Local Conference Call

Magalu

Earnings for the 4th quarter of 2022

March 10, 2023

Vanessa Rossini - IR Manager

Magalu's conference call will start shortly.

Good morning, everyone. Thank you for waiting. Welcome to Magalu's conference call regarding the quarterly earnings.

For those who need simultaneous translation, just click on the 'Interpretation' button via the globe icon at the bottom of the screen and choose your preferred language, English or Portuguese.

We would like to inform you that this event is being recorded and will be made available on the company's IR website at: ri.magazineluiza.com.br, where the release and presentation of the result are already available, both in Portuguese and English. The link to the presentation in English is also available in the chat.

During the presentation all participants will have their microphones disabled. Then we will start the question-and-answer session. To ask questions click on the 'Q&A' icon at the bottom of your screen, write your name, company and question language. Upon being announced, a request to activate your microphone will appear on the screen and then you must activate the microphone to follow up with the question.

Questions received in writing will be answered later by the investor relations team.

Now, I would like to give the floor to Fred Trajano, CEO of Magalu. Please, Fred, they are all yours.

Fred Trajano – CEO

Good afternoon to all. Thank you very much for participating in Magalu's earnings call for the 4th quarter and 2022. We had arguably the best quarter of the last six ones after the pandemic hangover.

Before I specify the earnings in terms of transparency, openness, fundamental characteristics of our company and our team, I would like to mention that we announced a material fact together with the earnings yesterday. This material fact describes an anonymous complaint about alleged commercial practices in violation of the company's code of ethics and conduct, specifically about irregularities in bonus operations with certain distributors and suppliers. The complaint names three distributors, which during the 2022 fiscal year represented approximately 3.5% of the company's total purchases - to give you an idea of the importance of this example.

Thus, the board of directors ordered the audit, risk and compliance committee, which is mostly made up of independent members, to fully verify the facts alleged in the anonymous complaint, and authorized the hiring of independent external advisors regarding legal, accounting, external controls, so that said verification can be done independently and in accordance with the highest levels of governance, standard of diligence.

The audit, risk and compliance committee has already started investigating the facts narrated and as conclusions are reached, and will present the its conclusion at the end of the process. Anyway, this is my opening on this subject, an anonymous complaint that happened a few days before the publication of our earnings, at a time when the market is obviously sensitive to these issues. I chose to initiate the call being objective about this matter. Much of what we can talk about is included in the material fact, in short, that is more or less what we can talk about at this moment.

I just wanted to say that an anonymous complaint that has not yet been investigated should not take the shine off the company's earnings for the last 4th quarter, for the last quarter of last year. In this 4th Quarter we are showing a very significant evolution in all those points that we addressed throughout the year. It was the monetization year; a year in which we made ourselves available to take a series of actions to increase the company's profitability in a difficult economic context of high-interest rates and a bit of a hangover from post-pandemic Brazilian e-commerce. We did an excellent job. And, considering the last year's 4th quarter, this one has clear and solid indicators that the company's walk the talk really did a fantastic job there in this period, and still with positive perspectives for the future.

Before talking specifically about Magalu, I have been talking about in the last three, four calls - actually, there is a slide in the presentation - where we show the evolution of Brazilian online retail penetration and in this graph what I have been mentioning, that I said Brazil in the future will not be analog anymore, everything in Brazil is digital. A lot of people looked at last year's e-commerce drop in the industry as a whole as a long-term trend, but it was actually just an adjustment for the abnormal growth that happened in the two years of the pandemic.

If you look at this slide that we have, on page 5, we show that as of the last quarter we can already see - probably as of this year - the resumption of growth in penetration of e-commerce in relation to the whole of Brazil, which is still far below countries like China and the USA. There was a bellyful, a small decrease over the last year. From now on e-commerce should grow more than physical stores - and I am not just talking about Magalu, but the market as a whole - and this continues to be our bet. Although, there is an opportunity specifically for Magalu to grow in both channels.

In the next slide, I will talk briefly about product penetration in Brazilian e-commerce. We have penetration above the market average for home appliances, closer to the international market average for electronics, but there are several categories where penetration remains well below the world average: beauty, clothing and footwear, pets, household items, auto parts. So, we have a great opportunity for growth in new categories that we are going to discuss a lot at Magalu, especially through the 3P opportunity. Next slide, please.

My view is strongly positive regarding the growth opportunities for Brazilian e-commerce, also from the microeconomic and competitive point of view that we can mention at the end. I believe the market will demand forthwith from companies that work in the digital universe is to grow with profitability. Growth will continue to be an important thing for companies and executives to look forward to, but this growth, even in the online world, must necessarily be accompanied by profitability.

In particular, I would like to highlight when we look at the Brazilian online market, although 64% of the GMV of the Brazilian online market is in categories above BRL 300, the profit pool of these categories is 84% of the online market. Thus, one important thing that I have emphasized a lot is that although we make a huge effort to diversify categories, we want to have an overshare and work in a way where we even have a lot of rights to win, which is in greater ticket categories. Magalu is known as a store where you buy good brands, higher tickets, of good origin, great care is taken in filtering the sellers in the marketplace.

Therefore, we have to greatly grow our 1P, but mainly our 3P in larger ticket categories, because the higher ticket categories also represent an opportunity for better unit economics. This slide shows that for unit economics below BRL 60, due to marketing costs - and the smaller the ticket, the higher the marketing cost - and delivery costs as well, the smaller the ticket, the higher the delivery cost, and the unit economics of a BRL 50 product is usually cash burn, it comes back negative and you end up losing, with each unit sold you lose a significant amount of contribution margin, while in higher tickets we get to have a positive contribution margin.

The marketplace is already in positive contribution margin territory. It contributed massively - Beto will signal an increase in our gross margin in the last quarter of the year. A major explanation for the increase in gross margin in the last quarter of the year was the increase and growth of the marketplace, their proportion on the company's total result and the increases in the take rate that we increased over the period.

I would like to emphasize the importance that diversification is fundamental for Magalu's growth in the future, however, we want to diversify in a territory with positive unit economics, and generally the higher tickets are where we have these positive unit economics.

When we look at Magalu's market share by range of tickets - next slide, please, page 7 - we see that we have an overshare in categories above BRL 1000. We have possibilities, we have a share greater than the average in the category from 300 to BRL 1000, and then smaller market shares in categories below 300 and BRL 100. Those below BRL 100 are the ones that represent the least profitability, and we want to continue gaining share in these categories above, especially above BRL 300, but between BRL 100 and BRL 300 I also see a positive territory, and continue dominating the categories over BRL 1000.

We have a massive space. Our fulfillment is projected for it. Our navigation style is designed for it, our credit offers are designed for it, so we think we have a great chance of gaining abundant share, especially in 3P, in these ranges of tickets looking forward, and that this tends to bring and continue to bring a positive contribution to our EBITDA margin.

About the quarter, I am going to talk a little about growth. It was the quarter with the best growth of the year: we grew an expressive 16% in the quarter, we reached 18 billion in GMV. If we take the average year including pre-COVID, since 2019 our average year of growth is 26% per year, so even in a year of profitability, of increased margins, in a year of pass on prices and fees to sellers, to reduce marketing costs, we continue to maintain a positive growth rate. In the year as a whole, we reached the expressive mark of 60 billion, grew single digits in the year and reached the level of 2 billion in adjusted EBITDA, which was an increase of 44% over the number of 2021. We are working to significantly improve these numbers.

From the physical store's standpoint, the company grew around 15% in the quarter. It has been a long time since we have grown in physical stores in this proportion. We did an authentic positive job. In the year as a whole, physical stores sold practically BRL 17 billion and we had a share gain of 1.3% in the last quarter, remembering that physical stores are very important for us, because they are cash generators margin, contribution margin, very positive for the company.

In the next slide, I would like to talk about e-commerce. We grew in these pandemic years by 44% CAGR since 2019, an average of three years. This quarter we also grew 16%, a very high volume. In the year as a whole, we reached almost 44 billion GMV in e-commerce 1P plus 3P, a substantial gain in market share. Thus, even raising prices, reducing freight, etc. and such, the company, in a market, which is a market that dropped in e-commerce mainly in the quarter, gained expressive 5.4, 5.1% of market share and we continue to present good indicators at the beginning of this year, showing our resilience in e-commerce, remembering that we had very strong bases from last year, especially in the 1st half.

And I wanted to show that in the 4th quarter especially the share gain was very expressive, because the e-commerce market in the 4th quarter fell 6% and Magalu grew 16%. This gain is well delimited, these market numbers. We use Neotrust data.

On the profitability topic, I would like to show you what is happening. We do not express the exact amount here, but just for you to have on a scale how much the percentage of logistics on our 3P has dropped, so it is dropping significantly and with greater logistical efficiency, new freight policy and also the fact that more than 20% of all marketplace sales are picked up in store.

We already have a fulfillment operation that also tends to take advantage of the Luiza network. The migration of couriers to the Luiza network, which is already 80%, to Magalu Deliveries, which is already 80% of the total business. We have been able to reduce the logistics cost of 3P, and that is why I said that 3P is already in positive territory, already contributing to our gross margin and to our EBITDA margin as well. Next slide, please. And the increase - return to the last slide, please - and also the increase here in the cash margin of the 3P showing that in addition to these logistical issues there was a series of work in marketing, take rate, etc.

The 3P specifically grew 58% a year in these pandemic years. We reached 15.4 billion in the year of 3P, so, finally, a super expressive and significant value. In December, the marketplace starts to have a lower comp and grew 33% in December - and continues at a very fast pace. If I consider January and February together, despite Carnival this year, which really had an impact in terms of movement both in the store and on the website. We managed to add up January and February to show very positive growth in the marketplace, and even making some price changes, fees for sellers throughout this year. We are very confident with our 3P. Next slide, please.

3P is a diversification engine for Magalu. Nowadays, if we consider the total online GMV, 51% of our GMV already comes from new categories. Today, at 3P, we have a platform offering that serves three large groups of sellers very well: we serve a huge share of the big sellers since we are one of the 3P's leaders in Brazil for brands and brand sellers. I already mentioned, these sellers usually have higher tickets, we already have a great penetration in these sellers.

We have a very nice relationship with the smaller sellers, the hyperlocal ones, which is the Magalu partner. We managed to enter - I am talking about slide number 15 - at the base of the pyramid serving these sellers, and we reached, I will discuss it later, 260,000 sellers, most of them coming from this base of the pyramid.

And I was talking about the high ticket as an important general economic unit. For a low ticket, it is important to be hyperlocal, because then the logistical cost you have is a local cost, so the smaller the ticket, the more hyperlocal the seller has to be. For low tickets and products with a lower frequency, our big bet is Magalu, and for medium sellers, which are the basis of the current marketplace, we intend to work very focused on gaining market share, and here we have a smaller share.

We have an opportunity to gain share with the fulfillment proposal. Fulfillment - which I will talk about a little later - will help us a lot to have a better offer for those sellers who usually do not have their own distribution centers and want to store the products elsewhere, and we now have a multichannel offer that we are selling to them, so we have the opportunity to grow in small, medium and large sellers. Next slide, please.

As I told you, we reached 260,000 sellers, 24,000 more in the quarter. We have more than 90 million offers available here, including the new brand positioning called Busca no Magalu, in which we are emphasizing variety a lot. We hit that considerably during the World Cup and we are getting great attraction in these sellers, in these non-core category offers. Next slide, please.

I would like to jump to slide 18 now, talking a little bit about our multichannel. It was fundamental for the profitability of the 3P to take advantage of multichannel, which has always been important for the profitability of our 1P. Thus, we have Magalu Agency to offer the seller. There are 517 stores out of our more than 1300 stores that we currently make available for sellers to be able to drop off products. There are already 60,000 sellers out of the 260,000 who use the agency as a priority, usually they are all Magalu partners, small sellers who, instead of posting the product in the mail, post it in our store, and we already have more than 1000 stores enabled for the 3P withdrawal. As I said at the beginning, 20% of the sale on the marketplace is 3P. We think this number will grow considerably with fulfillment as well.

Speaking of fulfillment specifically, we already have 1000 sellers in the fulfillment that we launched last year, in the 2nd quarter of last year, 21% of the total number of billed orders are posted for the client within 24 hours. One of the great advantages of fulfillment is to reduce the average term of our offer to the customer. Maybe this is our biggest challenge to gain share in the 3P. We believe that fulfillment will help us in the context of doing, but the secret is to do it on a cost-efficient basis, that is why the advantage of our fulfillment is that it uses the same network as 1P.

Today, we already have five DCs working as fulfillment. DCs are Louveira, Guarulhos, Extrema, Contagem and we started the operation in Alhandra, also in Paraíba. We have work and goals to grow significantly, sound feedback from sellers and we have fulfillment especially in Guarulhos for larger items, which do not have this offer on the market. We are excited about the possibility of 3P growth due to increased fulfillment and conversion growth as well.

We are delivering around 43% of Magalu's orders within 48 hours; it is growing quite quickly - but there is still a lot of opportunity to increase fast delivery. As I said, 80% of Magalu's orders go through (from 3P) Magalu Deliveries, anyway, we have evolved here but with a massive opportunity in the future.

About our subsidiaries, they all showed solid positive results throughout the year. Netshoes presenting 4 billion GMV, 7% growth, 56 million positive net profit - remembering that it was behind Magalu with losses and now it entered the positive territory and presented yet another fantastic result; fashion, which had a considerable highlight in our 3P, growth of 25% in the Magalu marketplace, and 65% of what we do in fashion today is in this category, it is in the fashion category of 3P, in Magalu. Época with nearly 1 billion sales, 15% growth, made a brilliant year, 76 million profit. Next slide, please.

KaBum! also with a very positive year, 4 billion in sales and 179 million in profit and it already has a KaBum! in-store pickup in 600 Magalu stores, also taking advantage of these synergies, and more than half of KaBum! Magalu's logistics platform does it too, the companies we acquired make their own deliveries and logistics.

And AiQfome also had a very positive year, with 1.4 billion GMV in 2022, 30,000 orders and a third of payments processed by our own platform.

I want to highlight Ads as well, a positive year that increases monetization. In addition to Fintech which Beto is going to talk about, a great opportunity to increase our margins is in Magalu and Ads. We already have a total of 500 million monthly interactions on all our content channels. Yesterday, we had the Canal Tech award here at the arena, which was very positive. We have a huge audience there and the Ads platform is being built in Magalu to deliver inventory across all our assets: Netshoes, Época, Canaltech, Jovem Nerd, Steal the Look, so a great platform, with one of the biggest audiences on the Brazilian internet - not just including e-commerce, but in general.

All of our assortment coverage is enabled for sponsored search. We know that the core of Ads is in sponsored search. We developed this system throughout this year, more than 6000 campaigns were created and today 2500 sellers are investing. The opportunity from 2500 to 260,000 is huge and there is a lot of opportunity to gain. I see cases like Flipkart in India, which went from 0.7 to 3.5% of GMV in three years, I think we have everything to be able to monetize a lot - remembering that Ads have a very high contribution margin, it is almost EBITDA at its core inside this product.

I'm going to give the floor to Beto to discuss the financial highlights. Next, we will have the Q&A.

Roberto Belissimo Rodrigues – CFO and IRO

Thanks Fred. Good afternoon, everyone. I am going to go through the financial highlights quickly, starting here with the 4th Quarter, where we grew by double digits in all channels, reaching 18 billion in sales; we made a lot of progress in gross margin and EBITDA margin; and in the last line we are close to balance; close to breakeven now.

On the next slide, we show the year as a whole, the highlight is that we reached more than 60 billion sales for the first time, also growing in all channels with evolution in gross margin and EBITDA margin as well, and a net income of negative 1%.

On the next slide, we show the consistency of our EBITDA margin evolution. A highlight here compared to last year was the growth in revenue from services, we had 44% growth in revenue from services. Fred spoke considerably about the marketplace growth and the adjustments in the commission policy, take rates and freight that we implemented throughout the last year, and we also started this year implementing them as well.

Revenue from services this quarter exceeded BRL 1 billion for the first time, so it is a highlight that has contributed a lot to increase our gross profitability; and then in the SG&A line we also had our best quarter, it was the most efficient quarter and the SG&A around 21% and all this contributed to the increase in EBITDA from 2.6% last year to 6% this year. We have already talked greatly about everything we did to reduce expenses.

Let's move on to the next slide where we show our cash position. We reached a total cash position of 10.6 billion in the 4th quarter, a very strong cash generation in the quarter of around 2.2 billion. We have a capital structure that we consider very solid, very liquid, and it is a net cash position, given that discounting our debt, we have a net cash position of 3.5 billion, which is 1.6x EBITDA.

It is also worth mentioning that we have all our debt is in the long term, so maturing from 2024, 25 and until the end of 2026. In a moment of turbulent market like the current one, the credit market (sic), we do not have any debt maturing nor have any need for funding and we have a debt that is relatively competitive, with an average cost of CDI+1.25.

In the next slide, we talk about working capital. Throughout the last year, we already talked about the expected evolution of working capital over the year, and in fact, in the 4th quarter we had our best evolution and working capital position. We managed to grow sales at a very fast pace and at the same time reduce inventories, which indicates substantial assertiveness, the quality of inventories, low stockouts. We improved inventory turnover at the end of the year, in the 4th quarter compared to the 4th quarter of last year by thirty days, so a very significant evolution that we will continue to make throughout 2023 as well.

We have already made an additional disclosure that also in relation to working capital, which we always, in the balance sheet we have now opened the total suppliers account how much is the balance of direct suppliers, how much is the balance of suppliers within the agreement with the banks we work with, and we always disclosed all of this, this line of anticipation of suppliers in the explanatory notes. Now, to further increase transparency, we brought it to the balance sheet.

And we also disclosed that for prepayment operations, we pay the bank on the date we would pay the supplier, on the date agreed with the supplier, and the bank, being paid in advance. And we pay the bank on the date we would pay it, there is an average term of 54 days, which is why we consider these operations to be very common, totally within the typical market terms. Our average purchase period today is around 90 days, and that means that on average mid-way the suppliers anticipate it. There are suppliers who anticipate earlier, there are suppliers who anticipate later, but on average, the average period of anticipation is about 45 - 50 days. And it is a triple-win operation as: we win, the supplier receives in advance, the bank earns its spread, and we earn a part of the bank's spread also within certain agreements for confirming the operation for it as well.

About the financial expenses topic, we also show a reduction in financial expenses compared to previous quarters, so we went from 6.3 to 5.1% of net revenue. Thus, this improvement is largely associated with cash generation in the quarter and the reduction in the prepayment of receivables, mainly. Our financial expense has the debt cost that I already mentioned, we reduced the prepayment of receivables this quarter due to higher cash generation and also due to the increase in PIX, which has already reached 34% of our sales. In some channels has already surpassed 40% of our sales and we continue to promote the PIX as a way to continue reducing financial expenses, in addition to other initiatives related to reducing the average term of cards, increasing sales with interest and so on.

On the next slide, we show the evolution, how we went from 9 billion to 10.6 billion, with a strong emphasis on operational generation; investments of 200 million; agreements that we made in the Fintech area of positive 200 million; and also leasing and interest of 600 million, reaching 10.6 billion, one of the biggest quarterly cash generation we had ever had.

Then, we will talk about LuizaCred. We kept the card base practically stable throughout the year. We have reduced the granting of credit since the beginning of the year, but even so we kept growing in revenue: grew 14% in the quarter, 30% in the year, total revenues of more than 54 billion, a loan portfolio of more than 20 billion. It continues to grow due to the activation, the relationship, the frequency of our customers, who are very loyal to our Luiza card and the Magalu card that we sell online.

In the next slide, we talk about LuizaCred's results. Here we show an evolution in short-term indicators. The latest crops are improving. The short-term defaults are improving. We have already verified positive results in recent months due to this improvement. It is important to highlight that short-term crops are more demanding under IFRS. They affect even the level of provisions more than long-term crops, because the long-term crops (over 90 days) are already practically all provisioned.

We see a slight increase in the NPL over 90 days. There are already signs of stability. Throughout this year we should see it falling again especially in the 2nd semester. But most importantly is that the short term is better, it requires fewer provisions and the earnings of LuizaCred. You can see on the right, it was the best quarter of LuizaCred and also in the year as a whole, driven by better operational efficiency, by higher revenues (also, more than 1 billion in revenues) and by a lower level of provisions.

About our Fintech, our TPV as a whole, we had growth in all channels, including payments, digital account and banking as a service growing a total of 15% in the quarter and 40% in the year, with total TPV reaching over 90 billion.

And finally, we highlight that Fintech presented a series of novelties, launches throughout the year and the highlight. And we highlight our digital account for sellers, which since September - October - when we started to encourage the migration of our sellers to our digital account - we already have 15,000 active sellers and in this quarter alone, they already operate almost BRL 1 billion (700 million) from our marketplace.

One of the main focuses of our Fintech this year, in addition to prepaying receivables, which is super profitable and contributed substantially to last year's earnings and will continue to contribute to this year's earnings, is to encourage the use of our sellers a lot, by our sellers from our digital account - and with that also offer our Legal Entity credit card and our Legal Entity loans and everything else.

Those were the financial highlights. Now, we would like to start our question and answer session. Thank you.

Q&A Session

Vanessa Rossini - IR Manager

We will now begin the question-and-answer session. To ask questions click on the 'Q&A' icon at the bottom of your screen, write your name, company and question language for their position in the queue. Upon being announced, a request to activate your microphone will appear on the screen and then you must activate your microphone to follow up with the question.

We also ask that in cases where there is more than one question, they are asked all at once.

Well, our first question comes from João Soares, an analyst at Citibank. João, please go ahead.

João Soares - Citibank

Thanks, Van. Good morning to all. I have two questions here, the first is to explore the beginning of the year. You commented in the release that you had good results from *Liquidação Fantástica*, and I think it is important for us to understand how the competition is doing in this scenario. Naturally, there is a relevant change here, we already see a change in traffic data when we look not only at traffic, but monthly active users. Thus, it is important for us to understand the outlook for the company growth, based on what you already see in the short term.

The second question I would like to hear a little about marketplace monetization. It is interesting that you are already reducing freight subsidies. Fred showed an interesting graph from the marketplace economics, an improvement in the logistical cost and in the margin. It is important for us to understand how you are looking at the marketplace margin for this year, and how we should contribute to it. Will it be reflected in the company's consolidated margin? Thank you.

Fred Trajano – CEO

Good morning, thank you very much for the questions. About the beginning of the year, I mentioned it briefly. We had a super positive start, January above expectations even. We had a challenge at the beginning of the year, which is the return of the Tax Rate Differential (DIFAL) tax, and it ends up reflecting all our interstate operations. This year, we had to pass on DIFAL to the price, so we had a great need to transfer and increase the prices of goods to compensate for the extra interstate tax.

We were even apprehensive about the volumes in the first quarter. So, in a very competitive scenario, it would be very difficult to pass on this tax, and we are managing to pass on DIFAL almost entirely in the year - with growth even lower than what is the potential for the year as a whole, because usually in the 1st quarter when you transfer taxes - I am talking more about 1P - you end up reducing your growth opportunity a little, but I think that the competition as a whole is much more rational, with the dynamics of the market - I will not go into detail talking about specific competitors - but with favorable market dynamics.

I have been in e-commerce for 22 years, I have never witnessed it - and 22 years is a long time - such a rational market. Everyone wants to make a profit; to pay their bill. There is a tax increase. Everyone passing on a tax increase; increase in the cost of gasoline everyone passing on the increase in freight; Everyone rational in marketing.

I see a scenario that is the one we like to work on because we have this philosophy: we never had a license to burn stocks. Therefore, I see a positive scenario. In this scenario, Magalu tends to gain share. In a scenario where everyone plays by the same rules, there is a tendency to gain share, which is what I have to do.

In this 1st quarter, we still have a substantial focus on passing on Difal, which we practically passed on in full to all companies in the group: Época, KaBum!, Netshoes, Magalu itself (1P).

Now, the highlight has been the 3P. In fact, in 3P we have a smaller base. I said that we had a great December, January, February and March. I am also very optimistic about the growth in 3P sales - I refer to GMV - because if you include revenues, it is much more because we have increased take rates. Although we have increased take rates considerably (we had a recent increase in January), we still have a total rate including all costs charged to the seller that is lower than the market leaders. There is still the opportunity to pass on additionally.

Regarding marketplace monetization, I talked about Ads. I have confident expectations. I quoted the case of Flipkart from 0.3 to almost 3.5 Ads. Flipkart has a feature similar to Magalu: same mix of products, same ticket, more or less the same purchase frequency. We have a great opportunity to improve Ads this year. We are investing emphatically in the platform; this is a great opportunity.

Also the Fintech matter, but I still see room to improve sales and margins, and the efficiency of 3P. I am excited about it. If you look at the gross margin for the 4th quarter, a good part of the increase in this gross margin was due to take rates in the marketplace.

We are already seeing the short-term impact of this on our results and on improving our margins. I am excited about it. I think we will continue - and it is a good thing that even in the marketplace everyone is operating to make money, because there was a moment when it was zero take rate, free shipping, in short, it was an almost impossible to compete situation. It is a more rational market. Although the macro is still not helping much, interest rates are still high, consumption is not growing much. In microeconomics, in terms of competition, it is the best scenario I have seen since I started in e-commerce in 2000.

João Soares - Citibank

Thank you, Fred.

Fred Trajano – CEO

Great question.

Vanessa Rossini - IR Manager

Thanks for your question, João. Our next question comes from Luiz Guanais from the BTG bank. Luiz, please go ahead.

Luiz Guanais - BTG

Good afternoon, Vanessa, Fred, Beto. I have two questions, Fred. Could you draw comments on this market equation that you are seeing at the beginning of the year; how is the rationality of suppliers in these negotiations; and how do you believe that this should progress throughout 2023?

The second question is: Looking at some of the monetization alternatives, how do you see fulfillment growing? You also showed an interesting chart there at the beginning of the presentation, but how do you see fulfillment growing in penetration in the marketplace throughout this year? Thank you.

Fred Trajano – CEO

Luiz, thank you very much for the questions. I will answer the second one first and then I will turn it over to Fabrício to discuss about our relationship with suppliers in the face of the 1st quarter and everything.

About fulfillment, as I said, there are five operating DCs. The operation started in Louveira, then we opened Guarulhos, Extrema and finally we are growing. The idea is to have the fulfillment operation in practically all of our more than twenty DCs. We have grown considerably in the number of sellers using the platform. It is a platform that was born very complete, such as controls, level of service. It received many compliments from the sellers.

We are not yet charging sellers for fulfillment, because the cost is marginal for us. We manage to have a more positive policy to encourage the seller to sell the product at the beginning. I am not going to give penetration guidance, but we want to grow considerably, keeping in mind that today we have idle capacity of 30% to 50%. Beto pointed out that we reduced by thirty days the inventory level for December of last year compared to the previous year, which creates space in our DCs that we are using to increase fulfillment with the rental cost that is already there, the security that is already there, a network that is already being frequent in the DCs. For us it is a marginal cost. We think that even when charging fulfillment, we will charge at levels far below the market, because we have a very efficient 1P logistics operation that we are transferring to 3P.

The idea is that it sequentially gains an important share in the marketplace, and we prefer to be giving options to sellers that have solid high turnover products. We do not want a product stuck in the DC, that is what we are prioritizing now. We are even choosing the seller that enters, and choosing their product that is also entering so we can be sure that this is entering, it is selling, it is increasing conversion, that kind of thing.

Regarding suppliers, Fabrício will answer the question.

Fabrício Bittar Garcia – VP of Operations

Good morning, good afternoon to all. I am Fabrício. Regarding suppliers, we have always had a very solid relationship with all of them. Currently we are the first customer of several of the suppliers, a very solid partnership.

We spent last year making some inventory adjustments, we have very healthy inventories. We are in the best moment of rupture that we have had in the last eight, nine months. With solid partnerships, the supplier also works to make the market more rational, this helps a lot, so a very positive scenario for us in that sense. Currently, we do not have a delivery volume problem - which is important for our business - and it tends to get even stronger throughout the year, so I am quite confident and satisfied with our relationship with them.

Luiz Guanais - BTG Pactual

Thank you, Fred.

Vanessa Rossini - IR Manager

Thanks for your question, Luiz. Our next question comes from Nicolas from J.P. Morgan. Nicolas, the floor is yours.

Nicolas - J. P. Morgan

Thank you, Vanessa, Beto, Fred. Thanks for choosing my question. I think most have already been addressed, but I wanted to hear from you, Fred, how do you see the customer acquisition cost? How has it evolved over the last few months? I believe that it is interesting to hear from you.

Also, about the marketplace: you mentioned small and medium sellers. What tool do you think is missing? What capability do you still have to develop to deal with these segments more effectively? Thank you.

Fred Trajano – CEO

Great question. CAC is the cheapest I have ever seen. We are in a phase in which everyone is more rational in their investments in marketing, including some companies that reduced, stopped bidding on Google, you have CPC, CPI much lower than what we lived with, for example, at the pick of the pandemic, when the numbers became unfeasible, let's say, the cost of CPI, CPC was very high.

We are managing to grow sales with marketing and higher ROAS. I have seen a good moment in terms of acquisition cost - but what we do not want to lose is rationality. Regardless of how the market is now - I will not mention, again, any specific competitor or anyone's situation - we will maintain rationality. We continue with the effort to try to increase our operating margin, and we will grow marketing, but always wanting it to increase the return as well.

Regarding the average seller and shortly about increased efficiency, we believe that fulfillment and the work of Magalu Entregas will be extremely important, because the shorter the term, the greater the conversion. If you have more competition you need to spend less on marketing. A job that we have to do is to have the fulfillment that we used to, but we did an integrated fulfillment, totally integrated with the DCs that we already have, so low marginal cost. We can operate economically in a viable way. By having it we have shorter deadlines, and with shorter deadlines we reduce it too, increasing our conversion and consequently only by the shorter term do you increase the conversion, not by spending more on marketing.

All the improvements in the sellers' platforms are providing, in short, a better conversion. The platform is excellent. The seller's current cockpit for them to operate - and we had a lot of gaps in relation to the market platforms - we removed practically all of them, we even have some things that the other platforms do not have. For the average seller, which was where we had the lowest share, it is where we evolved the most in the last year. The small seller is basically what we have that nobody else has, and the big seller has always been strong. We want to gain share in all of them, but there is a very significant opportunity in the average seller, and it is the core of the market today.

Nicolas - J. P. Morgan

Perfect, thank you.

Vanessa Rossini - IR Manager

Thanks for the question, Nicolas. Our next question comes from Ruben Couto from Banco Santander. Ruben, go ahead.

Ruben Couto - Santander

Hi everyone, good morning. The evolution in 2022 in margin and cash generation, even the liquidity level was excellent. This puts you in a privileged position to go through this year of 2023 - which still has a very high interest rate - very challenging. In this context, can you talk a little about what we can expect from Capex, deleveraging? What do you see in this scenario that could happen throughout the year?

And a second one if I may: Fred, the granularity you brought up there was impressive; about those opportunities in ticket ranges, more attractive unit economics, and I just wanted to understand: the comments are mainly within the 1P, right? I would like to confirm if that is the case, and on top of that, how do you see the current portfolio of brands, capabilities, technology, current logistics that you have today. Is it already at a level prepared to capture these opportunities that you described, or is it something that you are mapping and we should start to have something more being implemented over the next few years? Thank you.

Fred Trajano – CEO

Thanks for the question. I am going to start answering the first question about Capex. No, we are conservative in terms of Capex investment. Today it is basically all about technology, so it is for the Fatala team, it is the technology team that we continue to work with, we maintained it, there were no cuts, we even maintained growth in some segments because I think our future is being a platform, and as a platform, the big investments are more focused on technology, data, artificial intelligence, right in that line that is concentrated. This requires Capex, but in a much smaller proportion than when you are asset heavy.

From the point of view of opening stores and DCs, we have this idleness of 30 days less inventory, we do not have that much need to make significant investments in Capex, and the interest is very high too, any investment with a return it is more long term. We are prioritizing what gives a short-term return at this moment. Beto, do you want to add something, such as granting leverage?

Roberto Belissimo Rodrigues – CFO and IRO

Ruben, good afternoon too. Fred talked about Capex and what is most important in terms of cash generation and leverage reduction is first, we do not give guidance, but we are constantly working in terms of showing the evolution of operating profitability that you saw.

And in addition to operating profitability and Capex, another super important part is always working capital. Last year we improved our working capital considerably, we reduced inventory turnover emphatically, as we already mentioned, and this year, our forecast is to continue to evolve inventory turnover. Now, in a scenario of sales growth, it is even easier to improve inventory turnover. We have a very low breakout level, Fabrício said, and a great level of assertiveness and quality of inventories. We will continue to pursue improvements in inventory turnover.

On the supplier's side, we have an average term that is already quite healthy. We want that the supplier always has a balance with its inventory here. Currently, as we have evolved inventory turnover, we can even maintain the average purchase term at the healthy level that we already have, and this contributes to the cash generation.

And finally, I think another important component this year is the tax monetization part as well. Last year, with the return of DIFAL this year, we have more taxes to pay and consequently it is also easier to offset the taxes that we already have in assets. It is a year for us to evolve working capital again in all aspects, mainly in terms of inventory, taxes and also the supplier. We are very optimistic about the cash generation for the year, with the evolution of our net cash position, so to speak, throughout the year. Thank you, Ruben.

Fred Trajano – CEO

And about the 3P question, we made the disclosure, it is 3P there, there it is a typical economics of a 3P - I am not saying that it is Magalu - but I am making a rationale for how the unit economics of categories are more, of higher tickets and the unit economics of smaller categories. Of course, everyone can have their discrepancy, I am making an approximation, but it is important that the market has this vision. It is in the case of 3P; there is a take rate etc., that is the opening that we put.

Ruben Couto - Santander

Great, thanks.

Vanessa Rossini - IR Manager

Thanks for your question, Ruben. Our next question comes from Thiago Macruz from Itaú BBA. Thiago, please go ahead.

Let's continue with the questions, Macruz, then we return to yours.

Our next question comes from Danniela Eiger from XP Investimentos. Dani, please go ahead.

Danniela Eiger - XP Investimentos

Hi, good morning, almost good afternoon, everyone. Thank you for taking my questions. I have two, one I am just going to come back to understand a little about possible impacts. Fred - and I know that you commented that everything you had to say about the material fact is there, but I just wanted to understand something that was not clear exactly what is being sought, what exactly was the complaint in relation to this irregularity.

According to our reading and interpretation, it was very much for the buyer or distributor with the supplier, and this would not have a financial impact on Magalu. Therefore, it is more important to understand if the possible impact is perhaps the dismissal of an employee or if there was something that could possibly be seen in the numbers, which was not very clear. It would be amazing If you can and have some kind of detail on that.

And then my second one - about business - my question is about the dynamics of the margin. Fred, you said that it is good that everyone is rational now also in the marketplace, and then what I would like to understand is how you are seeing the margin dynamics for the year. You said that, if I am not mistaken, in the last quarter's call that you expected this margin to exceed 6%, this quarter was not the case.

I want to understand how we can think about this evolution, and even about your strategy in this sense, because with the macro as it is, we still see a very fragile consumer, so sometimes not prioritizing this expansion of margin at that moment to gain share may suddenly make sense to you. It will help to understand this margin equalization and growth in the short term. Thank you.

Fred Trajano – CEO

Dani, thanks for the questions. On the subject it is obvious that when you have a topic like this, the more details and information you can pass on the better - as long as you have it. If you do not have it, passing any kind of detail and information to me is irresponsible.

Thus, we have to stick to what we know. The material fact is very specific in relation to all the possible developments that would be investigated. For the time being, it arrived on the eve of our publication, imagine what that day was like for publication, in short, it is too early to say anything that is not linked to the material fact. If I had it, I would love to put it, because it eliminates uncertainty, reduces any possibility of misinterpretation.

What we put is what we knew, which are mentioned in the complaint are three distributors - not suppliers - distributors that the total sum of last year's purchases represents 3.5%. In terms of proportion, it is the only thing I can say in that sense. I cannot talk about developments now. As I said at the beginning, let's stick to what is there and when we finish the work, we will present it.

On the issue of margins, we evolved substantially throughout the year, I presented to you. The 4th quarter was not more than 6 just because it is Black's quarter, so they always have lower margins, however, if you put a quarter against a quarter of the year before last, it was the biggest margin expansion we had in the quarter, which is quarter against quarter of last year.

Our focus continues to be on increasing margins. For example, a lot of people ask me now: Considering this current competitive scenario, do you want to gain market share? And my answer is "no" because interest rates are still high. The main focus is that we will gain share - as we have been gaining - but not giving up margin. The main focus continues to be for the team to increase margins - remembering that we had, there is a challenge in the 1st quarter which is the pass on of DIFAL, therefore, especially in the 1st quarter, it was the most challenging and for us. Due to this less competitive or more rational scenario, we managed to do this in a satisfactory way, which is more or less what we had planned for the quarter. As of the 2nd quarter, 3rd quarter - but continuing to gain share. As of 2nd quarter, 3rd quarter and 4th quarter, I am very positive that, in addition to the DIFAL pass on, there will be even greater gains in share without loss of profitability.

We always want to bring our EBITDA margins to historic levels. I already mentioned some of the things we are doing. I spoke about 3P and Ads; Beto spoke emphatically about Fintech. LuizaCred contributed negatively to our margin last year and it always - always - happens in counter cycles. As short-term NPLs improve, it tends to be positive. It has more positive years than with one or the other in a negative crisis, so I think we are positive to continue improving the numbers going forward and getting closer to historical operating margins, while this interest rate situation is still not defined assertively downwards.

Danniela Eiger - XP Investimentos

And just a follow up in that sense: Is this strategy homogeneous among the different categories? My question is because we also cover the SBF group and they commented on a very competitive scenario in terms of sports, and then finally we thought that one of the players that would make sense to bother them in terms of relevance would be Netshoes. I want to understand if this is more headed at white goods, electronics that have a slightly more pressured margin, or if this strategy is in all these categories.

Fred Trajano – CEO

No, in all categories, including Netshoes, DIFAL has a relevant impact, so there was actually an increase in pricing. We are not very aggressive in Netshoes in that sense. We had to pass on the tax too, because practically all of Netshoes' sales were from the Extrema DC - substantially interstate. Such competitiveness did not start with us.

Danniela Eiger - XP Investimentos

Great, thank you.

Vanessa Rossini - IR Manager

Thanks for the questions, Dani. Shall we go back to Macruz's question?

Thiago Macruz - Itaú BBA

Everyone, sorry for the technical problem. I would like to understand the difference in economics between fulfillment and the 3P option via omnichannel. How should we understand this situation? If fulfillment gains a little more representation in the whole - and it should gain - should we read this as positive for economics? Would it be better if it was through 3P? How are you thinking about this within the company? Thanks, everybody.

Fred Trajano – CEO

Thiago, yes, when we start charging for fulfillment, because then we charge the seller the costs of operating the DCs and moving the goods, and then obviously how the goods leave the DC already for a network that serves 1P and physical store, the cost is marginal for us, so for us it tends to be much more positive than when we go to collect the merchandise at the seller, which then we have the cost of the collection that adds cost to the 3P.

But even though we are still not charging - considering our cost at the DC - I am already paying rent, having the operating cost, having the team there, the truck is already leaving to make deliveries in the cities, and it already has the route to the store when it in-store pickup, so it is positive in the sense that it increases our conversion. We obviously have to operate, there is just a little increase in the number of people at the DC operating the goods - but it tends to, once penetration increases and we manage to charge, economics tends to be better due to the way we set up fulfillment, which is piggybacking on 1P DCs and taking advantage of multichannel synergies.

Thiago Macruz - Itaú BBA

Perfect Fred. It makes a lot of sense. Thank you all.

Vanessa Rossini - IR Manager

Thanks for the question, Macruz. Our next question comes from Vinícius Strano from UBS bank. Vinicius, please go ahead.

Vinícius Strano - UBS

Hello, good morning. Thank you for taking my question. The question is about fulfillment. If you could talk more about the road map on fulfillment, both in logistical investment and also this subsidy for fulfillment. And how can we think of this evolving throughout the year.

And one more question on the tax side: apart from the DIFAL that has already been passed on, is there any other tax issue that you have been paying more attention to as a source of concern and any strategy that you may have to mitigate it? It would be great if you could comment on that. Thank you all.

Fred Trajano – CEO

Fulfillment and investment, as I said, with the 30-day inventory reduction in the 1P and our focus is on the growth of the 3P, we have an idle capacity in the DCs which means that virtually all of the investment we make is in platform, and the key point is to get state registrations to do this. There is a lot of technology and bureaucracy to be able to expand it, less investment in physical assets alone.

So, it concerns more Fatala's team. Even in technology, we have made precise investments. We are not open to everyone, and without a doubt one of the areas in which we have been more flexible in terms of hiring is the logistics, logtech, technology team that develops the platforms.

Our platform is already pretty cool, but there are some improvements for self-service fulfillment, there are some things that we actually evolved, but there are still things to improve, to facilitate the seller's operation. It is very much in technology in that sense of investment.

About tax aspects, Roberto, do you want to comment on something?

Roberto Belissimo Rodrigues – CFO and IRO

Good afternoon, Vinicius. No, the biggest tax change we had was DIFAL, which we have already mentioned emphatically, remembering that in addition to the pass on, we have the benefit of having DCs in all regions, having delivery from the store, having the multichannel operation and faster delivery from the store and from the DC closest to the customer, so we also have an advantage in that regard.

There are some topics that are being discussed nationally, which are public, including tax reform - but we do not have any additional information that is public on this topic. We are working with these topics that we have already talked about and are confident in the monetization of taxes throughout this year as well. Thank you, Vinicius.

Vinícius Strano - UBS

Great, thanks.

Vanessa Rossini - IR Manager

Thanks for the question, Vinicius. Our next question comes from Felipe Rached from Goldman Sachs. Felipe, please go ahead.

Felipe Rached - Goldman Sachs

Hi, good afternoon, everyone, how are you? Can you hear me?

Vanessa Rossini - IR Manager

Yes, we heard you right.

Felipe Rached - Goldman Sachs

Thanks, Vanessa. There are two follow ups here on my side. I would like to ask first about LuizaCred, how is the risk appetite in 2023 and how are you already seeing the default behavior?

And then a second question on another subject. Could you talk more about the roadmap for Ads, especially what capabilities you think still need to be developed which will allow you to increase this penetration over GMV. I think that is it. Thank you all.

Roberto Belissimo Rodrigues – CFO and IRO

Good afternoon, Rached. I will start talking about LuizaCred. Every month, we observe the crops extensively, and the most recent crops have had a better default performance, considering that we started to reduce the granting at the end of 2021, beginning of 2022 and we even made some adjustments in mid-2022. Since then, we have kept the granting practically stable, focusing emphatically on the pre-approved customer, the customer of our app, the pre-approved customer in our store, which is extremely important. That is why we have been able to keep the base stable, despite some defaults in Brazil as a whole.

January, December and January had a relatively excellent default; February was a little different even because of the carnival that Fred mentioned before; and we foresee an evolution, a positive trend throughout the year as well, both for the short-term NPL, which should continue to evolve, and the long-term NPL, which according to our forecasts should stabilize soon and start to fall, probably end the year at around 9%, for example - it is not a guidance, but it is an indication that we have today - with a slight expansion also in the customer base, not yet changing the approval rate much, but always making improvements looking to get the best client, get the pre-approved client, convert more clients with less risk.

We are optimistic for LuizaCred's result as well, for its evolution, especially mid-year to the end of the year, whether with revenue growth again. LuizaCred's efficiency ratio is already great and continues to evolve; it is one of the most efficient that we know of, which may arrive - in a few months - below 30% efficiency ratio, which is a benchmark. Default may improve and the cost of funding may improve as the CDI starts to drop as well. We are very optimistic for the result, for the evolution of LuizaCred's results throughout this year, and even more so for next year.

Eduardo Galanternick – Business VP

Good afternoon, Rached. I am Eduardo Galanternick. I will answer about Ads. I think 2022 was a year in which we delivered the core Ads platform, so all the ad systems are there, billing, recommendations, placement, everything is there.

What do we need? What is our focus now? It is in the evolution of it. We have evolutions, whether it be dynamic pricing algorithms for CPC, matching algorithms between ads and the audiences that are there, so that as we improve this, we will deliver more results to advertisers and naturally capture more investments from them, from this share of media investments.

We are quite confident that the main platform is ready and now it is an operational task. On the one hand, improve technically, evolve in the delivery of results, on the other, commercially, have more action on both sellers, brands and suppliers. We are quite confident that this is one of the main drivers of the company's profitability growth, not only in the long term but starting this year.

Felipe Rached - Goldman Sachs

Perfect, it was clarifying.

Vanessa Rossini - IR Manager

Thanks for the question, Rached. We are now closing the question-and-answer session. I would like to turn the floor over to Frederico Trajano for his final remarks. Fred, the floor is all yours.

Fred Trajano – CEO

Thank you very much everyone for participating in the call and have a good afternoon.

Vanessa Rossini - IR Manager

We appreciate everyone's participation and have a nice day.