

CONFERENCE CALL TRANSCRIPT
3Q19 EARNINGS
OCTOBER 30, 2019

Operator

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

Frederico Trajano - CEO

Good morning, everyone, and thank you for participating in our call for the 3Q19 results. I am here as usual with all the executive committee, and everybody will be available to answer your questions at the end of the call. I will be making the presentation, the introduction, and then Bellissimo will continue, and then we will be opening for questions.

This quarter was a historic one, full of very important things, even if you consider an over 60-years-of-age company. I would like to highlight some of the brands for the company. We opened the number 1000 store in August in Franco da Rocha, 63 years after the first one we opened. We had the coming on board of two new states in Brazil, Mato Grosso and Pará, and the acquisition of Netshoes. Although we announced it in the previous quarter, we integrated and now it is part of our financial statements as of this quarter. In the previous quarter it was only three days, so now is the first time we have a full quarter with the consolidation of the results of Netshoes.

We held the first large B2B event in our history, ExpoMagalu, and it was held in September with practically 1500 people, most of them entrepreneurs that are trying to make their businesses digital through our platform. So it was an event by marketplace, with sellers and delivery people in our ecosystem. It was at Center Norte, a very special event for us.

I would like to highlight as well, specifically in September, another very important point that shows the results of all these efforts of digitalization of the company. In September, as we said in our executive message, with the growth of marketplace we had 50% of our sales at Netshoes, and I think this figure is very emblematic of what we have been saying. We digitalized the company and this represents quantitatively such

digitalization. But I think it was especially relevant if we take into account the fact that it was not to the detriment of our physical stores.

Physical stores, as you will see, had a very robust quarter as well. Besides having our 1000th store being open, same-store sales was 9% over 16% in the last quarter. Overall, physical stores grew 20%. The omnichannel strategy once again is very well evidenced in the quarter. There was also a lot of competition, PR and investments, a lot of moves from a competition standpoint, both from foreign and Brazilian players. It is interesting because for over 15 quarters we have been delivering very positive results. Most are much higher than the market's expectation.

At one point I was told these results were coming from a weak competition, suboptimal from an investment standpoint. This quarter, no one can say that, because there are many things happening in the market, which I would like to mention because the company's results are driven by a talented and hardworking team. Our strategy is assertive and is being implemented with a lot of discipline over many years.

Recently it went to a redefinition, I would say. I would like to begin by stressing this point. We presented this during Magalu Day at the end of last year. We digitalized Magalu and now we want to digitalize Brazil, starting by Brazilian retail. So, everything that we lived as a company, the effort we made to digitalize the company, we want to roll out through 3P and the superapp and all our endeavors in terms of building a technology and platform. We want to make this available, we want to roll this out to the market as a whole. This is our new strategic cycle, which we are already living.

I would like to start with the first slide, the strategic drivers of the company. Here we have 2019, but of course it is pluriannual. As we said earlier in the year, we are focusing on the strategic pillars: exponential growth, platform leverage, superapp, new categories growth, better retail experience, fast delivery, and data-driven and automation culture. I am not getting into details, I will focus on 3Q results, but it is very clear in our figures that when you start a new strategic driver, consistently you have to show it in your figures and quarterly results, more than a PR narrative. You have to show this quarter on quarter. And the main highlight of the third quarter is exponential growth, which is the first driver.

Looking at the results, starting with the e-commerce slide, we grew 96% in e-commerce, including R\$ 700 million from Netshoes. But even excluding Netshoes, we had a 54% growth over a 50% growth base in the previous quarter. This is exponential growth based on exponential growth achieved last quarter.

We have been talking about the superapp as a main growth driver. I always say this is the future, including the apps of companies like Netshoes. We even reached MAU of 14 million this month compared to last year, significant growth. This includes the Magalu app, Netshoes, Zattini and Época. A significant number of app users. From now on we want to grow this even further, but we have already reached a very important figure if we consider all the apps in the group of highest number of downloads. If you look at the Google store and iOS store you will see we have two or three apps, and the Magalu app is fighting to be the first in shopping. In downloads we are in the top 20, competing with social media apps that are very relevant to the market.

The strategy for apps has been very good, and also for sales, not only downloads. The apps are very representative in our sales growth, and the app sales are driving overall sales besides marketplace, which I will focus on the next page.

I would like to focus on Netshoes. Márcio is here and will be talking too. This month was higher than expected, the full quarter integrated in the financial statements. Sales reached R\$ 700 million, much higher than expected initially. In supply chain dynamics of this category, we have been learning consistently from the Netshoes team. These purchases are made ahead of time too. We are planning for next year and we are able to increase our supply for the next quarters, because these purchases remain in cycles prior to the acquisition. In spite of that we had expressive results from Netshoes in both sales, based on the previous quarter, as well as a positive direction regarding balancing profitability, because we already have reached breakeven in EBITDA, which was also reported in our message from management. So we are reaping the benefits from this marriage between Magalu and Netshoes.

Savings, mainly in SG&A, comes from the logistics integration and the back-office integration we will have next year. We already have store pickup at some Magalu stores. One of the stores had over 1000 orders in this modality. On the Netshoes mobile platform you can choose the Magalu store for the store pickup and one store had over 1000 orders in two days. Customers bought products and chose to pick them up there. If we roll this out to all stores, and we only have a handful of stores with the power of penetration and savings in terms of shipping, because we also have free freight, there would be a very good impact on the 4Q as well. This is very positive.

A few days after CADE approved Netshoes' integration, we integrated the catalog and included it in the superapp. The brands had to authorize us. We integrated in the catalog, from the viewpoint of search and the catalog... So we already have most of the brands that we integrated at the beginning and some authorized us recently, such as Adidas. We are still going up in these categories and we are seeing a very good

evolution in our integration. Eduardo and Márcio will give you more flavor regarding Netshoes, and I am particularly satisfied and positively surprised with the first quarter of Netshoes and the way that we are integrating. So, congratulations to all of you and to all of us. You responded very quickly after this process, because this process of acquisition, M&A, etc. is not an easy task.

From the viewpoint of e-commerce, besides store pickup, which is already over 30% of the e-commerce purchases, we are rolling out shipping from store in order to deliver and we have over 145 stores already in this modality, and rolling this further out. So this is another factor that will help us a lot in terms of our delivery - and I will come back to that later. One of the highlights of e-commerce in the quarter, as it was in the previous quarter... I have already talked about ExpoMagalu, but I would like to talk about the 300% growth vis-à-vis the previous year. This is a very robust figure. We are talking about almost R\$ 1 billion of GMV in the quarter. So it is incredible from the viewpoint of growth, and over one fourth of Magalu's overall e-commerce sales, 11,000 sellers.

And I would like to remind you that we have a very good curatorship for sellers. By far we have the most rigid process for the authorization of sellers coming on board, and also the most robust process in terms of obliging the seller to issue invoices in all sales. So, we are extremely careful in our marketplace and we want to grow in the right direction, in the right way. We don't want to have people in the non-legal market, so to say; we want to have sellers that are as serious as we are in terms of paying their taxes and issuing their invoices and delivering the best service to our customers at Magalu.

I interacted personally with many of these sellers and saw that there are so many good people there, with the same commitment as Magalu regarding the level of service. And, by the way, it has been improving a lot with this exponential growth. All NPS indicators of 3P have been improving. They are not yet at the level of 1P, but this is consistent improvement with sustainability. Informal companies do not grow. If you look at the productivity of an informal company, they come to a shilling and they can no longer grow more, and you cannot have a large company growing informally or not paying taxes. We want these companies in our platform to become bigger and bigger in the future. So we made it very clear from the start that, in order to work for Magalu, all sellers have to abide by our requirements and delivering the same level of service. And it is very good for the sellers as well in the long run.

I would like to talk about Magalu Entregas, our delivery system. We have to tap into this base even more and we want to monetize this base with additional services, both Entregas and Magalu Pagamentos (Deliveries and Payments). There is a lot of room to improve the GMV, and we do not really monetize this very much. So, we are delivering

a basic model and as we roll out special delivery services and special payment services, we will be able to tap into this more and more and deliver better and better service to our sellers and our consumers.

And here I am talking about two points: delivery, or fulfillment, and payment, which is the prepayment of receivables and credit and financial operations for these three actions that go through the market place. So, we have opportunities there and we will probably be able to tap into them as we roll out the services that we are developing in our Labs, and with the help of our business people in marketplace. In the most basic model of delivery, which is Magalu Entregas, we already have 72% of our sellers, but I still consider this very basic cross docking and other things. We will be growing next year. During the Q&A we will be able to talk about this.

Talking about physical stores, it was a very positive quarter after a quarter in which we grew less, because of the comparison base with the World Cup. I also highlight the entry into two new states, Mato Grosso and the historic inauguration in Pará. The whole state practically came to a halt because of this. Even in the greater São Paulo, Santa Catarina, Rio Grande do Sul or the Northeast as a whole... But the entry in Pará was really symbolic, because we started very strongly, with a very assertive market of very well located stores and a fantastic team. I went there on the inauguration day and I was really impressed, and it continues to be very robust, and it is very positive. There is also the fact that we are getting into Mato Grosso. This quarter we opened 52 new stores, with significant market share gain, very well distributed in all categories – technology, white goods... So our core categories continue to be very good, and we are getting into new categories with our marketplace, and with Netshoes's 1P, many of our categories.

We want to be a one-stop shop, but we don't forget our traditional categories. They are the company's cash call, important for us to continue to gain share. And there is a lot of room to grow; if you look at the standard categories, our market share is about 15%. So, we still have a lot of room to gain share in our core categories. So we are moving into other categories, but we have a lot of room to continue in our core categories online and physical. We had about 15 quarters is this good dynamic.

And to end my presentation and give the floor to Beto for the financials... Clients are one of the most important KPIs for us. We evolved a lot, 24 million active customers. Here I include almost 5 million active clients of Netshoes, with a lot of representation in our base, which was one of the big objectives of the Netshoes acquisition. So, you can see we grew 44% versus 3Q18, and we are growing not only the base but also the service level much higher than other players. We are the only one that has the RA1000. We have the best score on the ReclameAqui website. We have to grow exponentially,

but at top-notch service level. So, I am very happy with this evolution. And it is very difficult to grow as much as we grew while improving the level of service at the Call Center. Waiting time is less than two minutes, and first-call resolution reached 95%. So, we are improving our level of service. We don't want any problems to arise, but when one arises we need to have first-call resolution. We have been doing a very good job in terms of avoiding problems, but if there is a problem we have to solve it quickly.

Average NPS is 79, and those who are not familiar with the net promoter score, this is an indicator to compare with companies all over the world. This is the first time that we open this. So we went up 3 p.p. versus last year. So, this NPS of 79 is one of the highest levels of retail not only in Brazil, but in the rest of the world. This is totally impartial. We hire external companies to evaluate this. I will continue to show you our NPS. The NPS is very important, and it is also one of the indicators for executive compensation, including the CEO of the company, so it is very important for all of us. And one of the things that has been helping our NPS is the fact that we are raising the bar for logistics and 1P. The data that I will talk about is: for 1P we have over 42% of total last-mile delivery, that is to say express delivery, and in Brazil the average was five to six days. We are bringing this down with a fantastic work being done by the logistics, supply, sales and operations teams, and the stores are also part of that.

So, 42% is very high. If I consider 48 hours that we deliver in two days, we are talking about over 60% delivered in up to two days. We promise 42%, but in fact almost 60% we deliver in two days. In some cities we promise one day delivery for most of the categories of our SKUs. I talked about 1P and 3P, and we are making our best endeavors to roll this out to three people. So, as I mentioned before, this refers to 1P, rolling it out to 3P or using Malha Luiza, Logbee... Everything that we did for 1P we want to do for 3P, but undoubtedly the NPS is very high mainly because of the brilliant job done by our logistics team. And I would like to highlight these factors.

And now, Beto, I give you the floor to talk about the financials.

Roberto Bellissimo – CFO and IRO

Good morning, and thank you for participating in our call. I will be talking about our figures, we talked about sales already, and just the highlights now.

First we will talk about the adjusted highlights, because we had tax credits and non-recurring credits and provisions, and the results are more comparable to last year's, but they include Netshoes for the first time. We were able to increase our gross margin of 0.9 because of Netshoes itself, that has a higher gross margin, around 40%, and also

because of the marketplace. Marketplace helped us a lot and is based on gross profit at this helped Magalu a lot.

As for the operating expenses line, we increased operating expenses a little bit because of the acquisition of Netshoes, and due to the first steps of integration, and also because of the increase in service levels and faster delivery, and the acquisition of new customers in line with our strategy. With that we had an adjusted EBITDA of about R\$ 300 million with a 6.2% margin already including Netshoes, practically with a breakeven in the EBITDA margin. Then we had a dilution of financial expenses and benefits regarding interest on equity. Adjusted net income was R\$ 136 million including Netshoes, 2.8% margin, net income growing versus last year. So this was a very sound result, and we continue to generate a lot of cash, practically R\$ 800 million in the last 12 months with a ROIC of 20% and return on equity very high as well.

We still have a very comfortable cash position of R\$ 600 million, net cash of R\$ 1.8 billion total, including receivables. And I think the main message is that we continue to grow profitably and generating cash. Including non-recurring events, EBITDA was over 500 million and IFRS 16 had margin of over 10%, with net income of R\$ 235 million.

Then we go to our client base. The MAU, Fred has already referred to this, then we show you the evolution of new stores. We opened 52 new stores and started investments to open an additional 50 stores in the fourth quarter. Most of that is already included in the total investment of R\$ 186 million this quarter, growing over 65% vis-à-vis last year. In the year as a whole we have already invested almost R\$ 400 million, in line with our strategy.

On the next page we show you the quarterly evolution of our sales. YTD 33% growth, with a major market share gain online and offline, and also the evolution of marketplace, almost R\$ 2 billion in the year. Then we showed the quarterly evolution of our gross profit on the equity income line. We see a better result of Luizacred and in IFRS 9, already impacted by the improvement in short-term delinquency indicators. This was the best IFRS quarter this year. Operating expenses went up due to the acquisition of Netshoes and also investments in increased service level.

We show you the evolution of our EBITDA on the next page. Once again, very consistent around R\$ 300 million every quarter. EBITDA margin 6.2%. And here we are talking about operating expenses over net revenue, but in GMV. Expenses have a lower weight, because we are growing a lot with marketplace. And the performance of e-commerce, marketplace etc. helped growing the nominal EBITDA from R\$ 281 million to R\$ 301 million. Margin from 7.7 to 6.2 due to the factors that we have already referred to.

Financial results. We were able to dilute our financial expenses in spite of all the Investments made this year, not only in capex, but also the acquisition and payment of previous debts of Netshoes. Financial expenses 1.9%, dropping. In adjusted working capital we continue to generate cash based on the working capital around 70 days, the average term for purchase is 90 days, so a favorable cycle for cash generation. Netshoes has already improved its working capital profile as well, and has already improved the inventory turnover and average term for purchases and generating cash for its own operation.

Here we show the adjusted cash flow. Adjusted cash flow in the quarter over R\$ 200 million from the operations, and we invented R\$ 186 million as already said. Net income was R\$ 136 million, R\$ 367 million YTD. 2.7% adjusted, including non-recurring events, for a higher result.

As for Luizacred, we continue to sell a lot of Luiza cards. We increased our base, reaching almost 5 million cards in total, with 90% active and very high utilization. We highlight that the TPV of Luizacred reached R\$ 7 billion - R\$ 1.6 billion inside Magazine Luiza and R\$ 5.3 billion effectively outside Magazine Luiza. Our card is cobranded, so it can be used in the whole market. Our credit portfolio reached over R\$ 10 billion, growing more than 40% in the last 12 months, a very healthy figure. And we show that the NPL 19 had a slight increase, from 8.5% to 8.8%, reflecting once again, such as in the last quarter, a very high number of new customers. On the other hand, we highlight the reduction of the short-term non-performing loans, which is very positive and ultimately generated benefits in our net income in IFRS 9, as we said.

So, these were the main financial highlights and now I would like to give the floor back to Fred.

Frederico Trajano - CEO

And I would like to open for questions already.

Operator

*Excuse me, ladies and gentlemen. We will now 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 Mr. Robert Ford, with Bank of America. You may proceed.*

Thiago Macruz – Itaú

Good afternoon. I have two questions. Could you share with us the KPIs of the 200 sellers that are doing cross docking with you? And what about the Improvement of the sellers' service that you are piloting?

And it is very clear that you are going towards the superapp. And the brands already have many apps inside, but you have always said that payment will be part of the strategy. Could you give us an update in the sense? What about the fintech operations? How do you see this?

Frederico Trajano - CEO

Good morning, Chicago. Thank you for your question. There is an important strategic component there. Some information is not public. I will do my best to answer about the sellers under the cross-docking model. I can give you an overview. As I said, we have 60% of our deliveries, up to 60 days for 1P, and if you consider 3P I believe that we have less than 20% in D+4.

So, the service level and the delivery time in 3P is much worse, and in 1P these 200 sellers already... Well, there is time regarding you sending this to the mail etc., and the operation becomes a little bit more complex, but for sellers that can post within one day we can already bring them on board for the three-day delivery. We already see a significant reduction in delivery times, a 60%-70% reduction on average, and also a significant reduction in delivery cost. Because we have a level of expenses that is much lower than with the standard carriers, both for higher volume products, such as courier. I would say 20%-30%. But, overall, just ballpark figures so that you may understand. So, reduction in delivery time and cost. Only 200 sellers are benefiting from that.

In Magalu Entregas, I already have a benefit because of my contract with a large carrier, which is this Magalu Entregas and not cross-docking, which is the 30% that I talked about. The volumes are much higher than the small sellers, so there is an advantage there, mainly in terms of delivery cost, and the level of service is better because when it is in Magalu Entregas, product tracking is much better. So, for consumers it is much better, the NPS for deliveries is better. More or less this is the answer, but the focus is to roll out the cross-docking modality.

In Brazil, I don't believe that storage will be as relevant as it is abroad, but we will be prepared to do this as well. So, we are going to expand our area to have it also, but mainly in cross-docking and not so much in shipping from store, and then we collect from the store and then we do the cross-docking. The whole mesh of storage will be a part of that, but it is not necessarily the core in my view. We will be prepared for both

situations regarding payment I can say, even less, because In order to increase MAU the (monthly active users) in the app we want to do this with new categories and lower ticket categories and higher shopping frequency, such as the net categories and Mercado Magalu, which is already representative. 25% of the website customers already come from e-commerce, but we will not achieve the high frequency...

We are talking about monthly average users. We want to go to daily active users and we cannot do this with goods alone. We will have to have other services. You talked about miniapps, and we are preparing to connect these miniapps. And payment is important, mainly in the context of increasing the frequency of utilization. The superapp is a major part of our strategy; however, I cannot get into details regarding the timing etc. But we will certainly be doing something.

In the short run it is a prepayment, and there lies a good monetization opportunity: payment to customers. Today's like a Red Sea. Although it is important from the viewpoint of generating frequency of use, which is important for our strategy, a major investment is being made. Even Caras magazine has wallet; for cashback and coupons etc.

In order to give this kind of attraction, it is too expensive, but from the viewpoint of profitability, with everything that is going on in the world, even the online... Well, of course, sometimes you can have a trade-off but we have to be very careful in terms of this direction not to get into this war of cashback etc. We will make some move but not so quickly and it has a possibility of representing something more significant to our bottom line. We have a very good opportunity in receivables discount for the seller. So this is the priority in terms of our endeavors in this direction. I am not saying that payments and customers are not important, but from the viewpoint of results and monetization the prepayment for sellers should be the first direction.

Thiago Macruz – Itaú

Thank you very much and congratulations for the quarter.

Operator

Our next question comes from Robert Ford, Bank of America.

Robert Ford – Bank of America

Good morning, everybody. Congratulations for the results. Could you talk about the response of MaS, Magalu as a Service? How does it work in terms of monetization? And how do you expect this to evolve Magalu As a Service?

Frederico Trajano - CEO

Good afternoon. In fact, thank you for your question.

Magalu As a Service... The concept is retail as a service. What we do today in the marketplace is a standard operation. We are generating sales for the seller. We are working with customer acquisition and taking advantage of the traffic that we already have in our digital channels and stores, but it is the basic service level in the context of the marketplace. Our strategy is to be a digital platform that will help the Brazilian retail to become digital. We have to have value-added services such as payments. Magalu Pagamentos is part of Magalu As a Service, so that the seller may use working capital etc. from the viewpoint of fintechs for sellers in this component. This is the most basic one. But there are many others regarding payments and credit that we can offer the sellers that will be coming on board.

And we also have deliveries with Magalu Entregas. If I take a delivery that I do for 1P and I make it available as a service to the seller, it will be in the context of Magalu As a Service. I talked a lot about delivery in the previous answer and we have an opportunity to monetize here, although in the short run it is more to increase the level of service and decrease the numbers of days for delivery. For those who use Magalu Entregas here, shipping is free, Magalu subsidizes it. We announced this during ExpoMagalu and it helps improve the delivery services. This is a service. I have contacts with carriers and I have a delivery service. I can make it available to the seller or via technology ,via APIs, via platform, I am doing the delivery for them. That is retail as a service again. And there is an important component that we announced during the ExpoMagalu: today, most of the sellers that are selling online are maybe 50,000 to 100,000 companies that sell online, but it is over 1,300,000 retailers overall. And only 50,000 to 1000,000 sell online, so we are growing over 1,000 sellers online per month via Integra Commerce, a company that we acquired in our platform.

We want to develop systems so that the analog sellers may sell, and we announced one of the first products, the startup Softbox developed the IPDV. Physical retailers place this in their store, the small and medium-sized retailers, as most of the large ones already sell online. They installed this in their physical stores and the system does all their tax forms, inventory, issues invoices, but when you have the inventory on this IPDV, it is made available to the Magalu app. It is still a pilot in Uberlandia, we intend to roll this out. We have already had some sales of goods that were in the physical world only and were sold on the Magalu app, and we intend to develop this even further.

During ExpoMagalu we launched Magalu Tech for the sellers that do it by hand, they issue their invoices by hand. And even some of the 11,000 sellers that sell through the Magalu marketplace have ERP, but some do not, and they do this manually. There are very small sellers among these 11,000. So we launched Magalu Tech in order to help them to collect taxes and issue invoices in an easier fashion.

So these are services that we will be delivering to sellers, to make their lives easier, and we will be charging a very small fee. These are opportunities that we have to improve the level of service in 3P; we want to be as good as in 1P, at the same time monetizing this base that has already grown 300% this quarter, almost R\$ 2 billion year to date. So at Labs we will be developing everything digital, with software as a service, and on the platform we will be making this available to the sellers and, of course, deriving some revenue from that.

Robert Ford – Bank of America

Thank you, Fred. There is a question about Netshoes. You said that it has already reached equilibrium or breakeven. Which is the highest gross margin in the category? How should we think about Netshoes margins in the long run?

Frederico Trajano - CEO

I will ask Eduardo to describe the integration process. Okay? And I will come back and talk about margin.

Eduardo Galanternick - Chief E-commerce Officer

Well, this last quarter we made a commitment to get to November with the design of this integration already completed with many work groups. And we are reaching the final process. The organization design... We are getting to Black Friday and we have to be totally focused on that. But right now we have already been able to tap into very important things, integration of catalogs and the possibility of store pickup for Netshoes. We launched a new version, which is much more user-friendly, with filters, and this is already in our Netshoes app. We have already taken Logbee to cater to Netshoes orders, in order to reduce delivery times, and we have already done the work in terms of synergy with contracts for service providers and, collectively, we have already decided on marketing initiatives. There is the Champions League, which will be broadcast by Facebook and our sponsors, only because we are together with these two brands. In terms of structural integration, we are finalizing the plan to be executed in 2020, and from the business viewpoint we are already capturing some advantages.

I would like to turn the floor to Márcio, who will be talking about this.

Márcio Kumruian – Netshoes Director

Adding to what Edu said, it is very important to have the inventory levels with the best situation possible. And this is what we have already achieved. We have new inventories and the payment terms already reflect the partnership that we have with our suppliers, with our partners, growing more than 20%, with the EBITDA already capturing everything that Edu said.

It is important to stress the new sponsorships with marketing, and this places Netshoes as a very beloved brand. Zattini too, but sports is growing. And the creation of a world within Magalu, together with the brand, in a very well structured model. We are bringing gradually to a controlled environment, a healthy environment, all that, so that we may grow very quickly. Just to give you an idea, we are already completing over 50,000 products on the Magalu base for November, for Black Friday. So these are some details of the business.

From the margin viewpoint we do not give guidance. But together with integration we are doing our strategic planning for Netshoes. We hired a consultancy company and we are drafting a business plan, tapping into opportunities, and my view is the following: Netshoes sold R\$ 2.5 billion last year in a market of R\$ 240 billion. The penetration of fashion in Brazil is still very low, if you compare this to any other place in the world. So, one of the biggest opportunities for growth in e-commerce is fashion and there I include sports goods as well, which has achieved high penetration in Brazil. It has really changed the world of sports goods. But if you look at fashion as a whole, penetration is low, about 5% not considering some figures from marketplace. But some countries already have 20% penetration. So the focus of Netshoes is growth. We want to balance the result, and we already have some signs of this breakeven. We want to improve the cash generation of the company this quarter, we already have evidence of that. But achieving this breakeven, the focus of the company will be growth in revenues.

Looking at the opportunity as a whole, including the fashion opportunity, we can further increase GMV in all categories operated by Netshoes. And this is Márcio's focus and his team's focus: growth with balance, because Magalu grows with balance. This is the way we do things. So, working with higher margins after we get to higher revenue. But the advantage is that this helps dilute fixed cost, and part of the dilution will be with the integration of the back-office next year. Netshoes would have to have a large structure for R\$ 2.5 bn, and for Magalu higher GMV needs less, and part of that has to do with Malha Luiza and store pick-up in many geographies. São Paulo not so much, but in many other places this will help reduce the delivery expenses of Netshoes, but the focus of Netshoes is to tap into this great opportunity, which is the apparel and fashion and

sports goods market. I believe that the major wave that is coming is in these categories, as was the case with electronics and appliances before.

Robert Ford – Bank of America

Very clear, thank you.

Operator

Our next question comes from Luiz Felipe, BTG.

Luiz Felipe - BTG

Good afternoon, everybody. I have two questions. The first one has to do with Netshoes. Can you already see some cross-selling? You said that 25% of traffic in the platform already comes from new customers, so you already see some cross-selling. Netshoes customers buying products that were only sold in Magazine Luiza. And the ways you monetize is the second question. You talked about Magalu as a Service. So what are the opportunities when you think about monetizing traffic? Maybe in terms of advertising. Can you already see an opportunity, as you already see in more mature markets than Brazil?

Frederico Trajano - CEO

Thank you for the question. There is very little cross-sell. We do have some categories, Adidas will be coming on board this week, so the major brands are coming on board now. The iOS store was updated during this last weekend. So we still have integrations in CRM already being debated, but it is still scratching the surface. Basically we have grown with the new categories that were already in Magalu, and the new categories that were already in Netshoes. So Netshoes within Magalu, but far from achieving the potential. We already see something and we have to celebrate every million that we generate. But we are still scratching the surface, it is the tip of the iceberg and we have a lot of room to grow in terms of CRM and cross-sell.

About Magalu Ads, when we talked about strategic priorities I said that we have a lot to grow in GMV and audience, and we have to grow sustainably. We are very much focused on growth, to the detriment of margin even, because when you have a large margin base it is easier to monetize it. We are not prioritizing new services yet. In Magalu Pagamentos, the focus is in terms of monetizing receivables from sellers and not end customers. In Magalu Entregas, it is even less than Magalu Pagamentos. But I would say that the main focus is to increase the active client base. We are talking about 25 million customers of 150 million people in our economically active population. So we want to have a much bigger base. We already have Magalu Ads, but this is not our main focus. We are focused on increasing the base and the frequency, and we want the

customers to return more and use the app more. This audience has to be monetizable. It is not only about having the customers that bought in the last 12 months, but always going to the app etc. Then we will have relevant results in the future. So, this is an important business line for the future, and this is an important path for our monetization, but the purpose is to increase monetization, the frequency of use, the MAU and the DAU as well - first the audience and then the revenues. We are focusing on the audience first.

Luiz Felipe - BTG

Excellent, Fred, thank you very much.

Operator

Our next question comes from Joseph Giordano, JP Morgan.

Joseph Giordano – JP Morgan

Good afternoon. Thank you for my question. The first question has to do with the customer base. I would like to understand the behavior in your physical stores and how the Luiza Card, which is a major part of the total revenue of the company, how do you compare the use of Luiza Card in the physical world that the online world. You have a lot of room to grow with your loyal customers.

Talking about Netshoes, you talked about Adidas and other brands that are coming across and leading the assortment of marketplace at the company, and as your competitor has a partnership now with another e-commerce platform. Do you have any talks going on in terms of expanding the mix of Netshoes? Because there are some products of these brands that are not available online.

Frederico Trajano - CEO

Joseph, could you repeat your last question afterwards? I will start by answering your first questions and then I would like to ask you to repeat your last question, because I have not understood it.

Well, physical stores. In the quarter, in the active client base of physical stores, yes, there was an increase in the client base in stores, a 16% growth in physical stores. Most of the growth in the e-commerce active base comes from 3P; and 1P is growing with and without Netshoes, less than 30%. I am talking about 1P now, okay? Overall, 54%.

Of course the customer base grows proportionally to the growth in revenue. So with Netshoes you have a 90% growth. This is a major growth in e-commerce. So the major generator has been e-commerce, 1P, but maybe there was a significant impact coming

from the active customers of Netshoes, and also the marketplace that helps ultimately in the Magalu context. But physical stores grew 16% in the quarter, and this is a very important figure for the physical stores. Like e-commerce, store teams have targets for active customers. And of course the base is older, but we have a very healthy growth rate in terms of new customers and the active base, and we are including clients of other markets as well. So all these from Pará and Mato Grosso are new customers, some of them bought online, but most of them are new customers.

As for the Luiza Card, it is very representative, and customers who buy with the Luiza Card are more loyal and the frequency is much higher than for customers who shop without the card. And the lifetime value of these customers is five times bigger than for customers without the card. So it is super important for us to increase the number of customers that buy with the Luiza Card. The IPP is 50% in physical stores. It is not so big in e-commerce, less than 10% In fact; this is still a very low figure but there is a huge opportunity to increase the penetration of the financial product in e-commerce. And we are now getting these questions in terms of the flow of the shopping process and also to have a better product for the online customer. It is a little bit different from the offline customers, and we have a huge opportunity to increase the penetration of the card in e-commerce, not to mention digital payments. It is not only credit, sometimes it is bank account, etc. It has to do with what I said to Thiago: there will be an opportunity as well, in terms of digital payments. But I cannot give you any details because this information is not public.

Could you repeat the last question, please?

Joseph Giordano – JP Morgan

The Netshoes assortment, the management of channels of global brands – Nike, Adidas and others – and some items were not available to online channels such as Netshoes, and we saw another company making a partnership with another company with a similar operation. And is there any intent to further strengthen the presence of Netshoes online, because of these reasons?

Márcio Kumruian – Netshoes Director

Fred has already said that we are doing strategic work with the brands. Sports, fashion... So that in 2020 we can achieve exponential growth, also increasing the portfolio such as in sports.

So we are talking with all the brands, in a very well structured and very transparent manner. Nothing is being done in an underhanded fashion. We are working hand in hand with these brands, and of the 10 biggest brands in sports, 9 have already given us

the greenlight for the Netshoes world. The 10th is already underway. And we intend to increase the mix, respecting segmentation and the different environments – Magalu.com, Zattini, etc., with a very well structured way. We will see how Netshoes can advance in this portfolio.

The competitors' partnership has not made available the full portfolio. We are already talking with the brand about this as well.

Frederico Trajano - CEO

Well, when we talk about the integration of Netshoes with Magalu, it is done in a highly complex level, with a system integration that is much higher. It is not webview. We took the catalog and we integrated. In the Magalu app you can search products and the catalog is indexed. You have it in Google, etc. You cannot do it overnight. So it is a native integration between their catalog and our own catalog. On the internet, if you do not integrate natively, if the catalog is not in the search it is the same as not being there.

Regarding this, I am not saying that nobody will do this with another partner. This is not what I am saying. What I mean is that we have a native integration and the brands have to be consulted, I need to have their authorization. It is in the search engine, it is so native that I need the brand to authorize me. Otherwise, I will not go ahead. It is as if it were not integrated.

André Fatala – CTO

The difference that we have is that they did their native integration, as Fred said, in all functionalities that we can give our clients. Also with the Netshoes products. Now we are increasing the store pickup and all the experiences natively. They are going to be delivered, their own improvements in the searches. So, in the analysis that we carried out, we have this desktop and mobile site version, with an iFrame that evokes the site of the other brand inside the desktop and the mobile site. So it is totally different from the experience in which all the features that get into the Magalu app...

All the customers will benefit from it, because it is fully integrated and natively integrated.

Frederico Trajano - CEO

It will be only natural for offline companies making partnerships with online partners. And we will be looking for other companies to have in our app. But we are looking for native integration, maybe with a different look and feel, but with an unique shopping experience. If you do not have this natively indexing, search sites and the catalogs for

internal and external search, this integration will not bring benefits to anyone. Not the retailer, not the platform.

We are not talking against any movement, but we are explaining the difference between our approach, in how we want to get ahead. I intend to have IPDV and other integrations with physical retailers, that we place their physical catalogs on our platform. We want to be a digital platform, not only with our own physical stores. So our mass strategy, or part of the strategy, is to integrate not only with the large retailers, but also the small and medium sized, of course with the large ones as well. We will make our best endeavors to integrate with large companies as well.

But when you have the product or the catalog inserted in our experience, it has to be totally seamless for all customers. I am trying to explain, it is not very easy to explain. And the shopping cart is unique, it is only one. I do not want to create many different environments within my superapp. Everything has to be totally integrated with a shopping funnel, so to say, with no friction whatsoever. Very user-friendly, in other words.

Joseph Giordano – JP Morgan

Perfect, thank you Fred, Fatala and Márcio.

Operator

Our next question comes from Richard Cathcart, Bradesco BBI.

Richard Cathcart – Bradesco BBI

Good afternoon. I have two questions. The first one has to do with it with... You said that you deliver in 24 hours in 40 cities. Do you see any change of conversion and frequency in the customers that are using the service in these cities?

And also regarding the initial results of what you made available in October. I would like to know what you see in this regard.

Eduardo Galanternick - Chief E-commerce Officer

Richard, this is Eduardo. Thank you for your question. About the impact regarding conversion, it is directly proportional. We have internal studies that show the conversion in terms of the promise of delivery times, and this is very obsessive on our part, that is to say reducing it. Logbee today is our main strategy to get this reduction today in São Paulo city. We cannot give you more information, but most of the deliveries in São Paulo, in 1P, already have one-day promised delivery time. When you go from one day to two you have a drop in conversion of about 20%. A drop in conversion rate.

About Click and Collect for Netshoes....

Frederico Trajano - CEO

Richard I really do not understand your second question. Could you repeat it?

Richard Cathcart – Bradesco BBI

Fred, you saw that you said that the initial results of Click & Collect in the Magalu stores were outstanding. I would like to better understand the results that you see so far.

Frederico Trajano - CEO

Well, today we have four stores. And in one of these four stores, we had 1,000 orders that were done in Click and Collect in 10 days. And in one of the stores only. So we are very positively surprised, and in all the stores you see many... So we have four stores. And I visited Lapa store yesterday. I went to 595 as well, and all of them have a lot of items available in the store that are being collected by the clients.

Talking with the teams, it is great to see that most of the customers go there and they are new customers. They had never been to a Magalu store before. So, there is an opportunity for the physical stores to convert, both selling financial products and financial services, physical products, like insure and other financial products? So there is a big opportunity there. And of course we are going to roll this out. We should be rolling this out very quickly.

Eduardo Galanternick - Chief E-commerce Officer

What is done for Netshoes is valid for 3P in general. So we have a pilot for Netshoes and we are going to roll this out to Netshoes and soon other partners of the platform. Other sellers.

Frederico Trajano - CEO

Well, Netshoes as a seller and other sellers will benefit from this movement. It is a part of MaS.

Richard Cathcart – Bradesco BBI

Very clear. Thank you Fred and Eduardo.

Operator

Our next question comes from Rubem Couto, Santander.

Rubem Couto – Santander

Good morning, everybody. I am curious about Netshoes and Click and Collect. What about opening new stores focusing on this category? I understand the relationship with the industry is very specific and it comes from Netshoes. And with all the benefits that you see from Click and Collect, I would like to know how do you see this possibility?

Márcio Kumruian – Netshoes Director

This is Márcio, thank you for the question. As we said before, we already have four Magalu stores, we are very surprised. The orders are going there and we are using this as a pickup point. Right now we do not intend to use Magalu stores for sales or just to show the products, and we will see how Netshoes behaves. We are thinking about online, physical, digital... All the models are being discussed. Going to the previous question, so that we may increase our portfolio and have a bigger footprint, and also using these stores in an omnichannel operation, more on the Magalu chassis, so to say.

We are very happy with Click and Collect so far, and the customers... Well, there are new customers on both sides and we did not expect to have this level of adherence. So we have to fill the Magalu stores with purple bags and bring other customers to Magalu.

Rubem Couto – Santander

I would like to go back to the initiatives that you mentioned to increase Marketplace and mainly the reduction in the prepayment of receivables. What do you intend to do in the fourth quarter? Can you see already some degree of acceleration in sales from sellers that are now participating and were not participating yet, but want to take advantage of the free shipping or free delivery? Have they joined because of that?

Frederico Trajano - CEO

Well, it is still very incipient. We launched this last month and many things have to be done by the seller, such as the time for posting and many other requirements. So we are not going to give you guidance regarding impact on our margins, but we made our studies and there is nothing very significant in this regard. The logistics is very efficient and we have good costs, and there are some criteria for the app, like over R\$ 99 purchases and so on.

We are already giving free shipping or free delivery for 1P, so the investment is not so difficult in the context of 3P. And it is very difficult to segregate 3P because it is going well overall, and to know exactly what contributed is very difficult. It is going very well. And payments, likewise. The advantage is the fact that the seller uses the platform more often. And today we still have a third-party platform. We already have Magalu Pagamentos, but the economics is a part of the company.

We intend to do this 100% internally and not using other acquirers. The objective of giving the discount to the sellers is to help them have working capital and have more products and also show that the seller uses the tool, and if the seller gets used to that it will facilitate our roll out.

Eduardo Galanternick - Chief E-commerce Officer

Just to give you some more color, the main driver to make the seller join free delivery is to give him a better term of payment. But all sellers that came on board in the program had a significant reduction in the delivery times promised. In São Paulo it was about 30% drop and when you go out of SP it is over 15% reduction in delivery times, connecting to what I said before. This has a direct impact on the increase in conversion. So we are learning a lot with this initiative.

Rubem Couto – Santander

Thank you.

Operator

Our next question comes from Irma Sgarz, Goldman Sachs.

Irma Sgarz – Goldman Sachs

Thank you for the question.

Conceptually, marketing is under SG&A. How do you conciliate this? Of course a level of investment has to be higher right now, for competitiveness reasons. So, how do you think about this line in the future? Maybe if it impacts your profitability, will you still be focusing on growth?

And the second question has to do with the macro-environment. Do you believe that customers or the market have a higher degree of confidence? And what are your plans for 2020 and for the end of the year?

Frederico Trajano - CEO

Once again, we do not breakdown the marketing expenses. What I can tell you is that, when we look at our investment, in the context of SG&A over revenues, there is an important consideration by Beto: when you look at the quarter figures, you have to include the Netshoes effect, because we got to breakeven. There is an impact on our margin. And you have to exclude the following, the GMV of the marketplace becomes higher than the total GMV of the company. It is already 25% of e-commerce.

When you compare the operating expenses with the net revenue, you are not considering GMV, you are considering the take rate. But when you look at your expenses vis-a-vis the total GMV and also the net revenue, it has been increasing much less than it is shown in the financial statements.

Marketing expenses as a ratio of GMV have not been going up significantly. They are remaining flat. I am keeping it flat. And you ask me why are our financial expenses going up versus GMV? Mainly because of logistics, investments in teams, and we have been working on D+2, we are investing a lot in the whole supply chain, more truck frequency, more travel frequency, a higher number of people with the DCs, a higher number of people in the brick and mortar stores. We had to increase the number of inventory clerks, because a lot is being picked up at the stores. So the inventory guys are the ones that are doing the hard work, and there is a team of inventory people in the stores. So, we are investing much more in logistics, percentage-wise. I am very careful, and I do not do any overspending in marketing. We have a more assertive marketing investment, more focused on the app and customers that give us a higher CLV – so card customers, channels and others who have a higher frequency.

A major part of the investment that we are making, shown in our results, are not in marketing. We are increasing the team in our marketplace and Labs people... So we are investing in many different areas, so that we may grow our revenues and not overspending in marketing. I do not like the dynamics of companies that grow based on customer acquisition cost that is very high. And our customer acquisition cost is very low versus the market. We have not started digital payments for instance, so we are not participating in this expensive game of wallets. The idea is to get into that, take advantage of the superapp, and not make an investment to have an additional app base. It is different from what the market is doing and I think it is going to be cheaper.

Irma Sgarz – Goldman Sachs

What about the macro environment? The second question?

Frederico Trajano - CEO

I am very bullish about the market. We had the approval of the reform last week, the decision about the FGTS, which was very good because the government had done this in one and a half years and it would not give the impact that retail needed. With a stronger stimulus given by the government, now we will see a positive fourth quarter, with tailwind and not front winds. We have been growing for four years, but the best GDP we got was 1%, either negative or zero. So finally we get to grow with the help of the macro environment.

And I am bullish because, with all the players that I have been talking with, I see that the economic recovery will be driven by the private initiative, not the public sector. And it takes a long time, because companies have to set up a business plan, submit it to the board, get funding, because private companies usually do not spend money that they do not have. Usually, I see a high cycle of investments, and this generates jobs and jobs generate consumption. And I see this as a recovery that will be slower initially than the one we saw in the past, but once it comes it will be more sustainable and sound.

I am very bullish about it, we have been accelerating investments. You see many Initiatives in terms of automation of DCs, and we already have this in place at Louveira, a very heavy investment, and we are accelerating investments in other fronts, and we are very bullish. We believe that recovery will come and it will become stronger in 2020 and in the following years.

Irma Sgarz – Goldman Sachs

Thank you.

Frederico Trajano - CEO

Thank you for the question.

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. Please, Mr. Trajano, you may proceed.

Frederico Trajano - CEO

Well, I have already talked a lot. It is already five minutes past one, it was a very long call. I would like once again to congratulate our team for the outstanding job done during this quarter, and I wish you all a very good afternoon.

Operator

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