Q1 2019 Earnings Call

Company Participants

- Eugenio De Zagottis, 'Corp Planning & Investor Relations Officer and Member of Exec Board'
- Marcilio Pousada, 'CEO & Member of Board Exec Director'

Other Participants

- Analyst
- Giordano Giordano

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to RD People, Health and Well-being Conference Call to discuss its first quarter of 2019 results. The audio for this conference is being broadcast simultaneously through the Internet in the website www.rd.com.br/ir.

In that address, you can also find a slideshow presentation available for download. We informs that all participants will only be able to listen to the conference with the company's presentation. After the company's remarks are over, there will be a Q&A period. At that time, further instructions will be given.

(Operator Instructions) Before proceeding, let me mention that forward-looking statements are been made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward looking statements are based on beliefs and assumptions of RD management and on information currently available to the company. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions because they relate to future events, and therefore, depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of RD and could cause results to differ materially from those expressed in such forward looking statements. Today with us are Mr.Marcilio Pousada, CEO; Mr.Eugenio De Zagottis, Investor Relations and Corporate Planning Vice President; and Gabriel Rosenberg, IR and Corporate Planning Director. Now, I'll turn the conference over to Mr.Marcilio Pousada. Sir, you may begin your conference.

Marcilio Pousada {BIO 16117399 <GO>}

Okay. Thank you. Good morning, everyone. Welcome to the presentation of first quarter 2019 RD As always, Eugenio present the results, and just before the questions and answers, I'll stress some points.

Okay, Eugenio, please?

Eugenio De Zagottis {BIO 7193695 <GO>}

Hello, everybody. First of all, thank you all for attending our first quarter '19 conference call. This was a challenging quarter in terms of margins, but at the same time, when we look in terms of growth, when we look in terms of the trends we see in our market, I think they're very, very positive -- very positive signals that prepares to resume the kind of solid growth we've always has worked on, and we believe this quarter in terms of possibility is also an inflection point for the company. So we ended the period with 1,873 store in Brazil.

We have -- we did 62 openings and 14 store closures during the period. I think one of the main highlights of the quarter was our retail market share. We saw 1.1 percentage point growth on a national basis, which improved in every single market and was again of 1 percentage point Sao Paulo, which ever -- I think was the main highlight here. We reached gross revenue of BRL4.2 billion, 15.3% consolidated growth with 1.9% mature-store sales growth, which marked an improvement over previous quarter and I think paves the way for us to end the year at or around inflation.

We had the 28% gross margin in quarter, a 50 bps margin pressure. Our EBITDA is under the historic criteria. We had BRL270 million, 6.5% of EBITDA margin, a loss of 1.1 percentage points. When we look our IFRS members, and I will tell you more about IFRS in the next chart, we have an EBITDA of BRL415 million and a margin of 10%, 90 bps pressure over the previous year.

And the same with net income, BRL105.5 million under the historic criteria, 2.5% net margin, but then under the IFRS 16, 94 million, 2.3%. Finally, we had a cash flow of BRL210 million negative and a total cash consumption of BRL203 million. On Page 4, we can talk a little bit about the IFRS So, this is the first quarter that we report under the new accounts criteria, which urges to recognize our lease payment obligations as a liability and also recognize the rights-of-use relating to these assets as a fixed asset. The problem here is that when you think about rental expenses are substituted by depreciation, plus interest expenses, whole -- and we can show here in the first part of the chart here, when we look over the whole contract life, the effect of neutral.

So in the end of the day, IFRS over the whole contractor term, it does not provide any economic effect. However, because the liability is higher in the beginning versus in the end of the contract, what happens is that the financial expenses start very high and then decreases progressively. As a result, there is a timing difference during the lifetime of the contract. So, in the initial years of the contracts, we have negative pressure on net income, and in the final years of the contract, we have a positive effect on the net income.

Having said that, because the Brazilian tax authorities don't consider the IFRS 16 for taxation purposes, the cash effect is absolutely zero. We are still paying the same lease obligations, despite the fact that they'll now consider rental plus interest expenses. And because the tax effect is also neutral, there is absolutely no cash effect or whatsoever. It's also important to mention that this is the criteria adopted on a global basis, but in Brazil, our rental contracts will range from five years, ten years and we have the right refill those contracts only by paying three months of rentals.

This is unusual rental decision the company can take in any point in time. And as a result, we don't believe the IFRS as adequately reflects the economics of the company. We will keep looking internally under the existing -- under the previous criteria, but will report both criteria so the market can take whatever criteria you want to track. When you look at the P&L here on the bottom left, the tax effect that explained is very clear here.

When we consider the IFRS, we have BRL145 million less in operating expenses because the rentals are no longer in operating expense, but then we have BRL136 million of additional depreciation and BRL27 million of additional interest expense. So, since the our existing contracts are more in the beginning of the year, in the beginning of the term than in the end of the term, there is a negative net income effect of BRL11.6 million in the first quarter. But regarding taxation, we paid the normal taxes just -- or same as recommended, the difference is treated as a deferred tax asset. When you look on the right in the balance sheet, we see a large non-current asset, which is the right-of-use, but we also see the same increase in liability, partly current liabilities, and the biggest part is our non-current liabilities.

Okay, back to business. Page 5, store development. So we ended the cycle with 1,873 stores. We opened 62 stores in the quarter and closed 14 stores.

By the end of the quarter, 36% -- 35.5% of the store, they were still under restoration. Here on Page 6, we have a very interesting chart that shows what's happening to the market, and this has to do with the cost improvement and with the accelerated share gain we have posted in the quarter, and I think it also helps us predict how this will evolved in the coming quarters. So in the top chart, we compare our historic annual growth each quarter versus the rest of our ABRAFARMA, excluding Raia Drogasil. So we see that in 2016, which is not in the chart, and beginning of '17, we had a huge gap over ABRAFARMA What happened here is that ABRAFARMA [ph] was going out of business.

So all of a sudden a huge number of stores were getting closed, and obviously this generated an improvement for us and decreased for ABRAFARMA on aggregated [ph] level. Then from the second quarter '17 to the third quarter '18, I think we had modest growth differentials of ABRAFARMA, and in the case of 3Q '17 and 4Q '17, very small edge versus ABRAFARMA And then we see now that since the 4Q '18, the gap between our growth and the rest of the large chains in Brazil is expanding, and the reason is in the chart below. Here we compare our quarterly net store addition versus the rest of ABRAFARMA net store additions. So in Q1 '17 alone, we had 218 store to be opened.

This is probably a peak, but still if you look through '17, the rest of 17, we can quarter ranging from 130 to 160 new store additions in all Brazil. In 2018, these number started going down. And now in the first quarter '19, it's probably the value [ph]. For the first time in the time series, we opened more stores on our own than the rest of ABRAFARMA did.

What's happening here is that these huge acceleration of store openings that happened, especially 2017, with some extent also in 2018, which happened in a very difficult market scenario, it failed to generate value. So company has allocated a lot of capital. They increased leverage to do it. And guess what, because of entry barriers, because the market scenario, these stores have failed to create value.

They actually created pressures. So when you look around the market, there are a lot of companies, especially the larger ones who try to pursue aggressive growth programs and that today have very -- a lot of challenges in terms of leverage and in terms of profitability. We have companies with negative profitability. Onofre is an example.

It's a company with negative result that we are in the process of acquiring, but there are other companies in the market and companies that have positive possibility, but lost a lot of margin. And then as a consequence, they now have to reduce growth, they now have to close more stores, and this is creating a very positive outlook for us, because we are maintaining our growth. We are very well positioned in terms of prices because of the investment we made and in terms of execution, and I think that now that the growth -- the capacity addition cycle has been reverted, I think you progressively walk towards comp normalization. On Page 7, we can see our store footprint.

So obviously, we have nearly 1,000 stores in Sao Paulo, but probably the most impressive figure is that we already have 220 stores in the Northeast region. And this is a region that we have struggling -- we have started pursuing after the merger probably 2013 I think, that's where we ended by year. We also highlight our entry in Para. This was our entry.

We can see that in Para, there is a smaller market than Bahia or Pernambuco. In two quarters -- we have been in the market for two quarters, and we already have almost half the stores we have in Pernambuco. So this was the most -- because we had Big Ben, which was the leader, going out of the market, this created a huge opportunity. We acquired 20 locations, historic locations, landmark locations like (inaudible) that belong to Big Ben, and we have made a very first entry to the market.

And it's great to see that these operations of Para is doing really well, they're projecting very high revenues per store, and also we have seen very good gross margins, almost in line with the average of the company already in the initial year of operations. So this not even in Bahia or Pernambuco we have seen this. So this is very encouraging for the company. And here when you look in terms of market share, we gained 90 bps on a national level and we gained 100 bps in Sao Paulo.

As you know, we had a lot of challenges in Sao Paulo, because first we decelerated our growth, we once opened more than 100 stores -- 100 branches in Sao Paulo, 100 pharma stores in Sao Paulo. We're now opening 67 stores Raia in Sao Paulo. And at the same time, we had a lot of new entrants coming to Sao Paulo, which obviously had an effect on us. Now as some of these new entrants have reduced in OP base [ph] or have stopped growing on together, and then our prices action and hedge translating in tremendous volume gain.

Especially in generics, what we've seen is that we've gained share again. So we gained hundred basis in Sao Paulo, which is, I think, just not a small fleet, considering the size of the operation we have here and considering the fact that we have accelerated our store open is in the. And then I'm not detailing, but we are also growing that in all the other markets where the company commit. On Page 8, we post a consolidation revenue growth of 15.3%, with 14.4% for retail, and 34% for Bio.

When we look at the mix -- with that performance was in the front, and we have seen this also happened in the previous quarter. But the main highlight here is that -- for the first time in a while generics has converged and actually starting to outpace branded. And what's happening here is there's a huge pressure erosion generics. So, if you look back to the 8, the average prices versus link quarter next year, with the big the revenue for, but still we have big -- we have been able to grow in tandem with branded, because the volume growth we achieved these are now new pricing strategy has been tremendous.

So we're very happy to see this happening and this is saying the company to get back to our historic growth to having much of starts around inflation. We believe, we are in the first direction that was achieving that by the end of the year. On Page 8, we posted consolidation revenue growth of 15.3%, with 14.4% for retail and 34% for 4Bio. When we look at the mix, the best performers was in the front, and we have seen this also happening in the previous quarters.

But the main highlight here is that for the first time in a while, generics has converged and actually starting to operate branded. And what's happening here is, there is a huge pressure also in generics. So if you compare to the average prices versus same quarter last year, it's a big difference. It's a very meaningful difference.

But still we have been able to grow in tandem with branded, because the volume growth we achieved based on our new pricing strategy has been tremendous. So we're very happy to see this happening, and this is setting the company to get back to our historic growth, to have much historic around inflation. We believe we are in a firm direction towards achieving that by the end of the year. On Page 9, we discuss the comp here.

And we had 5.6% same-store sales growth, with 1.9% for matured stores. So this was the best number in a year for sure, and as the comp base gets easier and as we keep getting sequential improvements, our expectation, as I said, is to converge our deflation or around inflation by the end of the year. And if we are able to do that, next year is a whole new story. We'll be very likely talking about expanding margins, recover some of the margins we have lost as we invested in price.

On Page 10, talking about the gross margin, we see a 50 bps pressure on the quarter, and obviously, this reflects the price investments we have made especially in Generics.

But the point I want to highlight here is that these investments did not happen here. They happened in the previous year so that structure of gross margin has already gone down last year. What happened is that we did a lot of opportunity wise, which generated more trade allowance and offset that structural loss.

However, as we normalize opportunity buys, we don't want to create any bubbles or any artificial risen to our numbers. So we are back to normal, back enough to buy. We now have normalized the trade allowances, and therefore, the structural loss that should have appeared next year is finally appearing in our numbers. But there has been no major price investment in the first quarter of this year.

And here in terms of cash flow of cash cycle, we had a three-day pressure, of which one day is due to calendar related to receivables. The main factor here is loss of operating leverage. On Page 11, we talk about expenses. And again, our focus on the previous standard and not on IFRS As I told before, I don't think IFRS is the best way to look economically at our performance.

So we will keep looking internally at the previous standard and encourage the market to do so, because I think that should be approx. of cash flows. And if you don't foresee the rental, it's very difficult for that to happen. So looking here at the previous standard.

We had a 60 bps pressure on expenses. Obviously, the main factor here is the loss of operating leverage as the matured comps are going below inflation, but it affects every line. But there is also some elements here that I think are transitory. The first one is logistics.

We're opening in the Raia three new distribution centres, the largest one that the company will have in Sao Paulo and Guarulhos. We are moving in these two different facilities. So we closed our existing distribution centre in the campus site of Rio, and we are opening a new one in the metropolitan area of the city. And so this should entail a big freight gains next year.

And we're also opening, as you see, in Fortaleza, which will reduce our freight expenses, because today we ship from outside the state. And this will also help us with gross margins, because when we shift from out of state, we have a loss -- we have a higher taxation that affects our gross margin. So these investments will attribute [ph] at the same time and close when you see this generate cash flow expenses. So we see 20 bps logistics pressure.

And then we also have some cyclical things, like 20 bps rental pressure related to the peak in ITPM, which I think at some point normalizes. And we have a 10 bp pressure in energy that's also cyclical. In terms of the EBITDA, we have a 6.5% EBITDA, 110 bps loss versus the first quarter last year. It's also important to highlight here that the first quarter assured very, very strong quarter for us.

You can see that it was a higher EBITDA margin than both the third and fourth quarter, regardless of the fact that January is a vacation month and February is a short month, and in the February, March, there is carnival. So the first quarter should always be the lowest quarter in the year. I feel this will hold through this year. I think this is a flow for the company and the inflection point for the company, but last year that was not the case.

Because the price pressure was Q2 to happen, we had a very good first quarter. So this magnifies the margin loss that we have. But over the next quarter, I think it's a very positive quarter for us because of the high inflationary ventures we will have. I'm not saying that we'll do the same margin next year, but even if we don't have much lower loss in margins, and then third quarter and fourth quarter will be the movement of growth.

And it will depend on where our revenues are and where our cost containment efforts are. For sure, it shouldn't be this kind of margin loss that we've seen in the first quarter. Net income, we lost 90 bps, 200 bps of standard. It's basically EBITDA loss and some pressure on depreciation and on interest expenses.

Some of the bulk is EBITDA loss, offset by pressure. On Page 14, cash flows. We had a BRL202 million investment in this quarter versus BRL134 million last year. So there is a bigger investment taking place here, especially because of the decease, which generated a negative free cash flow over BRL210 million and a total cash consumption of BRL203 million.

I think '18 and '19 are peaks in terms of investment. And then as we maintain the growth at the growth level and as we don't have these major investments in decease, probably, we'll certainly have less investments next year. Well, finally, before passing it to Marcilio, just to show how our price is doing. For us, the most important thing is the long-term view.

We have generated 25% annual returns since (inaudible), but even this year, our price is performing ahead of Bovespa, but this has more to do with the fact that share price was penalized as we ended last year. So these were my prepared remarks. Marcilio will discuss, okay, our numbers and our trends, and then I'll get back to talk about the capital market highlights before Q&A Thank you very much.

Marcilio Pousada {BIO 16117399 <GO>}

Okay.

Thanks, Eugenio. Let's turn to Page 16. Eugenio discussed about the expense percentages -- good -- shares about which is important business in three cities. We are opening in three cities this year and maybe help the business to help us to floatation tax for next year, okay? The other pressures for expense that we have run out the energy.

Because of these, we have change our energy providers. And we have 16 stores that you reduce the cost per energy the next year, which is good for our results. The good news for expenses, the expenses already started to show a reversal and maybe it'll better, it'll back to grow the mature store above the inflation. A good news for this quarter in terms of sales, okay.

The sales -- the main state of sales is actually compared those offering. You know how difficult to open new stores and not because the competitors is back, but it's difficult business. We are focused on these -- in good stores, matured stores. You know this cycles and the cycle tax will help us to give the numbers.

We are very good in generics price also and this help us to improve our market share 1.1% this year. We are launching right now -- to help pricing pack by pack, customer by customer, just to help us for the next quarters also. The other point that helped us a lot in sales is the digital growth. The Click & Collect strategies is good for us.

The company spent -- to extend our valuable position to get historic never corning, and I particularly believe realizing quarter physical and digital worked together. This has helped to give the number we are increasing, more than 40% in digital in these factors. When looking for the open results to opened or less big marketing in Brazil, in the Para state. We opened 29 stores, does very, very well.

And we believe we can grow very, very quickly this marketing number through marketing data in the year. We remain very optimistic about the business, because it is fundamental produce business to the same creation and population. We are worked very, very strong with the new stores. The marginal IR of the new stores is too high, with the most of the company's to bring capital allocation.

And much more important for us is digital initiative show relevance for us. We won't adjust travel using our store in the quarters in the (inaudible), it will great for future of the company. And not only digital, but growth in the distribute [ph] other revenue in the future also. And we know it will be only digital installs trends future because it can carefully helps the customers and employees in future for the better life to everybody.

Now Eugene will be take care about the new markets, and then begin for the question and answers. Thank you.

Eugenio De Zagottis {BIO 7193695 <GO>}

So I'd like to highlight that we did this quarter the first issuance of certificates of real estate receivables order to raise capital. So it was a variation of BRL250 million in a single trash with a seven-year maturity at an average cost of 98.5%.

So this is very good to diversify our funding sources. Until now, we were doing mostly debentures, which were bought by institutional investor. And now this is an interest that had tax exemption in Brazil, so it's bought by individuals. And I think it shows the strength of the membership of the company, it shows the fact that our credit rating really allows us to do operations like this in very low cost whenever we need it.

And then just in the terms of some upcoming activities. We will publish the second quarter result on August 6, 2018, and the third quarter on October 29, 2019. And finally, we have two investor conferences in the coming weeks. The first will be the Itau Conference in New York, May 15 and 16.

We will be represented by Marcilio and Gabriel at this conference. And finally, on June 5th and 6th, the Citibank Equity Conference in Brazil. So these were our prepared remarks, and now currently move to Q&A Thank you very much. (Question And Answer)

Operator

(Operator Instructions).

Joseph Giordano from JP Morgan would like to make a question.

Giordano Giordano

Hi. Good afternoon, everyone. And thanks for taking my question.

I have a couple of ones. So first on the pricing priority. So we talk a lot about the generics here, but I would like also to understand how the private label strategy in terms of differentiation and pricing position here is healthy to strengthen the competitive positioning of the company. And second, it's going back like the competitive pressure you have been seeing, particularly in Sao Paulo, I would like to understand like how you are seeing that evolving particularly with things like they are the structured players that's actually -- the threshold that pressure you, given that we started to see some significant store closures on that side? Thank you.

Marcilio Pousada {BIO 16117399 <GO>}

Okay, Joseph. Thanks for the question. I think -- I mean, it's very easy for our company to talk about long-term view and the actions you do on the short term and long term they are aligned. This is a year -- and actually this 2018 and 2019, these are two pair of years in which we had to walk the talk, which really means making investments that make us stronger on the longer term and have a cost for the short term.

So we completely changed our pricing strategy. We invested very aggressively in prices, especially generics, but not only in generics, and I think that this was a huge affected. If you see that how our growth is normalizing, you see the kind of market share gains that we have achieved, the volume gains in generics that prices are lower, but generics already growing incentive with (inaudible) branded and obviously in a difficult environment. I mean, this helps also view further barriers from our competitors.

So we are very happy with the results. Obviously, this is a considerable pressure and a considerable cost financial for the company. But we are very convinced this is the right strategy for the long term to accelerate the consolidation of the industry. In terms of private label, I think we're also advancing here.

We have a 5% thrust or private label penetration. We have a gross margin of 50% in private label. Every single private label product that we launched actually delivered a gross profit greater than the national brands. So we are very disciplined about that.

We have reviewed in the past launch in some categories in which we couldn't do that. So just having something cheaper in the same market is not good enough for us. So there is a lot of discipline by doing this. Every single process that we launch is creating value for the company, and this category also us competitive.

But I think the main impact is not exactly as a competitor, it's really improving our margin mix for the company. In terms of competitive environment, I think chart we've shown the beginning showing the growth deceleration in the market terms of new store addition, which is a an effect from less openings and more closures. I mean, I think it points you to the trend. I mean, a lot of companies try to accelerate growth, especially the national companies.

They were trying to grow ahead of what they could. They are trying to enter the markets a huger to barriers, just like these barriers did not exist. They do not have the same process discipline, the same real estate quality, to the same standard of execution inside the store. So for my view, what happened is what was expects to happen.

I mean, a growth like that doesn't work, it makes the company weaker rather than stronger. And that the company has to review the strategy, they have to stop growing, they have to close store, they have to manage for the short term to deliver profitability. You can see the level of pain in the market for most P&Ls of published companies who have access. We can see through one offering, which has huge negative EBITDA We are about to, we are already forecasting for the approved opportunities should happen relatively quick, which no reasons for that progress not to go through.

But we are now in the best possible scenario, the scenario which we have good momentum. We have are very competitive in every regard, including prices; in a moment initiatives a lot of weak in the market. So the scenario on a relative basis, probably the best we've seen in a while, at least the best in --

Giordano Giordano

Perfect. Thank you very much.

Operator

(Operator Instructions) (inaudible) would like to make a question.

Analyst

Hey, guys. Good morning. Thanks for taking my question.

I just want to clarify a point. So your expectation for same-store sales or matured stores are to reach inflation through the end of the year. What needs to happen in order for this to materialize? I mean, do you need to see a further improvement in competition? Or it's just a matter of comparison basis? And the second question. We just like an update on your omnichannel initiative.

Because if I remember correctly, one of this quarter you guys have assembled was focused on that. So just, if you guys could give just a sense of how this process going and when could we expect this to a go, go live at a large-scale that would be nice? Thanks.

Marcilio Pousada {BIO 16117399 <GO>}

Okay, Vinit [ph]. Thanks for the question.

Well, in terms of mature-store sales, I think it is a combination of two factors. I think the bulk is really the comp base. So the comp base gets easier as we move through. Right we're still comparing a lower generics price point with a high generics price point of the 1Q '17 -- 1Q '18, sorry.

I think, it will be the marginal Q1 '18 also shows that. So as the comp base in the second quarter, but especially in the third quarter, it gets easier. Third quarter gets much easier. So I believe that the main impact is from the comps, but also there is some need in from expectation of sequential improve.

But if I have to quantify it's more on the comp base, then on the sequential improvement. But you can see some improvement also in the average ticket, if you go for the other year, okay, help us the number in the year also. Yeah, when we look today, the average ticket is 2%, but as we move forward, the average ticket will go with this will drive. But volumes as well we are doing well in volumes, and I think we will keep improving.

In terms of our omnichannel -- and this is the main strategy of the company today, and we want to play, we want omnichannel to be the next -- the next big source of competitive advantage for the company and to be the next growth engine for the company. Obviously -- I mean, we have reinvesting in deliveries. We now have a one hours pilot to just the Sao Paulo. We will expand delivery very quick, and we're really well in Click & Collect.

Today, a huge percentage of additional is sales is Click & Collect. But for me, that's not -- the digital sales, that still a fraction of the total to the company's sales, and in my view, it will always be as more portion over the sale. I think the main metrics here is not how much additional sales. The main metrics here is how much of -- how what percent if our revenues are derived from consumers, who are digital consumers.

So, when the consumer has an act, and it can have much user excluding -- smart route to big route over the next year. And we're taking a lot of the people in the shop experience, leveraging the mobile technology that. Once you can send reminder to the construction -- reminder for the consumer to take the net in the morning. We can send content to the consumer relation due recent heart disease.

So, this is a huge tool for launch. And in the end, the digital sales administer then is part of making consumers more loyal and having higher share of wallet and having the highest expanding from that. So for me success will be when we get 20%, 30% or 40% of our revenues coming from digital customer. And it doesn't matter if the digital transactions will be one, two, three, or four, or five.

What matters is by the fact, additional consumer is trying to 30, 40 this is a consumer we are much value correct and value correct tend to move in needle which presently has a lead. This is not a Big Ben process. We're always doing improvement. That's are whole idea of agile.

So with our Click & Collect, with are actually proving our -- we are expanding our delivery infrastructure. We view also do more and more alternatives for the consumer to improve the journey by using the app, by improving the yield store experience. So this is a long journey. But I think than I can see only -- as more number of companies in the market who have the commitment, who had the resources to do.

It's not an easy thing. Analytics is something very expected to do high assignment for everybody, model it's to work, so I obviously won't be the only company in the market with a good rest of it will be modern. But I think we can lead that, and I think there will be a handful of companies completely tax model from the rest of the bed.

Analyst

Okay.

Thank you very much perfect answer.

Operator

There seems to be no further questions. Now, I will turn the conference back to the company for their final remarks.

Eugenio De Zagottis {BIO 7193695 <GO>}

Okay.

So, thank you all for attending this conference call, and I like to add some of the points we have discussed. Obviously, this was a very challenging quarter in terms of margins. I think, when we look at expense pressure, which was together gross margin that cope with here, it's good to see that some of these pressures are transitory, like the Matisse [ph] investors would be this year, like the fact that right was fractured by deficiency index, even energy things we can improve. But obviously these are pressures that we will do through the year and do drive in the market pressure for the whole years.

We believe this quarter inflection piloting. This is the lowest quarter -- and now we only move up our expectation in this stripping for the second quadrant through because we will inflationary gaming transaction, which will be higher than next year, but I think that in the second semester, when you compared to more realistic Obelisk second to last year -- second to half first year Sorry, by getting more sequential improvements and some of the things you can do I think would be leverage. Probably still pressure, but certainly in better place that we are in. However, I mean, these margin challenge is combined with a very good trend when you how the industry structure is evolving.

The fact that we've seen a reversal of the statistician cycle that had increased a lot over the last two years, we see a lot of weakened capacitor compared to negative profitability, like the case of an -- , but not only on offering the other players in that situation. Compared to who lost, a lot of margins complexion who are figuring out that expanding outside of state of -- the shoulder that every player who grows at home grows well because they know the market. They have a strong brand there. The owners of our executives can validate every single location outside, but reading things that were complicated when the size and the geography of that expansion just increasing.

At that point, you have to enter in a lot of new markets where nobody knows who we are, who have huge entry barriers. You have to buy write have the structure in this case providing locations all over the country market unless you don't know. You can have the normal seal the government revenue all the time to following months, when we location. So you have to have a deep structure, and great people process analytics to be able to do that.

And this is I think where we excel. We know how to do it. EBITDA first part, which was positioning our brand new market has already come true. So today we are harvesting all these things that you practice in the future, and that's why our expansion is more consistent and delivered -- and reintegrates value.

I haven't seen a large-scale national session who has great value besides ours. Again, there's a lot of pain in the market, and I think as I said before, our relative position is probably the strongest than it's been in a long time. The fact that we are well-positioned prices, our new stores are creating value, we are normalizing growth -- that investment cycle the markets a lot of the closures listed company. Really looking more at profitability now than looking at growth.

So this is all very good for us, and I think it to translate into a much added 2020. If we end the year where we expect, which is what you saw that inflation, I think we have a very different place to be a year of recovery part of the martyrs you lost and no longer of market pressure. That's -- and our aspiration is not only to have my first of many solution, but to be able to grow ahead of inflation, both because with their positions and practice and because of digital. This is not a guidance, this is an aspiration that that's how we're looking at the opportunities we have.

So thank you very much for your support, and we will remain available for visits to make a conference and road shows and even conference calls. Thank you very much.

Operator

Closing and disconnect. Have a nice day.