Market team; Célia Goldstein joined at the beginning of the year and assembled the team. We are finalizing all necessary platform improvements for evolution, including significant updates to our self-service platform and sponsored products. A major highlight this quarter was the 40% growth in revenue from this platform.

We now have over 3,000 active advertisers—almost 4,000, including sellers, brands, and major advertisers. We receive nearly 500 million monthly visits, covering all visits across our group's companies. Advertisers on the Magalu platform can place ads on Magalu, Netshoes, Kabum!, and also across our 1,300 stores, which feature over 20,000 TVs for offline media.

We've just relaunched the new version of Lu, our digital influencer, and she is now also monetizable. She recently secured a significant endorsement deal, appearing in a Burger King commercial—the first ad she's done for a brand outside of Magalu. Lu is becoming an important revenue source for us.

We're very excited about the opportunities in Ads and retail media. This is an agenda being pursued by retailers both in Brazil and globally, and it's almost universally successful.

For instance, some retailers achieve 500 to 600 basis points of GMV with an 80% contribution margin. Even if our agenda only reaches 200 basis points of GMV, it would still significantly contribute to increasing our gross margin, given the 80% contribution margin.

We're excited about this agenda and the enormous potential to monetize the vast scale we have across all our platforms in Brazil.

On the next slide, I'd like to highlight MagaluBank. I've already discussed Luizacred and the positive growth in services, including PIX transactions. MagaluBank is now integrated into nearly all companies within our group—Estante Virtual, Época, Kabum!, Netshoes, and others—all utilizing MagaluBank's services. Similarly, they are also using Magalog's services. We've achieved nearly maximum penetration across all channels in our ecosystem.

However, I want to particularly emphasize the launch of the CDC Digital. This represents a significant growth avenue for us in the second half of the year.

We've now launched a controlled rollout of the CDC Digital—Mauad will provide more details later—aimed at thousands of Magalu customers. We expect to have over 2 million pre-approved clients, with plans to fully roll out this system by September. This product is expected to significantly boost our sales, especially for high-ticket items, where we already lead but aim to solidify our leadership.

It's important to note that offline credit penetration is around 40%, while online credit remains quite low. This presents a huge opportunity to drive sales for both 1P and 3P products through CDC Digital. We anticipate that this product will bring substantial profitability to the group, helping us to increase sales and strengthen our leadership in high-ticket items, while also contributing positively to our EBITDA margin. We're very excited about this potential.

Finally, while it's not common to discuss in earnings calls, I believe it's essential because it's the passport to our future growth and organic expansion: improving our service level.

In July, Magalu achieved a significant milestone with the Encanta Magalu program. This year, we focused almost all our efforts, in addition to margin and efficiency improvements, on enhancing customer service.

The best indicator for measuring this progress is NPS (Net Promoter Score). We reached a consolidated corporate NPS of 78 in July, up from 67 in January. This represents a significant improvement of 11 percentage points, largely driven by enhanced service levels in our marketplace. This is a critical agenda, as the service level in our marketplace has traditionally been lower than in our own operations.

We conduct surveys for each unit sold, and since 3P transactions generally involve lower-ticket items, about 50% of our NPS surveys are for 3P purchases. Thus, half of the responses contributing to our NPS of 78 are from customers who bought through 3P sellers.

The 3P NPS has increased nearly 20 points from January to July, showing a very significant improvement. This level of service is among the highest in the world for e-commerce, even with the significant 3P base. This improvement generates positive word of mouth, and despite not being in the best position at the end of last year, we've not only improved but reached new heights that the company has never achieved before.

We've made several enhancements, including improvements in return times, cancellation ease, first-contact resolution, and post-order contact rates. We've also seen a significant reduction in legal processes, which was a major cost in our G&A. All customer service indicators are improving substantially, not marginally. Today, I consider Magalu's service level to be the best in the market, surpassing many competitors. We are committed to maintaining this high standard even as we adopt growth strategies for the second half of the year, ensuring continued progress in these metrics.

Now, I'll hand it over to Roberto Bellissimo for a detailed breakdown of the financial results. After that, I'll return to discuss the Aliexpress partnership, and then we'll open the floor for questions.

Roberto Bellissimo: Thank you, Fred. Good morning, everyone. Thank you for joining our earnings call.

I'll start with a brief overview of our financial highlights. We reported 15.4 billion in sales, marking a 4% increase. A significant highlight is the performance of our physical stores, which saw a 16% growth in same-store sales. We also achieved a notable increase in gross margin, EBITDA, which grew by over 60%, and have reported net income for the third consecutive quarter, with cash generation being a key highlight. Additionally, we'll discuss our cash position and net cash position in more detail shortly.

On the next slide, we explain the non-recurring events for this quarter. We reported a recurring net income of R$37 million. After accounting for non-recurring adjustments, our reported net income was R$24 million. The net effect of these non-recurring adjustments amounted to approximately R$13-14 million. These adjustments are concentrated in two major items: one is positive, a tax credit related to the revision of the methodology for excluding ICMS from the PIS and COFINS calculation base, which has been incorporated into our assets. On the other hand, we made an additional provision for DIFAL of around R$200 million, which is recorded in our liabilities. This provision has no cash effect, as we had already made a provision of nearly R$400 million for DIFAL at the end of last year.

Due to the recent publication of the decision and the ruling, our legal advisors recommended this additional provision. However, it remains a non-cash provision and is still pending the modulation of effects and the judgment of the declaration appeals related to DIFAL. It is also worth noting that we have over R$1 billion deposited in court on the asset side.

Additionally, regarding other non-recurring expenses, the majority were related to store closures. We closed 17 stores this quarter, resulting in less than R$15 million in expenses. In the same period last year, non-recurring expenses in this category amounted to around R$155 million. This reflects a significant reduction in non-recurring expenses, which we expect to continue decreasing in the coming quarters. We also account for the tax effects of these adjustments.

Following this, we again highlight the very consistent evolution of our EBITDA margin and emphasize the key levers driving this improvement. These include the growth of the marketplace and service revenues, the increase in gross merchandise margin, the expansion of fulfillment, operational leverage, and the improved profitability of physical stores. The results from Luizacred this quarter were also notably strong.

On the next slide, it's clear that the EBITDA margin improvement, from 5.1% to 7.9%, was primarily driven by the expansion in gross margin—already detailed by Fred regarding the growth in product and service margins—and also by equity income, which contributed an additional 0.6%.

It's important to note that, in terms of SG&A, general and administrative expenses remained quite stable compared to the same period last year, with effective control maintained. The allowance for doubtful accounts (PDD) in retail, which is more related to our CDC portfolio, also remained stable despite the relative growth in our CDC portfolio over the past 12 months. Other income reflects the renewal of the exclusivity agreement with Cardif.

On the next slide, we highlight the evolution of working capital. Over the past 12 months, we've improved working capital by R$ 1 billion, with significant reductions in inventory, increased average payment terms, and monetization of taxes. All major working capital accounts have improved considerably over the past year. This quarter, working capital showed little seasonality and remained relatively stable. Notably, we further reduced inventory. However, this was slightly offset by a shift of more sellers from a deferred payment model to an advance payment model. While this isn't as favorable for working capital, it benefits results and Magalu Pagamentos. As we enter the second half of the year, which typically shows improved working capital trends, we expect these numbers to continue evolving positively.

On the right side, we discuss financial expenses. We have significantly reduced our financial expenses since the beginning of last year, and specifically this quarter, expenses fell by 25% compared to last year, amounting to R$ 130 million less in net financial expenses. These expenses could have been even lower—by R$ 30 million—if it hadn't been for debt payments this quarter.

Due to these payments, we advanced more receivables. As you know, when we advance receivables, we incur the entire cost upfront, leading to a mismatch and a higher volume of advances, which resulted in an incremental non-recurring expense of about R$ 30 million. This will be reduced in the coming quarters. The trend for Q3, especially Q4, is a significant additional reduction in financial expenses, both nominally and percentage-wise.

And this, regardless of interest rates, we have been managing interest costs since the beginning of the year. Although everyone expected a more accelerated drop in interest rates, we have managed to navigate through slightly higher rates than anticipated. We have improved working capital, enhanced our capital structure, and increased sales through PIX, leading to a very positive trend in reducing financial expenses.

In the next slide, we show the evolution of cash flow from operations over the last 12 months, reaching a record level of R$ 2.2 billion in accumulated operational cash flow up to June, even surpassing the cash flow from 2020 at the peak of the pandemic. This achievement is directly linked to our EBITDA growth of 60%, improvements in working capital, and reductions in receivables advance expenses.

Due to this improvement in operational cash flow and the capital increase we made this year, we have significantly boosted our net cash position. Over the last 12 months, we have increased this position by over R$ 1 billion, totaling R$ 2 billion in net cash.

In the next slide, we again highlight that we have reduced our short-term debt by R$ 3 billion this year, and our total debt has decreased by nearly R$ 3 billion as well. Our debt is now entirely long-term, standing at R$ 4.5 billion compared to a cash, investments, and receivables position of R$ 6.5 billion. This results in a very high liquidity position, even after repaying R$ 3 billion in debt.

I'd also like to emphasize that this quarter clearly demonstrated the liquidity of our receivables. We discounted an additional R$ 2 billion in receivables, paid over R$ 2 billion in debt, and still maintained a cash and investments position of around R$ 2 billion. This resulted in a significant reduction in bank debt without impacting our cash and financial investments position.

Next, we again show a significant decline in the overdue portfolio of Luizacred, with the NPL over 90 days reaching 9% and the NPL up to 90 days at 3%, marking one of the lowest levels in our history. Luizacred's performance has improved significantly, as Fred mentioned, achieving one of the best quarterly results in its history, with a very positive outlook ahead.

This quarter, we saw a reduction in PDD expenses of nearly 20%, a more than 30% decrease in funding costs, and we have just capitalized Luizacred, setting it up for a new cycle of increased profitability and gradual growth.

With that, I conclude the financial highlights and pass it back to Fred. Thank you.

Fred Trajano: Thank you, Roberto. Before we move on to the Q&A, I'd like to highlight one of the most significant projects for the Company, which will undoubtedly greatly support our online platform strategy and the growth of our online operations. This is our strategic commercial agreement with AliExpress.

It's important to note that this is a unique agreement for both sides. For the first time, Magalu will list its own inventory on a competing third-party platform. Likewise, AliExpress will integrate its catalog with a local marketplace, marking a first in their global operation, which spans over 100 countries with a unified platform.

I'd like to announce that in the second half of August, we will be launching our partnership with AliExpress. Less than two months after announcing the MOU at the end of June, we will begin selling Magalu's 1P products on the AliExpress platform. We have high expectations for the sales of these products there, as they offer a range of items not available on our platform, and the digital audience of AliExpress in Brazil represents about 40% of our consolidated audience.

This means we will be able to reach a much larger audience and significantly boost our 1P sales for the second half of the year. Sales on AliExpress will commence in the second half of August. Additionally, in the first half of next month, we plan to launch AliExpress In, featuring AliExpress's Joice line products on the Magalu platform. Thousands of items will be added to our digital channels.

This model will be implemented through Magalu's PRC (Programa Remessa Conforme). We will handle the taxes for this operation, and customers will be able to browse AliExpress products in a dedicated section on the Magalu site, integrated with our product searches.

The products from AliExpress are highly complementary to our existing offerings, allowing us to provide a much wider range of options to our customers. We anticipate thousands of sales per month, potentially reaching millions in monthly sales for these products. This expansion is expected to boost our conversion rates, reduce app and install costs, and increase our audience reach.

In addition to the direct sales of these products, we are confident that this initiative will enhance the network effect, benefiting the sales of our 1P products on our platforms as well as products from other sellers.

I was pleasantly surprised by the strong goodwill from Magalu's sellers regarding this initiative. They recognize that this will drive more traffic to our platform, increase visits, enhance customer engagement, and boost purchase frequency, which will also benefit their products. The reaction from our sellers has been very positive. By the way, we will be meeting with them on the 21st at Expo Magalu. We'll be bringing together thousands of sellers at Anhembi for a major event, something we haven't done for many years.

The partnership has been realized very quickly. Hundreds of people from both Magalu and AliExpress, from China and Brazil, have been involved in the systemic implementation. The process has been more complex than it may seem, involving catalog integration, APIs, logistics, product information, reviews, and all the complexities related to cross-border payments.

Anyway, our teams managed to implement this in record time, and it will benefit us in the second half of this year and fully in Q4. We will be very strong for Black Friday and are quite excited about the prospects for Q4.

I think we've done our homework in the first half of the year, achieving an EBITDA margin that the market expected for next year. We are in a position that shields us from any negative surprises related to interest rates. I no longer want to be caught off guard by a Central Bank agenda that is beyond our control. We felt that one of the major anchors for lower interest rates was the American interest rate. With recent developments regarding the cooling of the American economy and the tendency for U.S. rates to finally decrease, this will remove a significant anchor—the other being fiscal, which we are aware of, but the American one was crucial for me. Therefore, I believe we don't need and aren't dependent on any good news in this regard. We have already proven that, but the trend now is that there is finally room for positive news, especially for next year.

But again, we've done our homework to ensure we are not reliant on that and to shield ourselves from any negative surprises in this regard. We are now positioned to pursue a growth agenda for the second half of the year without compromising our margins. I want to make it clear that our goal is not to make any trade-offs in this sense because we have avenues to grow margins regardless of other factors.

With that said, I'll open the floor to questions. Please feel free to ask, and our directors are here to respond.

Q&A Session

Vanessa Papini: We will now begin the Q&A session. To ask a question, click on the Q&A icon at the bottom of your screen. Enter your name, company, and the language of your question to enter the queue. When announced, a request to activate your microphone will appear on your screen, and you should then turn on your microphone to proceed with your question.

Luiz Guanais, Banco BTG: Good morning, Vanessa, Fred, Beto. I have two questions.

First, Fred, you mentioned the EBITDA margin improvement, which is indeed close to what you expected for the full year and you've achieved this in the first half of 2024. I would like to understand the potential for further gains in this margin, both from operational leverage and through new initiatives in Ads or even service monetization.

Secondly, regarding the partnership with AliExpress, can we also expect an evolution in the portfolio of services you might offer to AliExpress over time, potentially including advertising, fulfillment, or other services? Thank you.

Frederico Trajano: Good morning, Guanais, and thank you for the question.

Just to clarify, our margin is actually above what we expected for the year. What I mentioned is that Magalu's EBITDA margin is in line with what the market consensus anticipated for us for next year. We're currently ahead of our EBITDA margin goals.

The strategic choice to accelerate this margin, Luiz, was driven by our desire not to be caught off guard by negative developments in the Central Bank's agenda and financial expenses and interest rates, as happened in 2021. We made a strategic decision to focus on margins, and we plan to maintain this focus for now. We do not have an objective to change this direction because, at the beginning of the year, expectations were for interest rates around 9.5%, with some predictions even as low as 8.5%. However, they are materializing closer to 10.5%, which places financial expenses at a different level. Therefore, the correct and strategic decision for us was to increase this margin and advance our agenda. So, it is above what I initially expected for this year and aligns more with what the market anticipated for the end of next year. The consensus for this year was 7.4%, and we're already at 7.9% for Q2.

So, just to clarify that, but continuing, we still have avenues for growth through both Ads and monetization of services. I'll ask Edu to discuss Ads and Mauad to talk about services, and then I'll come back to discuss Aliexpress.

Eduardo Galanternick: Good morning, Luiz, this is Eduardo. Thank you for your question. Regarding Ads, as Fred highlighted in his initial presentation, the key updates from the first half of the year include not only Célia joining to lead the commercial team but also the building and training of the team she has put together. Our team is now complete, well-trained, and ready to deliver strong results in the second half of the year.

Additionally, we have a series of technological enhancements being integrated into the platform, which will further improve advertiser results. In this context, we believe we will be able to accelerate our growth even more, following the 40% increase we saw in the last quarter. Thank you.

Carlos Mauad: For financial services and insurance specifically, credit and insurance are the two main drivers of service monetization that we have integrated. Luizacred has transitioned from being a margin detractor to contributing positively to our margin. Additionally, insurance has become a significant growth driver for our service revenue, as reflected in the company's net revenue.

Moving forward, we have two major avenues for service monetization growth: the advancement of these two areas in the digital space. We have already made strides with CDC (credit card and consumer credit), and we have a robust agenda for further development of insurance within our digital assets. We are seeing year-over-year growth in the range of 70-80% specifically in this channel. Therefore, we expect to see even more significant growth in contribution margin from these elements in the coming quarters.

Luiz Guanais: Perfect, very clear, Edu and Mauad. Thank you.

Frederico Trajano: And regarding the Aliexpress question, Guanais, the focus over the next few quarters is on implementing the current stage of the partnership, which is the sale of our 1P products on their platform. This should significantly boost 1P results for the second half of the year, especially in Q4, because we'll have about a month and a half in Q3 and be quite strong for Black Friday. Additionally, the Aliexpress In sales on our platforms will also contribute positively to service revenue, as we will receive take rates from these sales, which will help with the gross margin.

So, we expect a positive impact starting in September and throughout the last quarter of the year. Other aspects will come later. Launching this stage of the operation has been complex enough. We want to focus on achieving our objectives and possibly exceeding them (which is my expectation), which will allow us to expand the partnership in other areas.

Again, there is full complementarity with very few conflict zones, and there's no reason why the partnership shouldn't evolve further. But first things first: let's complete the initial phase of the partnership first.

Luiz Guanais: Thank you, Fred, for the answers.

Clara Lustosa, Itaú BBA: Thank you for addressing our questions. I'd like to start by briefly discussing the physical stores. We've seen another strong quarter with significant same-store sales growth, even without accelerating credit. My aim is to get a bit more insight into this performance—how categories have been performing and if there's anything specific driving the growth. That would be the first point I'd like to cover quickly.

Then, linking to the second point about 1P, specifically regarding the disparity in growth versus physical stores. It's clear that the bases are not directly comparable, considering the DIFAL adjustments and other factors, but if you could provide additional details on whether there are other factors contributing to the disparity, such as category performance differences, category mix, or any competitive environment aspects like pricing aggressiveness.

Additionally, could you comment on how the dynamics have been in the early part of Q3? Thank you.

Frederico Trajano: Thank you very much for the question. I'll start with a brief overview, and then I'll ask Luiz Rego to provide more details on the performance. I've mentioned some aspects in the material, but he may provide additional insights to address your query.

Overall, the store performance has been extraordinary, with nearly all categories showing high growth. It's challenging to single out one category, as we've seen strong performance across the board. However, I'll highlight a few areas: white goods, which were somewhat dormant after strong pandemic sales and then experienced a phase of adjustment; furniture, which has seen significant growth; and portable electronics. Overall, performance has been strong across most categories, but these particular ones have stood out.

In terms of regions, I've mentioned some highlights, but perhaps Rego can provide further details later. Overall, the performance has been very strong, with nearly all states showing significant growth, especially in the regions I previously highlighted.

We've seen a gain in market share, and I'd like to emphasize that our store customers are typically from lower-income segments. Despite some macroeconomic challenges, such as interest rates and recent currency fluctuations, the broader economic indicators in Brazil are positive: full employment, relatively controlled inflation compared to other countries, and these factors create a favorable environment for the population, especially for the base of the Brazilian economic pyramid, which comprises our store customers. This is a positive trend, and our market share gains are undeniable.

So, the growth is widespread, affecting almost all sectors and states with a very positive trend.

Physical stores don't pay DIFAL, so in January last year, the e-commerce segment lost 5 percentage points of margin on Magalu's 1P (first-party) sales. Third-party sellers don't pay DIFAL; it's the responsibility of the seller on the platform. The 1P segment is crucial for Magalu, representing half of our online sales and a significant portion of the company's total GMV.

Achieving a 5 percentage point increase is very challenging and complex, especially since we had already passed on part of this in Q2 of last year. This process demands significant effort from the commercial team. Losing 5 percentage points of margin, which previously went to margin and now goes to the government as tax, has been a major hurdle. It's almost miraculous that we didn't see a drop in sales for 1P; it was truly a remarkable achievement.

I have competitors with 1P as strong as ours who experienced significant declines in 1P sales. Our commercial team did an excellent job of passing on costs without losing market share in these categories. The agenda is now complete.

Looking at the comparison base from last year, in Q1 we hadn't passed on any of the DIFAL costs. In Q2, we passed on about 50%, which increased to 75% in Q3, and by Q4, we had passed on almost everything, around 90% or nearly 100%. Therefore, the comparison base for the second half of the year will be much more favorable.

That said, it's important to note that there was a significant discrepancy, not in the price of Magalu's 1P compared to physical stores, but in the price of electronics e-commerce compared to physical stores. There was a large difference because physical stores paid more in taxes than online, leading to discrepancies where some products were up to 20% cheaper online than in stores.

The physical store is now more competitive. I mentioned this, I think it was in the last call, and it's in the transcript; you can see it there. I said: “Pay attention to the physical store because the price difference between physical stores and the market 1P prices has decreased significantly, and it will become more competitive,” which it wasn't at that time because it was paying all ICMS while the 1P was not. This has made the store more competitive overall.

So, basically, 1P was the channel that contributed the most to the company's EBITDA margin, while the physical store contributed more to growth. Looking forward to the second half of the year, this situation should normalize.

Luiz Rego: Fred was quite thorough regarding the physical store, explaining that this growth had been signaling since the end of last year.

Regarding e-commerce, there's just one fact: in this quarter, almost all of our categories are starting to show growth. There is one category specifically that pulled us down a bit, which is the telecommunications category, primarily because, as many of you might have read recently, there's been significant growth in the grey market for telecommunications. This affects the 1P more than the physical store. Aside from this, all other categories are also showing growth now in 1P.

Clara Lustosa: You're welcome! If you need anything else, feel free to ask. Have a great day!

Irma Sgarz, Goldman Sachs: Hello, good morning. Thank you for taking my question. I wanted to ask a bit about the opportunities in commercial margins. I think you've already covered well the progress and advancements you've made in various areas, but given that you’re also gaining significant market share specifically in the physical store market, I’d like to see if this is also bringing new opportunities with suppliers, given the larger size you’re reaching, especially compared to your competitors.

My second question is about logistics. Could you elaborate a bit on the adjustments to your logistics network? I understand you've reduced expenses, but as you look towards growth, both in physical stores and in 1P, is there a need for additional capacity, or are you comfortable with the current setup? Thank you.

Frederico Trajano: Irma, thank you very much for your question. Regarding the opportunities with suppliers, to clarify, the increase in the company’s consolidated gross margin was primarily driven by a 3 percentage point improvement in the 1P margin. The merchandise margin percentage for physical stores remained stable because it did not need to pass on taxes.

So, there wasn’t much change in that regard. What improved in the physical stores was the penetration of services, which is reflected in the service revenue that increased by 10% above the company’s total GMV. This contributes to the store’s gross profit, but it wasn’t from merchandise, since it didn’t have to account for DIFAL. However, it did contribute to the overall revenue growth of 11%, which I mentioned at the beginning of my speech.

From the perspective of opportunities, I'd like to elaborate on your question. There are two main ways we interact with the industry: one is 1P, whether it's physical stores or online, the process is nearly the same. You purchase the product, it's managed by the same buying team, stocked, planned—it's 1P. The other is 3P, where suppliers sell directly through Magalu's 3P platform. Both methods are applicable to us and the market in general.

There has been a cycle where suppliers have expanded their presence via 3P, with brands selling directly through platforms, a trend known as B2C. This has occurred both in Brazil and globally. What I’m noticing now, Irma, is that suppliers are looking to balance this approach. For example, Nike overseas made a significant shift towards B2C, focusing heavily on online sales, and in the process, lost a lot of its 1P retail partners, including physical stores and e-commerce platforms that used to buy their merchandise. Nike is now making a major effort to re-establish partnerships with these companies because, from a working capital planning perspective, it's much more beneficial for them.

Just like Nike, which faced significant challenges when it shifted heavily to B2C and struggled to maintain what it had in its traditional supply chain, we see similar trends among industries. They realize they need to balance B2C with 1P sales, and there’s no better 1P partner for them than Magalu. We are consolidating ourselves as the leading 1P partner for industries.

This applies not only to electronics but also to brands like Adidas, L'Oréal (due to Época), and various peripheral computer suppliers (thanks to Kabum!). We are one of the top 1P partners for all these companies. They need us, and they are increasingly looking to balance their B2C and 1P strategies, aiming to renew their focus on 1P growth.

We need to approach this with a lot of caution, ensuring we don’t overstretch our inventory and maintain positive margins for both us and our suppliers. It's about balancing carefully. I believe we are in a very favorable market position at a good moment, and we will leverage this opportunity. However, while we aim to grow, we also recognize that our suppliers want to benefit as well. We have a very comfortable position but intend to pursue this with a balanced and long-term perspective. Most of our relationships with suppliers, which are excellent, are long-term, win-win, and mutually beneficial.

In summary, we are indeed in a very favorable position.

Irma Sgarz: It’s very clear now. Thank you.

Nicolas, JP Morgan: Good morning, everyone. Thank you for the call and for taking our questions. We have two questions from our side. The first one, Fred, is about the competitive environment. Could you provide some insight on how you see the market and the competition as we enter the second half of the year?

Our second question is about credit. We've seen Luizacred improving significantly over the last two quarters. We'd like to understand if you see a possibility of expanding credit availability a bit more in the second half of the year. Thank you.

Frederico Trajano: Thank you very much for the question. Regarding the competitive environment, there is a significant change for the second half of the year: a competitor has become a partner, which is AliExpress. So, one competitor that was previously competing in the market is now joining forces with us, and we will explore the market together.

Apart from this significant change, the competition remains the same as in the first half of the year, both in physical stores and online.

As for the credit question, I'll pass it over to Mauad.

Carlos Mauad: Thank you for your question. Yes, we do have a more stringent credit approval process within our higher-yield structures, which is the case with CDC (Direct Consumer Credit). Both CDC Store and CDC Digital will drive portfolio growth in the second half of the year. In credit cards, which is a product with slightly tighter economics, we have smaller openings. In fact, this August, we are conducting tests with new target audiences to accelerate acquisition and resume portfolio growth.

So, the answer to your question is yes, we are taking a more profound and aggressive approach with our high-yield portfolios, while being more cautious with credit cards. We continue to monitor household debt levels and ensure that we maintain a solid credit environment, enabling us to sustain the monetization of our financial services. Thank you, Nicolas.

Nicolas: Perfect, thank you very much, everyone.

Danniela Eiger, XP Investimentos: Hi, good morning, everyone. Congratulations on the results. I have two questions. The first is regarding the credit dynamics. You mentioned accelerating cautiously, with room for this, and we also see other players with a similar cautious approach, but with a desire to accelerate.

My question is whether the investments you are making in Luizacred help provide Itaú with the confidence to accelerate credit alongside you. That's my first question.

Carlos Mauad: Hi, Danniela. Thank you for the question. What we have been doing with Itaú, especially with the recent improvement in Luizacred's results, is that it reinforces all our acquisition models. Once you can better monetize the relationship with our customers who use one of our payment methods, this helps to make the acquisition process more flexible. Both Itaú and Magalu want to position Luizacred again at a growth level higher than what the credit card market has been observing.

What we don't want is to have a volatile credit strategy regarding acquisition. We aim to take consistent, solid steps to ensure that we do not operate credit in cycles but rather evolve credit operations, ensuring that consumers have long-term sustainability, making the payment method a tool for customer loyalty, and bringing them back into the ecosystem to increase transaction frequency through the payment method.

So, we are increasingly optimistic about the moves we have made, especially because we have seen results improve significantly. Once again, having put Luizacred in the black gives us the confidence to invest more in acquisition.

Regarding growth, Danniela, we are also investing in portfolio initiatives such as stronger credit limit increases, a more rigorous overlimit strategy, and the return of balance increase products gaining traction. All these help us grow the portfolio and accelerate the Company's top-line growth. I hope I answered your question.

Daniela Eiger: That’s great, thank you

Carlos Mauad: Thank you

Vitor Fuziharo, Santander: Hi, good morning, everyone. Thank you for taking our questions. Regarding the performance of physical stores, it is clear that the market has contributed to sales acceleration and these tri dynamics, but was there any internal operational change that helps explain this good store performance?

And secondly, I would like to explore a bit about the creation of the new generative AI department, as mentioned in the release. If you could share more details about this initiative, that would be very interesting. Thank you.

Frederico Trajano: Well, thank you for the question. I will quickly answer the first one. Look, I don't think there was any significant change from the store operation's point of view. What happened was that we persevered with the model, maintained a good environment with the teams, and prevented high turnover during difficult times.

What happens in very tough periods is that retail, in general, disinvests a lot; there is a significant increase in store turnover, people become demotivated, many stores close—much more than the few we closed—and then, when the tide turns, when good times return, we are there with a strong, solid foundation ready to capture the tailwind.

I think it's about persevering and keeping the team well, strong, solid, and secure so that when the tide turns, we come back with strength. So, I think that's it. The stores are doing very well, I feel that our team is at a very positive level, and we are reaping the rewards of this good moment.

It is a cyclical business, especially physical stores, and we are taking advantage of it.

Regarding AI, I will pass it on to André Fatala, our CTO, to answer.

André Fatala: Hi, Vitor. It’s Fatala here; thank you for the question. Regarding Caio joining our team, we have been working on various generative AI research initiatives since last year to implement in Magalu’s businesses and processes. Now, we have the reinforcement of someone with a significant history in AI work, with experience in companies like Booking, Nubank, and Amazon, working with AI. He is now here to help us implement many parts of the research we have already done and put them into production.

Some things have already started; we have some initiatives using models to improve search. We will expand to recommendations and improve the catalog. The idea is to move from the research field in technology to implementation and have production gains by using AI in general.

Regarding generative AI specifically, we started an initiative last year that we called Lu's Brain, and the idea is also to expand the experience of using generative AI for Magalu's post-sale part and also already thinking about transforming the experience in the sales process. Thank you.

Frederico Trajano: And I think, to complement what Fatala said, I have been in e-commerce for 24 years, so I have seen many trends that never materialized, like the metaverse, for example. I see AI as very similar to what I saw in 2000. This revolution is here to stay; it is a solid, structural revolution and will change how consumers interact with companies in various sectors of the economy, and it will change how people work within companies.

So, the potential for AI disruption, to me, is similar to what I saw back in 2000. A more recent example was the advent of smartphones in 2007 with the rise of apps and super apps in 2010. However, I believe AI has the potential to disrupt experiences and processes now in the same way that the internet did in 2000.

Few things have this model, and Magalu has an advantage with Lu, right? We already have the digital assistant, which is famous, recognized, and even contracted by other brands. It is the main communication channel with our customer; our WhatsApp, which tracks orders, is one of the main touchpoints of Brazilian retail with consumers.

So, we have the channel; we now have a more sophisticated Lu, and we are confident that with these new technologies, we will finally have the technology to make her the main point of interaction with customers, both for post- and pre-sale. This technology is here, it's available, and we are confident that we will be able to use it and be part of another retail disruption. I am very confident that this will be an important agenda for Magalu moving forward.

People will shop differently, and AI will be the main reason for this change.

Vitor Fuziharo: Perfect. Thank you very much for the answers.

Felipe Reboredo, Citibank: Good morning, Fred, Beto, and the whole team. Congratulations on the results. From Citi's perspective, we would like to understand better how you see this future cycle of growth recovery. The growth of physical stores, as well as the expansion of the 1P gross margin, caught our attention and made us wonder if we should think of Magalu more focused on selling these core assets, consolidating this role as a discretionary player in Brazil.

Does this analysis make sense? If you could give more details on how you see this next growth cycle, it would be very helpful. Thank you, everyone.

Frederico Trajano: Look, I don't think so. Undoubtedly, we want to consolidate our leadership in core assets, and they will continue to be important elements of our growth.

Strategically, we are well-positioned to continue being leaders and protagonists in the sale of discretionary, high-ticket, branded products.

Magalu has a significant presence, a significant leadership in these categories. We not only want to maintain that but also want to continue gaining market share in these categories. However, our partnership with Aliexpress indicates that we will not limit ourselves to this. We have now found a way to do this profitably because my previous challenge with growing in lower-ticket categories was achieving this with profitability. Much is said about Shopee in Brazil and others, but they struggle to be profitable. We see the number of accesses going down, but we don't see profits; they are not separated, and they are not positive. A lot of cash is burned in lower-ticket transactions. So, for us, with Aliexpress, we found a positive equation to significantly expand our lower-ticket assortment, increasing selection for our consumers in a positive and profitable way.

So, one agenda does not exclude the other. Maintaining and consolidating our leadership or expanding our leadership in core categories will not prevent us from growing in other opportunities. We searched and found an intelligent way to do this.

Fulfillment is another example, as it enables lower-ticket categories economically and correctly. We achieved 20% in less than a year. There are much more established fulfillment operations that are now at 40%, while Magalu reached 20% in just over a year, so I think this is a great agenda, and fulfillment also helps us move faster in lower-ticket categories.

So, I would not see it as an “either-or” scenario. I would see Magalu, after restructuring, better positioned to grow in both categories: core and discretionary as well as expanding our assortment and serving more consumers and needs.

We are confident in the future, Felipe. Thank you for the question.

Felipe Reboredo Thank you, Fred.

Andrew Ruben, Morgan Stanley: *Hi. Thanks very much for the question. I'd like to focus a bit more on the 3P marketplace. It's been decelerating for a couple quarters now. We know there's been a profitability focus, some increase in take rates as well. Now you have Aliexpress. But if we maybe put Aliexpress to side for the moment, what other factors do you think are needed or still remaining to drive another leg of reacceleration in 3P? It would be very helpful. Thank you.*

Frederico Trajano: Thank you very much for the question. I think that when we encountered the additional tax on 1P, which happened last year, we ended up paying 1.5 billion more in taxes for the year, and this affected 1P, but it impacts our entire online profitability, which includes both 1P and 3P.

To cover this 1P cost, 1P increased its margin, but we also had to improve the contribution margin of 3P. We implemented a series of initiatives to increase the take rate, reduce shipping subsidies, and required 3P to provide a high contribution margin for the company. We've made this improvement over the past few years, and now we’ve reached a point where we no longer subsidize rebates or offer a lot of free shipping. We’ve also reduced overinvestment in marketing. 3P must now stand on its own, and not only that, but it also had to help pay for the 1P costs.

So, when you see service revenue growing over the past three quarters, much of that came from the increase in take rate and charging for delivery in Magalog for our sellers. All these factors also impacted the growth of 3P and were compensated by initiatives like fulfillment, for example. The fulfillment agenda is crucial for 3P growth but with solid, positive contribution margins. The more fulfillment grows, the more 3P grows profitably.

The fulfillment agenda is super important. Digital CDC will be introduced for both 1P and 3P, which will also help boost 3P sales, particularly in higher-ticket items. We are also one of the leaders in higher-ticket items in 3P. So, Digital CDC, fulfillment, and we can't overlook Aliexpress; it will enter our 3P and will bring us into categories we hadn't operated in before. This will make a difference in our results.

I want to highlight that the 3P agenda in our partnerships is going very well. 3P is growing significantly at Netshoes, 3P is also growing at Kabum!, and we just launched 3P on Época as well. These are all fantastic channels, so beauty sellers will now have Época to sell their products, and sports sellers are doing very well on Netshoes. The agenda is accelerating in these channels that had less developed 3P compared to Magalu, so we also have initiatives here to expand 3P in the group's channels: Kabum!, Netshoes, and Época, which we are launching now. There are several initiatives to get 3P accelerating again.

And again, we can't exclude the Aliexpress partnership, which will also accelerate our 3P sales.

Andrew Ruben: *That's all great color. Thank you very much.*

Bob Ford, Bank of America: Good morning everyone, and congratulations on the progress. Fred, how are the pricing algorithms and industry coupons impacting relative value propositions? And how do yours compare? Also, how do you view the competition in the Meli and Amazon categories? Thank you.

Frederico Trajano: Bob, thanks for the question. I think, if I understood your question correctly, one important growth lever for us in the second semester is the shopping and browsing experience. We've made great strides during the Encanto a Magalu year in everything related to the post-purchase experience. We've made it easier to cancel orders, return money quickly, deliver on promised timelines, and recover passwords and logins. There were countless initiatives here to improve the consumer experience after they paid, after they pressed the checkout button.

Now we're working on improving the pre-purchase experience. We noticed the need to enhance our search and recommendation algorithms. Fatala mentioned some AI initiatives to improve this process, also through Lu, which we should accelerate, but we understand that we need to do a better job of showing the best option to the consumer in a more consistent way.

So, there's what I call a "best offer" initiative, which means it's not enough just to have a lot of items and products; we also want to have the best prices on the market in 3P and ensure the consumer finds these prices consistently. This involves a lot of work in fostering sellers through the platform so they have the best prices, and once they do, prioritizing the exposure of these prices to the consumer.

This requires clearly setting up the algorithm, and we are setting it up to focus on price. And when I say price, I mean the combined cost of the product and shipping. The lower, the better—the lower the shipping, preferably free shipping, and the lower the product price, the better.

So, we are setting our experience to be more focused on offering the best deal to the consumer. But there's also a lot of work with sellers and in 1P to ensure we remain competitive moving forward without sacrificing margins. I'd say we're setting the algorithms to improve the experience and, I might invent a word here, the "findability" within our site. So, that's it.

Regarding the second point about competition in core categories, our core categories are doing very well. We had a challenge, Bob, as I've mentioned several times, in passing on margin increases to 1P. These competitors didn't have 1P or had a much smaller 1P than Magalu, so the DIFAL impact on them was minimal, but it was larger for us, and we had to spend more time passing on the cost to the consumer, which took over our agenda.

Again, I want to emphasize that passing on 5 percentage points in margin in a sheltered category like ours is not easy, and it required absolute focus. This had nothing to do with competition. We're in a very positive moment; I talked a bit about this 1P B2C dynamic. The supplier needs a strong 1P, and we are the undisputed leader in 1P with a solid market position, 20 distribution centers, and 1,300 stores with stock.

So, Bob, it's almost impossible to beat us in 1P.

Bob Ford: Thank you, Fred.

Vanessa Papini: We are now closing the Q&A session. I want to give the floor to Frederico Trajano for his final remarks. Fred, please, you can go ahead.

Frederico Trajano: Thank you all for participating in the results call, and a special thanks to the entire Magalu team for delivering another excellent result.

Vanessa Papini: Magalu's conference call is now closed. The investor relations team is available to answer any other queries and questions. We appreciate everyone's attendance. Have a nice day.