Q2 2012 Earnings Call

Company Participants

- Claudio Bergamo, CEO
- Martim Prado Mattos, CFO

Other Participants

- Daniela Bretthauer, Analyst
- Gustavo Oliveira, Analyst
- Irma Sqarz, Analyst
- Isabela Bacchi, Analyst
- Jason Devito, Analyst
- Lore Serra, Analyst
- Robert Ford, Analyst

Presentation

Operator

Good afternoon. Welcome to Hypermarcas Second Quarter of 2012 Results Conference Call. Today with us we have Mr. Claudio Bergamo, CEO, Mr. Martim Prado Mattos, CFO. And Mr. Breno Toledo Pires de Oliveira, IRO.

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 Hypermarcas' remarks, there will be a question-and-answer session for investors and analysts, when further instructions will be given. (Operator Instructions)

We would like to inform you that questions can only be asked by telephone. So if you are connected through the webcast you should email your questions directly to the IR team at ri@hypermarcas.com.br. Today's live webcast may be accessed through the Company's Investor Relations website at www.hypermarcas.com.br/ir.

We would also like to inform you that 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 {BIO 16015846 <GO>}

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

Please with just the one I start up on page five. In the Second Quarter of 2012, Hypermarcas continued its strategic plan to pursue sustainable, profitable growth based on organic growth of each brand, strong operating profitability, with positive free cash flow. And with debt reduction.

If you go to page six, in the Second Quarter the Company results were consistent with that strategy. Net revenues were BRL957 million in the quarter, leading to organic growth of 11% compared to Second Quarter 2011, accumulating an organic growth of 12.4% in the fiscal year of 2012.

The double-digit revenue growth in the Second Quarter was driven by a combination of factors such as the resilience of the markets in which the Company operates which continued growing in 2012 despite economic slowdown, strong brands with leading position in many segments. And mainly the result of actions undertaken in 2011 and in 2012 which now have started to impact the Company's results.

Among other measures which have led to this performance, it's worth to highlight the adjustment of the commercial policy in 2011, with predictions of discounts and improvement in distribution. Additionally, in 2012, the Company intensified such efforts with the restructuring of sales, merchandising, medical rep forces. And also increased media and point-of-sale investments.

Besides organic growth, the Company's operating results was very satisfactory, reaching an adjusted EBITDA of BRL224.5 million, representing 23.5% of net revenues in the Second Quarter 2012. This performance was marked by gross margin of close to 63% and (banking) investments of 19%, both in line with historical levels.

More importantly, also in the quarter, the Company was able to reduce by 100 bps its commercial expenses. And by 260 bps its admin expenses. Similar to the net revenues advance, the reduction in SG&A expenses was due to a series of cost reduction actions which have been executed since 2011 and early 2012, including the creation of the Shared Services Center in Goiania, the improvement of sales force productivity, the rationalization of expenses. And the implementation of operating synergies.

Additionally to organic growth and satisfactory operating result, with the reduction of expenses, Hypermarcas reported strong cash flow from operations in the quarter, reaching BRL237 million, representing 79% growth over Second Quarter 2011. That amount was enough to cover the Company's investment plan to consolidate operations such as for the Project Matrix and other CapEx needs in a total of BRL68 million, plus the interest expenses obligations of 58%, allowing the Company to end the Second Quarter with a free cash flow after CapEx and the financial expenses of BRL112 million for the quarter and BRL142 million for the fiscal year 2012.

This performance is also in line with the Company's objectives of generating cash to reduce its debt. Net debt reduction was not higher only because of negative foreign currency variation in a total of BRL161 million, which is totally related to the Company's bond, which matures in 2021.

Coming more specific to the division performance, on page eight, in the Pharma division in which the change in program started earlier than in the Consumer division. Result in the Second Quarter and first half of the year are already showing consistent effects such as the organic growth of 20.9% in the Second Quarter and accumulated growth of 19.1% in the first half of the year vis-a-vis the previous year.

If you'd also move to page nine and we see that not only the Company performed very good growth in the selling in the Pharma sector in the quarter. But also the level of sell-outs in terms of demand in the division reached its highest historical level, exceeding more than BRL1 billion in medical drugs commercialized in the quarter, represent a demand growth of 23% compared to the same period of 2011 and 57% compared to Second Quarter of 2010.

If you go to page 10. And we see that not only in the growth of selling as well in the sell-out. But as well the demand, that demand growth allowed the Company to reach historical market share peak in the Pharma market in the quarter, reaching 8.6% share in May and 8.4% share in June.

If you move to page 11, a great part of that performance, as I said, is due to many actions which have been implemented since 2011 and others which are being undertaken in the early fiscal year 2012 such as the higher investments in media for the OTC brands, where the Company remains the leader in the markets and gained 1% share in the quarter.

To support its strong brand portfolio of brands, the Company launched a total of 18 OTC advertising campaigns in the quarter. Also, the Company invested a higher investment in the point-of-sale exposure, supported by a new merchandising team that visits more than 70% of total market weighted average. Also, the Company strengthened its commercial structure and continued gains in distribution and in the Generics segment.

And specific to Generics, on page 12, the investments that the Company has been conducting since the acquisition of Neo Quimica in 2009 such as the Corinthians soccer team sports sponsorship, the expansion of the product line, the gains in distribution, among others, resulted in the historical market share peak as well in the quarter, reaching 7.8% of the total market in May and 7.5% in June and consolidated Hypermarcas as the third largest player in the Generics market in Brazil.

We talk now about the Consumer division on page 13. The Consumer division reached a total net revenues of BRL426 million in the Second Quarter, 1% above 2011, accumulating a growth of 4.6% in the quarter. The lower growth compared to Pharma is due to a combination of some factors such as later start of the changed program compared to the Pharma division, a slight anticipation of clients' purchases even price increase on April. And tougher competition in certain markets, especially in diapers.

In spite of that performance, the Company's -- the division is built on strong foundations to sustain profitable growth in the mid and long run, as can be seen in page 14. Among the actions implemented in the quarter, the division has focused strongly on building profitability, maintaining its discipline on commercial policy execution, taken important action to strengthen its commercial areas. And continues to relaunch many of our brands.

On page 15 and 16, we sum up these relaunches in line with our process. We have accumulated, as we have done in the past, for brands such as Risque, Bozzano, Monange. And recent case of success which allows the brands to gain market share and has a very satisfactory selling levels growth such as the diapers brand, Pom Pom, as can be seen in page 15. And the skin care brand, Paixao, as can be seen in page 16.

Furthermore, if we move to page 17, the division continues to build on the strong operational platform to reduce its costs, capture synergies. And improve client service levels. The Project Matrix is at full speed with schedule on time. Production already started at the new site in July and is expected to be fully operational by March '13. The new distribution center in Goiania started operated to the Northeast area on May, to the Midwest on June. And expected to be fully operational by First Quarter 2013.

In diapers as well, the consolidation process is underway and is expected to be fully operational by mid 2013. The consolidation of the operations for these products, the Consumer division, we believe we lead to the capture of synergies with operational improvement -- with operational results improvement in the next two to three years.

You can see on page 18 and 19 some of the photos of the new site and the new warehouse. But not only -- on page 12, not only the performance improvement initiatives at the division levels we are working on. Also, the Company has been focusing to consolidate its back office functions by the creation of the Share Service Center, which will be located in the Goiania warehouse. This project is also at full speed and is expected to be completed by First Quarter 2013 and will improve productivity and reduce Company G&A expenses.

Turn to page 21. Furthermore, to the improvements of operational results, the Company's focus to improve its cash conversion cycle, which, in the Second Quarter of 2012, reached its lowest historical level. These results can be explained by enormous effort that the Company has been pursuing in the reduction of its days of receivables. And increase in the days of payables. And the reduction of its (penny) stocks.

When turning to page 22, the ending results of all these initiatives that the Company has been pursuing can be seen in the material improvement in the free cash flow generation in the first half of the year. The Company generated for the first half BRL376 million in operating cash flow, which was enough to finance its CapEx and its interest obligations, generating BRL142 million in free cash flow, BRL241 million above for the same period of last year.

The Company reiterates its commitment to proceed with its plan of sustainable, profitable organic growth with operating cash flow generation with debt reduction. Aiming at aligning the whole Company on its goals, Hypermarcas also carried out in the quarter corporate efforts to disseminate a strong results-driven culture within the organization. The Company's results in the quarter confirms its moving the right path. But a number of opportunities still need to be captured in several fronts of the business to support long-term value creation over the coming years for our shareholders.

Thank you very much. I will pass on to Martim now.

Martim Prado Mattos {BIO 16015889 <GO>}

Good afternoon, everyone. Martim speaking. Starting on slide 24, we see that the net revenue totaled BRL957 million in the quarter with growth of 11% compared to the previous year. In the first half of the year, the net revenue amounted to BRL1.854 billion, a growth of 12.4% compared to 2011.

In the Pharma division, growth of 21% in 2Q12 and of 19% in the first half of the year. It's because of a solid combination of volume growth and strong price increase, both in the quarter and in the half year as well, compared to the previous year.

In the Consumer division, growth was up only 1% in the quarter and up 5% in the half year. Within the Consumer division in the disposables segment, relevant price increases introduced since the beginning of the year had direct impact on volumes, however, there has already been a relative improvement compared to the performance in the First Quarter of this year.

And within Beauty and Personal Care segments, growth in the half year had good performance in terms of volumes, combined with some price increases. Volume growth, however, was much more concentrated in 1Q12 given the anticipation of purchases by our clients before price increases starting on 2Q12.

On the next slide, we see that the consolidated gross margin in the quarter was in line with the margin in 2Q11. The margin in Pharma was 2.4percentage points smaller than in 2Q2011 as a function of a challenging comparison base in 2Q11 and the reduction of production volumes in our plants in Rio de Janeiro as close to one-third of its production was transferred to Anapolis. In Consumer, gross margin was in line with 2Q11.

In spite of the already mentioned decreases compared to 2Q11, we can observe on slide 26 that during the past four quarters we have consistent improvements in regards to margins in the immediately preceding quarterly both in Pharma and in Consumer divisions.

Among several reasons for this change we may highlight -- one, the price increases introduced, as already mentioned, two, the transfer of almost our entire Pharma production to Anapolis, three, a recovery during 2012 of the productivity of Sapeka disposable products and four, a healthier mix this year compared to the second half of the previous year, given that the process of changes in our commercial policy have taken place.

As we can see on slide 27, the adjusted EBITDA in 2Q 12 was up BRL225 million with margin of 23.5%. The adjusted EBITDA in the first half of the year amounted to BRL417 million with margin of 22.5%. It is worth remembering that both in the first and in the Second Quarter of 2011 we had high EBITDA numbers which benefited from credits booked as other operating revenues, which have made comparison basis particularly challenging for both 1Q12 and the second half of this year.

It is also worth stressing that we had in this quarter about BRL33 million in other credits, also booked as other operating revenues and expense. However, differently to what happened in 2011, there is no perspectives that such credits will be repeated again in the future as they are related to acquisitions, therefore, we consider this BRL33 million in credits as non-recurring items, excluding them from the adjusted EBITDA calculation.

The adjusted EBITDA in the year represents about 49% of the adjusted EBITDA guidance for the year, which confirms and makes us comfortable that we are on track to meet our goal. During the first half of the year, we had good growth rates with gross margins in expansion and operating expenses under control. During 2011, we made huge sacrifices to bring the Company to a route that we consider to be the most adequate. And our results so far in 2012 confirm we are in that expected path.

On the next slide, we see we had a net loss of BRL30 million in the quarter and a net income of BRL11 million in the first half of the year. In spite of the operating result of continued operations being 21% higher than in 2Q11 and additionally net interest expense has been 19% lower in 2Q12, unfortunately we had a non-cash impact of FX variation of BRL161 million as a function of a devaluation of the real against the dollar in approximately BRL0.20. Without that impact, net income in the quarter would have been approximately BRL76 million.

Flipping over to slide 29, we see that cash flow from operations, measured as the EBITDA minus net changes to working capital, was up BRL237 million, a result BRL105 million higher than in the same period of the previous year and BRL213 million higher when considering cash flow from operations accumulated in 2012.

That significant advance is related to the reduction since last year of the Company's cash conversion cycle, which totaled a19 days this quarter and is also related to the improvement in the recording of the results this year compared to the previous year.

Flipping over to the last page of our presentation, you may have noticed that we introduced in our earnings release metrics of free cash flow. And also as stressed by Claudio, as a straightforward way to monitor the results of our efforts towards reducing our net debt.

Operating cash generation, as mentioned, amounted to BRL377 million in the first half of this year. That cash generation was more than enough to pay for our CapEx, even if we considered that this investment included a large component of the consolidation of our manufacturing platform, particular Project Matrix. The Company's free cash flow, in addition, was also enough to pay for the net service of our debt, resulting in a positive balance of BRL143 million.

As mentioned during the last quarter, we have been acting firmly and diligently to allow further results like this one to be repeated. We will, therefore, continue looking for sustainable, profitable growth with cash generation and reduction of our debt.

Thanks, everyone. And we may begin the Q&A session.

Questions And Answers

Operator

Thank you. The floor is now open for questions from investors and analysts. (Operator Instructions) Our first question comes from Robert Ford of Bank of America/Merrill Lynch. Please go ahead.

Q - Robert Ford {BIO 1499021 <GO>}

Hi. Good day, everybody. And congratulations, guys, on the quarter. When you look at the pricing in Pharma, from my perspective it looks very impressive, especially when you take it in conjunction with the sales performance and the improvements in market share. Can you comment a little bit about -- or on industry dynamics across the major segments as well as your own operating efforts that have supported the market share improvement and the sales growth and the pricing?

A - Claudio Bergamo {BIO 16015846 <GO>}

First of all, congratulations for the day, Bob. I've heard you are happy having you -- a (good) --.

So coming to your point, the market share gain we saw in the Pharma as a whole for the quarter -- actually, the Company reached 8.6% and 8.4%. Actually, it did happen across the board in many segments. And I showed in the Generics market, we reached 7.8% in May, 7.4% in June. And as well in the OTC in the quarter, we gained around 1% share as well in the similar market. The only market that kept stable was the one on the prescriptions business. And if you come back to page nine, you see that we reached a peak historical demand for the quarter.

The question that we internally have to make and we have done all the actions needed to (objective) sustain that performance moving forward are on specifically on the OTC we have a wind in favor now given that the government has allowed the OTC to come back to the over-the-counter in the drugstores.

The question we need to continue seeing if we can sustain that level of demand and we have think all of the actions with that. And if that happened, I do believe that probably we have make it (a step) function on this vision. But I cannot make that segment now. I would love to see what's going to happen the Third Quarter and keep track on that metric and see that we can maintain that moving forward.

Q - Robert Ford {BIO 1499021 <GO>}

Great. And when I look at your gross margin in Pharma, it looks like you're down by 240 basis points, more or less. Can you talk a little bit about what's happening in manufacturing that put pressure on margins and the timeframe that you expect to recover sufficient levels of efficiencies so you can take those margins to where they were last year? And whether or not you see a need to perhaps maybe invest in price in the market, or do you think you could take those markets -- those margins to where they were last year?

A - Claudio Bergamo {BIO 16015846 <GO>}

Yes. Most of that reduction was due to a specific effect that we had at the product manufacturer at the Rio de Janeiro Mantecorp site. We downsized this site and we -- one-third and sent some of the OTCs to produce in Anapolis to complement the capacity we had there. Now, we are proceeding to reduce the fixed costs related to that. So that specific issues, I think, will be resolved by the third and Fourth Quarter. And the issue related to that will be not -- will be resolved.

A second issue, which is a different issue, which is so moving forward do you believe that gross margin levels are sustainable or they can be improved independent of new price improvements? The question is maintaining (inaudible) with all the variables. I believe they could, given that we still have a way to go to improve the productivity of the Anapolis site.

With that objective we have launched a program called Lean program, that is going through every area of the site and looking in details in all the opportunities. And we have seen already the first results of the Lean program and they are quite enthusiastic. So I believe that -- so as we move forward and we gain productivity, that will be another supporting effort to improvements in gross profit.

Regarding price increases, we actually are all the time looking to that. There are some specific discussions now at government level that some of the OTCs that are not controlled by government, that there are discussions the last six months already that if they should allow that specific products to not be controlled anymore by government. If that happened, I think there will be a window of opportunity given that some of these products haven't had a price increase above inflation for the last years.

So we don't have any trend or any direction on that decision. But it is on the desk of the government authorities. So we have to see. But it will be an upside if they decided to allow that.

Q - Robert Ford {BIO 1499021 <GO>}

That's great. And one last question, if I may. And that is that I think there's a view in the market that you could move to divest another asset and make a big reduction in terms of your net debt. Can you comment a little bit about your net debt right now within the context of the big improvements in cash flow? And is a divestiture something that you would consider at this time?

A - Claudio Bergamo {BIO 16015846 <GO>}

No. Whatever that comes from is not what the controlling group is think about, neither the management. We believe even the opposite. The Company has turned around the cash flow issue now, which is very good. Working capital conversion cycles are now in the direction of -- to improve its free cash flow, let's move forward.

For the time being, all the free cash flow will be used to reduce the debt. The debt at this point, if you not consider the exchange rate variations, actually the debt -- the net debt to EBITDA would be lower than at three times. So it's pretty much converging to our targets of being at 2.5.

And as we move forward and we reduce the CapEx cycle, which will happen probably in the second half of next year, entering 2014, we will accelerate the free cash flow and that will allow us to accelerate the reduction of that because then you're getting in a cycle -- in a vicious -- virtual cycle, given that when we reduce the CapEx that we will increase the free cash flow, then you reduce the debt, then reduce the interest. And then there was kind of a net factor -- a double effect for the free cash flow.

So coming to a point, no reason, no thinking, no objective to divest. The opposite -- to reduce debt and invest into the business.

Q - Robert Ford {BIO 1499021 <GO>}

That's very helpful. And again, congratulations.

Operator

Our next question comes from Gustavo Oliveira from UBS. Please go ahead.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Hi. Good afternoon, everyone, Claudio and Martim. My first question is on the Pharma division. You guys said that your price -- 60% of your growth comes from price, which means that your price increase on your mix was around 12%, was clearly well above inflation. This suggests, in our view, that the discounts that you're selling to the distributors and to the drug stores was reduced substantially because I think the Pharma price increase index was probably around 4% or 5% on average, right?

So what's -- do we still have room to reduce the discounts to the distributors and to the drug stores going forward? Or going forward we should expect the price mix to grow more in line with inflation? That's the first question.

A - Claudio Bergamo {BIO 16015846 <GO>}

I think that's a tough question to answer. I think there's a bigger effort done in the last half of the year, as we all know and you know, that resulted to this figure this (point), that we are able to have a price increase right above inflation due to our efforts to reduce discounts to the chain.

Moving forward, I think that that type of opportunities are more limited then it was in the past. We don't foresee that. We might have it here and there. But will not be as major as it was in the last year.

On the other side, as I said to Bob, the discussions on the OTC, like liberalization, that could help in terms of the total price. But that will not be an increase of price due to reduction of discounts. But more due to pricing stabled -- this price increase itself. So that's pretty much what it is at this point.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay. The second question is I'm trying to reconcile the initiatives that you highlighted in the Second Quarter with your long-term strategy for the Pharma. It's not clear for me if you want to gain share -- and you gained substantial share this quarter and quarter-over-quarter, even year-over-year -- but it seems that most of it was driven by the generics market share gains.

So I was trying to reconcile the initiatives that you are implementing now with your long-term strategy. If you could perhaps give us a little bit more visibility around what are you investing for? Are you investing to gain share, to maintain profitability, to gain share specifically in the generics? I think now that the business is a lot more stable, I think it's easier for you perhaps to have a longer-term view.

A - Claudio Bergamo {BIO 16015846 <GO>}

Maybe we'll start on that point. You should talk with more in details with Breno and Martim. But it's not that what happened. Actually, we gained shares in the OTC, which is a big piece of our business, of the Pharma, 40% of total business in the Pharma, not only in the generics. We gained in generics, we gained in OTC. We pretty much kept stable the similars and the RX.

And if you come back to the demand that we generated in the quarter, was across-the-board demand. The reason behind that is that many of the initiatives that we have pursued and we are pursuing, they go across-the-board. It's not only specific for generics, right?

We restructured the merchandising teams. We restructured the sales teams. We restructured the doctor visiting teams. And we increased the advertising on the brands and the point-of-sale management, as I said. So all of that altogether combined is supporting that growth.

The question again is how sustainable is that levels of demand? Then we are aware. We are looking at it in details to see that -- how they're going to continue in the next quarters, moving forward.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay. Very clear, Claudio. Thank you. And one last question is on the new product development, I think someone told me -- and unfortunately I could not participate in the Portuguese call -- but someone told me that there are some delays in the regulator's pipeline in terms of approvals of new drugs. If you could comment on that and how you think that could affect your -- the business growth for Pharma going forward.

A - Claudio Bergamo {BIO 16015846 <GO>}

Well that's a good point because most of the things we have been able to accomplish this year has been with not a (wink) so much in favor in terms of the regulated productivity in terms of being able to approve all the product registrations we have.

Just to put in perspective, at this point we have 500 products that we have already registered at Anvisa. We registered half of it in Anvisa and half of it we are in the process of registering. And of that half of it, some of them have been there for three years and still waiting for Anvisa to be approved. Except for generics, which Anvisa is quite fast, I would say. And also in similars, especially in the high value-added markets such as OTC and RX, they're still a little slow.

Fact of that, that happens not only for us, it happens for everyone else. So that -- on the other side of this thing, it helps in some way because it's increased a lot the barriers to entering this market. And the other side, when Anvisa decides at some point in time they will need to start approving that (inaudible), we will have quite -- I think quite a large number of large and we'll be able to pull out in the marketplace.

You could see it more as it was almost if it was like a backlog of growth opportunity for the next years going ahead. So we checking (quick) positive because we are focusing now more in the commercial execution and we are focusing on media investment, et cetera at all and that's our already moving. At some point in time when we -- this pipeline, we will be able to put out on the marketplace, that will help also the Company.

Q - Gustavo Oliveira {BIO 15129435 <GO>}

Okay. Thank you very much.

Operator

(Operator Instructions) Our next question comes from Lore Serra of Morgan Stanley. Please go ahead.

Q - Lore Serra {BIO 1506730 <GO>}

Hi. Good afternoon. And congrats on the improvement in the results. I wanted to just ask two questions. First, just to follow-up on the discussion in terms of pricing in the Pharmaceutical sector. I guess what I'm -- what would be helpful to see is is there a way you can break out sort of how much of that 12% average pricing came from discounts lowering versus front-line pricing? I guess what I'm trying to understand and reconcile is how you're getting so much pricing of generics to the fastest growing segment.

A - Claudio Bergamo {BIO 16015846 <GO>}

Well all of that --. Lore, how are you? Fine.

Q - Lore Serra {BIO 1506730 <GO>}

Great, thank you.

A - Claudio Bergamo {BIO 16015846 <GO>}

On average, overall, total price increased defined by government is somewhat around 4.5%. So the 12%, most of it, it's due to reduction in discounts which were implemented by the second half -- mostly by the second half of last year. And that was part of our major effort.

Part of it, I think generics specifically, despite the growth of generics, still when you look to generics and the total revenue base of the Pharma, it's something -- of our division, it's something around 8% -- 7% to 8%. So that's not so mature yet to impact our total weighted price increase. The real effort, as you know, was mostly in the OTC, OTX, RX. But the core three, Dorsay, Monange. And Farmasa efforts.

Beside that, generics, there's a mix that you can play since some products -- new products that we are launching where the value-added --. I don't know if you know. But historically Neo Quimica -- when we acquired Neo Quimica, their strategy towards pricing in the beginning of the development of generics in Brazil, there are two types of strategies.

One, one block of companies decided to put the list price high and give high discounts. And some set of companies decided to put the price -- the list price -- low. And we're thinking that would -- the consumers would perceive that and try to work with different discount policies. What showed over time that the right strategy was to put the list price high and give high discounts and let the drug store to define what would be the end consumer price.

So also in the generics specifically, every -- so when we acquired Neo Quimica, we received quite large amount of products which are priced below the 65% defined by the government. Every single product we launch we position at the limit at the 65%. So what happens for generics, that over time the average price point of the generic, it's going up. Given that the new products that we are launching are becoming every time being a bigger piece of that cake. And because of that, in generics specifically then you have a price increase due to that strategy.

Also, products from generics you launch, they have better price point given that many of them are recent patent expired moleculars, which have a higher price point, also higher margin levels. So generics are interesting because it is growing, the price -- the average price is growing as well. And the margin is growing as well. So it's somewhat counter intuitive for what you would think.

Q - Lore Serra {BIO 1506730 <GO>}

Great. That's real helpful. Then, the second question, I wanted to just switch for a second to the Consumer side, where you didn't have as much pricing. And I know the mix issues there make it seem kind of difficult for us from the outside for us, from the outside looking in, to understand what's going on in the different markets. But can you talk a little bit about the competitive and pricing environments, maybe in beauty/personal care versus diapers? That would be really helpful.

A - Claudio Bergamo {BIO 16015846 <GO>}

Yes. It's interesting, in the Portuguese call we also had that discussion. At the end, if you split up the (4.6%) in the first half of the year, actually if you look at cosmetics, cosmetics is doing quite well. We had a 16% growth in the half of the year. And most of that is volume and a part is (trust).

On the diapers, it's the opposite. Unfortunately, we have a reduction on the diapers in the first half of the year because we pushed very hard the focus on profitability and price increases for the diapers. And give that it's so elastic, it ended up having an (inaudible) effect on the volume. But not necessarily on the share, right? So it's because most of the channel was waiting to go through the process of the price increase.

Also, in the diapers, there was a -- on the consumer side, there is a trade-up, a trend moving on. And there was a big demand for our higher price position brand, Pom Pom. And we were not able to supply all the orders. So we have a back orders -- very material back orders for Pom Pom. So if we exclude the back orders for Pom Pom, it would -- we would have a positive growth on the diapers.

So what seems to be so -- it looks like from the outside that it's not so good performance. But if you look more in details, we are pretty comfortable that we are -- we doing okay as well on these markets. But we don't think the reductions in order -- not in order to sell diapers at the wrong price, given that you have like pulp -- have a devaluation of dollar and the cost is going up. So we now renewing our strategy, we will grow. But with profitability. So we'll not grow not only just to grow.

Q - Lore Serra {BIO 1506730 <GO>}

So with the pricing you took earlier in the year, I suppose you reduced the gap between you and the other brands in the market and, as you say, you took the impact in terms of volume in the Second Quarter. Are you comfortable with the current -- that current gap, or are you going to bring your pricing down a bit more to make a more attractive price point given that elasticity you referenced?

A - Claudio Bergamo {BIO 16015846 <GO>}

We are comfortable because the one that had the highest price increase was the lower end brand, Sapeka. And in that space, we're still a long way to the second least expensive, let's put this way. So actually, there was an opportunity to improve the price point of Sapeka. Then also part of that price increase is not only that you bypass to consumer. But again, similar to what happened in the second half of last year, you reduce somewhat the discounts for the distributors and then they have to, of course, reduce somewhat their margins.

So we are pretty comfortable with where we are and I think we are comfortable in the price point at this point. So we have to wait now what's going to see in the valuation. But I believe that staying at this level of BRL2 for dollar, this issue of cost increase will be over and then we'll be able to supply the demand in diapers. But with profitable -- with good margins.

Q - Lore Serra {BIO 1506730 <GO>}

Great. Thank you very much.

Operator

(Operator Instructions) Our next question comes from Isabela Bacchi of JPMorgan. Please go ahead.

Q - Isabela Bacchi {BIO 15086595 <GO>}

Hi, guys. Good afternoon. I just wanted to ask a quick question on your non-recurring expenses and income. I see that you commented about a BRL33 million tax credit that you adjusted to exclude on your adjusted EBITDA. Were those tax credits cash or no? Because I'm just trying to reconcile your BRL224 million EBITDA with the EUR237 million operating cash flow.

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

BRL13 million -- hi, this is Martim.

Q - Isabela Bacchi {BIO 15086595 <GO>}

Hi, Martim.

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

BRL13 million of it -- hi, how are you -- were cash during the quarter. The remaining close to BRL20 million were booked against tax credits on our balance sheet and they should become cash in the upcoming quarters.

Q - Isabela Bacchi {BIO 15086595 <GO>}

Okay, perfect. So when you talk about BRL237 million operating cash flow, that includes most of the tax credits, right?

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

No, no. It includes BRL13 million. But it does not include the other BRL20 million.

Q - Isabela Bacchi {BIO 15086595 <GO>}

Okay, perfect. And the BRL17 million that is non-recurring expense, those were cash?

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

Most of them, yes.

Q - Isabela Bacchi {BIO 15086595 <GO>}

Okay. Okay, perfect. All right. Then just a last question on your CapEx. I know you guys commented on the Portuguese call that going into 2014 probably going to see CapEx much lower due to the completion of the projects already, the concentration in Goiania, et cetera. For the second half this year, are you keeping any guidance or do you think it's going to be anything lower during the first half?

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

Our expectation in terms of the CapEx for this year since the beginning of the year was of approximately BRL200 million. We're still close to that objectives. We don't have any reason to change it at this moment. If it happens, it's because we are anticipating expenses that would take place from 2013.

Q - Isabela Bacchi {BIO 15086595 <GO>}

Okay, perfect. Thank you very much. Congrats on the results.

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

Thanks a lot. Just complementing the information on your previous question, the BRL17 million in expenses, they also affected the operating cash flow in the quarter.

Q - Isabela Bacchi {BIO 15086595 <GO>}

Okay. Great. Thank you.

Operator

Our next question -- and pardon the pronunciation -- comes from Irma Sqarz of Goldman Sachs. Please go ahead.

Q - Irma Sqarz

Hi. Good afternoon. This is Irma Sqarz from Goldman Sachs. Regarding -- this is a smaller line in your P&L. But I was just wondering, in the line of delinquent consumers, or the provisions that you make for potentially delinquent consumers, that line went down by about 50 bps in relation to net sales in this quarter. And I was wondering whether this was on a reversal of any provisions you had previously made or whether this is a new level you see going forward is about the PDD line. Thank you.

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

Hi, Irma, it's Martim. How are you? We had in this quarter very low levels of delinquency. But our perception is that it was a very good quarter. But the trends that we normally see for the delinquency line is a little bit higher than that.

You can look at the average of this year or over the last four quarters. It should be closer to what we may see in the future.

Q - Irma Sqarz

Okay. Great. That's very helpful. Then, just one other question, in regard to the medical visits. The portion of the marketing expenses going to medical visits increased a little bit now in the Second Quarter and I was wondering if going forward, given the restructuring you've made on the medical visitation sales force, whether that's a trend that should continue to trend up a little bit more given the implementations you've -- changes that you've implemented during the Second Quarter or whether that's already starting or whether we should already start to see some dilution of this line in the back half of the year, if at all? Is there -- I don't know much you see in terms of scope for dilution in this line. Thank you.

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

Good morning. If we compared that line with the previous year, we'd notice that the reduction was important and that's a structural fact related to the restructuring of those forces that were taking place after the acquisition of Mantecorp last year.

On the quarter specifically, what you mentioned increased from the First Quarter to the Second Quarter, it's more related to seasonal effect of the First Quarter. Usually, we tend to have more of those people on vacation. So because of that, the finally the expenses, we think, should be lower than what we saw in the Second Quarter.

Q - Irma Sqarz

Okay. So on a year-over-year view, we should see this account still lower than last year, despite the investments you've made in the teams?

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

Yes.

A - Claudio Bergamo {BIO 16015846 <GO>}

Yes.

Q - Irma Sqarz

Thank you.

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

The investments were of restructuring of the amount -- the combination of people that we (had there).

A - Claudio Bergamo {BIO 16015846 <GO>}

Just, Irma, to give an idea, the type of things we implemented is not that it increased the amount of expense. But it's more than that. It's improved the productivity of the existing expenses. Just -- I said in the Portuguese call and say now in English that, for example, before we had what we call a fixed (grid) when you go to the doctors, now we have implemented what is called a flexible grid.

What that means, that we know we have made a very extensive research to understand doctor by doctor, which is the type of brand and the type of product every single doctor prescribed more or less. And we implemented on July now using technology, the iPads, that we distributed iPads for everyone, the flexible grade. That means that when our sales person goes to the doctor, he puts in the computer, for example, the name -- the number of the doctor and it gives us the system -- the software gives us the (best) grid that they have to offer for the doctor.

So that type of initiative is what we call restructuring, is much more on gaining productivity as opposed to increasing the expense.

Q - Irma Sqarz

That's very helpful. Thank you.

Operator

Our next question comes from Daniela Bretthauer of Raymond James. Please go ahead.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Hi. Good afternoon, everyone. Congratulations on the operating performance and cash flow in the quarter. I wanted to follow-up on a question asked earlier about potential divestitures with regards to real estate only. Would you be looking to sell some of your plants that are not being used because you transfer the production to Anapolis or plants that are not being used in full or some site. And how much do you plan to raise with those sales?

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

Hi, Daniela, Martim. We are analyzing some due to the restructuring of our manufacturing facilities. We do have some opportunities in those sites. In some of the sites that we acquired, not all of them were acquired by us. But we are analyzing some divestitures if that does not compromise the operating flow of the Company.

We still do not have a projection of how much could that represent. But eventually -- or the way we think about it, it's that it may help us to finance the CapEx that we still have to do in the upcoming years.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Okay, that's very clear. Thank you. And I just also wanted to follow-up on another question that came up in the Portuguese and then again on the English call. It seems that you're doing very well in the volumes of the ex-diapers. And that it was your strategy to favor profitability over volume in the first half of the year at least. But would that strategy continue in the second half of the year?

In other words, Claudio, you mentioned multiple times that there's pent-up demand for Pom Pom and it was intentional to reposition the price for Pom Pom. But what sort of recovery can we see in the Consumer Goods division? And maybe if you can break down the answer into diapers versus non-diapers, it would be very helpful. Thank you.

A - Claudio Bergamo {BIO 16015846 <GO>}

In diapers, Daniela, it's typically -- we had two issues there. One is the price increase and the elasticity on the volume, which is stronger, especially in the Sapeka and less so in (Kramer), almost (nil) in Pom Pom. And what happened is that given that the consumers are trading up, consumers are looking more to higher levels of price point and higher quality products.

And in Pom Pom specifically, we are very -- I think the Company did a good job in the product engineering and also in the advertising for the brand. So the return of growth on diapers depends more at this point on offer and supply than demand. So that's why we are now -- (if Armando) we are rebuilding some of the machines in the Northeast which will allow us to increase the capacity for Pom Pom. And that the growth of that will be related to that, to the offering and not to demand.

So I think in diapers this story, in a way, it's a good prospect in that sense, that it depends less on demand and more on supply. And just to give an idea, we had around 5percentage points of growth on the diapers business for the first half of the year that we lacked a site because of the backlog of Pom Pom. So that's one thing.

On the cosmetics, the performance is doing okay. We believe we don't have any reason to see what should be worse than that.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

But if I may, Claudio, just to follow-up on your answer, is Pom Pom then not the bulk of your volume in diapers? Meaning, how confident are you that you can get back to at least market growth in the diapers, because that's a big weight, 40% of your Consumer Goods division? So I think that it would be critical, right, to get that volume back up?

A - Claudio Bergamo {BIO 16015846 <GO>}

Well the way we think -- first of all, as I said, the Pom Pom represents a 5% penalty. So only that would represent 5%. And again, we focused on profitability in the first half. So as we move forward, we will see what happens, right? We have working in many opportunities to sell across the board, many of our brands. As you know, Pom Pom is regional, it's Sao Paulo. Kramer, it's Rio de Janeiro-Minas. And the Sapeka is Northeast. So if you think nationwide, you can imagine all the opportunities behind that.

So that's as much as I can say given that the competition is probably listening to us. So that's it.

Q - Daniela Bretthauer {BIO 13380169 <GO>}

Thank you.

Operator

Our next question comes from Jason Devito of Federated Investors. Please go ahead.

Q - Jason Devito {BIO 15056215 <GO>}

Hi. A quick question. I kind of hear two cash numbers, like one is like BRL140 million of free cash flow and then I thought I saw a cash earnings number of BRL111 million. Am I thinking of this correctly?

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

Yes. That's a little bit different metric, in our perspective. Cash earnings is at the end -- the net profit of the Company adjusted by the non-cash variations. So it does not include changes in working capital. And on the free cash flow, we are looking more in terms of the cash flow of the Company and also the interest expenses that we incur because of our net debt.

Q - Jason Devito {BIO 15056215 <GO>}

Got it. Got it. Okay. Thanks a lot.

Operator

Thank you. This concludes our question-and-answer session. I'd like to turn the floor back over to Mr. Bergamo for any closing remarks.

A - Claudio Bergamo {BIO 16015846 <GO>}

Thank you, all for participating again. Our Investor Relations area, Breno, Renato, they are all available to answer further questions that you might not have been able to clarify during this call. And thank you very much and have a nice afternoon. Bye-bye.

Operator

Thank you for attending today's conference. The conference is now concluded and you may disconnect your lines. Have a wonderful day.