Q1 2019 Earnings Call

Company Participants

- Adalmario Couto, Chief Financial Officer, Investor Relations Officer
- Breno Toledo Pires de Oliveira, Chief Executive Officer
- Unidentified Speaker
- Vivian Angiolucci, Chief Financial Officer

Other Participants

- Analyst
- Gustavo Oliveira
- Irma Sgarz
- Joseph Giordano
- Marco Calvi
- Ruben Couto
- Tobias Stingelin

Presentation

Unidentified Speaker

Here with us Mr.Breno Oliveira, CEO; and Mr.Adalmario Couto, CFO and IRO; and also Ms.Vivian Angiolucci, Strategic Projects and Planning Officer. We would like to inform you that this event is being recorded and all participants will be in a listen-only mode during the company's presentation. After the company's remarks, there will be a Q&A session only for investors and analysts, when further instructions will be provided. (Operator Instructions)

Questions can only be made over the telephone. If you are connected over the webcast, your question should be sent directly to the IR team, at hypera.com.br. Today's live webcast may be accessed through the company's Investor Relations website at www.hypera.com.br/ir.

We'd also like to inform you that statements made during this conference call might be forward-looking statements which refer to future expectations and therefore are subject to known and unknown risks and uncertainties that could lead the company's actual results to not match the forward-looking statements.

Now, I'll turn the floor over to Mr.Breno Oliveira, who will start the presentation. Please Mr.Oliveira, you may carry on.

Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Good morning, everyone, and welcome to our results conference call relative to the first quarter 2019. Before I start the comments about the company's operational performance, I'd like to touch upon the works on the media of independent committee. No major news on top of what has been already reported in the last call. Works have been continuing as planned, but we do not have a deadline for the conclusion of the work conducted by the committee.

There was no impact on our everyday activities and not in the company's strategy either. We continue to work and make the necessary investment to speed up the mid-to long-run growth of the company.

Now moving onto the operational part. As I mentioned in the last call, the optimization of the company's working capital was one of the priorities for 2019 and we would go after that as early as the first quarter of the year. Since the change in the company's top management 1 year ago, we have been discussing the need of an investment in working capital, especially receivables. With operational improvements that we obtained since the end of 2017 including an increase in production capacity, reduction in lead time and also an increase in the coverage by our sell-out team out in the field.

We concluded that we have -- we were in a position to reduce our inventory at the clients and consequently invest our working capital. As expected, we have been successful in concluding that adjustment process in the first quarter of the year. So we have reduced sales, selling, and Branded Prescription and Consumer Health units, reducing the inventory levels those products at the clients, and consequently with an average time of receivables.

Starting the second quarter, we started to concentrate all our efforts in the growth of the sell-out brand -- arm. Keeping the current inventory at our clients, this new model brings onboard series of benefits to the company. Among them allocation of 100% of funds for clients for the sell-out of new products, a higher assertiveness in sales planning and a lower level of orders, which are not met at the factory level. An easier way to place projects with our clients of new launches, which is key to the success of our growth.

On top of a lower level of working capital, which will contribute to a positive operational cash flow and for the allocation of more efficient capital and expanding the plant and in projects of innovation. And we also -- we're able to book the tax credit relative to the favorable ruling over the exclusion of the ICMS, state tax in the amount of BRL 546 million, and we saw growth of EBITDA by 11% and of the net revenues of continuing operations of 10% despite the one-off adjustment, which resulted in a drop in revenue to the tune of 60%.

Starting this quarter, we'll now share information about sell-out and the objective is to give more transparency to the market about our performance. In the quarter, our sell-out grew 6% with a tendency to accelerate. In the month of February and March, the growth set at 8.5%, whereas the pharmaceutical market as a whole grew by 8.8% in the first quarter. This accelerated growth in sell-out of the company starting in the second half of the quarter was boosted mainly by investments in marketing, points of sale and also by the initial results with an increase in coverage by our field sell-out team.

We'll continue with our bold investment plans to leverage the sell-out growth in the second quarter and throughout the year including promotions, visibility actions at the points of sale and also media initiatives, which should benefit demand generation and also our revenues, which in the second quarter, will have a performance which will be in line to there of the sell-out.

On top of those investments, we also launched important products in this quarter, for example, Fluviral Day and Night in the market and the anti-flu drug and (inaudible) in the painkiller market. Lastly, in the last Friday, the Board of Directors approved the creation of a new planning and projects office which will be led by Vivian Angiolucci which will focus on projects that will generate value with the objective of reaching a new level of effectiveness in terms of commercial and operational arms.

The Board also approved the appointment of Adalmario Couto, IR and New Business Officer as CFO with the company. Adalmario will continue with his activities related to new businesses, and will add to that the CFO task. On top of those changes Luiz Clavis, Vice President of Marketing and Sales since 2018 is now part of the company's executive office suite.

Now give the floor over to Adalmario who will comment on the company's quarterly results.

Adalmario Couto {BIO 15110002 <GO>}

Thank you, Breno. Good morning, everyone. First, sorry about my rusty voice. I just bought Benegrip, Coristina and (inaudible) our anti-flu bundle to take care of that. So let's move on to the numbers of the quarter and talk about our future perspectives in more detail. In this quarter, we have an impact of 2 nonrecurring effects in our revenues. We had a reduction of BRL 386 million as mentioned by Breno. This was impacted by the optimization of the working capital, which led to a drop in sales of Branded Prescription and Consumer Health products.

We also had a positive impact of other revenues of almost BRL 520 million due to that tax-credit related to that favorable decision or ruling over the exclusion of ICMS from the calculation of the base of (Inaudible) federal tax. Gross margin reached BRL 148 million. That reduction is tied to a reduction in sales of Branded Prescription products, which raised the relevance of Similar and Generics in sales.

Our expectation is that gross margin will be normalized around 30% starting in the second quarter. Even with the drop in revenue, we maintained relevant investments of about BRL 160 million in marketing to boost mainly growth in sell-outs of our leader brand in several categories and also recent launches with a higher focus on initiatives to generate market share. For this year, our ad packages will be more relevant to the appearing in the second quarter because of the higher concentration of launches for this year, which will happen in the second quarter.

Expenses in SG&A had an increase of 5.5%, which reflected mainly the growth of 20% in our R&D expenses and also an increase in our sales force. This growth shows our commitment and continue to invest in innovation and accelerating the launches of new products. The total investments in R&D included an amount -- accounted for as intangible assets and totaling BRL 51 million in the first quarter, 31% above the first quarter of last year.

With that, continuing operations EBITDA reached BRL 401 million, a growth of 10.7% quarter-on-quarter and the net income from continuing operations reached BRL 331 million, up 9.5% when compared to the previous quarter. I'd like to emphasize that the company paid out interest on capital at the tune of BRL 161 million or BRL 0.25 per share, an increase of 20% when compared to the first quarter of 2018.

Moving on to our cash flow and indebtedness on Slide # 6. Our cash flow from operations set at BRL 192 million, 25% below the other quarter. And the main driver was an increase in income tax retention on capital when compared to the previous year, which will exclude that effect of cash flow stayed at the same level of last year. We will have a drop in cash generation in this quarter because of lower investments in this first quarter.

Free cash flow was lower than first quarter of 2018, also impacted by a drop in investments or impacted by the investments in the plant expansions in Anapolis and other R&D investment. Our net cash is at BRL 613 million. BRL 463 million was the number reached in the first quarter of last year. An increase in net cash or free cash flow when compared to last year was mainly due to a growth in free cash flow in the period.

Now, I give the floor back to Breno for his final comments.

Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Thank you, Adalmario. To wrap up in this quarter, we concluded the optimization of our working capital, which we had scheduled, which will bring about several benefits for the company for shareholders. On top of that, we started to concentrate our efforts in the sell-out growth besides having already find and implemented new initiatives to boost growth as early as the second quarter. Those initiatives include important launches for the Consumer Health units already scheduled for the second quarter in the market for vitamins and anti-flu drugs.

On top of innovations, which will contribute to a pickup in growth for vitamin D markets in the coming quarters. We're confident that all those initiatives will boost our growth in sell-out as early as this year and will contribute to our sustainable growth in the mid to the long run. We continue to remain confident in the potential of growth of this market in Brazil. Hypera Pharma is the best positioned company to capture those opportunities.

We have the most effective margins in the industry, and we are the company, which invests the most in innovation, in expansion and productive capacity. We are the only company which operates relevantly in all segments across the Brazilian pharmaceutical market: OTC, OTX, Branded Prescription, Dermocosmetics, similar and Generic products. We have invested heavily in the past to create this single unit unique platform which is very difficult to be replicated and we continue to invest to make sure we maintain our growth in a sustainable manner for the next 5 to 10 years.

We now move on to the Q&A session.

Questions And Answers

Operator

(Question And Answer)

Thank you. We'll start the Q&A session from investor and analysts. (Operator Instructions). The first question comes from Mr.Tobias from Citibank. Mr.Tobias, you may carry on.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Thank you. Good morning, Adalmario and Breno. If you could give us some more color in terms of sell-out for the remaining of the year. What kind of speed do you see that growing? You mentioned that in January, it was better but you're also investing in sales force, you're also investing in marketing. Can we have a better idea of what to expect moving forward for the end of the year, for the other quarters? And also specifically about the sell-out,

you're comparing those 6% with the market as a whole on a comparable basis or are you talking about an absolute number? I'd like to understand that number a little better. Are you going to adjust those different categories, so that you could have a better idea of what's performing better and what's performing not so well?

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Okay. Tobias, thank you for your question. As for the first question, we expect a gradual growth throughout the year. So a good portion of our growth will come from launches, some more mature markets and as I have mentioned have been decreasing somewhat, but we expect to offset that with new launches and this will happen gradually throughout the year. So the expectation is that at every quarter will have a small acceleration in growth in sell-out.

As for your question about the breakdown of the sell-out, that's the total number with no adjustments whatsoever that's. It's the market absolute number. So as the market, we also grew more under Similar and Generic products. As I mentioned, vitamin D market and anti-flu markets in the first quarter that market as a whole performed negatively, a drop of around 6%, but we have our own initiatives as I mentioned to leverage our growth in this specific market.

Anti-flu medication, you're going to be spinning out more. It's becoming more relevant in the second and third quarter because of the flu season of course and the market for vitamin D, we have a few launches and a few initiatives to leverage growth even in a market which is not so positive.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Okay. Just a follow-up question. Now sell-out is part of your compensation target. So is that target based on market share or are you talking about growth? You have a loss of market share. I would just like to understand is sell-out an absolute number for that target or is it not?

A - Adalmario Couto {BIO 15110002 <GO>}

Well, we also included some growth in that equation, which at the end of the day is what matters to define inventory levels at clients and also the delivery of our results to shareholders, but we could also do that based on market share but it's implicit, in our budget that there's an expectation of a gain in market share as well.

Q - Tobias Stingelin {BIO 18290133 <GO>}

For this year too?

A - Adalmario Couto {BIO 15110002 <GO>}

Yes. For this year as well.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Okay. Thank you.

Operator

The next question comes from Mr.Giordano from JP Morgan. Joseph Giordano.

Q - Joseph Giordano {BIO 17751061 <GO>}

Good morning, everyone. Breno, Adalmario, thank you for taking my question. Going back to the innovation issue, I'd like to understand a little more how has the innovation index behaved throughout the first quarter given the high volume and launches in the second half of the year? And also a follow-up. You mentioned that gross margin will probably resume 70% level. But when we look at the vitamin D, that's a segment with a very high margin right. So I'd like to understand if vitamin D may be somewhat of a hinder in that project?

As for the tax credit, I'd like to hear from you how will those credits be consumed throughout time? And lastly, if the receivables level today at about BRL 1 billion, if that level should be the standard going forward? Thank you.

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Hi, Joseph. I'll start with the first question, and then I will continue. So innovation index in the first quarter stayed at 28%, a slight drop when compared to the fourth quarter of last year, but it was expected. We expect that this year the innovation index will remain at that level around 30, but it will pick up in 2020 because we have products which are now leaving the index.

We only consider the past 5 years, so we have some relevant, Addera, for example, which will leave the innovation index, so -- but we'll maintain the index for the new launches. And starting 2020, we do believe that that index will pick up. I'll also answer the credits question, and then Adalmario will address the margin and receivables issue. As for the tax-credits, we believe that we won't be using that in the short run. We already had something close to BRL 300 million in federal credits.

So this year, we will amortize the bonus, so we'll start now consuming those tax credits now. And also the accumulated fiscal damage, which is --or -- which is above -- or loss, which is above BRL 1 billion. So there are several assets on the table right now but those credits will start being used I think I believe in about 2 years. An interesting thing to mention is that as this was a tax which was unduly paid, it is corrected as we move forward. So it's not a problem to use them in the mid run because we accumulate a financial revenue which will be corrected until the date when it's actually used.

I give back the floor to Adalmario for the other question.

A - Adalmario Couto {BIO 15110002 <GO>}

Hi, Joseph, we believe that starting the second quarter that margin we'll resume at the 70% level as I mentioned, especially because will be more relevant in terms of brands because of the sell-out initiatives and also because of new launches. So the mix effect will improve when we compare that year-on-year. The first quarter was a one-off quarter, right?

So the second quarter will be business as usual. So we'd expect a mix similar with what we have in the previous year's even with a drop in market for vitamin D As Breno mentioned, we have several initiatives which are already being implemented to gain market share in that market. So even with a slowdown in that market, we expect to gain market share there. And we'll be working with the level of inventory we closed in the first quarter should be maintained throughout the year. That's the strategy going forward. And as for the receivables question, that should increase in the second quarter as we have a more normalized revenue level, but we expect that investment in working capital will resume levels close to what we had in 2015, 2016. That's what we are working on.

Q - Joseph Giordano {BIO 17751061 <GO>}

Okay. Thank you. Just 1 follow-up about credit. We feel that there are some outstanding legal issues to recover past credits. Can you give us a magnitude of those credits still to be received? In your expectations, you mentioned that there are legal cases still requesting for credits. How much is that still outstanding?

A - Vivian Angiolucci {BIO 19917048 <GO>}

This is Vivian. Hello. Those credits are not really relevant, it's a materialized I'd say so.

Q - Joseph Giordano {BIO 17751061 <GO>}

Okay, thank you.

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Have a nice day.

Operator

We have a question from Mr.Marco Calvi from Itau BBA Mr.Calvi, you may carry on.

Q - Marco Calvi {BIO 19854632 <GO>}

Hello, good morning. We saw a nominal drop in marketing expenses, as you mentioned, in the release. My question is what should be normalized marketing expenses? Would it be something close to last year for the next 3 quarters of the year?

And the second question is if you have an idea of how much that drop in marketing expenses affected the sell-out? Or how -- where would the sell-out be if you had had a more normalized marketing expenses level? That's the question. Thank you.

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Hello Marco, as I mentioned in the release that drop had to do with seasonality of the year. So in the second quarter with several new launches that we are promoting also using media outlet and also the anti-flu medications coming onboard that will increase.

So for the year as a percentage of the revenue, we do not expect to see a drop excluding the first quarter of course, where we had a lower revenue. But for the remaining of the year, we expect similar levels to what we had in 2018 maybe with a migration towards marketing at the points of sale. With all the actions, initiatives that we have mentioned, we should see some migration towards marketing at the point of sale. Medical visits as well will increase. As I mentioned, we have increased our sales force in terms of visiting doctors, so that's also a place where we should be migrating marketing expenses.

Q - Marco Calvi {BIO 19854632 <GO>}

Okay. As for sell-out, do you have any idea it -- what kind of effect did the sell-out suffer with drop in marketing expenses?

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

No. There is no direct relation in the short run. We're talking about an investment in the mid-run and investment in the brand, so no relationship in the short run sell-out.

Q - Marco Calvi {BIO 19854632 <GO>}

Okay, Breno. Thank you.

Operator

Next question comes from Mr.Ruben Couto from Santander. Mr.Couto, you have the floor.

Q - Ruben Couto {BIO 20636571 <GO>}

Good morning, everyone. Could you talk about inventory level of the first quarter, in direct channels, small chains. And how was that received by the market? Is there still something to be done or can we assume that all adjustments irrespective of the size of the clients have been done? Thank you.

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Hi, Ruben, it's all been done. As I mentioned, the adjustment has been done in the first quarter and we are talking about clients who work with Branded Prescription both distributors and chain. And as you mentioned, we have been talking to those clients throughout the past month. So the process was quite agreed upon from both sides, a very transparent negotiation if you will. So there are no other adjustments planned going forward.

Q - Ruben Couto {BIO 20636571 <GO>}

Okay. And if I can, can you share with us the expansion status at Anapolis, just the schedule, if you may in terms of expansion for Annapolis?

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

So we hope to have the expansion finalized by the end of next year. So in the second half of the year, we'll start some civil works, construction and then we have assembly, equipment so that we have a plant operating at 100% capacity by the end of 2020.

Q - Marco Calvi {BIO 19854632 <GO>}

Okay. Thanks.

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Regarding -- regardless, we have other initiatives to increase our capacity. We're buying machinery, higher capacity machinery at the same time. So we hope to see growth in capacity irrespective of the completion of our expansion in Anapolis maybe in the next year.

Q - Marco Calvi {BIO 19854632 <GO>}

Okay. Thank you.

Operator

Next question comes from Ms.Irma Sgarz from Goldman Sachs. You may carry on ma'am.

Q - Irma Sgarz {BIO 15190838 <GO>}

Thank you for taking my questions. Breno, 2 questions. As for the adjustments you made, I thought it was interesting that you now have a metric, which is linked to the sell-out, which is related to the variable part of the bonus. So what has changed inside in terms of processes? What have you learned with those adjustments? Those were somewhat large adjustments that you made in the past 6 months and especially in the first quarter. So what's different now? You have checks and balances, a more monitoring (inaudible) probably in the future.

And the second question is with the guidance. I understand you are maintaining the guidance for this year. It would be useful to know -- if you have different impacts on the profit line, it would be nice -- useful for the market to know what you expect in terms of market growth, in terms of the top line growth, in other words around the company's fundamental.

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Alright. Irma, I'll start with the guidance question. As for the guidance, we are maintaining the guidance. As you mentioned, we see no reason now to change that. We are not providing a top line guidance as we did in the past, but the growth in net income is quite in line with our growth in top line and also with the growth with market growth. So excluding the first quarter, we're talking about a growth of around high single-digits both for our top line and for the market high single-digit growth, and consequently, maintaining margins to meet that net earnings guidance.

As for the other question about the changes in adjustments that were made, I'd say that in terms of visibility, we already had a good level of monitoring of stocks or inventory at the client. It was our internal policy. The policy was to have higher inventory. But with the improvements we've seen inside the company, we felt safe enough to bring the inventory level slightly down and maintaining the same level of service provided to clients.

So as I mentioned earlier in this presentation, we saw changes in efficiency, in logistics, in delivering the product improvements at the factory level in terms of capacity, fewer problems with lack of products by significant reduction in orders not filled. We also improved several processes. Sales and operational planning is one of them, which is now more in line with the business units and the plant and with the logistics arm and other areas of the company, which are involved in the process.

There were some changes throughout the past 1.5 years, which allowed us to make that adjustment at this moment. I'm not sure I addressed your question.

Q - Irma Sgarz {BIO 15190838 <GO>}

Kind of. Thank you. Thank you.

Operator

Next question from Mr.(inaudible) from Bradesco BBI. You may carry on sir.

Q - Analyst

Good morning, everyone. Thank you for taking my questions. Two questions. Number one, the changes with Adalmario and Vivian. I can't understand the scope of Vivian's new role. What does that impact the company's day-to-day operations?

And number two looking at your SG&A, it increased by 12%, which is partially explained by a drop in the payroll. Can you give us a breakdown of the impact? Is anything else to explain that increase? That's all. Thank you.

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

So (inaudible), I'll address the first one and then Adalmario will address the second one. This is Breno. As for Vivian's role, she will maintain some of the tasks she was already in charge of. For example, planning was something she already did and will add other activities, which is related to projects. And the idea as I answered to Irma, we are trying to achieve improvements in other processes in the company. And of course, at the end of the day, trying to generate more value for the company so that we can invest in those areas that generate revenues and benefits for the company in terms of marketing the company -- in other words reallocating investments. That's the main objective, the main target of Vivian in this new role that she will be playing.

As for the impact of the compensation, we are talking about BRL 8.6 million in EBITDA, but that was offset by an impact of CPC 16. So compensation alone we would reduce our EBITDA by BRL 8.6 million. And CPC 16, which has to do with reclassification of leasing revenues, will have an impact of BRL 8.2 million positive. In other words, one practically offsets the other.

Q - Analyst

Okay. Thank you.

Operator

Next question from Mr.Gustavo Oliveira from UBS. You may carry on.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Good morning. Thank you for taking my questions. Breno, going back to the inventory question, you mentioned that in the past 18 months, you implemented processes that allowed you to make those adjustments now. So what were the premises? What did you base your decision on? Is logistics better, more efficient? Or would you say that clients are more comfortable working with lower inventory levels? Are you going to be working with an inventory level, which will be much lower than that of the industry or not? Will that lead industry to decrease average inventory levels or not? May be you do not have such a sophisticated client that is able to work with low inventory level, and what kind of increase in logistics expenses that entailed? So what led you to make that decision, in other words?

And you did not adjust Similar and Generic products. Is that in the radar or we are talking about a different dynamic for that specific industry where you have different inventory levels? And when you complete your expansion process, do you think you'll need to make adjustments going forward? So I would like to have a better idea of the sustainability of that decision. How will that impact your consumers or clients in other words?

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Gustavo, we believe that -- as I said, the adjustment was finalized in the first quarter and we believe that we are closing with the inventory level is upwards in the range of the industry average. So we'll benefit from the fact that we -- that our inventories are essentially higher than the average, the idea is to avoid stock-out. As you know at some clients, that's not a simple issue. Some clients have 6, 7, 10 distribution centers throughout Brazil. So per SKU, we have about 1,000 SKUs,. So for each DC -- to analyze that, that's quite complex. So we are still sticking to that policy of staying in the upper range of the industry average in terms of stock or inventory.

Now as for change in the policy, as you asked, we are keeping a close eye on that and I mentioned that sell-out is part of the target. But just as working capital inventory levels those are also part of our target for the business unit. As for the logistics cost -- and it's the opposite. We believe that, that cost will drop because of that. We hope that with this new commercial policy, we will have a more efficient process that will lead the logistics prices to go down.

We do not believe we'll see an impact in the short run, no. But in the mid run, we expect that number to go down not up. As for Similar and Generic products, we have not made any adjustment. We did not see an opportunity there to improve. And in this case, the level of inventory that we have is beneficial. It's good. It's even helpful to clients that will encourage sell-out on their part. But in this case, we do not intend to make any adjustments, again for Similar and Generic products. Have I covered your concerns, Gustavo.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

I think you've covered, yes. Just one more thing. As for Similar and Generic products, it's like you said it's the opposite of what I thought, maybe because the margins are lower for some distributors. And if I'm right in my rationale here,.

I would expect an adjustment, to be frank, but maybe it's a little early to talk about that.

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

No. It's -- like you said it's the opposite. For us, margins are lower when compared to Branded Prescription. But for clients, margins are higher. Usually clients, especially the smaller ones, do not pass on the same level of discounts that they receive. So they have significant margins, much better in Generic and Similar products than with Branded Prescription. But on our end, we do not see our inventory levels as too high that would justify an adjustment in this policy right now.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay. I have 2 more questions. Your inventory level has increased 30% year-on-year. Accounts payable also dropped, I saw that, but the speed was not comparable. So how do you see inventory levels going forward? What would be the ideal level? And also looking at your numbers, when you consider -- when you compare net to gross sales, the return levels increased significantly up to BRL 30 million. Is that linked to the adjustment you mentioned? I'd like to understand the dynamic a little more.

And lastly, what's the percentage of vitamin D and anti-flu medications represent in your total sales? That might affect your margin down the road so if you could give us a breakdown for that. Thank you.

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Well, Gustavo, inventory levels grew significantly especially because of finished products inventory. Factory is working at normal levels, so we -- as I said, we're talking about finished products mainly. And as demand resumes normal levels in the second quarter, the idea is that we'll reduce the inventory levels throughout the year, especially for Branded Prescription products.

As for return, what would be the level which would be comfortable? Last year, we had a safety inventory for raw material. Today, raw materials we consider to be at an adequate level. Now we have a higher inventory for finished products. The idea is to close the year with the same levels we had for last year.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay. As you're going to have few less inventory for sell-out, would it make sense for you to have a higher inventory? Or would you say that the process is so much improved that you can work now with the lower inventory when compared to your DC? Do you have a higher delivery frequency I don't know.

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Exactly. We have reduced our lead time last year when compared to 2017. We (inaudible) that by more than half the number of days for the lead time for clients, that's clearly a major benefit that allows us to work with lower inventory levels. So in this quarter, we saw that impact because the factory -- the plant never stopped, but we are resuming normal levels in the coming quarters. Just to complement Gustavo even with this level that Adalmario mentioned the average last year it's still higher than what we had in the past. So we do not foresee problems in terms of lack of products because of the current level of inventory.

Okay? As for returns yes, you are correct. There is an impact coming from our policy to optimize working capital. We had an additional volume in terms of returns of products. That's another benefit another encouragement for us to optimize working capital going forward. So the idea is that as that volume drops, that will reduce that number of returns to the lowest possible level. That cost associated to returns was taken into account in our strategy to improve working capital.

Okay? And for vitamin D and anti-flu medications, well, they represent about 20% of our revenues, 20%, but as a complement. So that number is going down. If you look back that number was higher. But with the launches we've made in the other categories, the trend is that dependence, if you will, will drop throughout time.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Thank you. The questions remain to address for vitamin D and anti-flu medications. Are there issues of competitiveness or other nature?

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

For vitamin D, we see very serious competition. There is price pressure. There's the same goal for anti-flu medications. In both cases, well, the competition for Vitamin D has been in place for some time since 2016 as other players joined the market. We've seen strong competition, but the main problem with the slowdown in the market, which grew in the past 40% in the second half of last year grew only by 14% in the year as a whole. So in this year a drop of 6%, so very different dynamic.

And the same goes for anti-flu medication. In 2017, the market grew by 20%. Last year, it was flat. And this year, we see a drop also of 6%. So more than the competition itself the major impact came from other factors for anti-flu medications. We do have such a strong flu season in 2017 and for vitamin D the number dropped because we saw a lower number of prescriptions from doctors because of a change in guidelines, especially in the early months of last year.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay. Thank you for your answers. Have a nice day.

Operator

The Q&A session is now over. I would like to turn the floor now back to Mr.Oliveira for his final remarks.

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Well, thank you all for participating in our call today and as usual, our IR team remains available for comments or questions you may still have. Thank you, and have a nice day everyone.

Operator

Hypera Pharma's audio conference is now over. Thank you all and have a nice day.