CONFERENCE CALL TRANSCRIPT

1Q19 EARNINGS

MAY 7, 2019

Operator

*Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Magazine Luiza's conference call, referring to the first quarter of 2019 results. At this time all participants are connected in a listen-only mode. Afterwards, we will have a question-and-answer session when further instructions for you to participate will be given. If you need any assistance during the call, please ask an operator for help by pressing *0. Now we would like to turn the floor over to Mr. Frederico Trajano, CEO of Magazine Luiza. Mr. Trajano, you may proceed.*

Frederico Trajano - CEO

Good morning, everyone. Thank you very much for participating in our results conference call for the 1Q19 results. Once again, our entire Management team is here. I will start the presentation, then Roberto Bellissimo will share more details on our results, and then we will open for questions after the presentation.

Well, I would like to begin by saying that we started this first quarter with a new and promising strategic cycle, committing to a few pillars and drivers, including accelerated exponential growth - which we are calling “China-paced growth”, as in similar to the growth of the Chinese economy. We are leveraging our retail as a service or Magalu as a service plaform, meaning that we will significantly expand Magazine’s marketplace platform and provide third parties with services that we normally provide to the company. This pillar is very focused on expanding the marketplace and having third parties operate on the same level as we operate in 1P.

The superapp has been the focus of our digital platform as one of the main points of contact with customers - the app, our app. We have been expanding into new categories with the best retail experience, fast delivery at store or at home, and a data and innovation culture. These were the pillars we discussed in detail during our Investor Day last year, and also in the annual report for 2018 results. We are clearly on the way of successfully executing this new strategic cycle.

In sum, we have digitalized Magazine Luiza, and now we want to digitilize the entire Brazilian retail market. We want to digitalize Brazil. It has always been our purpose to provide for many that which is a privilege of the few, especially during such times. We want digital inclusion for consumers, as well as small and medium retailers, or companies that wish to learn and benefit from the same investments we did over the course of our history, and to achieve the same successful digitalization process we achieved in the Company.

But execution in this first quarter faced a challenging environment. We had a very high comparison base with the first quarter of last year, which included advanced World Cup sales, so especially in February and March of last year we saw extremely above-average TV sales for a first quarter, due to the World Cup. We also had the end of the Lei do Bem law and the benefits it provided for technology products, specifically cell phones, but also other items. We also had, in my understanding, a setback in market rationality - a market irrationality, offering free shipping and deciding not to pass through the effect of Lei do Bem, for example, to prices. The economy was also not as strong as expected.

Despite these challenges, we are currently very focused on accelerated, exponential growth, though without compromising service. We hope, as I mentioned, to improve service level and not grow to the detriment of service level. We don't want to compromise for a margin trade off - we want to trade off margin provided that it makes sense in the long term, if customer lifetime pays for itself. We don't want reckless free shipping, without a long-term rationale, customer lifetime value analysis, or long-term rationality and sustainability.

We also want to maintain our ethical and formal standard with all players in the chain, for example making sure that all sellers on our platform issue invoices and deliver high service levels. Despite these challenges, I can say that we performed very well in this first quarter, and I will show you some figures that illustrate how much progress we made in these areas. I will also share some metrics and bullet points that are important to address each of these bridges I mentioned initially.

Let's start with customer base. When I say exponential growth, I'm mostly talking about client base. Because it is possible to grow significantly solely by increasing the average ticket... But we do not want that, we want a larger, more loyal customer base. So, more customers buying more frequently during the year. In this regard we made a lot of progress; first-quarter customer base had 18 million active customers, growing 35% from the previous year. The highlight was the website, which grew 68% from last year, but physical stores also stood out, with a 23% increase in customer base compared to last year. This means that we are expanding both channels, not growing in one to the detriment of the other. I consider this growth very significant.

What makes me the happiest is that our customer metrics show growth not only in shopping frequency, but also service level. We are still the only major retailer to have the RA1000 seal from the Reclame Aqui website. We received that seal even after growing 240% in the marketplace, which still operates at a slightly lower service level than 1P. Marketplace accounts for approximately 28% of all customers who shop on the website. Despite this incredibly relevant marketplace, we managed to maintain our Reclame Aqui RA1000 seal, and are working to make marketplace service level as good as the service level we operate in the traditional chain, where I buy and sell products from my inventory.

Also in terms of customers, we had a 60% decrease in formal complaints for every one thousand orders. I believe this is a very positive metric, and the team worked very hard for that. We also improved first-call resolutions by 26%, and are improving the cancellation process and order tracking via WhatsApp. So, we have a series of improvements; there is no silver bullet, just hard work from the entire team to make sure we can grow as fast as we are growing while also significantly increasing service level, raising the service level bar in Brazilian e-commerce. We are not going to wait for an international player to get here and improve our service level. We will do that as a national player and raise the bar of retail as a whole. We are already doing that, even with some of the obstacles imposed by accelerated growth.

Specifically in e-commerce, our customer base expanded by 68%, as I mentioned, and sales grew 50%; customer base growth outperformed sales growth, because we want to sell more different items, so we doubled the number of different items sold in the first quarter compared to the same period last year. We entered categories with a lower average ticket, we launched the book category, we are significantly expanding the Magalu market category. We continue to invest massively in e-commerce on the app, and our goal for the app is to transform it into a superapp. Initially, the focus for turning it into a superapp is on expanding seller base, number of items sold and categories, and after that we can tackle services, payments, etc. Our focus in this first stage of the superapp is on increasing the number of product categories. The launch of the book category - and also something I'll comment on later, because everyone wants to know about it, which is Netshoes - is also very much focused on expanding our category base, which is part of our strategy.

The app, as you can see, reached 33 million downloads, and we currently have a MAU (monthly active users), which is the technical term for these things, of 6 million active users per month, also a considerable growth compared to last year. Furthermore, we significantly leveraged e-commerce growth, as well as marketplace itself, which grew 240% in the quarter, considerably contributing to the overall growth in e-commerce and the logistics service level. The entire logistics team is working very hard to implement 48-hour express delivery, having fulfilled 33% of the total sale promises in e-commerce - a very significant ratio which, combined with the Pickup at Store metric (is also at a 48-hour average), accounts for around 60% of our total e-commerce sales being received or picked up within 48 hours by consumers. This makes it very difficult for competitors to beat this service level, because they do not operate with our multi-channel logic with this service level, which we also have in 1P. Anyway, e-commerce had very positive results, despite the significant impact of accelerated marketplace growth. We reached 5,000 sellers and went to 5,400,000 SKUs on our platform. This creates a network effect, with more users attracting more sellers, and since I have more products I will attract more users... It's the famous network effect, which we are pursuing with this scale gain, this "China-paced" growth that is beginning to materialize.

We are also working hard in the marketplace; we have two clients: the end customer and the seller, which I see as a client as well. When you're working on an ecosystem platform strategy, you need to understand that this is now a two-client market. We started to provide services to these seller clients, not only acquiring customers through our platform, the app, but also rolling-out Magalu Payments and Magalu Deliveries in their most basic modality. Magalu Deliveries already has 53% of the sellers using standard agreements on our website, with much lower shipping fees that the ones negotiated directly with major couriers. But we are also rolling-out cross-docking modalities, where we use Logbee, for instance, to deliver for sellers, with much better service and even lower rates. We are running a pilot of the cross-docking modality with 20 sellers, and there are still many adjustments to be made for us to roll this out with quality. This is a service level with sellers, sharing our differential in 1P, which is the Luiza Network and Logbee, and we want to pass this on to the seller as well through the cross-docking modality. We already have 20 sellers in the quarter.

And Magalu Payments also has 3,750 sellers. In these cases, we are helping these sellers by advancing receivables, always at fair rates. Bear in mind that we believe it is very important for them to work with healthy working capital. Much of our payment strategy is about helping sellers succeed and grow sustainably with us. We want our platform to be the absolute best option for sellers, not only end customers.

Moving on to physical stores, we had yet another great quarter, with a huge challenge because last year we had already posted same-store sales growth of 16%, impacted by the World Cup. We managed to grow 16% in stores, 8% in same-store sales compared to 16% in same-store sales last year, without the World Cup. This is extraordinary work. We gained share in all regions and virtually all categories in this first quarter, despite the Lei do Bem impact, which negatively affects profitability for commercial teams. Still, we managed to grow. I would also like to highlight that we are constantly looking at stores, but this time we grew the total store base. Expansion accelerated significantly last year;

we opened 100 stores, and new stores are already contributing with 9 percentage points of the 18, helping physical stores grow. To sum it up, a 16% growth in physical stores in such a challenging economic scenario is a very positive figure. I believe the share of new stores in this growth shows that these stores are operating at a higher-than-expected profitability level.

In terms of new stores, I would also like to mention an announcement we made last week, regarding the agreement to purchase sales points from the company that owns some of the Armazém Paraíba stores in the North and Northeast regions. It was a total of 48 stores in Pará and Maranhão, marking our first operation in the North region - a very positive region, though forsaken by retail. Within our multi-channel model, these stores will not only help us expand our customer base and physical store revenue, but also improve e-commerce penetration in the North region. Note that a lot of people today have free shipping campaigns in e-commerce, and these companies always exclude the North region. After the launch, Magazine Luiza will no longer exclude the North region from its free shipping campaign. We will also benefit e-commerce consumers with our distribution center there, and with the support of our physical stores for most of the SKUs we have available in the region. So, that's another aspect that I believe will be positive for both physical stores and e-commerce.

I would also like to highlight LuizaCred. We usually talk about it from a more financial point of view. But I would like to emphasize LuizaCred's operating figures, for a better explanation of what is happening to it. Two years ago, we decided to accelerate the expansion of LuizaCred. It is part of our "China-paced growth" strategy, very important. LuizaCred is posting fintech growth. LuizaCred's credit portfolio growth this quarter was 48% compared to the same quarter of last year. LuizaCred reached a credit portfolio of R$8.8 billion, likely becoming the largest credit card company in Brazil, beating other companies in the market with strong reputation but very heavy numbers. The card base grew to 4.4 million cards in the quarter, up 26% from last year. 50% of all revenue from physical stores accounts for LuizaCred.

But I would like to point out that this is a branded card and 70% of customer spending is outside Magazine Luiza, so in this sense it is an off platform. Luiza Card's average utilization rate is around seven times a month. For cardholders, Luiza Card is already their first credit card option. We have very healthy and positive utilization rates. Based on the new accounting method for financial results - which for retail financial companies is no longer the Bacen-GAAP, used by all the banks, but rather the IFRS 9 - we have a much higher provision volume compared to the Bacen-GAAP at first, so profitability ends up decreasing a little. We feel that with equity accounting. For the long term, however, this is a great insurance for us. Before, if a financial company grew too much, profits would be high earnly on, only to decelerate to a financial result later. In this case, we are seeing financial result now, but the future tends to be very positive in terms of profitability, because we have much higher provisions than other financial institutions or banks, or anyone who is not provisioning. We are actually reporting both models, Bacen-GAAP and IFRS 9, so that the market can examine this well. When it comes to the company's strategic decision, we will not change it, even if it represents lower results under IFRS 9. We will continue to accelerate LuizaCred's results, because customers who shop using the LuizaCred card will buy five times more than customers who do not use the LuizaCred card. We want to maintain this level of loyalty and shopping frequency, so we are specifically making a CLV decision in the quarter, instead of a short-term decision. I think this is very consistent with our strategy, which we have been discussing for a while.

As for Netshoes, this is obviously great news. We announced it last week, so I believe there will be many questions about it today, from analysts and journalists. I would like to say that we are obviously very happy with the announcement of the acquisition agreement we entered into last week. We believe Netshoes is a great asset. Since this acquisition agreement is not an actual purchase, we are still subject to the approval of the Shareholders' Meeting to be held in approximately 30 days. We need approval from two thirds of all shareholders, so we will answer standard questions and comments. What I mean is that we are unable to share many details about what we are planning to do, because the asset still does not belong to the company. We still have this 30-day period ahead of us, and we also need CADE's approval, which should take another 40 to 45 says, even if we get the fast track. What I can say is that we are very happy with this acquisition. Netshoes's figures were announced recently, but it is the largest online player in the apparel, shoes and sports items segment, with exceptional high-value brands in Brazil, Netshoes and Zattini, and even Shoestock, an asset recently acquired by them. It has 24 million users, nearly 7 million active users, with growing marketplace, 1,000 sellers in the marketplace, an assortment of 250,000 SKUs which fully complements ours, we basically do not work with these categories. GMV of two and a half billion, marketplace with a 15% share of the business. The acquisition is completely in line with our strategy, as we explained in other conference calls, which is to acquire new categories, increase the active customer base and increase shopping frequency. But I would also like to point out the talents in wholesale, because any company that plans to grow exponentially needs to hire good people. Hiring these people in retail has been increasingly difficult, especially when you consider that Brazilian economy is likely to recover. So companies are hiring in advance. Netshoes has a lot of competent, talented people, which will help us immensely if the transaction comes to fruition. Once again, I would like to apologize in advance if I am not able to share too many details later on, other than what I just mentioned, but this is the recommendation of our lawyers and bankers.

Now I would like to turn the floor over to Roberto, who will comment on the financial results.

Roberto Bellissimo – CFO and IRO

Good morning to all. Thank you. I will begin with the highlights. We already commented on the accelerated sales growth. We saw a 0.9 percentage point decrease in gross margin, mostly due to the termination of Lei do Bem. Our marketplace contributed significantly, virtually offsetting e-commerce growth in traditional 1P, which continues to grow significantly, having expanded by 30% this quarter.

Once again, we were able to significantly dilute operating expenses as a result of operating leverage, diluting fixed expenses and outperforming inflation, despite the increase in service level and investments in new customers, in line with what we discussed last year. Consequently, we managed to increase EBITDA in nominal terms to R$318 million, despite LuizaCred's virtually flat result. If we consider LuizaCred's result in BR-GAAP, EBITDA would be R$336 million, with 7.8% margin, and the proforma net income excluding the IFRS 16 effect of R$139 million would have been R$156 million. ROI, which was 23%, would be even higher.

We continue to generate substantial cash, with very high ROIC of 20% in the quarter, 27% in the last 12 months, a very robust net cash position of R$1.4 billion, and total cash of R$1.8 billion including receivables.

On the next slide we have the evolution of active app users, which went from 2, 3 million to 5, 6 million. Active customer base also rose from 14 million to 18 million. Then we have the number of new stores, over 100 stores in the last 12 months. Investments also increased, as we more than doubled investments in the first quarter, and the highlight was technology and logistics.

Then we have the quarterly revenue evolution. Here you can also see that in the first quarter we sold almost as much as in the last quarter of last year, even though fourth-quarter sales are typically much higher.

Another highlight was e-commerce, with sales of R$2.4 billion in the quarter. In annualized terms, this is almost R$10 billion in revenue, representing over 40% of total revenue without Netshoes (including Netshoes, this level will be even higher).

Then we have gross income evolution. Expense dilution was concentrated in sales expenses, fixed expense dilution. Equity equivalence was virtually stable compared to last year, with contraction of 0.6 percentage points.

On the next page we can see the significant impact on our EBITDA. Proforma EBITDA was R$319 million, EBITDA under IFRS 16 was almost R$400 million, and margin stood at 9 percentage points.

Then we have financial expenses, which were very similar to last year, growing from 1.7 to 1.8 percentage points, also due to the increase in sales and the growth of Luiza Card. Not considering advanced receivables, we posted net financial revenue.

Below we have working capital. We continue to improve net working capital position, therefore improving net cash position, which in 12 months grew virtually R$100 million, from R$1.3 to R$1.4 billion.

Then we have cash generation and the net income evolution we mentioned. Then we have more information about LuizaCred. In 12 months we increased by almost 1 million the number of cards in LuizaCred's base. The highlight was the nearly 500,000 users of the Luiza Card app, which we launched around six months ago, and penetration in new accounts, which is almost half. More and more customers are enjoying the benefits of Luiza Card, further improving customer experience.
LuizaCred grew significantly, with revenue of R$5.7 billion, and the highlight was the expansion within Magazine Luiza, leading to an increase in LuizaCred's share of sales, which was almost 50% of physical store sales and grew 40% in total.

After portfolio evolution, overdue portfolio was virtually stable at a historically-low level of 7.7%, also one of the lowest in the market. With that, net income in the quarter under IFRS 9 amounted to a loss of R$900,000, while in BR-GAAP net income was R$36 million, still very strong. ROI was 17%, significantly contributing to our strategy as a whole.

Now we would like to open for questions. Thank you.

Operator

*Ladies and gentlemen, now we will start the questions and answers session. To ask a question, please press *1. To remove a question from the list, press *2. Our first question comes from Bob Ford, Bank of America. You may proceed.*

Robert Ford – Bank of America

Thank you. Good morning to all, and congratulations on the growth. Roberto, can you give us more color on your credit operations, please? You are adding a lot of new users with higher default risks, and there seems to be a small decrease in quality, excluding IFRS 9****. Are you happy with this performance? Is that in line with your plan? Or how are you looking at user growth going forward?

Roberto Bellissimo – CFO and IRO

Good morning, Bob, thank you for your question. Actually, Bob, we have a very conservative approval level, we are not adding high-risk customers to the Luiza Card base. What happens is that we have more new customers, which usually bring more short-term provisions, but then they bring higher return in the medium and long term. So, the portfolio's risk profile and LuizaCred's default level are under control. We are very happy with the operation and its acceleration. We want to accelerate and grow even more. This year we plan to sell a lot more cards than we sold last year, and the result of these cards in the medium and long term tends to be very positive for both retail and LuizaCred. There was no change in the risk profile, that's how we see it. We have very good activation levels and consistent default levels by range and by sales period. So, no. The operation is very well-balanced. In terms of IFRS 16, unfortunately it advances provisions significantly, but it is a fully accounting and conservative factor.

Frederico Trajano - CEO

I would like to add something to Beto's answer, Bob. I want to emphasize a couple of things. I would like to highlight LuizaCred's efficiency ratio, which has reached an all-time high, with lower operation expenses on revenue, which can reach 36%, 38% by the end of the year. This makes us one of the most efficient financial companies in the market, because with this scale gain we are able to dilute this issue significantly. We are also being able to increase revenue per cardholder considerably. Cardholders are using the card more frequently, inside and outside the company, and are also consuming other types of products, like personal loans and bill payment in installments. We have been able to make each cardholder more profitable, making the long-term dynamics of this new customer extremely positive. We are very confident in LuizaCred's future results, despite the short-term figures.

Robert Ford – Bank of America

OK, very clear. Thank you. Fred, there are many hardline items for sale in Brazil. Do you believe the market is leaning towards leasing businesses, similar to what you saw at Armazém Paraíba?

Frederico Trajano - CEO
Sorry, can you repeat the question, Bob?

Robert Ford – Bank of America
Yes. I see a lot of hardline items for sale in Brazil's hardline industry. I am asking if you think sellers seem more willing to accept a leasing business, similar to the structure of Armazém Paraíba.

Frederico Trajano - CEO
Right. Bob, I do believe that. The industry was very weak after the crisis, so a lot of regional networks were severely impacted by the country's recession. Some companies are simply abandoning their operations in this category. For us, the acquisition of these sales points follows maximum rationality. We did not acquire the company, we acquired sales points, as you said, for an amount that is in line with what we pay for launches, which is less than one million per point, as negotiated. For me that's very important, I'll always favor expansion based on an investment rationality for sales points. If the store of the future is a shoppable distribution center, my rents and investments must be consistent with that. It does not make sense to pay large premiums per point and all that. For a long time we have been following this extreme rationality in terms of the amount we pay per unit. I think we will continue to favor organic growth, because there are still more vacant sales points available than retailers struggling financially, Bob. But when you want to enter a state like Pará, sometimes the best alternative is to negotiate in wholesale, and also retail in terms of sales points, depending on the case. We will never give up on that sales point investment rationality, because we believe the trend is becoming a digital platform with fixed points, and huge investments in physical points will not generate return on invested capital.

Robert Ford – Bank of America
Very clear. Thank you very much.

Frederico Trajano - CEO
Thank you for your question.

Operator
The next question comes from Mr. Joseph Giordano, J.P. Morgan.

Joseph Giordano – J.P. Morgan
Hi. Good morning, everyone. Good morning, Fred and Beto, thank you for picking up my question. I'd like to talk about e-commerce top line. It is still very strong, regardless of the sales points we find. I would like to understand two major factors we have seen in

the company, even with Netshoes now, which is category diversification. How do these new categories the company has been producing, including higher-frequency categories, contribute to e-commerce and store growth? Lastly, how should we look at marketplace evolution? It is slightly above expectations in terms of short-term penetration. How are you looking at your target for the end of this year and the next? Lastly, how are fulfillment services by Magalu evolving for this seller base, which is growing strongly? Thank you.

Frederico Trajano - CEO

Joseph, good morning. Thank you for your question. I will answer very quickly, and then Eduardo Galanternick can give you more details about this quarter and some outlooks, of course. I believe we had two main growth drivers in e-commerce in the first quarter. We are talking about two main drivers. In the marketplace, by increasing SKUs from 4 million to 5.4 million and significantly growing the seller base, we end up having a lot more items available for customers who are visiting our digital platforms at extremely high rates. This helps us convert sales we would not convert if we did not have these categories, and in some cases we would not even get visits, because customers find us on search engines when looking for a product we did not have before. Once we have the product, it shows up in search results. In terms of network, more items bring more customers, who buy more, who bring sellers, who offer more products, and it becomes a network effect. Marketplace, as previously mentioned, will be the main growth driver of e-commerce going forward, at an exponential pace we have not seen in 1P. I believe that is very important, and we are strongly focused on this user base growth, not only GMV. I am very focused on that. I believe all healthy e-commerce operations should look at these two figures comparatively, GMV and active user base; the number of categories and even the nature of a lower ticket, in both the marketplace and some new categories we are adding, helps us have that growth. In terms of 1P, which continues to grow significantly compared to last year, the main driver, apart from the excellent work performed by Edu's commercial team, was the exceptional logistics performance. Our delivery ratio is currently much higher than our competitor's, and we currently deliver 33% of all orders within 48 hours and over 95% in one day in the metropolitan regions of São Paulo and Belo Horizonte. We will probably reduce promised delivery time to one day for São Paulo and Belo Horizonte this year, in a few of the product categories, because the logistics team is really doing an exceptional job from a delivery standpoint, which significantly helps us increase conversion. Look, delivery tine is even more relevant than price in e-commerce and app conversion. We have had a sustainable growth basis. The good thing is that we are not doing this by increasing free shipping, we are doing this sustainably, based on an economic rationale, which is what we do at Magazine Luiza since day 1. Edu will add to that.

Eduardo Galanternick – Chief E-commerce Officer

To complement, Joseph, in terms of sales growth, it is a positive network effect, like Fred explained. The main driver is traffic, which is created by expanding assortment. We grew 75% in traffic compared to last year. When we look at the number of items sold, even though our GMV is 50, more than 90% of the items were sold in the period. This leads to and increase in visitors who buy everything - new products, traditional products... As for the marketplace, like Fred mentioned, we will maintain this accelerated growth. One of the main drivers of marketplace is naturally the number of sellers, and our onboard capacity, which is sellers joining the platform, has been growing every month. So, seller base has been expanding much faster than early in the year. As for Magalu Deliveries, we currently have two modalities. In contracts, as we mentioned, we have more than 50% of the sellers, growing every month, and today this figure is already much higher than at the end of the quarter. We made a series of adjustments to the cross-docking modality pilot (tax and operation adjustments), and we are ready to expand Magalu Deliveries at the end of this quarter or beginning of the next, OK?

Joseph Giordano – JP Morgan

Perfect. Thank you very much.

Operator

The next question comes from Ruben Couto, Santander.

Ruben Couto - Santander

Good morning, everyone. Could you give us a little more color on gross margin performance? I think we saw a decrease compared to the previous quarter, specifically in terms of goods. Could you explain if this is a product mix effect, and also due to Lei do Bem, or is it still mostly an increase in e-commerce share of total sales? And what can we expect in terms of gross margins in the upcoming quarters? Will it contract like in the first quarter? I believe the second quarter is more difficult to compare, given last year's performance, but just to have an idea of how you are looking at gross margin for this year. Thank you.

Frederico Trajano - CEO

Good morning, Ruben. Thank you for your question. I will give you a more conceptual view, then Beto can complement my answer. The thing is, the greatest impact on margin in the first quarter, as explained in the earnings release, was the end of Lei do Bem. We are now paying PIS and COFINS taxes on a key revenue category for us, maybe the main category today, which is telephony, so the impact on margin is very significant. If you look at the results disclosed by the market, you will see that everyone who sells this important category had an impact on margin. On our side, this impact was offset by a few positive factors. There is a tax factor - because we won a claim last year, which was confirmed by the Supreme Court - as well as earlier factors, like PIS and COFINS on ICMS: we used to pay PIS and COFINS on ICMS-SP, mitigating a significant portion of PIS and COFINS on telephony in the first quarter. This should continue, because it is recurring. Also, in addition to this claim that we recognized last week... Not recognized, excuse me. We published a notice last week announcing the amount of R$750 million, as the Supreme court ruled in our favor. This amount will be recognized over time and reduces PIS and COFINS payments, because it refers to previous years. This will help further mitigate those impacts, because what we did in the first quarter only affected recurring items. In the next quarters, in addition to recurring items, we will also find the best way to account for that; we will discuss with the auditors and the Board the most correct way to account for that. This will also help offset the return of PIS and COFINS on telephony. But specifically in the first quarter, recurring PIS and COFINS on ICMS-SP has already partially mitigated this increase. Other accounts are included in that margin. Marketplace growth generates a take rate, which is included in the account, and has grown considerably helping to generate revenue. With marketplace growth, the company's gross margin is expected to improve. So we have already offset that. Evidently, we still have services, other accounts that end up getting included, as well as margin expansion and other categories, to offset the impact on telephony. I believe the long-term dynamics is that there is not a lot of room in the market to absorb the non-pass-through of PIS and COFINS on telephony, which is what happened in the first quarter. That is not a sustainable practice, and I think after a while the market will be forced to pass it through, because margins have not been positive. The market will have to eventually equate this period. If the market does not pass it through, we will not either; we will absorb these costs in margin and try to absorb them by increasing other revenue or services... Anyway, we did win the PIS and COFINS on ICMS claim, which will offset this effect in the coming quarters. But if the market remains irrational and decides not to pass it through, we will not give up growth and will continue to play the game as well. Do you want to add anything?

Roberto Bellissimo – CFO and IRO

I think that is clear.

Ruben Couto - Santander

It is very clear, Fred. Between offline and online, did you notice any difference in this decision to absorb the impact? Did competition change too much between the channels? Looking at gross margin for goods only, excluding the marketplace effect, did offline and online have similar impacts on gross margin? Just so I can understand the dynamics. Thank you.

Frederico Trajano – CEO

They did. We felt it in both the online and the offline. Prices were not adjusted for the return of this tax.

Ruben Couto - Santander

Great. Thank you.

Operator

The next question comes from Pedro Fagundes, Bradesco BBI.

Pedro Fagundes – Bradesco BBI

Good morning, everyone. Thank you for taking my question. I would like a little more color on assortment expansion. I would like to understand if you have any bottlenecks today preventing you from expanding a little faster into these new categories, which are underpenetrated online, whether it is in terms of system, revenue, integration or even warehousing, given that some of them have a shorter replacement cycle. If there is, I would like you to explain, if possible, whether the acquisition of Netshoes would help you with some of these bottlenecks. Thank you.

Frederico Trajano - CEO

Good morning, Pedro. Thank you for the question. Any category we add to our base requires adaptations in systems and logistics, and even shopping experience. We have to make a series of changes to the search engine, filters, product categorization, media... These are marginally different dynamics, not intimately different. We have yet to enter perishables and regulated products, so we have yet to enter categories that are significantly different in terms of supply chain, etc. Some categories have different sizes, some have different life cycles. Overall, it is nothing we cannot adapt to or do. The thing about lower-ticket categories is delivery cost. Globally, these categories have lower penetration in e-commerce, because the traditional dynamics of major couriers and shipping companies are expensive. It is expensive to have a R$15 delivery cost in São Paulo for a R$20 or R$10 product, because you end up paying more for shipping than for the product. With lower tickets, the weight of delivery costs is higher than the lower ticket. In the market category, for example, that is a classic. If you buy an Omo laundry detergent, you will pay more for shipping than for the product to receive it at home. This is what ends up happening with the penetration of these categories, specifically; it is very low. But that is the beauty of our multichannel model, and I think we have a great advantage compared to any online-only operator. For example, the book category and Mercado Magalu have been growing significantly in the Pickup at Store model. 80% of all book orders are delivered at physical stores under the store pickup model. Magalu

Market also has very high penetration in store pickup. Since the cost of store pickup is marginal, because we already have trucks leaving our DCs every day to go to the stores, we can have a significant advantage compared to e-commerce-only or digital-platform-only formats. Our delivery costs in the Pickup at Store format are much lower than theirs. We may even consider ship from store, if it makes sense to store products at the store. I think the problem with the market in general is a competitive advantage for us.

Pedro Fagundes – Bradesco BBI
Got it. Thank you. Just one last question: do you have any SKU target for the end of the year?

Frederico Trajano - CEO
No, our target is for active customers and revenue. We have no SKU target.

Pedro Fagundes – Bradesco BBI
Great. Thank you.

Operator
The next question comes from Rodrigo Cuestas, Goldman Sachs.

Irma Sgarz – Goldman Sachs
Good morning, this is Irma Sgarz, actually. My question is more about what you think of the physical store expansion cycle. Given that the physical stores are increasingly functioning as distribution centers, becoming more integrated with e-commerce, how do you know the right density, or capture barrier maybe, for each store? I would assume it varies depending on city size, purchasing power, etc. But maybe you can explain how you look at the way omnichannel and different store functions are impacting your store opening plan in the short term, and maybe medium term.

Frederico Trajano - CEO
Good morning, Irma, thank you for your question. Irma, the answer to your question is very simple, because we are in the very early stages of this process. With the stores in Pará we are now approaching 1000 stores in nearly 80 cities. If you consider that Brazil has 5,000 municipalities, store opening potential is still very high in Brazil. Also, we have the ability to open stores in cities with a population of 20,000 people through the virtual store model. In large capitals, we have formats for shopping malls and street stores, we have a very flexible variety of formats that generate return in virtually the entire market. Our goal is to cover the majority of Brazilian municipalities. We are now favoring new regions. This is why we are opening stores in Pará, and why we opened stores in Goiás last year. There are a few states left. We are currently not present in Rio

de Janeiro, the Federal District, Espírito Santo, other states in the North region, Mato Grosso... So, there are many places and cities left, even in states where we have zero stores. We are not opening one store right next to the other, in the same neighborhood or city; they are all very distant sales points, generating completely new customer bases. And they are automatically helping us improve e-commerce service level in these regions. For now, there is still a long way to go. It is very simple to decide where we need to open stores, where we have no stores, cities where we are not present, or districts in big cities where we have no stores.

Irma Sgarz – Goldman Sachs

Just another quick question. Could you give us more color, or maybe a more detailed figure, on this marketing campaign called #MagaluHasIt, which I believe is meant to associate Magalu to the higher mix you are building? What should we expect from this campaign? Maybe you can share some initial figures about how much it has helped you expand your customer base. Thank you.

Frederico Trajano - CEO

Irma, this year, marketing will be more focused on institutional efforts. Of course we also have performance marketing, which is meant to boost sales in both the online and physical store environments. In the last few years, we focused on the app. We worked very hard on the app in terms of mass media, which is what you are talking about as well. We also worked hard on our channels, social networks, app downloads, etc. We will continue to invest in marketing for the app, but we want to complement the fact that we have a very good, easy-to-use app. We offer free shipping for purchases on the app, for which we also use the #MagaluHasIt hashtag. #MagaluHasIt is nothing more than a huge effort we are making, based on our huge category diversity, to show customers that they can buy much more than a refrigerator, a cell phone or a piece of furniture from us. They can buy virtually any product they want, with the exception of perishables, as I mentioned, and some regulated markets. We really want to make our assortment known. We are still... I cannot share too many figures other than the ones we have already shared, but the number of distinguished items sold in the first quarter grew twice as much as revenue. So, e-commerce grew 50% in revenue, 100% in distinguished items sold in the first quarter. The number of items sold at physical stores also grew more than revenue from physical stores. This means that we are selling to more people, different people, in different categories as well. These are concrete figures, but it is not only about the institutional branding marketing campaign #MagaluHasIt, but also an entire link building initiative, with different offers. We have TV host Faustão announcing beauty products and consumer goods, we have the same happening in social media, promotions, 30-second spots, one-minute campaigns... We are adding products that consumers are now recognizing as Magalu products. It is a process, which requires time, but the short-term metrics are very positive.

Irma Sgarz – Goldman Sachs

Thank you.

Operator

We are now concluding the questions and answers session. I'd like to turn the floor over to Mr. Frederico Trajano for his final remarks.

Frederico Trajano - CEO

Once again, thank you all for participating in the call. Thank you very much.

Operator

Magazine Luiza's conference call is closed. Thank you all for your participation, and have a nice day.