CONFERENCE CALL TRANSCRIPT
2Q17 Results
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Operator:

Good morning, ladies and gentlemen. Thank you for waiting. Welcome to Magazine Luiza Second Quarter 2017 Earnings Conference Call.

(Operator Instructions) At this moment, all participants are connected only as listeners and, later on, we will follow to the Q&A section, when futher instructions will be provided to all. In case of help needed during the audioconference, please, request the operator's help by dialing asterisk zero (*0).

Now we turn the conference over to Mr. FredericoTrajano, CEO of Magazine Luiza. Mr. Trajano, you have the floor.

Frederico Trajano:

Good morning, everyone. Thank you for joining us for our conference call related to the earnings of the second quarter 2017. Today, I have all the management of the group with me, and we'll all be here to take your questions at the end of our presentation. Roberto Bellissimo, our CFO, is here with me.

Like I said, in the previous quarter, my expectation about the second quarter of this year was of as good earnings as we had in the first quarter. We ended the first quarter call talking about this, but it was even better, actually.

We posted figures even more robust in nearly all the lines in which the first quarter was already very positive. And at the end of the day, we posted the highest quarterly net income ever since the IPO, so the highest in the track record of the company.

We were already very confident about the quarter, vis-à-vis the moment of the company. Retail relies heavily on a very well-designed strategy but also a very good team, and our team is going in a very positive performance phase, a lot of inspiration, hard work and a lot of balance in the performance and implementation in our figures, strategies and the search for operating indicators as well.

However, in addition, we also had more robust economy than I personally expected. And we'll highlight PMC/IBGE in April, particularly in May. Our category in May, went up 3.8% vis-à-vis May of the previous year PMC. For me, that is one of the most robust retail sale indicators we have available in Brazil, and pretty much due to economy that has already immunized, so to speak, about the Brazilian crisis, the political crisis, and at the same time, also owing to the capital injection stemming from inactive FGTS accounts.

So we have to highlight that there is a pent-up demand, and if you inject money in the economy, people want to start buying again. The penetration of products in Brazil is very low compared to other countries in the world, and when Brazilians have extra money in the pocket, they want to buy things, they want to make their dreams come true. And in our industry, when there is a crisis, it is the first to be affected but the first to recover when we have an upturn. So this quarter, we also had a recovery effect exceeding our expectation and also with beneficial results.

When it comes to microeconomics, the rationale of streamlining both online competitors and also offline was maintained. So we see players that are more rational, some still struggling cash wise, and being forced therefore, to adopt commercial policies in a sustainable manner, which was always Magazine Luiza's philosophy.

When everybody plays the same rules of the game, the team that has a more robust strategy model - which I believe is what we have, human service platforms with an equiated execution - this player, at the end of the day, is above other players under the same conditions in terms of strategy and execution in-house and that's why we benefit. I believe that's a structure characteristic that we expect to see in future quarters, competition wise, and we also like to work and operate under this philosophy and context.

A major highlight -- well, actually we had several highlights in our bottom line. I'll be mentioning by channel. E-commerce persists, driving our growth quite a lot. Growth of 55% vis-à-vis the previous year, very solid, robust growth already happening for many quarters.

And I also highlight sales by mobile apps. We had our app with a lot of share in this growth, over 6 million downloads. More than 50% of our traffic is already mobile, both from apps and also our website. The bulk of our sales already stem from our apps -- mobile apps and devices. And we're going to launch 2 interesting items in this regard.

Free navigation.We are just about to launch it. We believe that this has come to stay. We believe the future of e-commerce will be mobile, so we're launching now navigation to our customers who are buying 3G, 4G, Eduardo is going to talk more about it later.

And e-commerce also benefited from store pickup available in a 100% of our operations of our stores today. And products that are eligible, very high, we improved in our DC, ensuring that more customers will benefit. And in several stores, we have just 1-day delivery time for store pickup and extending to other units as well, but the vast majority is focused on 48-hours delivery time to buy online and have store pickup. There is no shipping fee, so that's a benefit and a huge advantage to customers.

And in store pickup, we also have something new, we're launching a partnership with 99Taxi, which is a cab app for transportation in general, and it gives a bonus of BRL 20. A BRL 20 coupon for our customers to use to store pickup purposes. So can have up to BRL 10 with a cab to go to the store and then go home. So there will be no additional cost to go for the store to pick up the goods. It's a very innovative partnership, and Eduardo is going to give more detail with the partnership with Brazil and 99 cab, the app, but I wanted to announce it right off.

In e-commerce, we had an increase in traffic and conversion, so I see that as a very sound and healthy strategy. And we highlight new channels, particularly Magazine Você, which added more than 100,000 stores with more than 500 stores in total with very high sales growth.

And it also highlights something very important, we grew 55% in e-commerce and we have the best historical levels of customer service and -- customer service at [RA 1000]. So growing 55% with a very-balanced operation is really tough, but our logistics, our team of development also worked hard to improve integrations in the platform. And also, our order tracking system, information available to customers and the purchase experience both pre and after sales, the service team, so everybody is fine-tuned, so we congratulate them on the business volume driven by the sales area with very positive levels of service.

Looking at the stores situation, there’s also one big highlight.A sales growth of 15%, very robust figures. Double-digit growth in all departments of the company: South, Southeast, Midwest, Virtual, Northeast, many regions, the Greater São Paulo as well, results were really positive. But I also highlight the performance in the Northeast region, double-digit growth, very high growth. Also Virtual stores growth in small cities with amazing performance for many years, performing really great. Very -- a very great model, and we can see the results of this model for a while now. And at the same time, this quarter, well, smartphones was not the only star, we also had white line, great numbers; smart TVs with very positive growth in our TV line this quarter; and furniture also recovering well. So when it comes to different departments and regions, we have a very balanced and well-distributed growth, and we are even more confident for the future.

For brick-and-mortars, we have an expansion since last year. Now we are accelerating our expansion, 27 new stores for the last 12 months in our group of stores. This quarter alone, we opened another 12 stores, so really accelerating the expansion pace. We firmly believe the multichannel model and the store is a very important point of contact with our consumer, supporting the website growth, giving options like store pickup and with a local network to deliver, to have home delivery in the end consumer, last mile delivery. So it's very important to match e-commerce with brick-and-mortar stores, and it's important to improve the number of stores. We have 5,000 municipalities in Brazil, about -- we still have a long way to go, tapping into new markets. And now that we have an economic upturn, we want to expand with more digitized lean stores.

Speaking of digital transformation stores, we keep on implementing IT efforts to digitize stores, it is a pillar of our strategy. We already concluded mobile sales in all stores, and now we're about to conclude the implementation of the stockist mobile for the team that works at the store back office, working on inventory and also the implementation of store pickup. So we have the right tool, stores available to provide good service. We have stockist mobile in our stores, and now we have the Pinpad, Mobile Pinpad, so the seller can get the order and the credit card data so we can close the sale in less than 2 minutes compared to 45 minutes in the past, greatly improving productivity in our group of stores and improving consumer experience as well.

So Pinpad is in nearly 200 stores and we are about to have in all 800 stores implemented by year-end, which is our goal for mobile sales at the store level. We also have several digital inclusion services available to support our customers who are buying IT to better use technology. Fabrício Garcia is going to give you more detail later on.

Definitely, well look, [Conecta], it is an installation service that is being very successful, very high acceptance rates at the store. All devices have the setup, the installation. And when customers go home, they can also call our call center for additional support, so in addition to the WiFi plan with carriers in many different areas in Brazil.

And we also launched the after-sales plan in mobile sales with our carriers, telephone carriers. So if you want to buy a postpaid model at Magazine Luiza, we are very much focused on providing good data plan, so that through mobile phase you can do it in less than 2 minutes. So we think we are going to have a sales leap postpaid of all telephone carriers due to a digital sales process at a point of sale, and Fabrício is going to share that later on.

I think we also evolved a lot when it comes to logistic. I've talked about the level of service and reduction of delivery time at a store, we also have a lot of room and fruit to reap. And we're also increasing the e-commerce volume, brick-and-mortars, without increasing logistic space, owing to the right efforts of kaizen and continuous improvement. And also lean manufacturing, we are implementing these for logistic purposes in all our DCs, and greatly improving the productivity per square meter and, by logistics, operators in our DCs. So we greatly leverage our results owing to this improvement in management logistics in a very remarkable manner and also maintaining high level of service, and also, shorter delivery times.

And last but not least, Marketplace, a highlight e-commerce growth where we don't report GMV yet. GMV, well, we could be reporting, but first we want to focus on our platform. We don't want to give too many information, but it's very robust. We have more than 250 sellers and 550,000 SKUs available to our consumers. It took us 60 years to get to 50,000 SKUs, and in less than 1 year since we launched the platform, Marketplace platform, we reached 550,000 SKUs available through our consumers. So now we are very excited with Marketplace implementation. And I highlight that we're doing that, well as we always do, in a very consistent manner.

So the level of service of Marketplace today is nearly as good as the level of service at e-commerce. Our very positive numbers for marketplace as well,and our NPL seller, we are one of -- when it comes to platforms, we have the best assessment by sellers involved, and this has a lot to do with the acquisition and integration of Integra Commerce startup from Minas Gerais, with a lot of usability, easy integration for the seller in Magazine Luiza's platform.

Any seller interested to be integrated uses Integra Commerce. And automatically if -- well, because we have a hub, if you want to connect with another Marketplace, the option is available. So Integra commerce has greatly helped us to expedite the implementation of new sellers and also improve the level of service, but we still have many things to work on. And we are even above our expectations when it comes to the expansion growth of Marketplace.

Another highlight is our corporate governance, the addition of 2 members in our Board of Directors: BetaniaTanure, is one of the main professionals in personnel management in Brazil, very close to Dom Cabral Foundation; and Silvio Meira, one of the experts in IT in Brazil, where the innovation center in SEC, one of the founding members and in charge of the Federal University of Pernambuco’s success in IT engineering. So great members to our board giving more support.

And in the compliance area, very robusted in the current world, well, we are more susceptible to problems of compliance, every company is more successful -- susceptive. And our board wanted to have a compliance area with experienced, seasoned professionals, so we welcome it very, very positively.

And as to our brand, we launched the second season of the reality show, Digital Mission, partnering with Globo (TV). A reality show with 12 episodes in which we get a family at the store and we turn it into a digital family. We launched in July, and we have a great repercussion of the program. And it's part of our purpose to help Brazilian families to better use technology, ordinary Brazilian citizens, not those who are experts in technology. And now, we're back in Dança dos Famosos, wich will be starting next sunday on Faustão's show (tv show) benefiting from the economic upturn to strengthen our brand, always very much focused on a digital platform with human interface, which is our model, but also digital channels.

Once again, I congratulate Magazine Luiza's teams for the performance this quarter, and I also thank all the shareholders and partners for the support in the first part of the year. And now I turn the floor over to Roberto.

Roberto Bellissimo:

Good morning, everyone. Let us begin our presentation on Slide #2. We will have the main highlights -- financial highlights. Sales growth 26% this quarter compared to 5% in the market, very significant market share gain. In e-commerce, 55% growth compared to 12% in the market also even higher market share growth. E-commerce 28% of our total sales excluding Marketplace, a very high share in our total sales. We grew a lot in our gross profit. The gross margin went slightly down basically due to the change in the mix owing to faster growth of e-commerce, but this margin was fully offset by dilution of expenses, which was very strong, of 2.1 percentage points. And our SG&A level is again around 22%, certainly one of the lowest SG&A levels in retail. Our expense level increased 15% versus 26% of net revenue, so the operating leverage was very high.

EBITDA increased 45%. We had our highest EBITDA margin on a quarterly basis of our track record, 8.7%, and net income was the highest of our track record at BRL 72 million, ROE of 40%.

In addition, we also highlight cash generation this quarter. We greatly improved our working capital, reduced our net debt at 12 months, nearly BRL 600 million, a very low level, only BRL 268 million, the lowest level since our IPO. And this net debt over adjusted EBITDA is the lowest of our history, 0.3x EBITDA. Cash generation this quarter. Operating cash was almost BRL 400 million this quarter, and for the last 12 months, operating cash flow was BRL 950 million. Therefore, improved cash generation that was very robust.

And another highlight, Luizacred, it keeps on reducing delinquency, growing sales, improving the portfolio, which is very healthy, and also improving income compared to last year despite lower interest rates for revolving credit. Since April, we lowered revolving credit from 15,90% to 9,90%, and despite of that, Luizacred managed to improve income and profit.

On the next slide, Slide #3, we show the evolution in the number of stores, 27 stores opened last year. We highlight the second quarter and also growth in investment, both on a quarterly basis and the first half of the year, increasing investment in over 50% vis-à-vis last year. We highlight IT, which accounts for nearly half of our investments in line with our strategies.

On Slide #4, we show the performance of gross revenue, the sixth quarter in a row that we grow at a higher rate, 26% on a base that was higher, 5% last year. And e-commerce keeps on growing at a very high pace, also over a base that was already very high.

On Slide #5, we show the performance of gross margin. There was a slight drop, like I said before, due to the mix effect. And an important highlight is the level of operating expenses. We diluted selling expenses and SG&A expenses. G&A expenses, for instance, increased only 6.5% this quarter. This stems from ZBB and EMM, expense management matrix, as to selling expenses we greatly diluted personnel expenses. This has to do with digital transformation of brick-and-mortar stores; the implementation of mobile sales, which increased, a lot, productivity by seller; and also store pickups, which helped us to reduce shipping expenses. Overall speaking, we reduced 2 points in expenses, one of the best reductions we had in our expenses. As to equity income Luizacred, 8% higher, Luizaseg 16% higher, also contributing to the total results.

Now on the next slide, we talk about EBITDA. Evolution of 1.1 point .So basically we lost 1 point in the margin but had 2 points in expenses. We went up from 7.6% to 8.7%, reaching EBITDA of BRL 236 million, 45% growth in EBITDA vis-à-vis last year.

On Slide #7, a couple of comments on financial results. We also had a very good evolution. Percentage of financial expenses went down from 5.4% to 3.7%, a dilution of 1.7%. And part of it was in the prepaid interest account, pretty much related to the CDI drop. But the other part, which has to do with debt service, went down 1 point, 1.9% to 0.9% of net revenue, and this is very much related to a reduction of our net debt and also CDI.

As to net debt, you can see reduction was BRL 587 million in 12 months for 0.3x EBITDA. It went down last 12 months and also went down this quarter, BRL 444 million to BRL 268 million. And this is after payment of dividends and stock buyback last year, so total cash generation was very strong and a lot influenced by improved working capital as well. Over 12 months, it improved BRL 516 million. Including improved inventory turnover, we reduced 11 days of inventory turnover this quarter to 69 days. I also highlight, that's a very good turnover, one of the best in retail as well. And at the same time, we managed to increase average purchase time in a very sound, sustainable manner.

But not only for inventory and suppliers, we improved nearly all accounts of working capital. We also highlight reduction in tax. Our recoverable tax account, once again, amounted to BRL 100 million for the last 12 months. So considering all of that, improving results, EBITDA, working capital, we managed to reduce our financial expenses, net debt, and consequently, we improved our net income.

On Slide #8, we show the growth of net income, BRL 10 million to BRL 72 million. In the release, we also had a disclosure about the return on invested capital. On a quarterly basis, we show, as of now, the ROE, and we also greatly improved our ROE to a level of 30% -- ROI 30%, and ROE almost 40%.

On Page 9, we show Luizacred figures. Once again, a lot of increase expediting growth, 26% revenue. The portfolio also increased and NPL had a dramatic drop, provisions also decrease a lot. So Luizacred, despite lower interest rates, managed to save when it comes to provision expanding, funding costs with higher profit compared to last year.

So these were the main highlights, the main financial highlights. And on Slide #11, we have the outlook for the future. And I will give the floor back to Frederico.

Frederico Trajano:

So let us move straight ahead to the Q&A, and then we can talk about the outlook for 2017.

QUESTIONS & ANSWERS SESSION

Operator:

Ladies and gentlemen, we'll start the Q&A section. To ask a question, please, dial asterisk 1 (*1). To withdraw the question off the list, dial asterisk 2 (*2).

The first question is from Fábio Monteiro from BTG Pactual.

Fábio Monteiro:

Good morning everyone. Analyst I have 2 questions. The first question -- well Fred, you talked about streamlined market in online, offline, a more rational approach. I would like you to elaborate a little bit more, in which fronts do envisage or do you see this rational approach, both online and offline? Do you consider an average price rise or reduction in price concerning market players? And when it comes to shipping and installments, could you give us some flavor?

And the second question is about Marketplace. Fred, you also talked about it already, but I'd like to better understand the level of service part. I know Marketplace is relatively small, but in your opinion, what are the major challenges to maintain the level of service? And can Marketplace, this year, reach 5% of GMV online? Basically, these are my questions. Thank you very much.

Frederico Trajano:

Thank you for your question. When it comes to the rational approach in the market, streamlining approach, there are 2 facets. The players that use to operate with very low margin which were not enough to pay their expenses, their operating expenses, a lot of these players eventually filed for Chapter 11, went out of business or shut down their stores. And other players used to run their business at low margins but are still managing to survive but having a hard time, and they to show more robust margins for their shareholders or to the financial institutions which support them. So in this regard, well, by and large, we see more rational policies for prices and mostly for installments. So an attempt by everyone to charge the price that is necessary to be charged for the operation to be sustainable, not expensive price, high margin, but just enough to pay G&A or to -- for cash generation purposes. That's what I refer to as sustainable and rational. So we feel some rational pricing strategy, balanced strategy, but that's not the reason why average price is going up. But I don't see striking differences in terms of commercial practices and policies. It happened in the past.

It happened more online rather than off-line. In online, our operations used to charge prices below the cost. Pricing the merchandise below the cost, they will buy from suppliers, and we've talked about that already, right? I talked to you about this many times, so this no longer happens. And in online, for many players, there was significant new pricing, not at high levels but minimum levels, just to balance the operation, our EBITDA or not so negative result. But I don't see this changing, because it makes no sense, running the business or selling for a lower price than you buy from suppliers.

So for online mostly, we saw that happening, but because our model, the cost structure online in our case is shared with brick-and-mortar store. Therefore, lower compared to players who are online only, then our model is more superior and sustainable over time and then we greatly benefit, many quarters in a row, from this model that is simply better. I say that, to make money in Brazilian e-commerce, there are only 2 ways, there is not a third way. Either you're multichannel or you are Marketplace. Ideally, this is what we're doing, we want to have a multichannel Marketplace.

So answering your second question already. Our strategy is to be a digital platform or brick-and-mortar store and human interface. And to provide a good level of service, it is very important that everything that we have is a point of uniqueness available for e-commerce and brick-and-mortar store. For instance, store pickup, the store network, it has to be available for the seller as well. So we are investing a lot to enable our network which supports brick-and-mortar and e-commerce to work with sellers too, being some of them Fullfilment by Magazine Luiza and the store pickup avaible for sellers. They are all projects that we're focusing very heavily for next year.

But even in the short term, when it comes to level of service, as we have a profitable operation, a balanced online operation, we are not desperately jumping to the marketplace. This is a consistent jumping, since it does not rely on the marketplace to be profitable. The marketplace is just to improve our profit and not to save our operation, so we're doing this very consistently. Today, we are the most prudent retailer for inbound seller. Then, we get the clearance certificate, a lot of red tape just to have the right people inside and we have been significantly investing in IT, monitoring and tracking, so that if someone enters, well, we can remove this seller who entered, and even though it went through all these filters, or we sometimes put them on standby and we disable his listings, but when he uses, we also have their seller score, for instance. If the seller score is low, we disable to have the right level of service. As this is not a desperate move, but rather very consistent, solid move, we have been careful in order not to harm our greatest asset, which is customer relationship.

Fábio Monteiro:

Okay, Fred. Thank you very much.

Frederico Trajano:

You're welcome. Thank you for the question.

Operator:

Our next question is from Richard Cathcart, Bradesco.

Richard Cathcart:

Good morning, I have 2 questions. The first question is about improved inventory days and how you manage to achieve that? Mostly stores? DC? Or a little bit of both? And we wonder if we expect to see improvement in the future quarters?

Second question. Frederico, could you elaborate more about Magazine Luiza's strategies for Black Friday? I know we still have 3 months down the road, but possibly you already have the planning. So what are your thoughts about how consumers may react to Black Friday this year? Thank you.

Frederico Trajano:

Good morning, Richard, thank you for your question. Roberto is going to answer the question about inventory.

Roberto Belissimo:

Morning, Richard, thank you for your question. About inventories, what I can say is that we managed to improve in both channels. Turnover in brick-and-mortar stores improved a lot, but e-commerce has an even better turnover compared to brick-and-mortar stores, naturally because we don't have inventory in the store display, everything is centralized into DC. So our e-commerce turnover is around 50 days, for instance, which is a very efficient inventory turnover level. And as e-commerce grows faster than brick-and-mortar stores, it also drives the average down.

But despite of that, we improved our turnover in e-commerce and also brick-and-mortar stores. And at stores level, this is also related to sales growth, which also supports. So inventory turnover at stores improved as sales went up and also owing into internal processes developed for supply purposes with more accuracy. So the turnover trend is very positive. Average purchase term for both channels is similar -- the time is similar. So as e-commerce grows, we tend to drive average turnover downwards and maintain average purchase time equal. So working capital dynamic trends is very positive for us in inventories versus consumers. Fabrício and Eduardo is going -- are going to talk about Black Friday.

Fabrício Bittar:

Good morning Richard, Fabrício speaking. We're already working on Black Friday. We expect to have a good last quarter. And it is critical to have Black Friday as a good event, so we're working a lot with our suppliers. As usual, the categories that may stand out at Black Friday are white line and IT items. So we're working on it, we expect to see an increase in our inventory in October to support the campaign, I believe it will be in late November.

Eduardo Galanternick:

Richard, Eduardo speaking. Thank you for your question. By and large, this is the most challenging time of the year for us. We'll be facing a base of last year of 40% growth, which we had in the last quarter, and we're very confident about what we are planning to do. There are 3 phases that are pretty well set. First, November, before Black Friday, how can we sustain the growth -- the strong growth, exceeding any kind of pent-up action and then we have Black Friday. And everything related to IT items, our ability to maintain a stable platform, we've been managing to do that over the years and our IT team is working heavily on this as well. And the third phase is right after Black Friday, which is a quick return to our operations, and logistics is fully dedicated as a team so we can go back delivery times as soon as possible in order to have the first -- a great first 2-week period and, therefore, a great full quarter. So we're very confident, we're planning ahead. I think this is it.

Richard Cathcart:

Alright, thank you. If I may ask a follow-up question. You talked about more rational competition, you also talked about the reduction in number of installments and more sound pricings. What about free shipping fee? One of your main competitors is increasing the level of the volume of free shipping, do you have -- what's your opinion on this? Does it make sense? Do you feel any impact?

Frederico Trajano:

No we don't feel any impact. We grew 55% this quarter, so it was even better than the first quarter. And I believe the competition started this policy in early May, so we didn't feel this effect. We have a policy of free shipping and it happens in a very clever manner.

We have this for everybody who buys via app, which makes sense at the end of the day. If you buy through the app, usually this customer is a recurrent customer, so we don't have acquisition cost to sell to him, so the shipping cost offsets. So we give free shipping for those who buy via app, we want to encourage people to buy through app, and it's very considerable. And we also have free shipping for brick-and-mortar stores.

So if you consider app plus store pickup, we have a substantial, sustainable part of our sales online, which have the free shipping, and besides sales with more profitable categories. So I prefer to have a smart free shipping policy for specific channels, specific cases, that prove to be sustainable and not so nonrecurring. Sometimes you give on a quarter and have to step back.

So this is our strategy, we’re not feeling any impact. So we'll keep on having free shipping under this model for store pickup because we're going to have even better delivery times, leveraging our multichannel and also our app, which is our bet for the year.

Richard Cathcart:

Sure, thank you very much.

Operator:

Excuse me. Our next question is from João Mamede, Santander.

João Mamede:

Hi, everybody. I have 2 questions as well. The first question, Fred, you mentioned in the presentation about Mobile Pinpad in the stores and the rollout. I think I missed the number of stores that already have Mobile Pinpad implemented out of the total.

And a follow-up question, what about the behavior of stores which already have the bulk of the initiative to mention implemented for the digital transformation, could you tell us some numbers? Sales per square meter, for instance?Or gross margin? EBITDA margin at the store compared to an old store which doesn't have everything implemented yet? Just to give us some flavor about the gain in productivity, or any other metrics under this reform -- I wouldn't say reform, but once we have these initiatives implemented.

Second point, a common topic over the last discussions with you due to the very strong cash generation mentioned by Roberto, almost BRL 1 billion of generation of operating cash in the last 12 months, the company's balance sheet today is very comfortable, and a common question is, what will happen in the future, assuming generation remains strong? Today, the current net debt is nearly 0, almost net cash. Selic is going down a lot, so leveraging when Selic is 14%, 14.5% might not make a lot of sense. But now that the debt cost is lower, what about the future? What about leverage and optimum capital structure? And what to do with so much money? Considering your CapEx is so small, you don't spend too much to keep on growing.

Frederico Trajano:

Thank you for your questions, João. With regards to productivity at the store and the model, well, there are many benefits by the way. One of them, naturally, is the increase in sales, customer satisfaction index. Because you provide a better experience to the customer at the point of sale, you tend to have customers who come back and improve conversion. And also, well, the main focus of digital transformation of store today is to improve profitability.

Nearly 70% of store costs has to do with payroll, so our main goal is to improve sales per seller. And remarkably, it is not necessarily to cut down the staff number but having more sales per person at the store. 40% of the staff is at the back office and we tend to reduce this ratio, having more people selling at the store. So in 2014, our sales were very similar to what we expect to see. Well, similar to last year, by the way. So in 2014, we had 24,000 employees, and last year, sales were equivalent with 20,000.

A lot of this gain of sale per seller came from e-commerce but also a lot from the increase of sale per total number of people at the store, because we have back-office people who did not generate sales and converting into sellers, or digital services or credit products, but particularly merchandise sales. So increasing sales by employing at the store, I cannot disclose this number, but the overall figure you can get from our release. So that's a good indicator, showing that we are increasing our productivity a lot.

And our digital transformation initiatives are not only for a couple of stores and you'll call somebody to make it digital, but rather, this for a 100% of the stores, Pinpad in these 200 stores, but we're going to roll it out for the remaining 600 stores by year-end. So we're going to have over 800 stores going digital. We don't give a guidance, how we're going to be store-wise, but 100% would be Mobile Pinpad by year-end.

By the way, we already have mobile sales in all stores and mobile stockists in not all of them but many of them. And Pinpad is particularly the seller taking the payment. For instance, if the customer goes to the website, navigates in the product and go to the store to buy the product, if he already is registered at the website, he don't have to do it again at the store. So the whole inventory of the website is available at the store, so the seller can see -- visualize all the inventory at the website. And by year-end, he'll also have a view of Marketplace and e-commerce as well, so that will improve productivity quite significantly.

When it comes to cash generation, even though we are improving quite a lot, our capital structure is not ideal. We don't have excess cash. Our current operations, João, still has financial expense of 3.7% over net expense. I consider this to be high, and low net profit. So if we consider indebtedness our company like Magazine, you have to consider bank debt, but you also have to consider receivables discount. In this regard, if we consider a broader debt scenario, or at least expenses and services from the prepaid cost, I think we still have a long way to go when it comes to reducing indebtedness and receivables discount.

João Mamede:

Alright. Thank you Fred.

Frederico Trajano:

You’re welcome.

Operator:

Excuse me. The next question is from Guilherme Assis, Brasil Plural.

Guilherme Assis:

Hi, Fred.Good morning. Thank you for choosing my question.I think you talked a lot about the sales performance already, but what about looking forward? We see more uncertainty down the road. I think you already talked about your planning for Black Friday and Christmas, but assuming FGTS, for instance, which supports you, it is just about to finish and end this week. Do you have any plans for the future and to keep on growing your sales through all channels at a very strong pace? Or should we expect to see a slowdown? What is your budget in this regard? That's one question.

And maybe, could you also talk about sales in July? July still includes FGTS, but any changes to the pace that was so strong in the second quarter?

And another question has to do with expansion. You talked a lot about store opening. The last 12 months, you opened 27 stores after some time, but not so many store openings, about 12 in the last quarter. What about the expansion pace for the future? And where do you believe there is more room to grow? Maybe more Virtual stores in smaller cities? Or any specific region, you consider to improve your footprint, for instance? I would like to better understand your strategy and your expectation for the expansion plan for brick-and-mortar stores. These are my questions. Thank you.

Frederico Trajano:

Thank you for your question, Guilherme. Well, since the beginning of the year, Guilherme, we already expected the second quarter to be not as challenging, particularly because last year, in the second quarter, we did better compared to the first quarter of last year of 2016. So the comparison base, particularly for the last quarter of the year, is more robust. So we had already budgeted smaller growth levels for the quarter regardless of macroeconomics because our comparison base is stronger in the third quarter, but particularly in the fourth quarter, both for e-commerce and brick-and-mortar stores, they had great performance in the fourth quarter of last year.

And in the budget, we expected to see a slowdown, a lower growth but still robust growth for the coming quarters. What is difficult to quantify is the impact of FGTS in the economic recovery of the last quarter. Early this year, I was more bullish about the economy of the second quarter, and I remain bullish, with interest rate reduction lower than 8% as they speak right now. And if you consider, very strong pent-up demand that may come back any time with a little bit of stimulus and initiative, I believe we have everything to have a better economy, not only in terms of share gain in the second half of the year compared to the first half of the year.

So what may offset the comparison base, the tough comparison base that we have, particularly in the last quarter, is a more robust economy, regardless of FGTS but mainly due to lower inflation rate, interest rate, which grabs less from consumers, and also better employment rates. It's hard to say anything, but I'm confident that the comparison base will be tougher.

Guilherme Assis:

Okay, Fred. And Fabrício, could you comment more on TV sales? We saw a change in the digital system in São Paulo. Do you have any plan for smart TV and the national rollout for this program? And do you believe it also helped to improve the result of the second quarter?

Fabrício Bittar:

Guilherme, Fabrício speaking. Thank you for your question. About digital TV, up till now, this only migrated in the Greater São Paulo, and now in July, in Recife. And the growth of the category was high countrywide. So we did improve demand due to the conversion in São Paulo but not in Brazil as a whole. Now we had Recife last week, in September there will be Salvador and Fortaleza; and in November, Belo Horizonte and the countryside of São Paulo; this will generate demand. But there is a pent-up demand for digital TV. From 2014 to 2016, there was a drop by half. So this category has demand, and what stood out on top of our planning were our promotions and our product availability, which was superior to our competitors. So Magazine Luiza did stand out. If you think about the Northeast and the South, we had a lot of growth in this category. We performed nicely all over the country.So we do have the demand of the conversion and also in e-commerce.

Guilherme Assis:

What about store opening?

Frederico Trajano:

Well, when it comes to opening stores, like we said in previous calls, we intend to recover our historical levels. If you think about the last 10 years, except for the 2 years of crisis, we had historical openings, about 50 stores per year. So we intend to be closer to this year compared to last year. I cannot tell precisely the number because this information is not public yet. But I mentioned in previous calls that it tends to be closer to historical levels like the one I just mentioned. So we'll be opening in all regions, all formats, always under the concept of lean stores, low operating costs, not investing so much in key money, not investing so much in civil construction, low rental fees. And by this perspective, I think it has to follow the concept of fully digital stores as well.

Guilherme Assis:

Okay. So just 1 last question Fred or Roberto. The operating leverage, you already talked about -- or you talked about the dilution effect of the gross margin and e-commerce growth, but this was more than offset with the record EBITDA margin of the company. If we consider -- we expect e-commerce to keep on growing, do you see more room for the operating leverage to remain having a positive performance? Could you give us an idea, to what extent do you think you can improve the EBITDA margin of the company through this operating leverage?

Roberto Belissimo:

Guilherme, Roberto speaking. We cannot give you any projection or guidance yet when it comes to an increase of the EBITDA margin for the future but what we can say is that there are several initiatives to keep on reducing our operating expenses, both in brick-and-mortar stores and also e-commerce. We have the opportunity to benefit from higher operating leverage in the future as we increase our sales. Just to give an idea, our rental expenses are growing very little. Per square meter, it increased 4% this quarter. So when we grow 15% same-store sales in brick-and-mortar stores and the rental per square meter increases only 4%, there is a very strong dilution. On top of that, for instance, Fred talked about the implementation of Mobile Pinpad, mobile sales. We managed to decrease the number of cashiers at the stores, 2,500 cashiers 2 years ago to about 1,500 cashiers today. So it is not even operarting leverage, it'sgain of productivity with digital transformation and also other expenses that we intend to further reduce, but it doesn't necessarily mean that there will be an increase in the margin, it could also be converted into more efficiency, better competitive edge and more sales growth, et cetera. We do have opportunities to keep on further diluting our operating expenses for sure.

Guilherme Assis:

Great. Thank you Beto.

Roberto Belissimo:

Thank you, Guilherme.

Operator:

Excuse me. Our next question is from Thiago Macruz, Itaú BBA.

Thiago Macruz:

Everybody, good morning. My question has to do with commercial dynamics. This quarter, the margin was even better year-on-year. To what extent -- well, when you come to such levels, to what extent should you invest more in competitiveness? What about this trade-off going forward? This is my question, thank you.

Frederico Trajano:

Thiago, thank you for your question. We've been managing to have high growth rates with this level of profitability. We have to work on this equation considering the margin vis-a-vis growth. We -- actually, we did not have gains but we maintain the margin per channel. And in gross margin, there a slight drop, but we gained in the operation, like I said, in the EBITDA margin. Today, we have no intention what so ever -- or we don't fore see a sudden change in the commercial policy, but we feel very confident to do it anytime. So if we see growth is going down that we're willing to have more volume and grow more, then we can make use of this strategy. It will largely depend, Thiago, on how the economy will be without FGTS and at lower interest rates. Because we don't have a precise reading, we'll like to have options, but we don't have a set commercial strategy. But it's very important to a company such as ours to have a healthy EBITDA margin because should we need, then we might have a more aggressive commercial policy to go for volume. We want to keep on growing, high growth rates, gaining market share, so we want to keep on increasing our share in the market in all channels.

Thiago Macruz:

Superclear, Fred. Thank you for your answer.

Frederico Trajano:

You're welcome. Thank you for your question.

Operator:

Excuse me. Our next question is from Maria Paula Cantusio from BB Bank of Investments.

Maria Paula Cantusio:

Good morning, everyone. Congratulations on your results and thank you for choosing my question.You said you intend to expand Magazine Luiza's logistics network to sellers, does it also include store pickup? And could you tell us more about the customer profile? Customers who buy online and have store pickup, has this been converted to additional sales to the company?

And then, I would like to talk later about Luizacred. The sales of the private card improved both in-store and out of the store and out store card lost the percentage. But when we think about the card, well, there was a drop of 3%, the financing company. Is this due to revolving credit or any other factor?

And in the last call, you also mentioned that you're doing a pilot study, a partnership with Santander similar to what you already have with Losango, could you give us an update about the ongoing status of the project? And if there is any news to share about partnerships and financial services?

Frederico Trajano:

Paula, thank you for the question. Marcelo is going to answer the questions about Luizacred, and then I'll come back to answer your first question.

Marcelo Silva:

Good morning Paula, thank you for your question. Firstly, like Roberto said, there was a significant reduction in the interest rates of revolving credit. And at the end of the day, the financial margin goes down. But we are speaking of revolving credit and the exchange for installments, and in future quarter, you'll see the result going up. Basically, we did this before, every customer that walks into the store, we show the best interest rates for financing purposes, which is, for instance, a product known as sales installment. We already have -- well, we did not depend so much on revolving credit, it's smaller compared to competitors. And what we're doing is to continue the process to support the customer to have financing at a lower interest rate. Possibly, this is the worst quarter in terms of financial margin because everything happens here this quarter without creating a higher portfolio for installments. So possibly in future quarters, you are going to have an increase in financial revenue.

The second question…We are using the same name of the Marketplace strategy. So products that we cannot have in the current platform, providing services to customers, then we use other partners to serve our customers. Every customers, who go to the stores, we want them to have the better chances of having financial services, so we want to have a store for that purpose with many possibilities to our customers. So in addition to financial products, for instance, payroll deductible loans, Santander for instance, Losango, they provide DCC. And we are creating another partnership for those customers who want to have personal loan. So we are choosing another partner, specialized in this segment, to add another possibility to our customers to finance and to be happy. In other words, to come back to the store and be happy with it. We already have the pilot study, which has proved to be very encouraging. And in future, customers will be sharing more detail about it.

Frederico Trajano:

Answering your first question, Paula. Once again, we want to be a digital multichannel platform with brick-and-mortar stores. So all those services that we made available through the website, we want to have them available through the seller, including store pickup, including the seller's ability to sell a Marketplace product. So actually we are multichannel Marketplace, and that's how we design our platform. So all areas can provide the same areas that the back office provides to e-commerce and brick-and-mortar stores, all these services will be made available for Marketplace sellers as well. We are making massive investments.

We had a big change to our structure this year, it was the integration of labs with the IT area. So André Fatala is now in charge of the whole IT area because now all the gains that we had in our digital platforms, we want to have them in our back-office platform as well, so with logistics, logistics systems that will be made available to sellers, matching payment systems. So it is important that the lab philosophy were also added to the corporate area, financial, PR, payroll, all systems, WMS, PMS, logistics, all these systems should also be there. We are no longer multichannel only, we are multichannel multi-org. So under this structure, all the services provided to internal channels should also be made available for outside channels in the IT area. Now -- and this new setting should also be available to meet the needs of all these channels.

One detail that I want to mention is that we absorb this code of our commercial PR, which was a Bematech with us. So now we absorb this code and the whole development team of our commercial area, which is the core of every retail business, is now being designed by Luiza labs under this new setting. It was a big change after several years outsourcing, now we have it in-house, the commercial PR. And now we maintain some services, outsource systems that make no sense being in-house, but we are more and more working on our new technology and our own ability to provide services in-house and create innovations to consumers.

Maria Paula Cantusio:

Thank you Fred and Marcelo.Fred, if I may, just 1 other question. Could you talk more about the customer profile that have the store pickup? I remember you mentioned before a couple of times that usually those who buy in Magazine Luiza e-commerce had a larger share of wealthier portion compared to those who went to the stores. So I wonder if these customers also use the store pickup service. And how much is converted into additional purchases when these customers go to the store for store pickup?

Frederico Trajano:

It's too early to say anything, but most of the customer who have the store pickup, never walked into the store before. They are visiting the store for the first time. And of the total number of customers for the store pickup, well, depending on the store, 20% to 30% buy an SKU or a service, installation service, for instance, or extended warranty or a supplementary purchase.

Numbers are very incipient yet, we cannot say they will remain as such in the future, but these are encouraging figures. We are further improving the conversion of customers who walk into the store to benefit more from the traffic, but this is the beauty of multichannel. I firmly believe the best way to work on e-commerce in Brazil and worldwide is a multichannel operation and preferably with a platform. That's what we're doing as well.

Maria Paula Cantusio:

Thank you everybody. Good morning.

Frederico Trajano:

Thank you.

FINAL CONSIDERATIONS

Operator:

Excuse me. This concludes the question-and-answer session. We give the floor back to Mr. FredericoTrajano for the final remarks.

Frederico Trajano:

Once again, I thank you all for joining us and congratulate our team for the excellent performance this year. And once again, I thank you all. Thank you very much indeed.

CLOSURE

Operator:

This concludes Magazine Luiza's conference call. Thank you all for joining us. Have a great day.