

## Q3 2016 Earnings Call

### Company Participants

- Claudio Bergamo dos Santos, Chief Executive Officer & Director
- Martim Prado Mattos, Chief Financial Officer & Controller

### Other Participants

- Robert E. Ford, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning. Welcome to the Hypermarches Third Quarter of 2016 Results Conference Call. Today with us, we have Mr. Claudio Bergamo, CEO; and Mr. Martim Mattos, CFO.

We would like to inform you that this event is being recorded and that all participants will be in listen-only mode during the company's presentation. After Hypermarches remarks, there will be a question-and-answer session for investors and analysts when further instructions will be given.

We would like to inform you that questions can only be asked by telephone. So if you're connected through the webcast, you should e-mail your questions directly to the IR team at [ir@hypermarches.com.br](mailto:ir@hypermarches.com.br). Today's live webcast may be accessed through the company's Investor Relations website at [www.hypermarches.com.br/ir](http://www.hypermarches.com.br/ir).

We also would like to inform you that the statements during this conference may constitute forward-looking statements. Such statements are subject to known and unknown risks and uncertainties that could cause the company's actual results to differ materially from those set forward in the forward-looking statements.

Now, I'll turn the floor to Mr. Claudio Bergamo, who will begin the presentation. Mr. Bergamo, you may begin your conference.

### Claudio Bergamo dos Santos {BIO 16015846 <GO>}

Thank you very much. Good morning, everyone, and welcome to our third quarter earnings call. Our net revenue in the quarter reached BRL 800 million, representing a 10% growth in the quarter. Our EBITDA reached BRL 255 million, a 14% increase compared to the same year of last year. This result was achieved from a combination of gross margin increase and SG&A reduction as percentage of net sales.

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In the year-to-date, our net revenue reached BRL 2.445 billion, representing an 11% increase. Our EBITDA year-to-date reached BRL 870 million, representing a margin of 35.6% of net sales, 1.8 percentage point increase compared to the same period of last year.

Our net income was BRL 203 million in the quarter, more than two times compared to the same period of last year. For the year, our net income reached BRL 1.4 billion. This amount includes the impact of the capital gains related to sale of the Cosmetics Business closed during first Q 2016.

We also had, in the quarter, a good growth of our operating cash flow, which amounted to BRL 222 million. For the year, our cash flow from operations reached to BRL 703 million.

In October, we finished the sale of our Condoms Business to Reckitt for a total amount of BRL 706 million. We received the second installment of BRL 571 million in the quarter. At this point, the company has a pro forma cash position of positive cash position of BRL 723 million.

Our robust capital structure has allowed the company to return cash to shareholders in a consistent manner. In August, we paid BRL 158 million in dividend, representing a point - BRL 0.25 per share. For the full year, we distributed a total of BRL 316 million in dividends, representing BRL 0.50 per share. We also continued our share buyback program as we believe is one of the best use of our cash position at this moment.

I'd like to finish reminding that we have completed our new Innovation Center in Barueri. Our research and development teams will work very closely with our business unit with the objective to increase our innovation index to maintain our long-term sustainable organic growth above the market average.

Now, I will turn the floor over to Martim, who will discuss our numbers in great detail.

### **Martim Prado Mattos** {BIO 16015889 <GO>}

Good afternoon. Let's quickly review the main highlights of our quarterly results starting in page two of the presentation. Continuing operations net revenue was about BRL 811 million, a 9.8% growth compared to the same quarter of the prior year, driven mostly by the price increase implemented this year. In terms of market segments, our Generics & Branded Generics unit was the main contributor to the revenue growth.

Gross margin increased by 30 bps. The price increase led to 3.1 percentage point rise in margin, but on the other hand COGS caused (05:48) a 2.8 percentage point reduction driven primarily by FX, given that the average dollar in our COGS was around pretty high (05:57) last year. There was no mix change between this quarter.

Operating expenses increased only 7.3% and were therefore diluted by 1.1 percentage points. The biggest portion of this reduction came from selling expense by 70 bps,

followed by G&A expense by 60 bps. Marketing expense on our other side remain approximating the same level last 3Q 2015.

Therefore, the EBITDA margin reached 31.5%, up 14.3%, increased to BRL 255.5 million. After this result, we remain on track to reach our guidance of EBTIDA around BRL 1.1 billion this year. The financial result was slightly positive, reflecting the company's new capital structure and in the absence of significant debt prepayments as was the case in the first quarter and second quarters of this year.

Thus, the continuing operations net income was BRL 183.9 million, a 212% increase compared to last year with net margin of 22.7%. Discontinued operations posted a net result of BRL 18.7 million, a 14% increase compared to 3Q 2015, in spite of the portfolio reduction at the former Consumer division. The main driver for this expansion was the substantial improvement of the Disposable segment, which has returned to the gross margin levels that are comparable with the segments after aggressive price increases implemented since last year. Reported net income was then BRL 202.5 million or 169% above the quarter of 2015.

On the next page, we see that the gross debt ended the quarter at BRL 1.353 billion, given that we have already paid this year a total amount of BRL 3.6 billion in debt. The cash position was BRL 1.156 billion, which including non-realized hedge gains of BRL 348 million led us to end the quarter with BRL 152 million in net cash.

On October 4, we announced the closing of sale of the Condoms Business, receiving a second installment of BRL 571 million. Therefore, our net cash position taking this amount into account ended the quarter at BRL 723 million even after dividend payment of BRL 158 million and share buybacks of BRL 86 million in the quarter.

Thanks, everyone, for the attention. We can now start the Q&A session.

## Q&A

### Operator

Thank you. The floor is now open for questions from investors and analysts. Our first question comes from Bob Ford from Merrill Lynch. Please go ahead.

#### **Q - Robert E. Ford** {BIO 1499021 <GO>}

Thank you. Hi, Claudio. Hi, Martim. And congratulations on the quarter and the results. Following your comments on the Brazilian conference call, (09:58) is already out with the headline that you're accepting client payment delays. So I was hoping that you might address that, as well as the general payment compliance of your client base? And in the earlier call you also mentioned that you're taking some products out of the channel. And I was wondering if you could reconcile that for me as well, please, given the higher days receivable that you're reporting in September?

**A - Claudio Bergamo dos Santos** {BIO 16015846 <GO>}

Well, hi, Bob. How are you?

**Q - Robert E. Ford** {BIO 1499021 <GO>}

Great, Claudio. How are you?

**A - Claudio Bergamo dos Santos** {BIO 16015846 <GO>}

Look, as we said in the Portuguese call, at the end of the quarter we had some clients requesting to postpone some of the payments. When they do that, we charge interests; not meaning that we want to receive interest, but meaning that's a way to not incentivize them to have that type of behavior. And then, of that, two to three clients reached some concentration of values that they bypassed to October that payment which at this point that we are talking now, they already paid back. And that in some way represent a strategical change that (11:30) our days of receivables for the end of the quarter.

Said that, we are also managing our stocks in the chain in a way that we took some advantage of the increase of our increase in sell-outs in the quarter. We're projecting to reduce the number of days we have the stocks in the chain, because that's the key variable for midterm in terms of being able to reduce our terms to client.

As I said in the Portuguese call, we had a pretty good quarter in terms of sell-out demand for our branded Prescription businesses. We have a 20% increase in the demand for these businesses and we have 11% demand for the Consumer Health. These two businesses are the most profitable ones. They represent around two-thirds of our revenue base, and I think they're performing very well in the quarter. And I don't see any reason (13:01).

**Q - Robert E. Ford** {BIO 1499021 <GO>}

It's very helpful.

**A - Claudio Bergamo dos Santos** {BIO 16015846 <GO>}

So that's pretty much where we are. And maybe I have clarified your question. Maybe Martim can also have some further insight on that.

**A - Martim Prado Mattos** {BIO 16015889 <GO>}

Yeah. The amount was approximately about BRL 20 million that Claudio has mentioned. So that caused the increase from days of receivables from the second quarter to the third quarter.

**Q - Robert E. Ford** {BIO 1499021 <GO>}

Okay. And the income from that penalty interest, if you call it, is that something you recognize in the financial lines or is that in the operations?

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**A - Martim Prado Mattos** {BIO 16015889 <GO>}

Correct.

**Q - Robert E. Ford** {BIO 1499021 <GO>}

Okay.

**A - Martim Prado Mattos** {BIO 16015889 <GO>}

Financial income.

**A - Claudio Bergamo dos Santos** {BIO 16015846 <GO>}

Yes, yes.

**Q - Robert E. Ford** {BIO 1499021 <GO>}

No. And then, I guess the other question is, as you were saying, I mean you killed it in sell-out, right, especially in the branded products that are much more - were profitable. You indicate that the sell-out in the period to Generics were weak, but the sell-in which at the numbers that you're reporting and that we're seeing on income statement, you've redoubled your efforts clearly in the September period on Generics and you highlight those, right?

**A - Claudio Bergamo dos Santos** {BIO 16015846 <GO>}

Yes.

**Q - Robert E. Ford** {BIO 1499021 <GO>}

Now, should we interpret the deceleration - or the implied deceleration of the branded product in September, is that simply just an effort to reduce stocking the channel. And if so, is it something that we should project into the next quarter or two quarters as you adjust channel inventories? I mean, how should we think about sell-out versus sell-in over the next three months to six months?

**A - Claudio Bergamo dos Santos** {BIO 16015846 <GO>}

Yeah. You are right, you are correct. In the branded products, we did have an important deduction in the stocks. And then with the part of our projections to enter 2017 with a tighter, with a little stronger (15:05) bargaining power with our clients in order to go out and reduce (15:12) our terms with them. Basically, that's the distraction, right.

But we have to do that always careful in order to not reduce too much because, as you know, Brazil has somewhat an efficient distribution chain; and we believe that a certain level of minimum fixed stock that we need to maintain in the chain in order to not provoke stock option. So there is a plan that we believe it's kind of a minimum and a maximum that we have to manage, and that's how we do on a client-by-client basis. But the benefit of doing that and maintaining that is basically to try to reduce overtime our trends with clients based on a lower stock level.

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We don't intend to increase that from now on. Actually, our objective for 2017 is pretty much to match spending and sell-off. And when you do that, to-date, I mean you grow and you reduce slightly your base as you move quarter-over-quarter basis. That's pretty much our target.

I believe the point we are now is in pretty good shape to go after that and maintaining this level. So that was (16:44) for the quarter. That's why you don't see for the branded products the same level of demand in sell-in and sell-out.

**Q - Robert E. Ford** {BIO 1499021 <GO>}

Okay. So even in maybe in the fourth quarter - and I don't want to put words in your mouth - in the fourth quarter we should see fairly balanced sell-in and sell-out as well?

**A - Claudio Bergamo dos Santos** {BIO 16015846 <GO>}

We should...

**Q - Robert E. Ford** {BIO 1499021 <GO>}

Okay, great.

**A - Claudio Bergamo dos Santos** {BIO 16015846 <GO>}

We should. That's our objective to do that...

**A - Martim Prado Mattos** {BIO 16015889 <GO>}

Especially 2017.

**A - Claudio Bergamo dos Santos** {BIO 16015846 <GO>}

And especially in 2017 as well. Said that, sometime here and there you had certain negotiations that sometimes the clients try to go a little beyond what should be the financial rationale of a negotiation; and then, we don't enter in that type a bargaining.

**Q - Robert E. Ford** {BIO 1499021 <GO>}

Yeah.

**A - Claudio Bergamo dos Santos** {BIO 16015846 <GO>}

The cost of capital is pretty high enough in Brazil, so some clients try to bet on that, let's put this way, to try to use us as their finance house; and we don't do that. And we have a very big client in this quarter, but I don't want to name it, but try to use us to finance their expansion plans. And we didn't accept it. And then, we took advantage and also further reduced the stocks there.

**Q - Robert E. Ford** {BIO 1499021 <GO>}

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Got you. Got you. And then the question was made earlier, but I think we got a little convoluted. But could you comment a little bit on the outlook for the pipeline? You mentioned brand extension for (18:33) - I think it's a new capsule, right, for (18:35), but I was wondering if you can comment more broadly on the pipeline. You've had a lot of things have been authorized. I know you're prioritizing the bigger opportunities as you see them. And I was wondering if you could just provide some general commentary on the outlook, please?

**A - Claudio Bergamo dos Santos {BIO 16015846 <GO>}**

Okay. Well, let's start first in the probably in the broader Prescription businesses. We have a very solid pipeline for this business entering 2017. We were - as you probably know, (19:10) ago is the clones, which are products that you can basically copy and do a (19:21) of an existing product.

So we went where we follow the process, looking into our now (19:31) similars pipeline and we think the prior couple of products that we could launch at the doctor community, in some specializations that we are not so strong, as for example, as in cardiology, that we don't have so much product in gynecology and also in psychiatry. I'm sorry for my English.

**Q - Robert E. Ford {BIO 1499021 <GO>}**

Okay.

**A - Claudio Bergamo dos Santos {BIO 16015846 <GO>}**

And so, we found ourselves specific products that we could mirror and we will have a couple of launches for next year based on that strategy because that is a launch that we can get out pretty quickly, especially because we do have already (20:21) more bureaucratic process. So that should be part of the growth of Prescription for next year. As well, we have a couple of very nice pipeline for our dermal Cosmetics Businesses, but we are conducting. We are second in the marketplace. So the business is doing pretty good, now growing above 20% per year and we believe that we'll continue in that trend moving forward.

As well, we have like some new line for ophthalmology, which is we just launched a new line this year and we have a rollout of that strategy entering 2017, 2018 and 2019. So we now have a very strong sales force towards ophthalmology. We are visiting 90%, 9-0, of the total ophthalmology results of Brazil. So it's the (21:23) of ophthalmology in Brazil. It's not a market which is that explored, so we believe (21:32) that will bring us some nice growth as well.

As well, we have like a very nice brand extension for Alivium. So we will be able to launch. As you know, Alivium is the (21:47) of Brazil, right. So we compete head-to-head with Alivium and we will be able to launch now geocache for (22:01).

(22:02) actually is an interesting case, because it's the brand that we play both at the doctor, so we take the doctor for prescription for especially for implant where the allegiance a legion was created, but as well we are doing a mass media for the geocache.

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It's a brand that we are using a mixed and marketing to hybrid, I call, hybrid marketing to. And we believe that it will be a very nice growth from that, and a very good - Alivium is going to become a very important brand for us. There, as you mentioned, we are able to also launch the geocache, so we're just launching right now. We're in the process of launching that. So there are many initiatives on that front that I believe that's a nice (23:04) momentum for 2017 on that front.

**Q - Robert E. Ford** {BIO 1499021 <GO>}

Right.

**A - Claudio Bergamo dos Santos** {BIO 16015846 <GO>}

On the other - and similars and generics as well, we have many launches that we take advantage separately. As you know, we have been investing quite a long time in filing products and now that pipeline is maturing. So we have a couple of launches of very important products that we didn't have in our pipeline, and that will come out 2017, also entering 2018.

So in terms of the OTCs, where we still don't have so much of a boost yet in the pipeline, but we do have many products that we launched recently in about one or two years back that we still have important follow-up rollout traffic, for example, the Benegrip Multi liquid version, the Doril Enxaqueca and some other products, and we're also working some other opportunities.

And you have to (24:26) we are very cautious, and then that's part of our strategy that innovation and launching is our - the name of the game now. And then, we are now above a 20% innovation index; innovation index, meaning products that we launched in the last five years. And then, we want to increase that to around 30% in the next three years. So we're working very hard on that. And then the creation of the business unit will help a lot that alike with the new Innovation Center. So all that will push further the strategy of - or potential of our brands and business.

**Q - Robert E. Ford** {BIO 1499021 <GO>}

That's great. Very helpful. Thank you very much. And congratulations again on the quarter.

**A - Claudio Bergamo dos Santos** {BIO 16015846 <GO>}

Thanks a lot.

**A - Martim Prado Mattos** {BIO 16015889 <GO>}

Bye.

**A - Claudio Bergamo dos Santos** {BIO 16015846 <GO>}

Bye.



## Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Claudio Bergamo for any closing remarks.

## A - Claudio Bergamo dos Santos {BIO 16015846 <GO>}

Thank you very much all for participating. Our IR department is available to discuss any further questions you might have. Have a nice day and nice week. Thank you very much. Bye-bye.

## Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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