Conference Call

Magalu

Results for the 1st Quarter of 2023

May 16, 2023

Lucas Ozorio – IR Coordinator

Magalu's results conference call will start shortly.

Good morning, everybody. Thank you for waiting. Welcome to Magalu's conference call about our quarterly results. For those who need simultaneous interpretation, please click on the 'Interpretation' button via the globe icon at the bottom of the screen and choose your preferred language, English or Portuguese.

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

During the presentation, all participants' microphones will be disabled. Then, we will start the Q&A session. If you have questions, please click on the 'Q&A' icon at the bottom of your screen and, enter your name, company, and question language. When you are announced, you will see a request to activate your microphone on your screen. You must then activate your microphone to ask the question. Questions received in writing will be answered later by the Investor Relationship team.

Now, I would like to give the floor to Fred Trajano, Magalu's CEO. Fred, please take the floor.

Fred Trajano – CEO

Good morning, everybody. Thank you very much for being here at our 1Q23 earnings call. I am here once again with all of Magalu's executive board and some of our subsidiaries. They will be available to answer your questions at the end of the call and clarify any doubts you may have about this period and the future of this year, as well as the period before that.

I would like to start by speaking a little about our context in the 1Q. In the macro scenario, as expected, we faced a challenging scenario, especially in the online market but also in the offline market. We had a feeling, an expectation that this was going to happen in this 1Q, and all of our potential and expectation in this quarter was in gaining share. In this macro scenario, as we knew that the pie was not going to grow, the company's focus was getting a bigger share of the pie. That was the team's focus throughout this quarter. According to Neotrust data, our online market showed a 14% drop in 1Q23. It had been a while since we saw an online performance at this level. The offline market, according to GFK data, the best measurement for our categories considering that we work with physical stores, grew only 2%, that is, walked sideways.

In this scenario, the company managed to grow in all its sales channels: We grew 11% online and 8% offline. After the online, I will speak a little about 1P and 3P). We reached our largest market share in our history by gaining 6 p.p. in this period. The business as a whole grew 10% in 1Q, coming from a high CAGR for 2020. We practically doubled in size from 2020 to 1Q23 and are growing at an average of 27% per year. The base is not low, as we have been growing consistently every year.

We grew 10% and reached our history's highest revenue in 1Q2023, which is 15.5 billion, with a 73% online share, achieving a high market share and offsetting this market that moves sideways offline and backward online, with a significant gain in share. In fact, Magalu was one of the few companies that gained share in this 1Q.

As for our physical stores, we came from a quarter of growth in 4Q of last year and again could grow in a market that is moving sideways. My expectation for our physical stores this year, although contrary to this macro scenario, income shrinking and restrained credits, is that physical stores have a differential this year, the Difal, which is bad for 1P but good for physical stores.

Difal is a tax we pay in interstate e-commerce transactions. It was implemented again this year, meaning that 1P online transactions have to add this tax to all prices. As this tax is added to prices, the differences between online and offline prices decrease and physical stores become more competitive.

Physical stores have always been vital for our value proposition for several reasons but also as a sales channel, so it showed 8% growth despite this unfavorable scenario. I still see potential for this to happen in the coming quarters and we see a wave of positive growth this year. So 8% in total, a little less for same-store sales, but with a more positive trend due to this competitive scenario and the regularization of online and offline pricing, which was always the standard practice before this Difal issue that I mentioned.

In the online scenario, we had a CAGR of 40% in the last few years, total growth of 11%, and a 6 p.p. of market share gain. Again, this is all in a shrinking market, showing that Magalu has consistent operations and is one of the largest sales channels with more than 450 million monthly accesses in all its operations: Época Cosméticos, Netshoes, KaBuM!, showing that it has a significant presence and a large market share.

But this quarter's main highlight—next, please—was our marketplace. We grew 19%, and this is the strategy that I have been reinforcing in our calls for some time now:

Magalu wants to become a multichannel digital platform, a multichannel marketplace. Our growth is focused on growth opportunities and profitability is in this channel. If you take a look at this channel since 2020, it has been growing 52% every year on average. So it grew 19% over a base that had grown 50% last year and that had grown 98% in 2021.

These are challenging bases, and yet our marketplace keeps growing. Please note that the GMV grew at the same time that we reduced our freight allowances, optimized our marketing investments, and transferred part of our operating costs to our take rates, and we still had positive growth in this period, showing the strength of our strategy. Next, please.

Our marketplace surpassed physical stores for the first time in the quarter as a whole. I think this is historical data, given that we have had our marketplace for five years and our physical stores for 65 years, which shows the exponential growth and relevance of this channel. Our initiatives here, about which I will speak more later, such as improvement in delivery times, conversion improvements, an increase in the number of sellers, an increase in the number of sellers that sell every day, a larger catalog, an increase in our catalog of available goods for our marketing partners, in short, a series of initiatives that have provided us with consistent growth. So, I really think this is a highly relevant historic milestone. Magalu's marketplace is already surpassing our physical stores and showing its full potential in terms of scale and growth. Next, please.

I believe that this shows that it becomes more positive and powerful within the context of improved margins. So, we have been doing a consistent job of evolving our 3P take rate. I see the Brazilian platform and marketplace markets as extremely rational. Almost every month, a platform rationalizes prices, transfers costs to commissions charged via take rate, via freight charges, and this has allowed Magalu to be able to transfer these prices as well while staying far below many players in the market.

Therefore, we take the total charges we make between Magalu Pagamentos (Magalu Payments), Magalu Entregas (Magalu Deliveries) and take rates and divide this number over the total GMV and it's still below, so we are still one of the best options for the most profitable sellers. This is why we have attracted so many sellers and the number of sellers who sell daily here at the company has increased so much. We have achieved a 19% increase in GMV, but when we look at the marketplace revenues—Beto will talk more about this later on when he explains the impacts this has had on our gross margin—our revenues grew 39% here, already having a clear impact on our P&L and balance sheet, showing that we are walking the talk in this regard.

From a cost standpoint, we also increased our logistics efficiency by reducing our 3P cost percentages, implementing more intelligent freight policies and having a more efficient logistics operation. And with the growth of fulfillment, as it is developed and its design was based on the same operating bases as 1P, the marginal cost of operating 3P on this basis is very low, so as fulfillment evolves in the participation of 3P total deliveries, this cost tends to decrease, the percentage of 3P In-Store Pick Up tends to increase. With this, we will be able to have the same efficiency we always had in 1P, both in terms of delivery time and course and also for the 3P, thus continuing this positive trend. Next, please. This is ultimately reflected in our contribution margin, which is positive and is the channel that grows the most today, having better profitability and a greater perspective of growth going forward.

Thus, the marketplace growth is even more relevant within this context of greater efficiency and profitability, showing that we bet on the right things and are on the right path. So we must celebrate these evolutions. Next, please.

I would like to point out that the e-commerce market is a market of hundreds of billions of reais here in Brazil, so it's a large market having all kinds of categories. We believe that we have a greater right to win in better unit economics categories. Magalu comes from a 1P operation of larger tickets, so we want to operate our marketplace with quality products, with the best brands and tickets greater than R$ 200. And I always comment on this analysis to make it clear that it is almost impossible to obtain results in Brazilian operations and tickets of around R$ 50, R$ 60, and below R$ 100 when we look at freight costs over GMV and the marketing course which is also higher for smaller tickets. Unit economics get really tough, so it's almost like we must have take rates of 50 to 60% to operate in positive territory.

We have a characteristic, a channel which consumers join and in which they trust, in which they know they will buy products that are of good origin, not smuggled, that come from actual brands, not counterfeit, and that the company has payment options available for consumers to buy larger products.

We also have particularly good logistics for medium and large items, which also fit this characteristic. We have focused a lot on gaining a larger share. It's not that we are not going to operate with other products; we want to have a greater share in products with higher tickets, which is why our 3P has been profitable due to this assertiveness in relation to product families. We have over 190 product families that are different even from what we originally work with in Magalu's core categories, but which represent an opportunity for sales growth looking forward. Next, please.

And we have also grown our share. We have increased our product share. I don't have the specific figures, but here on this slide, we can see here our share of the online market in 1Q23 for products above R$ 200. We grew from 200 to 1,000 and above 1,000 we continue to gain a lot of share. We have been operating with assertiveness in these categories. Categories such as tools and lighting products, several categories are significant and at the same time allow us to diversify our base, without losing bases, and to place our unit economics as a heavy trade-off. Next, please.

Magalu reached 280,000 sellers. We continue to increase our seller base consistently. We gained 21 thousand sellers in this quarter alone, up from 260 thousand at the end of last year, and more than 9 million offers, reaching a base of 100 million offers. As I said, these sellers have increasingly more liquidity and sell more every day.

We have a feature, an offer (next, please), that provides a good value proposition for large sellers. We even started our marketplace with big sellers, so large Brazilian big industries and brands have Magalu as one of their main sales channels. We even lead in several of these large sellers' categories.

During the pandemic, we developed a differentiated and unique work at the base of the pyramid of working with small and hyperlocal sellers with our Parceiro Magalu (Partner Magalu) initiative. It was one of the main drivers of our geographic dispersion and our category base diversification. Because it is hyperlocal, we can work with slightly smaller categories and have a strong competitive advantage for this base. Please note that there are 6 million retailers in Brazil and only 300 thousand of them sell online, so our physical stores help them ship products, working as a support point. Therefore, the great attraction factor for these sellers is our physical stores.

And we also focus on growth for medium sellers, a market that shows high potential for gaining share, in which we are now offering some new tools such as integrated fulfillment for 1P and 3P and the work of assisted sellers. I have a team that works with these medium sellers by providing customer service and helping them use our tools and our entire platform better. Anyway, I believe that our value proposition today is very well tailored to all types of sellers, and we are also managing to grow as a result of this assertiveness.

I said that our marketplace has surpassed our physical stores, but I need to emphasize the importance of physical stores in our marketplace strategy. Our differential in our value proposition is our physical stores. They play a key role in what I call the multichannel marketplace. It is important from a ranking point of view, as 55% of sellers reach us through our efforts of attracting store teams. It is very important from a logistical point of view. Today, 70,000 sellers use our stores to drop off goods, especially sellers at the base of the pyramid. Instead of sending them to a post office, for example, they use our store to ship products at lower costs.

These stores are present in several Brazilian locations, and another great differential of ours from the—this is the first mile—last mile standpoint is our In-Store Pick Up, with over a thousand participating stores. In the first quarter of last year, only 10% of Magalu's 3P sales were picked up in stores. This number doubled to 22% and grew in relation to the last quarter of last year as well. Next, please.

You can skip this one as well, I already mentioned Partner Magalu. Looking forward, the 3P growth triggers show a conversion increase, which necessarily involves improving delivery times for 3P. We already have exceptional delivery times in 1P, and it is, without a doubt, the operation with the shortest delivery time in 1P. It's like this:

85% of everything we deliver in 1P is delivered within two days, so this operation uses and leverages stores and store inventories and our 20 Distribution Centers (DC).

We are evolving in 3P by trying to make 3P delivery times similar to those of 1P. We went from a delivery rate of 31% on D+2 in 1Q22 to 45% in this 1Q, which decreased our conversion gap between 1P and 3P to 1.4x compared to 2.3x in 1Q last year and 2.3x in 1Q21. So, the conversion differences between 1P and 3P are getting smaller as we improve delivery times and manage to improve these conversions. As I mentioned, we have implemented some initiatives related to this, one of the most relevant of which is our fulfillment.

When sellers leave our partner shipment, in which they ship their goods sold for fulfillment, their conversion doubles. We have 6 DCs already working with fulfillment operations—we have achieved over 1 million orders placed by fulfillment this week, and this operation started only a few months ago. For those within fulfillment, 30% of deliveries are made in D+1 (not even D+2), so a considerably low evolution.

As I mentioned before, because this operation is integrated with our 1P, its cost is marginal. Over 1,200 sellers have already opted for fulfillment, and this process is evolving. Next, please.

We prepared this slide to give you a glimpse of the progress of the connection of our ecosystem. We've been talking about this a lot, and we are in the year that I call Ano Simplifica Magalu (Simplify Magalu). The key to simplifying the company is connecting our delivery, payment, search, and back-office platforms with the companies we acquired, Ads as well, and all our content, thus generating value for these two things.

From the Magalu Entregas point of view, practically all operations operate with our delivery, Magalu, Netshoes, part of Época, KaBuM!, 3P Logistics the same thing. For financial services we have Magalu, Netshoes, Zattini and part of KaBuM!, and Aiqfome. For KaBuM!, we process PIX payments via Magalu Pagamentos. SmartHint, which is the search operation we bought two years ago, is already on Magalu and Netshoes and recommended on Estante Virtual and KaBuM!. Hubsales are also in all relevant operations. Our back office is almost completely integrated, fully integrated, and it is in Franca, reducing costs and optimizing operations. This is true for Luiza Resolve as well, which is part of our customer service.

We have evolved a lot. For the content part, our content companies work for all our partners, and we want Magalu Ads to work, as it is the platform that was first implemented within Magalu. If sellers invest in Magalu Ads, they should be able to publish ads in all of the Group's companies.

Now that I've mentioned it (next, please), we reached 3,300 active advertisers on the platform from a small base. Our revenue quadrupled to over 10,000 campaigns in the quarter. We put Magalu Ads in our search platform, which is our greatest growth factor and potential, and this has been one of our biggest bets for the future for more profitability based on what has been done by marketplaces and for all our digital channels. Eduardo will give your more details about this operation later in the Q&A.

I would like to finish my bit before giving the floor to Roberto Belíssimo to talk about insurance by speaking a little about the monetization point of view. For those who don't know, Magalu sells more than R$ 1.3 billion per year in insurance, this was little known about our business. We sell insurance of all types: extended warranty, insurance, robbery and theft, guaranteed purchase, which is insurance linked to credit, a very strong residential protection insurance, so several categories.

We sell more insurance than many banks. We renewed our contract with Cardif last year until 2033 and agreed on a total amount between the contract renewal and the sale of a stake in Luizaseg to simplify the operation, thus having fewer CNPJ enrollments and being able to operate more simply, focusing on what creates value for the company. Our negotiation totaled 1 billion between its two elements, showing our company's size and potential and the influence it has in these matters.

We signed this contract while maintaining our commissions, including profit sharing looking forward. We believe that Ads, insurance and the other initiatives we will explain later, but especially these two, help us simplify the company's focus on products and elements having a relevant contribution margin, such as Ads and insurance, and on further scaling these elements internally.

Now Roberto will talk a little about our financial highlights, and then we'll be taking your questions.

Roberto Belissimo Rodrigues – CFO and IRO

Good morning, everyone. Thank you for participating in our earnings call. I will start with the financial highlights. Fred has already mentioned our growth in all channels, a remarkably high growth of 10% in total, with 15.5 billion in total sales.

I call your attention to our gross margin of around 27.3%. The next slide will give your more details about the evolution of this gross margin and the EBITDA margin, close to the 5% level. Our net final results here are negative at around 300 million, a figure greatly influenced by the high interest rates in Brazil and the seasonality of financial expenses. I will talk about that in a moment too. Just to point out, here we have our adjusted results also due to some non-recurring, extraordinary expenses accounted for in 1Q at around 120 million.

Speaking of the evolution of the EBITDA margin, we practically maintained the same level compared to last year. Please note that 1Q for our retailers is seasonally the quarter with lower margins due to promotions and sales that are seasonally lower in the 1Q. Our EBITDA margin evolved throughout last year, and this quarter we have almost the same EBITDA margin as last year, with a dynamic of variation in the gross margin of around 0.5 p.p., practically entirely offset by a dilution of operating expenses, while general and administrative sales were diluted by 0.6 p.p. in relation our net revenue. If we look at it in relation to total sales, it decreased by 1 p.p.

Therefore, our EBITDA margin was highly impacted by the gross margin and Difal, which we highlighted here. The return of Difal represented an increase in the tax burden on gross profit from goods of around 3.2 p.p. We started to transfer this tax increase in January, due to the liquidation as well, then we a little in February and a lot from March onward. On average, we transferred 0.8 p.p.; that is, more or less 25% of the increase in taxes since the beginning of the year. So, this is as though we had started close to zero, evolved to 25, and then reached 50% in March.

The most important thing here in terms of gross margin was still the growth in revenue from services, with emphasis on the marketplace, which contributed 1.9 p.p. in total gross margin. That's why the gross margin on goods decreased by 2.4 points, but revenue from services almost completely offset this variation. Thus, the consolidated gross margin decreased by only 0.5 points. If it weren't for Difal, our gross margin would have increased 1.9 points, almost 2 p.p., just to show the impact resulting from the marketplace growth and commission adjustment from last year and February this year. This isn't reflected in the quarter as a whole yet, but the combination of growth in marketplace sales of almost 20%, in addition to the take rate growth, increased our revenue from marketplace services by almost 40%. This is a long-term trend in the marketplace when it comes to gross margin growth for the future.

The next slide shows details of our working capital. Again, we improved inventory turnovers and nominally reduced inventory again. We reduced inventories by 1 billion in the 1Q of last year and now, when we compare March of last year with March of this year, we see that we reduced another 500 million and had a reduction compared to the end of last year. Therefore, our turnover improved in the quarter by 12 days compared to last year, which meant that the variation in working capital, which normally involves cash consumption by working capital in the 1Q of all years, was 2.2 billion this year, 700 million better than last year's variation of 2.9 billion. This is closely associated with the reduction in the balance of suppliers, mitigated by the evolution in inventory turnover.

In the quarter, we reduced the balance of suppliers by around 2.5 billion due to the normal seasonality of purchases and supplier payments, as purchases made at the end of the previous year are paid in the 1Q of the current year. Now, moving on to financial expenses, we have a relatively non-recurring impact, that is, a seasonal impact, which is typical of the 1Q. As we reduced the balance of suppliers by 2.5 billion, we had proportionally more discounts in receivables. This generated practically 100 million more in financial expenses than would be the case in a normal quarter without a variation in the accounts payable balance.

Our financial expenses evolved last year and increased throughout the quarter because the CDI also increased. The trend this year should be the opposite, starting now that there is seasonality in the 1Q. In the coming quarters, the dynamics of working capital are more favorable, and we will no longer have supplier payments as we had in the 1Q. Therefore, the tendency is that discounts in receivables decrease gradually. We have also increased our share in PIX and cash sales are growing a lot in our payment mix, while the future interest curve points downwards. Furthermore, as Fred mentioned, we renewed our contract with Cardif, which will mean more than 1 billion in cash, thus reducing financial expenses for the coming periods.

On the next slide, we will comment on our cash flow evolutions. We went from 8.5 billion in March of last year to 7.1 billion in March of this year. This variation is entirely associated with investments, CapEx, paying the last installment of KaBuM! of 500 million, and other investments. Investments all together represented almost 1.4 billion, which was practically the change in the balance of cash and receivables, thus increasing the generation of operating cash, which last year had been around 800 million and has now improved in the last 12 months and risen to 1.3 billion. This increase was almost enough to pay the entire interest and leasing accounts.

Finally, we made a simulation here to add the funds from renewing our contract with Cardif. This would mean we would return to a cash position of over 8 billion and a net cash position of around 1 billion considering our debts, almost all of them in the long term.

On the next slide, we talk a little about LuizaCred. The credit policy remains conservative, and we currently have 7 million cards and a trend of stability and growth for the second half. Billing continues to grow a lot due to our customers' use and recurrence: It grew 10% in total, 15% outside Magalu, and within Magalu there was a small migration to the PIX method, which reduces financial expenses as well.

Next, we highlight LuizaCred as a whole. Revenues grew at a very high pace to 18%, reaching R$ 1.1 billion in total revenues, our highest historical mark. LuizaCred has been highly efficient in terms of operations, with expenses growing at a very low, super-controlled pace, which is a benchmark when we talk about efficiency ratios. The result was practically stable compared to last year, still reflecting two accounts: The cost of funding is still high due to the CDI and the still conservative provisions, although we have already seen a stabilization in the NPL and an improvement in recent harvests. The prospect is that soon, in the short term, both the flow of funding and the provisions will start to decline, and profitability will return to historical levels.

Finally, some highlights of our fintech. A TPV of 10 billion, growing 30%, and linked to the growth of the marketplace itself. We launched Tap Magalu to allow our sellers to use their cell phones as a card machine, and today we already have 26 thousand digital accounts of sellers receiving all their sales—R$ 300 million in the quarter—deposited in Magalu Pay digital accounts.

These were the main highlights that we wanted to comment on. Now we can go back to Fred and start our Q&A session. Thank you.

Q&A Session

Lucas Ozorio – IR Coordinator

We will now begin our Q&A session. To ask questions, click on the 'Q&A' icon at the bottom of your screen, write your name, company, and question language to join the queue. When you are announced, you will see a request to activate your microphone on your screen. You must then activate your microphone to ask the question.

The first question is by Maria Clara Infantozzi from Itaú BBA. Maria Clara, please proceed.

Maria Clara Infantozzi - Itaú BBA

Good morning, Fred and Beto. Thank you for this opportunity. We have two questions. The first is related to the gross margin. What should be our mindset in relation to this margin from now on, given that it is being impacted by two opposing forces? On the one hand, there is an impact from the return of Difal payments, but on the other hand, we end up having an increase in service revenue penetration.

And then the second question I would like to ask is about the 3P contribution margin. You said today that it has a very attractive value proposition compared to peers. Do you believe that there is still room to improve the economics of this channel? If so, how far do you believe you are from an optimal 3P contribution margin? Thank you.

Fred Trajano – CEO

Good morning, thank you very much for your question. I'll just make an additional comment that I believe contributes to the gross margin, which is the sale of financial services. Some services that have been added to this area, and I'm sure that as we increase, and we have very ambitious targets for penetration of financial products, especially insurance, and I'm sure the new agreement will contribute significantly to our increase in gross margin looking forward, ok?

But to answer your questions, I will need to break it down like this: I will ask Fabrício to talk about the 1P gross margin and what the prospects are, so he will address the entire 1P online and offline channels, and Edu will talk from the point of view of the 3P gross margin and then about the 3P contribution margin as well. Fabrício?

Fabrício Bittar Garcia – VP of Operations

Good morning. Thank you very much for the question, this is Fabrício Garcia.

Well, regarding the gross margin, as we said, we need to transfer the Difal amounts, and we knew from the beginning of the year that this would be a challenge. This transfer has been happening gradually, one month better than the other, so we started transferring an average of 25% in the quarter but reached around 50% of this transfer in March.

The tendency is that we will continue doing this. Obviously, we must be careful to balance the Difal transfer with the market share gain, and we are still managing to do that. I think the scenario is more rational, so we've been able to transfer it, and I think it will continue to be transferred gradually and our margin should evolve.

I also think that we have a favorable environment in negotiating with suppliers, as we have been putting a lot of effort into it. The recent fall in the Dollar also helps us, so I believe that we will improve this margin month after month.

Eduardo Galanternick – Business VP

Hi, good morning, Maria Clara. Eduardo Galanternick speaking. Now, moving on to the next part of the question, about the 3P gross margin. As announced in early January, we communicated a change in our commission tables to the market. They were implemented on February 1st. In other words, two of three months have been affected by the result we see in this 1Q, which already has a carry-over to the next quarters.

And speaking of perspectives and possibilities, we believe that first, on the one hand, we have a take rate that, as Fred mentioned, is below the main competitors, and on the other hand, we have initiatives such as Ads and monetization by Fintech account of our seller base. In general, we see–we cannot disclose exactly where we expect to get to, but I think this can contribute to your analysis.

Maria Clara Infantozzi - Itaú BBA

Super clear. Thanks, everybody!

Lucas Ozorio – IR Coordinator

Thank you very much, Maria Clara. The next question is by Eric Huang, from Santander. Go on, Eric.

Eric Huang – Santander

Good morning, Fred, Beto, and everyone. Thanks for taking our questions. I think that we would divide our question into three parts, so bear with us. The first one is this: You recently renewed your contract with Cardif, so there's the billion in cash that you raised. We wanted to understand this in terms of indebtedness. Most of the company's debt is in the long term, so can we expect prepayments of debt or any other allocation of funds from this deal? And still in this context, do you see other monetization opportunities within the company?

I think the other question would be in terms of great opportunities for operational efficiency. You said you are trying to gain in this context, so I would like to know at what rate can we expect this to happen and what would the impacts be in terms of EBITDA margin throughout the year.

And, finally, going back to working capital. You said there were improvements, especially now on inventory. I think that this improvement does indeed come from last year, but do you see opportunities to improve on the matter of suppliers? We know that things are a little more complicated in terms of cost when it comes to drawee risks, thus perhaps reducing the attractiveness for suppliers a little. However, is there also an opportunity to gain something more in terms of payment terms? Thank you.

Roberto Belissimo Rodrigues – CFO and IRO

Good morning, Eric. Thank you for your question. Well, we can break those down into several questions, so I'll try to address them little by little. Please let me know if I fail to answer any of them.

First, about Cardif's funds, I believe that this reinforces our net cash position, further increasing our liquidity. Our debt is all in the long term at a cost of CDI + 1.25, a relatively low cost. The market this year is relatively more turbulent, and we did not suffer effects from this on our financial expenses, for instance, precisely because our debt was all in the long term.

Our prepayment of receivables is highly efficient, very cheap in terms of spread and CDI percentage. The drawee risks that you mentioned are a cost ultimately paid by suppliers. I'll explain this later, but the fact is that our current debt has a low cost and is in the long term, and we find it important to increase our liquidity and cash generation constantly. We have several initiatives in this regard, from improving margins to improving working capital, as well as negotiations like the one we recently had with Cardif.

Thus, we place a lot of importance on evolving constantly, increasing our cash position, and when the long-term debt is in the short term, we address it in the best possible way by prepaying it, renegotiating it, extending it or simply making new issues and so on. But the important thing is that we have high liquidity, which is being increased with these funds now that we have more than 1 billion net cash.

Now, the second question is related to working capital. Again, we highly improved our inventory turnover and have a healthy average purchase term. In this quarter, normally the balance of suppliers always decreases in the 1Q. The balance of drawee risk transactions, under agreement, also decreased in the same proportion as the total balance of suppliers. It decreased a little more, going from practically 40% of the total balance to around 30% of the total balance of suppliers because costs rose a little due to market variation, and our suppliers had fewer demands in a way, as that they also have other options and didn't want to prepay, some didn't want to prepay costs at relatively higher amounts than before.

But we continue to work with all our suppliers and partner banks. When the volume decreases, we also lose because way we are an agreement in some ways, which is a win-win-win, meaning that the bank wins, we earn a take rate, and suppliers earn prepaid amounts. I believe this is temporary and soon the cost of this line should return to normal and stabilize as a percentage of our total balance of suppliers.

I must mention that we once again disclosed our open balance and that the average term of this line, according to our notes, is only 47 days, which is a common payment term. Those are suppliers that want to receive in advance and choose to pay in advance as well, so we pay banks on the day that we would pay suppliers. It doesn't affect the total balance, our cash flow, or the balance of payments as a whole.

Finally, in terms of operational efficiency, I think we already talked mentioned it. We diluted 1 p.p. in relation to the total GMV and saw improvement in all lines, from marketing, logistics, and administrative expenses to fixed expenses. We closed some stalls, closed a DC, always seeking to improve and obtain the maximum possible operational efficiency.

Eric Huang – Santander

Thank you, Beto. Just a quick follow-up on the question about working capital. You were very clear in your explanation about the banks, but do you see other opportunities, or do you think that these gains you presented should be maintained but have no great opportunities for future improvements?

Roberto Belissimo Rodrigues – CFO and IRO

Eric, we are always looking to improve working capital, as in improving inventory turnover. We continue to seek to improve inventory turnover, maintain a healthy purchasing time, and all other working capital accounts and tax monetization as well. As we said before, we are paying more taxes this year because of Difal and have monetized more taxes; therefore, we estimate that the balance of taxes to be recovered will be reduced on our assets, so we have several initiatives toward generating more cash from working capital.

Eric Huang – Santander

Thank you, it was super clear.

Lucas Ozorio – IR Coordinator

Thank you, Eric. Our next question is by Gustavo Senday from XP. Go on, Gustavo.

Gustavo Senday – XP Investimentos

Good morning, everyone. Thank you for the questions. I have two questions. First, I just wanted to understand the issue of Difal a little better. You said that 50% of the transfer was already done in March, so just to be clear: What are your expectations about the remaining 50%? Should we expect that this impact is neutralized by the end of the 2Q? Will it be a little more distributed throughout the year?

And the second question is about Ads. You said that Ads are a strategic priority for the company in this release. Can you tell us a little about the internal KPIs that you follow in terms of conversion and sellers' adherence? And what we could expect in terms of investment in Ads functionalities from now on? Thank you.

Fabrício Bittar Garcia – VP of Operations

Hi Gustavo, this is Fabrício speaking. About the Difal transfers, we cannot say right now if they will be completed until the end of the 2Q. The market has its own dynamics, there are differences per category. What I can say is that the 2Q will be better than the 1Q. We will try to transfer as much as possible and should be able to complete almost all of it throughout the year. But we will certainly have transferred more in the 2Q than in the 1Q.

Eduardo Galanternick – Business VP

Gustavo, Eduardo here. Now, let's talk about Ads. From the external metrics standpoint, we have a very clear plan with two important variables: The first is inventory expansion, which we call Ads rate, meaning how many impressions we have of ads versus non-ads; and the second is the quality of our algorithm, which we measure through the CTR evolution. These are two of our main metrics. We can't disclose the exact figures, but we follow their evolution very closely and see proof of this evolution.

We released some figures, such as the number of sellers on our ethics platform, which grew from 150 to more than 3 thousand. We have over 10 thousand campaigns and quadrupled the dedicated revenue of the platform, but we know that we are in the early days and still have a lot to do.

The most important thing for me is that our team is growing strong. We reinforced the Ads team from a commercial point of view by bringing a new leader to the area. From the Labs point of view, we are more than doubling our technology team involved in these strategies. We expect to see a sequential evolution in our platform, which you will notice each time you browse our app, as you will see more sponsored products. This is our detailed plan for evolving the business.

Gustavo Senday – XP Investimentos

Perfect. Thanks, everybody. If you'll allow me one last question, it's from a CapEx perspective. Can you tell us a little more about your expectations for this year? Investments in technology have been growing steadily, so I would just like to know more about the expected dynamics for the other quarters this year. Thank you.

Fred Trajano – CEO

Thank you for your question. I'll ask André Fatala to talk more about this. Indeed, as we mentioned in recent calls, CapEx proportions in technology have spiked because we have been investing less in physical assets, and marketplace operations, platform operations, depend more on technology than analog operations. So, I now ask Fatala to explain more about the labs' investments and initiatives.

André Fatala - CTO

Good morning, Gustavo. Fatala here. Thank you for your question. Regarding CapEx investments, as we mentioned in the presentation, we evolved greatly on the platform front. This ultimately leads to greater investments in technology, from adding people to some teams, as mentioned by Dudu, Magalu Ads, and a roadmap front of platform evolution. This front is focused on empowering the participating sellers and creating tools to allow them to conduct their business more simply within the Magalu platform.

We are also investing heavily in the logistics front. As mentioned, the fulfillment service relies on strong investments in development and technology, processes have evolved within the hubs, and as we increase the volume, we need to develop on time with the products that we have and the packages that we ship. So, we've been working hard on logistics as well.

Besides that, we are investing heavily in infrastructure in our physical stores, so they are playing this role of being extremely connected as a point of support for the platform in the physical world. This leads us to invest mainly in connectivity and tools that make store operations simpler for those who operate from hunting to the packages arriving at our stores.

Finally, this year we are investing heavily in AI, as it is a hot topic. We have a dedicated data team working on some artificial intelligence fronts to help us streamline several of the existing processes within the company and depend less on people in the future by having artificial intelligence help us to scale.

Gustavo Senday - XP

Perfect, guys. Super clear. Thank you.

Lucas Ozorio – IR Coordinator

Thank you very much, Senday. The next question is by Irma Sgarz at Goldman Sachs. Go ahead, Irma, please.

Irma Sgarz - Goldman Sachs

Thank you. I wanted to ask about Magalu's card operations. The number of cards, the two base cards, dropped. I understand that maybe this comes from seasonality from the 4Q to the 1Q, but I would like to understand your expectations. This perhaps reflects a close sector in politics and a clearing up of the base. And how much do you think your product is adequate to the requirements and the competitive forces in the cards market in Brazil, which has obviously grown a lot in recent years? Thank you.

Carlos Mauad – CEO Fintech Magalu

Good morning, Irma. I am Carlos Mauad. Thank you for your question. The card base reduction that you saw from the 4Q has two underlying problems: The credit environment is more difficult, causing customers to enter into involuntary credit attrition due to the pressure of this environment; and acquisition is more restrictive, meaning that the number of new customers is smaller than LuizaCred's history. These two elements pull the active base down. You will see that we will resume this baseline growth as time goes by and the credit environment improves.

With regard to the value proposition, our biggest challenge here is that the value proposition is centered on credit limits and the consumption power we offer our customers through payment vehicles. So, the first thing we must have is an approval rate and an allocation of limits appropriate to what our customers need; then, we must work with all the commercial structures we have within the Magalu ecosystem on a promotional layer that builds long-term engagement with our customers. This gives us a competitive advantage to be able to compete with all the players in the current payments arena, be they fintechs, incumbents, or big techs. We can indeed have a competitive product. Is that clear, Irma? I hope I answered your question.

Irma Sgarz - Goldman Sachs

Perfect. Mauad, thank you. Since you are here on the call, I would also like to understand this point a little more, this last point of long-term engagement as a product. Do you believe that you have today all the products you need to engage this principality and generate this principality for customers in the customer base? And could you give us an example of which slice of the customer base already has a very intense and very strong relationship with a platform that you have?

Carlos Mauad – CEO Fintech Magalu

Irma, I do think that we have all the elements necessary to build this engagement within our current business structures. I believe their combination does make customers more engaged with our products and services. A lot has already been done, obviously, with commercial structures, but I think we can still combine and intensify other things.

We just talked about renewing our insurance agreement with Cardif. This will be a front for growth or cross-selling within our digital environment; we have the Magalu card, which today we sell exclusively through digital channels and still has a lot to offer from a growth standpoint within the company; we have a direct consumer credit platform that is extremely powerful and relevant and that will gain space both within our store operations and the digital environment.

So, I would say that it is less about building new things to achieve customer engagement over time and more about combining or accelerating elements that already exist within our ecosystem.

Irma Sgarz - Goldman Sachs

Perfectly clear. Thank you.

Lucas Ozorio – IR Coordinator

Thank you very much, Irma. Our next question is by Joseph Giordano, from JP Morgan. Go ahead, Joseph.

Joseph Giordano - JP Morgan

Hello! Good morning, everyone. Good morning, Fred, Beto, and the team. I have two relatively quick questions. You mentioned the issue of historical market share levels a lot, so I would like you to explore this issue a little and try to breakdown the competition by channel and tell us where you have seen evolution. On the one hand, we can see a little more clearly that take rates help the marketplace, but I would like to understand how you see the margin evolution beyond the competitive dynamics for the channel.

And my second question relates more to LuizaCred. You have had a slightly more restrictive credit policy for some time. Can you somehow measure how much this could be impacting the company's revenue today? Those were my questions. Thank you.

Fred Trajano – CEO

Well, Joseph, thank you very much for your question. About the 3P dynamics, I believe the 1Q numbers speak volumes about how we are managing to grow our GMV and increase the take rate. I think this is only possible because we now have a much more rational competitive scenario than five years ago when we launched our marketplace. I remember hearing in the results conference that the take rate is just a detail, that several companies don't even charge it and even subsidized shipping to sellers, while others applied 20% discounts on sellers' prices, and that the marketplace price management is up to sellers rather than the platform. The platform itself applied discounts.

So the environment was irrational for a moment, I think even boosted by the Asian platforms that entered the market at the time, creating a fee war and so on. What I have been seeing every week, every month, are platforms increasing fees and rationalizing their operations. I believe this is still an exceptional business for sellers, but is now good for everyone: customers, sellers, and platforms. I see a more rational and economic environment and believe what we've seen in the last two quarters shows that this is the new market reality, so I see it in good light.

As for credits, it is a fact we left 2020 and 2021 with much more relevant operations by opening new accounts, and that this impacts mainly physical stores and their sales. I think we are at the end of a challenging cycle not just for LuizaCred and Magalu but for the economy as a whole.

I will take this opportunity to make some final comments too. Oh, you had one more question. My point is this: I believe that the bad news, in the macro and credit contexts, are coming to an end. I think a positive cycle is soon to arrive. The company's operations have clearly improved, but the Brazilian economy has not. These things tend to converge at some point, and we are coming to a turning point when the economy will improve and we will have a driving force to help us do justice to all the work and efforts we have been doing internally. And credit is one of those points.

Lucas Ozorio – IR Coordinator

Thank you very much, Joseph. Our next question is by Vinícius Preto, from Bank of America. Go on, Vinicius.

Vinícius Preto - Bank of America

Good morning, everyone. Thanks for allowing me to ask a question. I wanted to follow up on the Advertising business. What do you think of the demand from 3P sellers and 1P suppliers for this business? And what still needs to evolve in terms of technology and platform to absorb this demand?

And you also mentioned the fulfillment contribution to the margin. What do you think about the dynamics between growth in fulfillment versus monetization?

And finally, could you comment on what you think of the dynamics in this 2Q and especially on Mother's Day? Thank you.

Eduardo Galanternick – Business VP

Vinícius, Eduardo here. How are you? Well, in terms of Ads, in general, as I said, we face challenges in increasing our inventory of sponsored products; that is, as you browse our website, whether on the homepage, the product pages, or search results, you will see more Ads. This will happen as the CTR, which is Ad clicks, evolves and we improve our algorithms and partner with more advertisers.

From a demand standpoint, we have latent demand. Our number of advertisers grew from 150 to 3 thousand on this platform in one year and we still have 3 thousand of the over 210 thousand registered on our platform, so there is plenty of room to improve this point. As we improve these two aspects, especially through technology, we will naturally capture this demand and revenue.

Regarding the full and monetization, we launched the full last year and have been evolving consistently, resulting in increasing representation in Magalu Entregas sales. When we increased the take rates, we informed the market that we would still provide subsidies for the full until the middle of the year. We are now working toward how we will implement this for the second half. We cannot reveal details about this yet, but as we announced for the second half, this context will change.

Fabrício Bittar Garcia – VP of Operations

Joseph, Fabricio speaking. About Mother's Day, we have a very favorable calendar this year. The best calendar for us is when the first of May falls on a Monday because then we have two weeks of sales until Mother's Day. And sales were good, we performed well in both online and offline channels. We had good results in relation to our target and in terms of growth compared to last year.

Vinícius, sorry. I said Joseph, but it's Vinícius, I'm sorry.

Vinícius Preto - Bank of America

Thank you, guys.

Lucas Ozorio – IR Coordinator

We are now closing the Q&A session. I would like to give the floor to Frederico Trajano for his final remarks. Fred, the floor is all yours.

Fred Trajano – CEO

I would like to thank everyone for participating in our results call and wish everyone a good week.

Lucas Ozorio – IR Coordinator

Magalu's conference call is now closed. The Investor Relations team is available to answer any other queries and questions. We appreciate everyone's participation. Have a nice day.