CONFERENCE CALL TRANSCRIPT

1Q16 Earnings

May 6, 2016

Operator:

Good morning, ladies and gentlemen. Welcome to Magazine Luiza's conference call to discuss 1Q16 earnings.

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We also note that any statements that may be made during this conference call concerning prospects for Magazine Luiza's business, projections and operating and financial targets will be based on the company's management's beliefs and assumptions and on currently available information. Forward-looking statements provide no assurance of performance since they involve risks, uncertainties and assumptions related to future events and therefore depend on circumstances that may or may not occur. Investors should understand that overall economic conditions, industry conditions and other operating factors may also affect Magazine Luiza's future performance and cause results to differ materially from those expressed in any forward-looking statements.

To start the conference call, we are handing over to Mr. Frederico Trajano, the CEO who will be making the presentation. Please go ahead Mr. Trajano.

Frederico Trajano:

Good morning, everyone. Thank you for joining our earnings call. Together with all our executive officers, I am here today to discuss our 1Q16 numbers.

I would like to start by saying that despite all the difficulties arising from the turbulent economic and political situation in Brazil, Magazine Luiza's team has made a highly focused effort and been able to post positive numbers for almost all 1Q key indicators.

I will start by talking about sales. We have been able to post a positive number for sales growth, although only marginally so, despite a significant fall in demand for durable goods. The IBGE [official statistics organization] reported a 13.4% fall in January and February; we do not have the March data yet, but the same downtrend is likely to continue.

We have managed to gain market share in the quarter based on highly detailed research have been working on since last year to identify regional opportunities for gaining share in physical stores for each of Magazine Luiza's main categories, and obviously everybody in commercial and operations made a great effort to seize these opportunities that we detected in the project we did with McKinsey.

The great driver for sales growth was e-commerce. We grew 27.8% while the market remained virtually stagnant in the same period according to E-Bit data, which reported growth of just 1%.

This result, which had already been significant in 4Q15, legitimizes the success of our multi-channel strategy and all the efforts we are making to transform Magazine Luiza into a digital company that also has physical [bricks-and-mortar] points of sale and shows personal or human warmth in relationships.

Moreover, since the Company's final result really improved with our e-commerce gaining share, we have proved that our multi-channel model makes for success on the Company's top line and its bottom line. For a long time we have been saying that our e-commerce strategy is the only profitable operation in the market, and we have been able to show this again for another quarter.

As we said in our previous earnings call for 4Q15 earnings, we would gain market share this year without compromising profitability. Our belief was that there was this potential at this stage in the market. And we have shown precisely that in this quarter with gross margin up 2.1 pp on the same quarter of the previous year.

It is true that on the basis of the previous year, if we take all 2015 quarters, Magazine Luiza's lowest margin was in Q1. Therefore we have a reasonably favorable basis of comparison for 1Q15. Nevertheless, we have shown that we can develop sales and gain share without necessarily going for that irrational pricing policy that sometimes prevails, especially in e-commerce, but in physical [bricks-and-mortar] companies too. You do not necessarily have to give way on profitability in order to gain share.

On the costs side, we have been able gather the fruit, and we are still doing so, from concentrated efforts we made for two major projects we worked on with Galeazzi consultants, namely zero-based budgeting (ZBB) and matrix management of expenses (MME).

We have made a huge effort in virtually all Company account groups, including personnel and administrative, energy, rent, credit-card expenses too, shipping, lots of expenses we are working on through a highly focused group of people who are concentrating on renegotiating contracts and optimizing processes, so that despite higher inflation up to 9.77% last year, which eventually impacts almost all our contracts, we were able to get expenses diluted. The Company's total SG&A was down 3.2% yoy in nominal terms.

LuizaCred bounced back after two quarters of major difficulties in terms of earnings due to net adjustments of products and tighter lending criteria. We were able to get back to profitability levels for LuizaCred that I think show the right balance for a year as difficult as the current scenario. After two tough quarters we have had a good one with LuizaCred's good result, although still below 1Q15.

Finally, although aware of the scenario, which is still a challenging one, we were able to reduce debt by R$191 million for 1Q16 compared to 1Q15, and post a net debt / adjusted EBITDA of 1.5x, which we see as a reasonably comfortable situation to tackle any turbulence that may emerge in the future.

Finally, before handing over to Roberto Bellissimo, I would like to say that our view is that the economic and political environment remains very unfavorable for consumer spending, but we believe that [since we are] operating in Brazil's consumer durables market - worth over R$100 billion a year - and our share is less than 10%, there is still plenty of space there to consolidate this market.

By balanced management across all the retailing fundamentals and continuing to deploy our successful digital strategy, we have space to gain share, maintain profitability and reduce fixed costs.

On that note, I will conclude my introduction and hand over to Roberto Bellissimo for his comments.

Roberto Bellissimo:

Good morning, everyone. Let's go through the presentation quickly. We are showing the highlights on page 2. Frederico has already mentioned that sales grew around 3% to R$2.7 billion and we gained market share and same-stores numbers showed significant improvement against the last few quarters.

Our e-commerce grew to a very substantial 22% share of our total sales. The highlight was our gross margin rising 2 percentage points and in particular we posted an improved sales mix.

In this quarter, for example, we sold more smartphones and fewer items in other categories that show lower margins. For example, let's take air conditioning since January was not a very hot month this year so air conditioning sales were not as significant as the previous year. So the sales mix by categories was better.

We have already told you about charging customers for shipping and installing or assembling, we which started doing in April last year. We managed to boost gross margin in furniture, charging for assembling items, heavy electrics charging for shipping for example, and so forth.

All sales channels are more efficient with higher margin both online and offline and e-commerce posted a higher margin due to a more rational price scenario too.

Then moving on to the EBITDA line, EBITDA was up 13% to R$144 million. Adjusted EBITDA reached 7.2%, which was one of our highest margins, and here the adjustment is for non-recurring expenses of R$19 million, which were specific events and basically in the months of January and February only. Net income was R$5 million and adjusted net income was R$18 million.

Turning to working capital, we saw an improvement in inventories and inventory turnover. A healthier situation and very positive for gross margin too. We were also able to add to the suppliers account, thus favoring working capital as a whole.

We reduced net debt by almost R$200 million against March of the previous year. We reduced gross debt and increased cash. Then let's highlight [lending through] LuizaCred, which grew in Magazine Luiza - 5% - and outside too, which also shows a quality customer base with customer activation.

On the next page, number 3, we show how the number of stores has evolved. We have 27 more new stores than in the same quarter last year. We invested R$23 million this quarter, which was less than in 1Q15, but we spent more on technology, which is a major focus for the Company. And we have almost 25% of our stores in the maturation process.

On the next page, number 4, we report quarterly evolution of gross revenues, clearly showing a fall in sales in every quarter of last year. So this was the first quarter in which sales grew, on a level of R$2.7 billion.

Our e-commerce posted higher growth than in all recent quarters. At the end of last year, we had grown at a rate of 19% whereas this quarter's growth was 28%, to over R$600 million billing. And the same-stores number was unchanged on growth in e-commerce and physical stores performing better than in recent quarters too.

On the next page, we show the evolution of gross profit. A small point here is that payroll taxes were reduced, so we reclassified the numbers for previous year, when we recognized social security (INSS) as a tax line. For comparative purposes, we have moved this INSS to the operating expenses line, which pushes up prior-year gross margin a little, while expenses rise in the same proportion.

Here we have the gross profit table showing 30.2% gross margin, which was better than 1Q15 and more or less in line with the margins we posted in the middle of last year, and gross profit growing around 7%.

On the top right, in expenses, we show that selling expenses were lower. General administrative expenses fell too, so even with sales growing we were able to reduce expenses in nominal terms, despite inflation of almost 10% and INSS rising after the exemption period ended.

On the Other line, we have the effect of deferred income less non-recurring expenses. At the end we got dilution of general and administrative expenses and a slight increase in the total due to these non-recurring expenses.

On the share line, we also see quarter-to-quarter evolution clearly showing that 1Q16 was better than 4Q15, given LuizaCred's improved figures.

On the next page, we show EBITDA excluding those non-recurring expenses. [there was] evolution to R$163 million in 1Q16, reaching 7.2% EBITDA margin, which was driven by growing sales, higher gross margin and dilution of SG&A.

Below, we show a detailed comparison against the previous year, again clearly showing an increase of 2.1 percentage points in gross margin and 0.4 percentage points in selling expenses, and 0.2 pp in general and administrative expenses. Equivalence slightly down from last year's by 0.5 percentage points, PDD and other expenses.

Then we move on to the bottom line. Interest income rose slightly but was significantly below the CDI (interbank rate) variation in the period, also somewhat influenced by growing sales, as interest charges on advances from cards rose, while other net financial expenses - which were more related to debt servicing- fell because net debt was lower than the previous year's.

Then we show that we have reduced net debt and leverage too, which went from 1.7x to 1.6x for this quarter. Below, we show that working capital improved too. I have already mentioned the stocks and suppliers account, but we also improved the receivables account.

Then we show evolution of net profit quarter by quarter. We had a small net profit of R$5 million in this quarter or R$18 million excluding non-recurring expenses.

On page 9, we show that LuizaCred's turnover grew 2%, due to the Luiza card, in-store and outside too, but again we reduced direct-consumer credit (CDC) billing and personal loans too, as part of LuizaCred's strategy of a conservative stance with a focus on the Luiza card.

As a result, NPL rose over 90 days compared to March of the previous year but fell compared to December, largely due to reduced credit and better quality of a portfolio more focused on the Luiza card. This was also reflected in provision for doubtful debt, which was lower than in recent quarters. Hence LuizaCred's performing better than in 2H15 for example.

Now I will hand it back to Frederico for his final remarks. Thank you.

Frederico Trajano:

I am going straight to the last slide. I will reinforce expectations for 2016 around the main focal points of our work for this year, which are: accelerating deployment of all our digital transformation projects; we have more than 20 projects aimed at transforming the company, which is still a traditional retail business with a digital side and making it over into a digital company with physical points of sale that shows warmth in person-to-person relations. Projects include mobile sales, in-store picking, and others such as the market place, for which we are about to roll out a pilot project; so we can talk more about that later.

Continuing to gain market share on a sustainable basis without undermining profitability while diluting expenses. Focus on reducing operating expenses, continuing to deploy ZBB and CMM projects, with a conservative stance toward consumer credit and continuing our current strategy mix of LuizaCred products as Roberto mentioned before.

Continuing our efforts to improve cash flow and hedge cash flow in a crisis year - these are things we have been implementing in Q1 and must continue in the coming quarters. Finally, we have to keep the company up there among the best companies to work for in Brazil [as shown by] the main rankings published by Brazilian magazines.

Now let's open up for questions from analysts.

Marcel Moraes, Deutsche Bank:

Good morning, everyone. Congratulations on the numbers. My first question relates to both in-store and e-commerce sales. It seems to me that you are starting to gain more market share; in 1Q it was more obvious that sales performed well in relation to the competition.

I would like to know whether this relates to a specific region, if there is a region in which you are making more progress, due to closing stores, and what expectation do you have specifically for e-commerce, since its performance was very much off the curve in relation to the competition in the quarter. Thank you.

Frederico Trajano:

Good morning, Marcel. Thank you for your question. As I said at the beginning of my remarks, 1Q16 reflected the effort made by both the physical-store and e-commerce teams to gain share. We made a very detailed survey to find potential micro-regional sites in absolutely every region in all categories, and we worked hard to capture these local opportunities identified by our project, which we call 'focus on sales' specifically in physical stores.

Magazine Luiza has been consistently gaining market share for over four years, and we have gained share nearly every year since the IPO. Even last year, when sales were slightly down on the previous year's. We must remember that we had the World Cup in 2014 with an extraordinary gain in market share. So the 2015 versus 2014 comparison base was a very difficult one.

Now we have a base comparable to the previous year's, 2015, a more normalized one. But if you look [at the numbers], since the IPO we have been gaining *share* without hurting margin, since the first quarter of the result published.

Specifically this year, we are gaining physical-store share in almost every region, especially the South and Northeast regions, where we have gained slightly more share through our survey, consolidating stores too, and specific competitive scenarios in each these regions. But in São Paulo outside of the state capital and in other regions.

Specifically in relation to e-commerce, this is the second quarter in which our growth has outstripped the market; note that the 2014 -2015 base was a tough one too, but this is somewhat in line with what I have been talking about since the last call: we feel that there is now a trend toward rationalization of the e-commerce market in Brazil - better late than never.

Because many players were selling at prices below the costs they were paying suppliers, which is not sustainable in the long term. They kept going for a while by funding and finding investors, but we think that at some point investors will want to get a return on their capital, so these operations will have to generate cash flow and to do that you must have rational pricing.

We feel that there is a trend toward rationality in this market, a prolonged one I should hope. If this materializes, with an operation that has a shared cost base like ours, which is a multi-channel operation, we will benefit from this rationality.

But I cannot fail to mention that there was a very strong showing from the e-commerce team to ensure the best pricing for each of the categories.

Marcel Moraes:

I understand. Frederico, when you look at the coming quarters and think of the sales mix you will have, can we imagine how different categories will evolve? Which do you think may outperform others in the coming quarters, and which will not be doing so well?

Frederico Trajano:

Which category?

Marcel Moraes:

The categories in general. Which ones will be outperforming [the others] and which will not?

Frederico Trajano:

I will answer specifically on the category that has continued to show attractive growth despite the economic situation, which is cellphones. We saw a good quarter for this line since it gained overall share of sales revenues both on the Internet and in physical stores.

We see a market in which penetration is still below 40% in Brazil. This is a product that everyone wants - just take the whole collective commotion last week when WhatsApp was taken off the air due by a court's preliminary order. Everybody wants a cellphone; sales are penetrating different age groups than before.

So we see there is still huge interest and people are very strongly motivated to buy cellphones, which have short life cycles. Unlike a refrigerator that people will replace every five to ten years, many people get a new phone every year. This category has shown that it is very resilient to crisis, but other categories have good prospects too.

I will let Fabricio supplement my answer. Fabricio Garcia is the company's Commercial and Operating vice-president.

Fabrício Garcia:

Good morning, Marcel. As Frederico noted, through the work we did with McKinsey, we detected opportunities region by region, category by category. The year's big performer will be smartphones, but there are some categories that we identified that may perform well, and we have them do so: white line, which is a very large stable market that we have worked on this year. In 1Q we were practically zero to zero, and this tends to show growth in the course of the year.

A category that is performing better than we expected is image / televisions, because people are switching to smart TVs. Last year it was very [pronounced] because of the World Cup; I think there was a lot of consumer spending in advance for 2014. So we see that a category that is performing better than we expected here, namely the image category.

Furniture is a category in which we have a lot of share to gain in every region, all of them, in all our stores. This category posted growth in Q1 but the number was low. We will be working on this category to ensure growth in the course of the year.

So [the answer] would be smartphones and white line goods, together with portables, image and furniture.

Marcel Moraes:

In that order Fabricio?

Fabrício Garcia:

Yes. In that order.

Marcel Moraes:

That's fine. Thank you.

Luiz Cesta, Votorantim Corretora:

Good morning. Thank you for taking my question. On gross margin, you listed three reasons that led to it rising, namely better sales mix, charging for shipping and better operational efficiency. Could you provide a little more detail on these issues? Which were really [key] factors, or whether the improvement was spread across each of these factors? If you could share a few more details about this, which would be important for us.

In relation to e-commerce, I would like to go back to the question of growth rate. If you can drill down a bit more, what is driving the channel to grow like this? Are there more visits? Are you converting more to sales? Which is the specific channel? Cellphones, mobiles, traditional sales, desktops. In short, I would like a little more detail as to how you getting conversions, if it’s the app, how it is doing. Thank you.

Frederico Trajano:

Good morning Luiz. I will answer on margins and for more details of e-commerce growth I will hand the question over to Eduardo Galanternick, our e-commerce officer.

On margin, as Roberto already mentioned in his explanation, we are operating with a level of profitability for 1Q16 that is similar to two quarters last year, 2Q15 and 3Q15. We got back to the same margin and profitability levels as last year's, as you saw in the published results.

The main driver for this, I think there is only one. In all categories, in stores too, as well as e-commerce, we worked to improve margins with more rationality in the market. These [factors] all contributed to this growth, but I'll point to the telephony *mix* as the main one.

Let us recall that there was a heat wave in 1Q15 whereas this summer has been quite cool. So, the fall in the white line share together with the above mentioned increased share for smartphones, was a major weight in the *mix* and this was the one single factor that did most for this increased margin. Again, we have seen these same levels in the middle of last year.

Now I will hand over for Eduardo to answer your question about e-commerce.

Eduardo Galanternick:

Good morning, Luiz. Thanks for the question. In relation to e-commerce, we expect to continue to grow above the market and gaining market share sustainably, which is company policy.

Going into a little more detail on 1Q sales, our total number consists of a sum of factors, including visits, conversions and tickets. We posted gains on all three variables, with more visits, more conversion and a higher average ticket. In relation to *devices*, yes the application has help a lot with growth in visits and conversions.

We had already noted that visits were very quickly migrating to mobile devices so we had to provide an application with an experience that would drive conversion as much or better than desktops, in order to avoid lost sales.

The application was rolled out at the end of last year, with all the personalization side for low friction applications, and it did actually show higher conversion, as we expected.

Therefore, this migration of traffic from desktops to mobile devices is making a contribution to our sales in general.

Luiz Cesta:

OK. Thanks.

Guilherme Assis, Brasil Plural:

Good morning, everyone. Thank you for taking my question. I would like to go back to the issue of gross margin. Frederico, you explained and clearly showed that perhaps the main factor that has helped with margin was mix effect. We also know that there was the impact of charging for shipping and assembling. Just to help us out, could you quantify this? Because we saw in the year-on-year that there was an increase of 210 base points in margin, after adjusting for lower payroll tax charges. Of these 210 b.p., do you know how much came from what? How much came from charging for shipping and assembling? How much do you think came from sales mix? So that we can get a better idea of this.

And adding to the question on margin, we know that your main competitor had a more aggressive strategy for their physical stores. What was your view on that? Because, when you look at the results, this does not seem to have had any impact. You did not have to respond aggressively on prices. I would like to know how you assess the competitive environment, and whether you have actually noticed competitors being aggressive or more aggressive in general, or perhaps the main competitor more specifically; and how you have responded to this and managed to maintain such a strong growth rate with a significant gain in margin. These are my questions. Thank you.

Frederico Trajano:

Good morning, Guilherme. Thank you for the question. I will divide my answer to your question into two parts. Firstly in relation to the composition of the margin gain. Actually I have nothing more to add. All those factors contributed.

I will not go into weights here because we do not disclose these data, nor can I answer the question in this way, but I will emphasize that last year's lower margin in 1Q15 was due to the white line's high share reflecting last year's heat wave with high shares for air conditioning, fans etc.

So the mix effect has been the main component, but all the others - shipping and assembly, e-commerce market rationalization and consequently our improved margin for e-commerce - all made important contributions; not as much as the mix effect, but also important contributions for this 1Q margin growth.

In relation to the second part of your question, when we decided this year's strategy for gaining market share while retaining profitability, we saw that the potential was there. The market is still very de-concentrated since the *top players* have under 30% market share. There are many small and mid-sized players comprising a total 70% market share in the main categories.

We feel that these companies have been more affected by the crisis than the more structured and more capitalized companies, and they are facing a shortage of products. There are very many companies closing stores, we have seen news of companies with high volumes of store closures. We are only not closing stores but also adding 28 new stores in the quarter on a yoy basis.

We are managing to deal with this competitive scenario. The crisis is a significant one that affects everyone, but it has affected some retailers more than others, especially the least prepared.

So I really see no reason or need for big margin cuts to gain market share, or for protection at this point in time, precisely because of this scenario that I have described.

Guilherme Assis:

I think that is clear. Thank you. And if I can ask a follow-up question in relation to cost cutting, because you post a nominal reduction too, despite increased payroll taxes. I would like to understand this zero-based budgeting process with Galeazzi. Do you think you have already reached the sweet spot? Or do you think there is more fat to burn off? How should we look at this going forward, bearing in mind that we are still in a weak sales environment, and that inflation is still high despite its slowing? What should we expect going forward from this operational leverage that you have shown in 1Q?

Roberto Bellissimo:

Good morning, Guilherme. We have done a very consistent job working on expenses in the course of the past year. In this quarter, we have again reduced almost every expense.

We have even cut back marketing expenses without losing sales. We have a very big job to do in terms of cutting costs without harming sales or harming customers. There has to be a lot of planning.

We started planning last year. We started zero-based budgeting in September or October. We did the entire budget using this methodology. Now management is on a day to day basis every month to stick to the budget that we posed.

We have potential to continue cutting costs; this is an obsession for the Company. We are reviewing all contracts, shipping, rent etc. We are on the right track to continue posting sales growth, very strict control of costs, focusing on every opportunity from personnel and marketing expenses to rents and shipping rates. We are constantly addressing all the major expenses.

Guilherme Assis:

Alright. Thank you, Roberto.

Leonardo Cavalcanti, Nova Gestão:

Good morning. Firstly, I would like to congratulate you on the excellent results. I basically have two very simple questions. In the debt profile I saw there was an alteration in relation to last year: there was an increase in short-term debt. I would like to know how the company sees this over the next 12 months, whether you will be funding. [I am asking how] you see this, whether you are comfortable [with this].

Another thing I would like to know is this: since you have a multi-channel strategy, you should have a margin gain between e-commerce and physical stores. How much are you attributing to the changing e-commerce market in Brazil, margin gains, or Magazine Luiza's particular characteristics for having this multi-channel opportunity? Thank you.

Roberto Bellissimo:

The connection was breaking up here. We could not quite understand your question. Could you repeat it, please?

Leonardo Cavalcanti:

Of course. There are two questions. Basically about the debt profile, there has been an increase in the short-term [portion]. How you see this [developing] over the next 12 months, whether you are planning on funding or changing this profile.

And the other question, since you have a multi-channel strategy, you gain synergies between e-commerce and physical stores. How much of this margin improvement do you attribute to this special feature of Magazine Luiza and how much to the change in Brazilian e-commerce, which is improving its margins in general?

Roberto Bellissimo:

Good morning, Leonardo. I will answer the debt part first. Since the end of 2014 and beginning of last year, we worked hard to reschedule the debt profile. Last year we reduced net debt in nominal terms. This year we are continuing to reduce it; our Q1 net debt was much lower than 1Q15's with a better cash position too.

This quarter we did not many debts due for repayment, and we rolled them over of course. This year too, we do not have major concentration of repayments since we had already rescheduled. We have a few repayment dates toward the end of the year. We have enough cash and time to negotiate and continue rescheduling our profile.

Of course, current market costs are higher. This is clearly seen in all recent public issues, debentures etc. I think the cost of money has risen for everybody. Since we have a small part to be rolled over this year, this should not materially affect our average cost of debt.

We show that debt servicing cost this quarter was even lower than in the same quarter of last year, and that the increased financial expenses was basically only advances on credit cards due to higher sales, to sales on credit cards.

So we will be dealing with debt on these lines, working on earnings, cash flow, continuing to improve working capital to generate cash and rollover debt in the best possible way, ensuring a comfortable ratio of cash and net debt to EBITDA. We are comfortable [about this] and we are working to maintain this comfortable [outlook] for the Company.

Frederico Trajano:

In relation to the margin, the answer is the same one I gave to the other questions. Again, the main factor was [sales] *mix*, although all the other components have been important to show growth on the previous year. There is not much to add. Thank you for the question.

Leonardo Cavalcanti:

Thank you.

Frederico Trajano:

Thank you all for joining our earnings call.

Operator:

Thank you. This concludes Magazine Luiza's 1Q16 earnings call. You may hang up. Have a nice day.