Local Conference Call
Magalu
Results for the 3rd Quarter of 2023
November 16, 2023

Operator

Good morning, everyone, thank you for waiting. Welcome to Magalu's conference call regarding the quarterly results. For those who need simultaneous translation, just click on the “Interpretation” button using the "globe" icon at the bottom of the screen and choose your preferred language, English or Portuguese. We would like to let you know that this event is being recorded and will be available on the company's IR website at ri.magazineluiza.com.br, where the earnings release and presentation, in Portuguese and English, can be found. The link to the presentation in English is also available in the chat.

During the presentation, all participants will have their microphones disabled. Afterward, we will start the Q&A session. To ask questions, click the “Q&A” icon at the bottom of your screen enter your name, company, and question language. Upon being announced, a prompt to activate your microphone will appear on the screen. You can then activate the microphone to ask your question. Questions received in writing will be answered later by the investor relations team.

I would now like to give the floor to Fred Trajano, CEO of Magalu. Please, Fred, you can get started.

Fred Trajano - CEO

Good morning, everyone, thank you for participating in our results code (sic) referring to 3Q23. I am here once again with the presence of the company's entire executive officer, who will be available to answer your questions at the end of our presentation. Roberto Belissimo and I will present the company and return here for the Q&A.

This quarter perfectly reflects an obvious instruction given to Magalu teams throughout the year. From a strategic point of view, this instruction was the growth of the marketplace with a corresponding increase in profitability, and from a tactical point of view, mainly for the 1P store and online team, absolute focus on increasing gross margin to offset tax increases DIFAL that we observed this year - if possible with share growth -, but not necessarily.

And when we look at the numbers for this quarter we see that we delivered exactly that, and that it ends up consolidating in numbers this orientation passed throughout the year. We had a historical gross margin of 30.4% in the quarter, the highest gross margin in the last 6 years, and yet we managed to grow 5% GMV in a market context, mainly in part of our results, our volume, which the part of durable goods, still challenging. So I consider that achieving this gross margin and still presenting a total GMV growth of 5% was a job very well done by the teams.

When we break down this 5% growth, looking at each channel specifically, we see that we grew 2% in physical stores in the quarter. In the physical store, the scenario started more challenging in the quarter in July and August and ended very well in September. We have observed in October, especially now in November, very positive store results, including this last one that we already have 15 months of November, including this last Saturday we had the best sale of the year on a Saturday - except the *sábado da liquidação fantástica* we do at the beginning of January. So we are really seeing a resurgence in physical stores. Of course, we have the basis for comparison from last year's World Cup, which makes the comparison a little more difficult, but we are reaching record levels in terms of absolute values . Monday was very good, we are also excited about what we observed both in October and at the beginning of November.

From an online point of view, we have two slightly different stories. The story of 1P is a story – as I said from the tactical point of view – of DIFAL transfers, and we managed to complete the DIFAL pass through in Magalu and a good part of the group's companies also in this quarter. We put less pressure on the teams to grow sales and gain share, focusing on ensuring they could reach the ideal margin profitability level so that from now on we can grow. We are still focusing on consolidating this in the 4Q, but certainly looking at the horizon ahead, we are sure that these volumes will grow again. Remembering that Magalu's 1P is also concentrated in durables. We have a much greater diversification in long tail in 3P, which I will discuss later. As durables tends to return with falling interest rates, it is a highly cyclical sector, a highly cyclical category, certainly 1P and stores will be sailing and we are finally seeing a little bit of a tailwind, and also in November the 1P outlook is better, but still with the prospect of consolidating the gross margin that we said we achieved in 3Q, and having a full pass-through of DIFAL in our margin.

From a strategic point of view, talking about 3P, I will address more in my presentation about this channel, which was the great highlight of the quarter. We grew 25% in 3Q, accelerating growth over 1H. If we look at the average annual growth over the last 4 years – a growth of 51% –, then the operation is growing at solid levels.

But more important than the 25% growth in GMV from 3P, is the increase in commissions and revenue. Next slide, please. We grew 44% in revenue, and when we look at the company's gross margin, Roberto will explain this better in his presentation, a good part of this growth in my gross margin came exactly from 3P and the revenue increases that are being incorporated there to our results. We have already been observing this throughout the quarters. Still, this quarter there was a very big highlight both in GMV and in the increase in revenues as well, and 3P today, the more it grows, the more share it gains in the company, the greater our profitability, the higher our operating margin. Next slide, please.

About 3P also in the 1Q: we had already addressed in the last call that in a few months 3P had already become the company's second most representative channel, surpassing the physical store, which has been in operation for over 65 years. Today our 3P has a 30% share, it has gained a lot of share and the tendency is for this share to continue to increase. It is the channel that we are investing the most in growth, and as I said, it has contributed a lot to our profitability rates in general.

Explaining this growth a little more, let's talk about the increase in sellers. We reached 323,000 sellers this quarter, growth over 2Q and growth over 3Q as well, in terms of number of offers, 114 million offers available here on our platform. We don't talk much about this, but we have greatly evolved our platform. We included some of this in our results release, it's in our presentation too. We had some very positive changes, today our sellers praise our platform a lot.

Today, for example, they can manage all their stores through the Magalu super app. The seller can use the same customer app to manage the store. In the past, they had to access a separate platform. Now, they can access the Magalu super app and do their store management, see their reputation, manage their offers. It is a huge change that makes life a lot easier for the seller, which makes the process much more fluid.

We also created *Magalu indica*, a seal, an offers program on Magalu to indicate to our customers the best offers from our sellers. So the full items – the Magalu fulfillment – are on *Magalu indica*, the items from the best reputable sellers are on *Magalu indica*. These items have the best prices on *Magalu indica*. Also, the items from Magalu's 1P, and items from group companies that sell on Magalu too, Netshoes, Kabum, Época, are *Magalu Indica*, that is, *Magalu Indica* is a seal that guarantees that our consumers have access to the best offers.

When you have 180 million offers on your platform you have to have some curation to prioritize in search, recommendations and to facilitate your customer's decision, which has helped a lot to offer what is best for our customers within our platform.

And we also launched an alternative to provide more interactivity with the customer, which is chat with the seller, in which the seller can interact with the customer, even giving coupons during this interaction. It is really a chat; not a Q&A. It is just another change to the platform. Various other platform improvements are being developed and implemented monthly. Next slide, please.

I also want to highlight – about 3P – that we have grown a lot in the base of sellers in new categories, so Magalu's diversification movement occurs mainly through 3P, and we see in the graphs presented in the company that a good part of new sellers come from new categories, and when we look at units sold, 86% of the products sold in 3P are from new categories and complementary to our 1P; when we look at GMV, it is around 52% of the group's total, including 1P as well. More than half of our online content comes from new categories. These categories will drive growth and profitability for us looking forward.

Giving an example of these categories, some families, even more specific than the categories, for example, that grew this quarter: we grew 69% in running shoes, 84% in fitness bikes, 84% in automotive tires, 63% in vacuum cleaners, 85% in lawn mowers. In other words, these are families that we are prioritizing. Families that, we believe, have a positive economic unit - generally tickets above 100, R$ 200 - in which we have customer recognition who sells quality products, we do not sell counterfeit brands' products, with Inmetro, with Anatel, in short, all the necessary conditions to sell these products. And we are always making improvements for these growing families, which is our focus, navigation improvements, marketing and publicity improvements and knowledge of our consumers' categories.

Now, I would like to talk about logistics. We had another quarter with progress in our fast delivery indicators. Today, 80% of all Magalu 3P orders go through Magalu Entregas, which is our delivery platform. If we look at 3P, 1P is a reference, deliveries in up to 2 days went from 81 to an incredible 85% in the quarter, which are 1P products that we deliver in up to 2 days. From a 3P perspective, we also made a jump of 51%. From 41% in the previous quarter to 51% in this quarter. An increase of 10 p.p. in delivery in up to 2 days in 3P, which has helped the growth of 3P, increased conversion and improved experience. The NPS of this category as well.

A highlight of this faster delivery operation in 3Q is fulfillment. Fulfillment has evolved a lot. Currently, 14% of total 3P orders go through fulfillment, 2,400 sellers are using this modality, more than 8 distribution centers enabled for this, some now in the northeast where we didn't have this option. We are sure it will grow there is a lot of sales there in that segment, in that region that is already important for 1P. About 75, 70% of all light products ordered at DC Louveira are from fulfillment already, and the seller who adheres to fulfillment has a 25% cost reduction, and their conversion increases by 25%.

The interesting thing about our fulfillment is that it is a multichannel operation. In our fulfillment, our DC is the same DC as the physical store, the same DC as 1P, and we have great benefits in multichannel, at Retira Loja. Our costs are lower because our operation shares 1P's infrastructure, so its cost is only marginal.

I also want to highlight the evolution of Magalu Ads. I apologize. Before Magalu Ads, I want to talk about physical stores and their important role in Magalu's multichannel operation. We put together a slide to show the before and after of the physical point. Many people ask me about a physical store. It is important to understand the physical store not as a purely sales channel context, but as a context of a competitive differentiator for our 1P and 3P operations.

When we look at the physical store a few years ago, 100% of the orders that passed through the physical store were sold by the physical store itself; now, when you go to a Magalu physical store, 70% of the orders that go through that physical store are not sold in the physical store. For example, orders that go through there that were from a Netshoes seller who dropped the product in the store, at a drop-off agency; a Kabum order that the customer purchased on the Kabum website and selected to pick up in store; A 3P product from Magalu that you selected to pick up at the store, that is, the store is a local support point for our ecosystem and a competitive differentiator that helps us in terms of delivery time, service level for sellers, in several other powers, that is, it is part of a larger component of ours, our strategic positioning, our sustainable competitive advantage.

I would also like to highlight Magalu Ads, talking about monetization. From a take-rate point of view, we have already reached a maximum level of pass through to sellers. From now on, monetization has to come in other ways, and these ways will come, for example, from Magalu Ads. We tripled revenue at Magalu after introducing sponsored search here in the previous quarter that I told you about, and we are also expanding Magalu Ads to all companies in our ecosystem. This quarter, we also installed Magalu Ads at Netshoes, it is the same platform that will cover all the company's channels - and the content channels too, being the first step towards expansion to all the company's channels.

And another way to monetize is our fintech. Mauad is here, he will be able to talk more about this. Despite all the market momentum, we grew fintech TPV by 20%, more than 10 billion. Currently, we have 58,000 entrepreneurs who have joined the Digital Account and are sellers receiving their sales through the Magalupay Digital Account, an account that we created for them with 500 million TPV in the account.

We also carry out the entire PIX operation for Magalu and some companies in the group also through the fintech engine: there were almost 8 million PIX transactions in 3Q, also showing how important we are. This gives us security, lower costs, and shows the importance of Magalu Pagamentos for the ecosystem as a whole.

And we launched a partnership with bitcoin so the customer could buy bitcoin from our wallet. We are having a Cyber Crypto Friday now with a discount; if you want to buy a creation, a coin in cryptocurrency via Magalu Ads you have cashback, so this is a way for us to be boosting this issue.

Before giving the floor to Beto, I would also like to highlight the performance of our subsidiaries. They also had a very big challenge in passing DIFAL through this year. For example, Época had between 8 and 10 in DIFAL to be passed through, Netshoes 7, Kabum 5 and even so, operations went very well this quarter. Mainly from the point of view of net profit, Netshoes is growing a marketplace 25% compared to last year with 21 million in net profit and leader in the category and top of mind in the category, very positive work and a better result than the 2Q; Época Cosméticos went through a complete ERP change, financially and commercially, a process that was always truly complex, difficult, and even so it managed to present a net profit in the quarter and now it is having a super positive 4Q too. A great job made by the whole team, which managed to go through this conversion successfully; and Kabum which sold 1 billion, a fantastic result of 30 million in net profit even with all the DIFAL that came in, and for the first time it entered the RA 1000 on Reclame Aqui. So the subsidiaries were great. I would also like to highlight that it has yielded positive results, that is, our subsidiaries have fulfilled what we expected of them at that time.

Finally, let's move on to the financial highlights. I wanted to quickly share with you the conclusion of the investigation process installed by the company in March this year, after the board of directors received an anonymous complaint. The investigation was absolutely rigorous, transparent and independent. There were 9 months of work conducted by PwC and Tosini Freire, a leading office in this area. The analysis concluded that the anonymous complaint is unfounded. Still, flaws were also found and reported in accounting for some bonuses, without their performance obligations being observed accurately and with the correct competence.

These flaws have already been duly corrected. The company investigates, verifies, takes measures and moves forward. I will now give the floor to Beto, our CFO, who will give more details about the conclusions of this process and the measures that the company is taking to mitigate these identified flaws. And, finally, we will go into great detail. We are also available for Q&A at the end of our presentation, thank you very much.

Roberto Belissimo Rodrigues – CFO and IRO

Good morning everyone, thank you for participating in our call. The adjustments that Fred mentioned, which in practice resulted in some anticipation of bonuses, were resubmitted, so we reviewed and rectified the results for 2022 and 1H23. These restated results are already in the pertinent accrual period that is, they are already considering all the bonuses released under CPC 47 or exactly in the pertinent accrual period. The values represented Amountsrefer solely to these releases. They refer solely to this bonus adjustment and the net impact of this adjustment is in the order of R$ 830 million on equity on June 30.

Later we will describe a little more about these values, but it is worth mentioning that there was no change in the company's cash flow, in the operating cash flow, as well as in the cash positions, debt positions, none of that; it was an adjustment specifically to this bonus account.

On the next slide we talk about measures we are adopting to mitigate and eliminate risks. First, given the implementation of a system that we are implementing and is already involving the majority of our suppliers and it is called Tradelink. Our system manages funds, and so you can have an idea, in 2022 we issued 16,000 debit notes, involving 50,000 product campaigns throughout the year. Then it was necessary for us to invest in this system, because this system validates all campaigns with acceptance from suppliers, even validates the campaign's performance, calculates total sales, for example, generates the debit note electronically, the supplier signs digitally and so on. The system is very robust, which allows us to make significant progress in this funding management process and ensure that we are launching, as we did in this 3Q, all bonus funds in their correct capacity.

In addition to systems, we also address governance mechanisms that we implemented in the sense of segregation of functions. Also, we implemented a new process in a new commercial purchasing process policy and revised the internal audit plan and routine. A series of measures aimed at improving governance and controls.

Additionally, another launch independent of the launch I mentioned about bonuses, we recognized in this quarter tax credits related to PIS Cofins on bonuses received from suppliers in previous periods until 2022, these bonuses were taxed, so here we are crediting these taxes based on a decision recent report from the STJ and in the opinion of our legal representatives, so this decision and these tax credits had a positive impact of R$ 507 million on the company's equity in this 3Q result.

On the next slide, we show some of these effects over time. The bonus adjustments represented a total of R$ 830 million, as I mentioned, in equity; they reduced the results before 2022 and the 2022 result, but it is also important to say that they improved the recent results, 1H results. Bonuses launched in 2022 were for 2023, so they improved the 1H result.

And when we include the effect of tax credits, which the accrual period was before 2022, we have an effect on equity in the period before 2022 of 189 million; in the period of 2022 of 226 million; and in the positive 1H in 93, totaling 322 million. This adjustment, again, has not been made to cash, it represents 1% of the company's assets and 3% of the company's current equity.

Moving on to the highlights, Fred has already mentioned the growth in sales, highlighting the marketplace, the increase in gross margin. Just a minute, I'm going to change microphones.

Is it better now? Moving on to the highlights... is it still low? Hello, has the sound got better? Continuing. Moving on to the highlights, we already talked about the growth of the gross margin marketplace as major highlights. Adjusted EBITDA was 5.7%, also improving compared to last year; the adjusted net income was still negative at 1.7%, but it is also important to highlight that it is an income that already reflects much lower financial expenses, falling, and also a better result than previous quarters, last year and even than the 1H too.

The total net income was positive at 331 million, including tax credits, and it is also worth highlighting that in this quarter we practically reduced non-recurring expenses. In 1H, we had non-recurring expenses of more than 100 million in each quarter. In this quarter, there were only approximately 40 million, so the total result is also much better than those of previous quarters.

On the next slide, we detail a little more about the evolution of the EBITDA margin, which increased from 5.6 to 5.7. This is where the very important effect of the increase in gross margin comes into play. The merchandise margin increased by 1 p.p., so as Fred mentioned we finished the DIFAL pass through. This increase in the merchandise margin also better reflects the balance, especially in the 1P between sales and margins. In addition to the merchandise margin, all the growth in service revenue (which exceeded R$ 1 billion in this quarter), the total service revenue grew 35%, service revenue from marketplace grew 44%, and this service revenue boosted our gross margin by 1.9 p.p., a trend that we have already talked about in previous quarters that the marketplace should increase our gross margin level as it is the fastest growing channel in the company and has the potential to continue increasing this gross margin from now on as well.

When we look at the expenses part, in this quarter we did not have a relevant dilution, in part it is due to the dynamics of the marketplace itself, which tends to increase the gross margin but tends to put a little pressure on expenses on net revenue, but then it is also important to look at GMV and the marketplace tends to dilute expenses from now on. So this quarter we had the effect of very high growth in the marketplace and a little more investment in marketing also associated with the marketplace, which again grew a lot. In the coming quarters, the trend is for the effect of the marketplace on gross margin to be greater than the effect on expenses concerning net revenue. We have already observed the month of October in this sense and disclosed in our message that October had a higher EBITDA margin level of between 6 and 7%. This is an important trend driven by the marketplace again.

On the next slide, the working capital continues to evolve. Compared to last year, we reduced more than R$ 500 million in inventories, and on the right side we highlight an important reduction in financial losses. As we said in the 1Q it was bigger, then the trend was downward, and this quarter it fell 100 million compared to last year, and compared to the beginning of the year net revenue fell from 7 to 6 to 5 now, and the trend is to continue falling in the 4Q and in the following quarters as well. This reduction in financial expenses is a consequence of working capital, a consequence of the increase in PIX, and a consequence of the reduction in expenses with anticipation of receivables.

On the next slide, it is the cash flow for the quarter, so another quarter of relevant operating cash generation of around R$ 300 million, and paid for investments and interest and leasing expenses. In this quarter, we maintained a total cash position of around R$ 8.1 billion, with emphasis here also on the increase in the portion in cash and investments, which increased from 2.5 billion to 3.3 billion, and also for the fact that we concluded the sale of Luizaseg in this current quarter and received the remaining portion of the agreement with Cardiff of over R$160 million.

On the next slide we show that we continue to have net cash. We have a gross debt of 7.4 billion, a net cash of 700 million, and 3.3 billion new in cash and investments, which compares to a short-term debt of around 3 billion. There is more cash invested than short-term debt and total cash considering receivables practically 3x the short-term debt; and long-term debt is well distributed for end-2025, end-2026.

Lastly, about Luizacred, we had another quarter of growth in revenue from Luiza cards, reaching more than 14 billion. 6.8 million active cards are growing both inside and outside Magalu.

And on the last slide, on the last two slides actually we highlight the default performance, which has also been very positive. We said we had reached a turning point in the delay indicators in June. We had a relevant reduction in defaults in both the short and long term, positively impacting Luizacred's results. This quarter has almost reached breakeven with a trend to return to profit in the short term, in the coming quarters.

And finally, we show that default rates on the DCC and the Luiza card are falling significantly, with the new harvests contributing significantly to improving the portfolio's quality indicators.

Those were the highlights, now we would like to thank you, start the question and answer session, thank you very much.

Question and Answer Session

Operator

We will now start the question and answer session. To ask questions, click the Q&A icon at the bottom of your screen, enter your name, company and question language to join the queue. Upon being announced, a prompt to activate your microphone will appear on the screen. You can then activate your microphone to ask your question. If you have any further questions, please ask them all at once.

Our first question comes from Vinicius Strano from UBS. Vinicius, the floor is yours.

(silence 34:06 – 35:28)

Let's move on to the next question. The next question is from Clara Lustosa of Banco Itaú BBA. Clara, please go ahead.

Clara Lustosa – Itaú BBA

Hi everyone, good morning, thank you for taking our question. I wanted to talk a little about the prospects for the 4Q. I wanted to understand a little about the view on inventories to face the end of the year events. You even mentioned in the call that sales are strong in October and November in physical stores, and we also followed the logistical problems that the drought in Manaus generated in the industry.

I want to understand a little about the vision in terms of both volume and quality of these inventories to face the Black Friday and Christmas events. That is my question. Thank you.

Fred Trajano - CEO

Good morning, thank you very much for the question. I am going to start the answer and then I'm going to pass on to Fabrício Garcia to complement it. As we said, we started the year very well, always remembering that our focus continues to be on consolidating our profitability in this line that we already have in the entire 3Q, especially in the case of 1P.

We are facing a very favorable situation. We ended the year, the quarter with very positive stock, already anticipating problems that we knew would happen due to the drought on the Amazon River, which makes the logistical situation of suppliers a bit difficult. We worked with inventory, we closed a slightly larger inventory than we initially expected because the suppliers already gave us the tips that we would need to have this excess to withstand this. So we have normalized, positive stocks.

As I said, we started October and November very well, I already gave some tips on how the first 15 days of November were and we are excited, positive; I just need to remember that we remain super focused on working with high gross margins, and also that last year we had a World Cup effect, which from the specific point of view of the television category makes the basis for comparison a little more difficult. Fabrício.

Fabrício Bittar Garcia – VP of Operations

Good morning Clara, thanks for the question. As Fred said, we are well prepared. I think we adjusted our approach at the beginning of last year, so the quality of our approach is very good. As Fred said, we anticipated some receipts, mainly for air conditioning and TV due to the Amazonas situation, the biggest drought in the last 120 years. So we are well prepared, we hope to have a great Black Friday. And the October sale already shows that we are doing well, and November shows that we are very prepared. We are very confident, we should have a good Black Friday and a great December. We are very confident that the quality of our inventory is great and availability is also excellent, which is essential for the business.

Operator

Thanks for the question, Clara. Our next question is from Vinícius Strano of Banco UBS. Vinicius, please go ahead.

Vinícius Strano - UBS

Hi, good morning everyone, thank you for taking my question. Could you comment a little on the current profitability level of the 1P categories, both in the physical store and in e-commerce, and how this has evolved? And how are you thinking about investments to grow the 3P business?

And a second question regarding supplier deadlines. We see an increase in previous periods, so thinking about working capital lines, what do you consider to be recurring supplier terms going forward? Thank you.

Fred Trajano - CEO

Thank you very much for the question. I will talk a little about 1P, then Fabrício if you want to complement me and Roberto on the issue of deadlines. As I said, for our 1P the focus of the year has been the transfer of taxes, mainly in 1P, although DIFAL takes a bit of store too, it was not just exclusively online, it also had an impact on store margins. So we made this pass through. This quarter consolidated the pass through, it was the best quarter of the year from the point of view of profitability of the 1P and physical store operations - again, prioritizing gross margin more than growth.

Once we stabilize this level, I think it will be easier for us to work towards growing again and gaining operational leverage. We had the best quarter of the year. In October, the margin was even better, the operating margin, than in the 3Q, and we believe that we will continue to observe this from now on.

But once you decide to pass on this magnitude of tax, you have to make decisions. Our decision at that moment was to transfer the price and then think about growing again, which is what we will start looking at from now on. With this consolidated margin, we have and believe that we have room to gain share, mainly in stores, but not exclusively; in 1P there is also room to gain share - but always preserving the level of gross margin that we achieved from this quarter onwards, and I think you have to make this decision, execute your plan and, from then on, grow again in healthier foundations.

From a 3P point of view is to keep growing. We think we have already reached a very positive skill level for 3P. The more it grows, the more it adds to EBITDA and the company, so continue in this line - but also grow without going back to the crazy subsidies that marketing, we had two, three years ago and we see the market very rational. We still have lower rates than our main competitors, so I see a positive space for positive growth in 3P. André, do you want to add something?

André Fatala - CTO

Yes. It is on? Thank you, Vinicius. Regarding working capital, I will comment on working capital as a whole. What we had this quarter? We reduced inventories compared to the past by more than 500 million. In this sense, we also reduced the supplier account compared to the past. Still, we continue, and this is something we are always looking for and have achieved, a balance in this relationship, a balance of suppliers that finances our inventory investment, in other words. So we finance our customer, we have financing from our customer and work with our sellers to achieve this balance to the point where our winners are financing their inventories in our distribution centers.

So we have achieved this. This year we also managed to increase the average purchasing period compared to the past and now, from now on, we have the prospect of improving inventory turnover. We have been reducing inventories and have not yet improved turnover due to this strategy of balancing the best growth versus margin, which Fred mentioned.

From now on, with greater growth, in this quarter the level of sales is already much higher, so turnover has already improved significantly, and with growth expectations for the coming years, we should see an improvement in inventory turnover and maintaining a healthy average term, always financing, always seeking to finance the investment in inventory at more or less the same magnitude as we currently have.

Operator

Thanks for the question, Vinicius. Our question comes from João Soares of Citi. João, please go ahead.

João Soares - Citibank

Thank you. Good morning, Fred. Good morning, Beto. I have two questions here, the first one I wanted to explore the opportunity here for a lot of EBITDA as you are monetizing the marketplace platform better. So I want to hear a little, Fred, about how we should see this trajectory from now on, of reflecting this monetization in EBITDA.

The second point I wanted to explore, guys, I understand that you did a good review of the controls. I think that looking from now on, it will increase, the operation will be much smoother for this level of control of debts with suppliers, but I just wanted to understand guys, just to make it clear, if the investigation has already been completed and if there is any risk, perhaps for us see some restatement looking back. 2022 was the restatement, but looking at balance sheets back to 2022 if there is any risk in that, thank you.

Fred Trajano - CEO

Thank you very much for the question. Regarding 3P specifically, regarding EBITDA, we have already seen an improvement in October concerning 3Q, an improvement that I would even say is relevant, and we see that this is the trend going forward. So in fact, as our projects, our work evolved both in 1P, as I said here in the previous question. In 3P, we also see sales expenses from the past quarter being more temporary due to a specific investment there. Then I see the tendency for the margin to improve to return to historic levels that we had before the pandemic.

This is the contribution of 3P to the EBITDA margin. In the management report we talked about the end of October, and I think that is more or less what we have observed, and we already want to harvest in the short term, okay João? When I say short term it is now in the 4Q, although the 4Q always has Black Friday, the margin tends to stabilize or even fall, and we want to continue seeking growth and showing the market the evolution of our work, as it has already been demonstrated in 3Q, but even more significantly looking ahead.

Regarding the second point, I think we did extensive work so that the numbers accurately reflected the reality of the facts and avoided any restatement, which has already happened in several market situations in the past. I think this creates unnecessary wear and tear. It was important to have a number and there is 100% reliability. I wanted to pass it on to Beto about this.

Roberto Belissimo Rodrigues – CFO and IRO

Thank you, João. The numbers have been extensively revised from the beginning of 2022 to the September 2023 numbers. All the numbers in the balance sheet, that is, current financial statements, the situation of the capital structure, total accounts receivable, have been extremely tested and we are very convinced that they will not change.

The audit processes for the quarter were normal, the 3Q numbers were significantly revised. As you know, the audit is annual and now in the 4Q we complete an annual audit for the year 2023 compared to the year 22, going back to the beginning of the year 2022 as we demonstrated the effect there of the net adjustment in that table from the initial balance of 2022 to the current moment. There is no obligation or need to return to periods before 2022. Still, for sure we, the audit is already working and we will audit all quarters of results from 2022 and 2023 so that everyone has 2 years as required by the CPC of audited financial statements and compared. So we are very convinced that these are the final numbers.

Operator

Thank you for the question, João. Our next question comes from Eric of Banco Santander. Eric, please, go ahead.

Eric - Santander

Good morning everyone, thanks for taking our questions. One from our side is if you could comment briefly on the competitive environment. So I think mainly in the corner segments of electronics, household appliances, and also understand a little about the industry relationship you mentioned in the working capital part. Still, if I can explore a little better here, mainly with the entry of some marketplaces, companies that historically were marketplaces entering a little more into 1P, understanding how this has evolved.

And if you could also explore a little more, the second question, from Ads. I think we saw a growing service revenue, and to understand a little better the contribution, how much we had in gross margin gains this quarter coming perhaps more specifically from Ads, which we understand as a very interesting opportunity in the future. Thanks.

Fred Trajano - CEO

Thank you very much for the question. The competitive environment is favorable. Our biggest competitor has been taxes and interest in recent quarters. There is no issue like we've already faced with market rationality, with marketplaces selling and making GMV with zero take rate, subsidizing the price and freight. I think that in 1P operations everyone has to pay DIFAL tax, it's the same tax for everyone; it's a reality for both sellers and large operators.

In physical stores we still have a huge space to grow. Our share in physical stores is smaller than our share at 1P, and I see a big space there for us to take advantage of and continue to grow share in physical stores. Even if the physical store market declines, we have space to more than compensate for this looking ahead in terms of share gains. I think it won't fall; it will grow, because we are leaving the bottom from the point of view of the electronics category in physical stores. I'm sure with the reduction in interest rates and the increase in credit that should come, certainly in the coming quarters. With the reestablishment of the purchasing power of the low-income population, I see this path as very positive, and we have a very comfortable physical store position.

And in 1P too. Our 1P has a competitive advantage, which is multichannel. No other operator has this competitive advantage. Deliver 85% of our 1P category within 2 days; no one can do that. We use the stores for Retira Loja. We use the stores for ship-from-store. Our 1P model is very competitive. What happened to 1P has nothing to do with competition; It has to do with the macro economy; it has to do with high interest rates; it has to do with high taxes - and now the tax is given, it has been passed on and interest rates have to go down. By improving the macro, the 1P operation will evolve looking forward for sure. I don't know if I wanted to discuss the relationship with suppliers, Fabrício and Edu, please take the lead.

Fabrício Bittar Garcia – VP of Operations

Good morning, thanks for the question. Fabrício here. Magalu has a historical relationship with the industry. Today, we are the second largest player among our major suppliers in our core business. The relationship with them is the best possible and we have had a great year, one month better than the last. We are very well planned for the end of the year, and as Fred said, the competitive environment is more rational, in the store we are very strong and this helps us and gives us confidence that we will sell profitably, which is the most important. The relationship is excellent and the prospects are the best possible.

Eduardo Galanternick – VP of Business

Good morning, Eric. I am Eduardo. Just giving a little context about Ads, within the service margin, there is already some influence from Ad revenue on it. We are not yet revealing this number, we still understand that there is plenty of room to grow this share.

This year was a very important one from the platform expansion point of view. We took our sponsored products platform throughout the year within Magalu to different spaces such as search, our entire recommendation system, all the showcases, everything integrated. During this last quarter we took an important step, which was modularizing it for expansion to the group's other stores, implementing it in Netshoes, because it increasingly gives advertisers the possibility of offering their products and displaying their products not only on Magalu, but now at Netshoes too and in the coming quarters certainly in all the group's stores.

So we will also have a change in our display platform after Black Friday, expanding the possibilities even further. So this story is just beginning, it has some impact on this service revenue, but the best is certainly yet to come.

Operator

Thanks for the questions, Eric. Our next question comes from Vinícius Pretto of Bank of America. Vinicius, please go ahead.

Vinícius Pretto - Bank of America

Good morning everyone, thanks for taking our question. We want to understand better what your thinking is concerning the capital structure. An important portion of the debt matures in the short term, and last night there was news that the controllers were considering a capital increase. We want to understand a little better what your thinking is in this regard.

And if I could ask a question, a second question, you mentioned several advances you have made in monetizing 3P. This seems to have contributed much to the gross margin expansion, but we did not see this fully translating to EBITDA margin. So I would like to understand a little better which expense components limited this margin expansion, and also understand today how this 3P EBITDA margin compares with the 1P in physical stores, and how you see this evolving from now on. Thank you.

Fabrício Bittar Garcia – VP of Operations

Well, thank you Vinícius, I'll start here by talking about the capital sector. Thanks for the question. Vinicius, we don't comment on market rumors. These rumors happened several times throughout the year. Hence, they are rumors, they have no relationship with the company - but I'm going to take advantage of this question to say that (reinforce that), as I mentioned, from a capital structure point of view you can analyze in various ways. From a liquidity point of view, we have 8 billion in liquidity, cash, investments and receivables, completely liquid, with daily liquidity.

This is super important, and in this sense we have liquidity much higher than our gross debt, and even more so about our net debt. Even considering only cash and investments are already greater than short-term debt, we are entering a period where cash flow from operations is growing. We talked a lot about the growth of the marketplace, about the expansion of operating margins; The financial expenses were falling significantly, so this is a trend that should increase over the next year as well.

We have the opportunity to continue improving inventory turnover and working capital as a whole, so we have the prospect of increasing, accelerating operational cash generation and further reducing financial losses and financing cash flow, significantly improving our leverage on other metrics in the coming quarters and years. We have a capital structure today that we consider very solid and very liquid and there is no need for discussion regarding a capital increase in the board of directors. These are, again, market rumors.

Fred Trajano - CEO

And talking about margins, I already answered the previous question but I will reinforce that we expect that margins will continue to increase; As the marketplace gains share, the margin tends to increase. As we transform this new level of gross margin into also sales growth in 1P, due to everything we have observed regarding market dynamics and the reduction interest rate, which also has to greatly leverage the top line of this category, with a return to credit for the store, with a return to growth in the durable categories, which are important for 1P, we will also improve the dilution of expenses o EBITDA in the future. As I said, we already have a very positive indication for October, which is at a level above 3Q and we imagine that this trend will be observed from now on.

Operator

Thanks for the questions, Vinicius. Our next question comes from Daniela Eiger of Banco XP. Dani, please, go ahead.

Daniela Eiger – XP

Good morning, thank you for taking my question. I only have one here on my side, it's a question about a strategy, perhaps on the medium term. You have always been very vocal about the 3P strategy, and it has even been a major driver of the company's growth; but I want to understand a little bit how you see yourselves positioned in the market like this, even in relation to other platforms.

Is the idea to have this strong 3P but in a more complementary or synergistic positioning with your 1P categories? Lastly, to understand a little bit how you see your main competitive differences in the face of this more aggressive competition, mainly from international platforms and international players. Thank you.

Fred Trajano - CEO

Good morning Dani. Thank you very much for the question. I'm going to be very objective in my answer. I see two major differences in our value proposition: The first is multichannel, I already mentioned its importance. When we built 3P, we built it by leveraging the existing structure, our DCs, the store, important from a drop-off point of view, important from a Retira Loja point of view - more than 20% of sales 3P can be collected in store. It is also important from the point of view of increasing fulfillment, which will further help participation and increase Retira Loja.

With the store, with the multichannel, we have lower 3P costs and we don't need to charge as much from the seller relatively, or charge even less from the consumer and grow it profitably, without subsidies. The multichannel – a differentiator for us to become a leader in 1P – will be a differentiator for us to be a relevant player in 3P.

The second factor, Dani, I've been saying this for a few calls too, we try to work with larger ticket products. Currently, Magalu, even in 3P is the leader above, products above R$ 1,000, we have a very high penetration share. Coincidentally, the electronics categories - not necessarily the families that we are strong in 1P - but the general electronics categories do very well in categories above 1,000. Still, other categories, you saw us talk about lawn mowers, tire, all categories with bigger tickets, are important.

I think that Magalu, concerning the international platform, is where you will buy quality products, from reliable sources. When you are going to buy a product that is not R$ 10, R$ 20, but is a product you will spend 400, R$ 500, you even want to be sure the product is original from the factory; that it is a product of quality; a product that you won't have any problems with, not that product that costs R$ 20, I bought it and if anything breaks I'll return it.

We have a leadership in tickets above 1,000 and a strong focus on having an overshare also in products above R$ 100. It is a quality product, with good origin. We have a logistics and credit component that will help us have a good share, thus a good positioning in this quality product.

In short, quality products with multichannel is a differentiator for our marketplace value proposition, like others that are coming - but you don't need to anticipate too much.

Operator

Thank you for the question, Dani. Our next question comes from Irma Sgarz, of Goldman Sachs. Irma, please go ahead.

Irma Sgarz - Goldman Sachs

Hello, good morning. Thank you for taking my question. I wanted to quickly go back to sales expenses, which increased a little with investments in new customers this quarter. Could you comment a little on how you see the cost of customer acquisition in the market, and how you observe what we think about the evolution of this line in the future, with 3P still being an important area of investments, also reaccelerating 1P? I understand that perhaps there was a slightly larger investment, a little atypical in this quarter, but what gives you confidence that this line will be more diluted in the future, even with greater growth?

And the second question maybe to quickly go back to 1P for a moment, Fred. When you think about the main levers that will bring greater growth to 1P, I understand that macro is certainly a part of it, but what other levers do you intend to activate to reaccelerate this part of the business?

Fred Trajano - CEO

Irma, thank you very much for the question. In terms of expense, I think I'll reinforce some points that Beto said. It's true that the marketplace – when you look at it in the balance sheet – you have to look at it relative to GMV and not net revenue. It contributes a lot to the margin, but marketing expenses increase when you increase its share. As it is positive and tends to contribute to EBITDA, what you improve in margin is more than proportional to what you improve in incremental sales expenses, so it is positive, it has contributed a lot. We have a concept of the marketplace's net contribution margin that has increased significantly over the past two years and has continued to contribute. In October, already in this quarter, we are convinced that this expense will be diluted and that the more the marketplace increases as a share of the company, the more the company's EBITDA percentage will increase because the take rate more than compensates for this increase in expenses in the future.

There is a specific impact that I wanted to talk about regarding sales losses, which is also the following: we made a price transfer in 1P in the 3Q, a significant transfer there for the DIFAL pass through. Whenever you have slightly higher prices at this moment of pass through - we, as market leader, end up being the first to make the pass through, then the market ends up following us - the PLA's CPC grows, so you have a cost per click because your price is higher in the search, you end up having to pay more in the marketing auction. It's a temporary effect because I think that afterwards the market stabilizes at that price and returns and ROEs will increase.

This will happen now in the 4Q. I'm already seeing it. The returns increasing, conversions improving, so I'm convinced we will show operational leverage and an increase in EBITDA margin in the coming quarters. It's a broad focus for the entire team and will be clear in the future results, so that's what I wanted to discuss.

The other question, the growth of 1P. We have been publicly traded for 12 years, but Magalu has been operating in the physical store category, in durables, for 64 years. It is a cyclical category, the fact is; every 7 years you have 2 years that the category operates below and then they say, “the category will end, the physical store will end”. When I took over in 2016, in 2015, all the analysts questioned me: “Are you going to close the physical store?” “Is the category going to end?” "What will happen?" Then you have a virtuous cycle as interest rates fall: in 2015 the interest rate was, I believe, 14, it dropped to 8, 7 and then the category started to grow; 2008 the same thing happened, the category with difficulty, high interest rates, the store don't sell, then have a high advance cost, Luizacred pays the cost, there is high default.

It is a cyclical sector. We have been doing work in 3P so that we don't depend 100% on this sector - but it is a sector that is cyclical, we have been operating for a long time; We have already been through the worst, interest rates are falling, financial expenses fell 100 million compared to last year, 1 percentage point less, and certainly the demand, what I am seeing now in November is already showing that it has reached time for the consumer to buy. It stays there for a year or two, there was a little anticipation during the pandemic, the customer bought a lot of durable goods with a little bit, with a full inventory. I think there comes a time when you need to change the refrigerator; you need to change your cell phone; you need to replace your TV. This tends to improve in the future.

Mainly is a macro factor, but we also now, with this base of profitability and margin that I mentioned, Irma - and you can't do both at the same time, you need to make a choice and then move on to another -, we think we can gain share, especially in physical stores, but in 1P too. Our 1P share is very high in traditional categories - but there is still room to grow further.

Operator

Thanks for the questions, Irma. Our next question comes from Vitor Pini of Banco Safra. Vitor, please, go ahead.

Vitor Pini - Banco Safra

Good morning, everyone. My questions have already been answered. Thank you.

Operator

OK. Our next question is from Joseph Giordano of JP Morgan. Please Joseph, go ahead.

Joseph Giordano - JP Morgan

Hello, good morning everyone, good morning Beto, Fred, Vanessa, thank you for taking my question. I wanted to explore the issue of 3P a little bit again, as you mention it a lot. I would like to understand how far you think you can get on the take rate side, as you add new services here, this is a point, it is a little for the potential of *remessa conforme*. We see the company applying for this opportunity. How do you see this here?

Finally, when we look a little at the commercial strategy for 2024, how do you see the industry targets considering this slightly cooler market, that is, if we could perhaps think about normalizing these bonuses. Thank you.

Eduardo Galanternick – VP of Business

Hi Joseph. I am Eduardo. How are you? Answering your first question about take rate, Fred commented, a good phase of this improvement in the marketplace comes through adjustments that we have been making in the take rate, as well as a series of efficiencies that we make in terms of incentives. We understand there is still a table of charges when you compose what is charged to the seller, what subsidies you give for freight, which is still competitive.

But we also understand that the marketplace brings a series of profitability growth options, such as Ads and the provision of logistical services, such as financial and credit services. So in this context we have made significant progress, but we think there is still room to improve profitability by better using these options that we have,

Concerning the *remessa conforme*, we signed up, attached it, requested to join the program. Since we now have a legal framework that gives us confidence, we understand that it is an opportunity that we bring into the company to complement our assortment; to bring products that are not available in Brazil, brands that are not available here. We understand that currently our product portfolio is not very exposed to the issue of these foreign products, which makes this an opportunity for us. This is how we are looking at this business. About the second question, I think the current level already reflects the market condition. I don't see any changes in that regard.

Operator

Thanks for the questions, Joseph. Our next question is from João Paulo Andrade of Bradesco. João, please go ahead.

João Paulo Andrade - Bradesco

Good morning everyone, thanks for taking my question, can you hear me? Hello?

Operator

Yes, we hear you.

João Paulo Andrade - Bradesco

Hello, hello, can you hear me? Hello, hello?

Operator

Yes, we are listening, João, you can continue.

João Paulo Andrade - Bradesco

Thank you, sorry. AntA-Voice was not working here. Good morning, Fred, Vanessa, everyone, thank you for taking my question. It is more about trying to see if there is any color refresh regarding physical store expansion given that you, after all, have already passed the decoration period, you are now at a profitability level, with a more adjusted gross margin, you have all the synergy with the other businesses with lots of things flowing through the store. It's much more of a medium-long refresh, term of how you're seeing the expansion potential, and, finally, triggers in addition to interest that you could see to be able to resume physical store expansion.

And one more question, it's a quick color of how the expansion of financial products and services at fintech Magalu is finally underway. Thank you.

Fabrício Bittar Garcia – VP of Operations

Good morning João Paulo, this is Fabrício speaking, thanks for the question. In the physical store scenario, our focus now is to make our current stores profitable, so we do not have an expansion plan in the medium term. We have the plan to return to having the channel very profitable as it always was, so we have been gaining gross margin by focusing a lot on new regions that we have opened: Mato Grosso, Brasília, Rio de Janeiro. We have a lot of market to gain in these regions, so in the medium term, we focus on making our current store network profitable. About fintech, please Mauad.

Carlos Mauad – CEO Fintech Magalu

Entering here to answer the question - JP, thank you very much - the road map is all aimed at scaling and monetizing our insurance solution within the digital layer of our business, the entry of credit at the checkout of our digital channels, which currently we have a well-developed product for the store chain. However, it still doesn't reach the digital layer of our business.

We have a series of fronts linked to monetizing this relationship with the seller, our growth frontier in 3P. So, everything is focused on building scale and profitability. The product roadmap is super grounded, pragmatic for us to build this monetization appropriately in a short time. I hope I answered your question.

Operator

Thank you for the question, João. We will now close the question and answer session. I would like to turn the floor over to Frederico Trajano for his final remarks. Please Fred, you can continue.

Fred Trajano - CEO

Thank you very much for participating in the call, have a good week everyone.

Operator

The Magalu conference call is finished. The investor relations team is available to answer other questions and concerns. We appreciate everyone's participation and have a good day.