Q1 2021 Earnings Call

Company Participants

- Eugenio De Zagottis, Investor Relations and Corporate Planning, Vice President

Other Participants

- Irma Sgarz, Analyst
- Joseph Giordano, Analyst
- Unidentified Participant

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 1Q '21 results. The presentation can be found on RD's Investor Relations website ir.rd.com.br, where the audio for this conference will later be made available. We inform that all participants will only be able to listen to the conference during the Company's presentation. After the company's remarks are over, there will be a Q&A period.

Before proceeding, let me mention that forward-looking statements are being made under the safe-harbor of Securities Litigation Reform Act of 1996 (Sic -1995). 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. Eugenio De Zagottis, Investor Relations and Corporate Planning, Vice President; and Mr. Fernando Spinelli, Investor Relations and Business Development Director.

Now, I will turn the conference over to Mr. Eugenio De Zagottis. Sir, you may begin your conference.

Eugenio De Zagottis {BIO 7193695 <GO>}

Hello everybody, welcome all to the Raia Drogasil 1Q '21 conference call. And I'd like to say to start by saying that we're very happy with this quarter. This was not an easy quarter in terms of the comp base that we faced. Let's not forget that last year in the first quarter, this is exactly when the pandemic started. So we had a huge surge in demand in the first quarter last year, as people were getting ready to source of isolation. And indeed in April, we saw a huge source of isolation taking place all over Brazil.

So, if you look back 1Q '20, our top line grew 25%. So the comp base, we had to face this year was very high, this is true in terms of sales, but this is also true in terms of expenses, expense dilution results, et cetera. So in the end of the day, despite this huge comp base, I think we've got a great first quarter, which shows tremendous momentum. And I think it's a very good start for a year that starting to become a promising one. We ended the period with 2,319 units in operation, we opened 40 stores and we closed 20 in the quarter.

Our market share grew 30 bps on a national basis. We reached revenues, consolidated revenues of BRL6 billion, 14.9% growth and again 14.9% top line growth over comp base in which we had grown 25% over 2019. And exactly, because the 2020 numbers are now becoming a roller coaster, huge first-quarter very low April, May, and June. We also start to look a lot on two years back figures. And so, if you compare our top line growth versus the 1Q'19, we did a 43.9% growth, which is an acceleration versus previous quarters. We reached a contribution margin of 9.7%, 10 bps margin expansion and then adjusted EBITDA of BRL416 million, 7% consolidated margin with 12.6% of growth.

Finally, the net income reached BRL178 million, 3% of net margin and a 10 bps expansion versus last year. And finally, we posted negative BRL132 million free cash flow, with BRL126 million cash consumption over the fourth quarter. This is related to seasonality. The fourth quarter is always a good quarter in terms of cash flow. And in the first quarter, we stuck by inventories in order to leverage the inflationary gains on inventories. So on a 12-month comparison, we have positive cash flow generation, but when you compare the first quarter, which is March versus December the seasonality generates such pressure.

Talking about our expansion here. So we opened 40 stores in the quarter and we closed 20. These rate of closures is abnormal and this reflects the fact that last year because of the pandemic, we minimize the store closures, and we closed less stores than it would have been normal. What happened is that, the pandemic shifted demand from (inaudible) store to the other shopping malls were initially closed, then shopping malls had restriction periods to open. The downtown stores lost volume because of not [ph] working, neighborhood stores gain. So it was very difficult last year to read our sales per store in order to take long-term decisions related to store closures.

So we only closed extreme stores in extreme situations. But by the end of the year, as the sales normalize, we start -- we recovered the visibility and then we could reassess store closures. And so we closed in this first quarter, a lot of stores that should have been closed last year under normal terms. But now, we get back to normal closure stores, we'll get back to historic base. If you look here in the quarter, 32% of the stores are still undergoing maturation, and we are also reiterating the guidance of 240 new stores, both for this year and for next year.

Here we have some color on the expansion, and I think the main point here is the number of new cities we have -- we are occupying. We have here a four-year time series and it's obvious how the base of new CD entering are accelerating. So we entered in 54 stores during the year, this is way more than we have done in previous years. Despite of the fact that our expansion, today is more marginal and less cannibalizing than it has ever been. Obviously, in the past when we opening a lot of a A-class stores in densely populated areas where we had a lot of stores already, the cannibalization was much higher than it is today, when many of the stores are taking place in new markets. And even the stores that we open in existing markets, they are more -- there'll be more concentrated in peripheric regions, more upside of the greatest store concentrations that we have.

If you look at the store composition it also, it saw -- it's diversify as a result of that. So in the last 12 months ended in the quarter, Premium pharmacies account like A-class stores accounted for only 12% of our expansion, while hybrid stores have been the bulk 60%, they serve the diversified consumer basis. And then finally C-class pharmacies, they accounted for 29% of the expansion. So our expansions popularizing more and more. And obviously, our aggregates base of stores still has 34% of premium stores more than the popular. But the trend is, I pointed is completely opposite from that, and we'll see more and more growth here and maybe here. And we'll show slight compression here as we get national and as we get more diversified geographically in economy.

This is the Brazilian map with our occupation per state, and there are couple of interesting messages here. The first message is that, now -- we now have both banners with more than 1,000 stores, higher open, the store number 1,000 during the quarter. So Raia has more than 1,000 stores and obviously Drogasil has 1,300 stores. If you look in terms of revenues, we own both the number one and the number two player in the country. Obviously, there are other chains that have more stores than higher alone has, I mean, the drug, a higher brand, not the higher Drogasil company. But on a revenue basis, Drogasil is the number one brand in Brazil and Droga Raia is the number two banner in Brazil.

When we look at our footprint, I'd like to point to the fact that we had only three states where we didn't operate and actually we still don't operate, but we already have contract signed for these markets. So we are entering in (inaudible) in the next quarter, and we also have contracts to enter (inaudible) which we should enter by year-end.

So by the end of this year, we will have operations established in all states in the country. Some highlights here. We already have in the Northeast, more than 300 stores -- 200 stores, we have 300 in three [ph]. We are the leaders already both in Salvador and in Recife. We are becoming the leaders also in the state of Bahia, in Pernambuco. Either, we already are or will be coming in the next months, because of the international growth from maturation that we already have contracted for those markets. And this is a really successful operation, in terms of sales, in terms of expansion base, in terms of profitability as well.

When you look at the north, the north has been another highlight. This is our most recent market, we entered both Amazonas, in the specialty city of Manaus and (inaudible), recently these are the two most recent states. But in the whole northern region we already have six stores. And like also to stress the Southern region, in which we have already close to 250 stores. We recently opened our DC in Porto Alegre, and this is being instrumental to allow us to further expand here in the state.

You see that Rio Grande do Sul is a state in terms of potential, slightly larger than Parana, and we have less than half of the stores we have in Parana. We had Santa Catarina is a much smaller market, we have more stores than we have in the Grande do Sul. But our operation in Grande do Sul is an amazing one square profitable. We're very happy with it and now we are accelerating growth here driven by this new DC, that opens up the countryside for us, which before was too far away from the Curitiba distribution center for us to fulfill.

In terms of market share, I think we have a slight increase here on a national basis and in most markets and a slight decrease in Sao Paulo. This has to do with the way that IQVIA does these calculations. The numbers that IQVIA used to calculate market share, they come from actual demand numbers informed by the larger chains. So chains like us, we form (inaudible) how much we sold month-by-month, store-by-store. But in the case of smaller players, they don't have direct access to them. So what they do is, they get sell-in data from the wholesalers. So wholesalers like Profarma [ph], Santa Cruz and others, they will tell IQVIA how much merchandise they ship to each independent pharma stores small chain over the months. So this is a calculation that mix is up, sell-out data, demand data or selling data.

The first quarter of the year is a moment in which every retailer was just getting ready for the price increase in order to get inflationary gain on inventories. So what happened in this moment is that the selling increases and so there is a distortion in this calculation. But we -- IQVIA informs also the share only on a sell-off basis, obviously this is a part of the market, not the full market. But in the part of the market that gives a lot of information. We recorded 1.7 percentage point national gain with a 60 bps gaining Sao Paulo. So we -- I believe this is much closer to the reality then this number here.

Now talking about our top line growth, we reached in a quarter a closure of BRL6 billion in consolidated revenues. So, if you look at our retail business, it grew 14.4%, on a two-year basis, it has grown 43.4%, while 4Bio grew 22.6%, where for two years that growth of 55%.

If you look at the mix OTC has been the fastest growth category, exactly, because of the pandemic. I mean, all categories related to the pandemic are here, I'm talking about the COVID -- talking about hand sanitizers, masks, et cetera, et cetera, et cetera. Then we had moderate growth here in generics and HPC, and we have lower growth here in branded. But the most important figure, I think of the quarter is in this chart, which is our comp. Let's not forget that we're comping versus our first quarter last year, in which we had grown top line, 25%, and mature stores are 11.5%. So these comp base of the 1Q is a completely abnormal comp base, because people were stuck by the projects at our stores, before locking down.

And by the time of the lockdown, we saw in the second quarter, minus 7% mature, 6.3% total. So this is now a roller coaster, and this is why we start looking at two years back figures for us to understand where we are. So when we look, it's clear that the comps are accelerating, so we came from 36% for the third quarter 40% and now close to 44%. We are also publishing the April data exactly because of the second wave of the pandemic for you to get a better grasp that this is different from most year in which people were really locking up at home. And not by much, now demand has been normal, so we look at 41.6% two-years the growth, but with a negative calendar effect of 1.2%.

So, if we look on a calendar-adjusted basis, this is very similar to the first quarter, so we're maintaining this great momentum. And in the case of the mature stores, 14.1%, if you add up 1.2% in calendar effect, we're at 15.3% even slightly better than the first (Sic - fourth) quarter. So the structural growth momentum for the company has been great. And looking at the mature store growth on a one-year basis 4.6% plus the calendar effect, this is 5.8%. So this is strictly in line with inflation, despite the fact it's coming on top of 11.5% on a normal -- abnormal comp [ph]. I read tonight -- last night, many of the sell-side notes about the result and a lot of most analysts were talking about good as expected. And hence I have to tell you that for us, this is everything but expected. We're now going to expect it, to have inflation adjusted comps in line with inflation over this huge comp basis, was never our expectation. And we've been way better than our budget to be very candid here. So, in my view this highlights how strong, in our view and this quarter was.

I think another great news here is the digital penetration. So in the second quarter last year, when people really locked up at home, we saw a peak of 7.6%. As customer traffic start the normalizing this has -- these had seen at somewhat, but still we were by year end much better than we had started. But we are happy to see that in the first quarter we restarted growing the digital penetration. We got to a new record, which is 7.7% and the best news here is that, the March figures and the April figures are even higher than this. So it's been really, we think the quarter we have seen this growth. So there is a great trend in increased utilization for the rest of the year. So this is for me -- this is very important.

Well, as I mentioned before we don't see digital has amend itself as a business in itself. Digital is only a means to increase customer engagement, frequency, spending lifetime value. And we have measured that the people who have adopted digitalization based brand, 20% more than they spent before. So as people get digitalized, the total spending grows and this sustain the comp growth. The only reason why we have a comp growth like this is exactly because digitalization is driving an increasing customer spend. So we believe we'll be able to sustain Raia, mature store sales growth for the foreseeable future, exactly, because of digitalization. When you think about, talk about digitalization, it's important to mention that we have increased a lot, the infrastructure to support this service.

So we had to ship from stores, from only 72 stores by the beginning of last year. We have increased this number and ended one more stores through the year and now we have a new jump to 354 stores, with more dry shift from store. This comes on top of the fact that 100% of the stores you can collect and 100% of stores they do neighborhood deliveries, which is customers who leave in the immediate neighborhood, they send WhatsApp to the store, they order through WhatsApp directly from the store. And we deliver with the existing store personnel in the immediate neighborhood.

So neighborhood delivery plus Click and Collect, which are very low cost services for us, they represent more than 50% of our digital demand. Ship from store is less than 50%, so the economics is very good also because of that. And finally, we reached a total of nearly 10 million cumulative app downloads in the quarter, and this is a number that has to keep growing. Lets not forget also here, that we have two new businesses that we are developing, the marketplace and the health platform. This business are fully digital businesses and they depend on the digitalization that we able to do through the new pharmacies to feed that. So it's exactly these 10 million customers who have downloads today. And then in the future, I hope, there'll be 12 million, 15 million, 20 million or more, who'll back from the marketplace and who you use our health platform. So this is why digitalization is so important.

Talking about gross margins, we had a slight pressure here, 20 bps over last year, 30 bps on a sequential basis. When you look on an annual basis here, 10 bps is due to the adjusted net present value adjusted, which is really a non-cash effect, related to interest rates and 10 bps related to promotional intensity to drive customer digitalization. We have been very aggressive with coupons in the stores especially smart coupons, because they drive deduced onboarding of the customers. So, net from other gains, they accounted for a 10 bps gross margin pressure.

And then, in terms of the cash cycle, we had a flat cash cycle versus last year. But obviously, the first quarter, level of the working capital is always higher than the fourth quarter. So it's a big increase over the fourth quarter, because we have stockpiled the inventories to get ready for the forward buying. But we are in a similar level, both in cash cycle, ending inventories versus where we were last year. Selling expenses were a great highlight here. Despite the fact that the mature store growth was below inflation and only on a calendar-adjusted basis was in line with inflation. So, the normal thing to see would have been a slight pressure but we have -- we are getting more efficient and we got a 40 bps dilution in selling expenses.

When we met this gains, and expenses from the gross margin pressure, we still get to a contribution margin increase of 10 bps. This is a very important figure, because this is where we understand the quality of the operation, how we are doing structurally. And I mean this, because as we are investing digitalization marketplace platform, we have a lot of G&A, that the company is absorbing, in order to deliver those businesses. So, depending on when we look, it's possible that we see pressure because of the G&A. But I think this should be temporary pressures, because this investment has been done, with the goal of growing, and creating values. So longer-term they will be compensated, but in the short term it could be depending on the quarter a source of pressure. So the fact, despite what happen (Technical Difficulty) but in the short term they could be depending on the quarter, a source of pressure. So the fact, despite what happen (Technical Difficulty) the underlying strength and profitability of the operation, because we factor out the G&A out of this metric. But still G&A increased by 30 bps, 20 bps here of these G&A base are directly related to the digital execution. But there are more effects from digital like corporate overhead, management team et cetera, that are not factored into this number. So this is what explains the increase in G&A.

Let's not forget that we once had the G&A of 2.3%, we now have 2.8% and this is a choice. So we are adding developers, we adding people in analytics, designers and a lot of management structure in order for us to deliver this new strategy. So this is part of the process. But happily, the core reason has been so strong, that we have been able to offset these G&A increase with the contribution margin growth we have -- we see. Finally, our -- with our 7%, in line (Technical Difficulty) very happy to deliver very strong results here.

We show our accounting EBITDA was BRL350 million -- sorry here BRL432 million. But we had non-recurring gains, mostly tax gains from other periods. So the adjusted EBITDA is below this BRL460 million. Obviously, if you look at account EBITDA, it's a huge increase. But these tax credits that relate to previous periods we are not factoring them in this calculation. So, we always look at our normalized figure, and I think this is the right thing to do.

Finally, we had over BRL170 million in net income, 10 bps higher than last year, despite the huge comp base that we had seen. Finally, in terms of cash flow, we had pressure both on free and total cash flow, because we are comparing March with December, which are very different cash cycle points, because of seasonality, if we were comparing March with March, this would have been a positive cash flow generation. So, this is only related to seasonality, but still net debt to EBITDA stays at 0.6%, which is somewhat lower than we had seen last year. Our share price was pretty much constant, only 0.1 increase year-to-date. The index was slightly down, so there is a positive alpha of 2.3%, and an average trading volume of BRL155 million. And obviously the compounded total shareholder return since the higher end (inaudible), they are always very high. And the good thing is that quarter-over-quarter, year-after-year we maintain these kind of figures.

So making here a summary of what we talked, I mean, this is a great first quarter for the company, we are very happy about it. We had huge comps because of the pre-pandemic demand surge, because of the leap year last year, but still on a calendar adjusted basis much of stores were in line with inflation. That we have more and more to look at the two-year stacked figures, because the one-year become a roller coaster, so it's high now, but then it will be very low, the second quarter. But we are sequentially accelerating, reaching 44%. Digital penetration is an all-time high of 7.7% and growing. As I mentioned in March and April are higher than this figure.

So, the transformation of the business, we talked a lot about digital, but then when you think about the healthcare, which is the other element of the new pharmacy. We have performed since May last year nearly 2 million COVID tests. And in the first quarter alone, due to the peak of the pandemic, the second peak, 1 million COVID test, I mean this is huge figures. I mean, you can compare this figures to the public listed life companies like Dasa, Fleury, et cetera. I'm not saying they are higher, but they are very meaningful and we are in the same conversation, at least when you talk about COVID tests. And obviously very, very healthy margin in line with last year, slightly higher on the net margin, slightly lower on the EBITDA margin. So very good performance overall across every metric.

And when you look for the year this is also very positive outlook as well. We have sustained similar comps on a two-year basis for April, 42%. here. If you consider 1.3 negative calendar, we are talking nearly 42%, obviously on a year basis because of the roller coaster is now very high, but this is our (inaudible). The digital penetration increasing as I mentioned, and we had a very healthy price cap increase, which I think sets a good perspective for the year, even considering that we have a increasing inflation. But this price increase will allow us to absorb that, and I think we are expecting overall a very good year across every metric, because of how these strong start and also because of the price comp increase -- price cap increase.

Here, we like to provide the highlights about the marketplace, it's too early for us to start issuing general figures. We will come to that point, sooner rather than later, but we still will see the marketplace in a pre-operational stage. We started a pilot in November only in the Droga Raia website. In January, we launched the marketplace in the Droga Raia app, so it shows how recent this is.

We currently by end of the quarter, feature 84 sellers, 18,000 3P SKUs. So it's increasing versus the -- for Q1 we had drop sellers and 12,000 SKUs. The sellers that we are adding, they not only expand our offering to new health and beauty verticals, but they also expand the mix in existing verticals like beauty, for example. And one of the best news here is that, 39% of the marketplace orders had a 1P order coming together. So this is -- this was the synergy between the marketplace and the new pharmacy, just like there will be a synergy between new pharmacy in market place and the health platform.

The view here, the focus here is increasing the cash flow on a lifetime value. We have 40 million customers, we want to -- they have higher frequency, probably with the highest frequency channel in Brazil. So we believe that obviously, new pharmacy marketplace and the platform, whom they have their (inaudible) announced. But the beauty is the synergy between them, because we digitalize the customers with the new pharmacy, and then the customer experiences the marketplace, then the customer experiences the platform. Because of starting to use the platform on a regular basis, to take care of their health, as a consequence used more frequently, buy from the marketplace and buy from the new pharmacy.

The marketplace customers by the time we understand that we have a one-stop shopping offering in healthcare, become more frequently and they also buy more 1P. So the beauty is way beyond one plus one, is one-third -- this is, we're multiplying this different businesses. So these times, I think we change the customer lifetime in a very meaningful way, which were successful. This is what we're looking at. And the construction of the platform will continue through 2021, 2021 still a soft opening year. So -- but what we are currently negotiating with over 150 sellers, we have more than 1,000 sellers in the prospection. We have strong focus on onboarding them in a correct way, activating them, where we have seen the platform taking good care of them, maybe customers of the company. The company starts having the -- the individual the customer and the seller as a client as well and we have to treat them like that. So, we're taking care of the customer experience and the seller experience is very important.

And right now, the full logistics is done by the seller. But over time we have to absorb more and more of the logistics, start integrating for DCs. But in the end of the day, having the pharmacies a logistical hub. We have 2,300 pharmacies, all over Brazil. We serve 90% of the A-class within a mile. So, we can get a seller, who is based in Sao Paulo and get their products in the countryside of Amazonas in a couple of days and let the customer do a Click and Collect in the store with a zero or very low delivery cost. So, by using the start as a hub, we improve service to the customer, we improve the capillarity and the service and the complexity of the seller. And this is what we do that no one else is able to do.

When you think about the large platforms, they have done an amazing job, but they don't have the capillarity that we, to do a quick and cheap logistics like we can. Our customers don't expect when day-to-day for the delivery, they expect one hour, two hour, four hours, with 1P. And even if the 3P, it won't be one hour, four hour, because they eventually was we're not be sitting there, but then it will be one day, two day. So, I think that, it's very difficult to the large platforms to do. And it's important to mention that Drogasil is to not integrate into the platform, because we are switching the version of (inaudible) Brazil. So, we believe that in the third quarter Drogasil will have a marketplace as well, which right now only higher as such. Shows how shipping this is, but how promising this is as well.

And finally just before Q&A, we have recently-unveiled to the market, a lot of changes to our government, that I think improve and strengthen the governance. It starts, so we have a new strategy that's a much more complicated strategy. We're shifting from a regular expansion driven retail strategy to an omnichannel strategy, a strategy that relies on our platform, relies on an ecosystem. And the first good news here that we recently-unveiled is, that the majority shareholders we had signed a new shareholder agreement for 10 years, which we entered into effect in November this year. So until November, the current agreement stays into effect normally. And in November the new shareholder agreement starts, it will last for 10 years. This is involving the three long-term shareholders of the Company, (inaudible) and performance families. And this were families together they own 30% of Raia Drogasil. So we have a long-term commitment from the shareholders would have been, with the company for a very long time. It's always important to mention that this group of families include both the founding family of Drogasil, which is the Pires [ph] family who founded Drogasil, 85 years ago. And the Pipponzi family who founded that Raia [ph], 115 years ago and these families along with the (inaudible) family has been in Drogasil since '70s. We will be around for at least another 10 years to provide stability for the Company to deliver this new strategy.

As a function of these revamping of the governance, we have expanded our Board from 9 to 11 members and we have increased the number of independent members from three to five. So this new Board has already been voted on our general assembly that happened, one or two weeks ago. And on top of the six, the six Board members, who are appointed by the shareholder agreement, we have five independents and we have very complementary capabilities being added to the Board, exactly in line with this new strategy. So Marco Bonomi, he was already in our Board, he is now the Vice Chairman of the Company. Marc comes from Itau, he is our Board member of Itau. He was next General Director of Itau, and he was the guy who led Itau Unibanco's gist [ph] the transformation. So, this is, his second terminal Board. These are the Board members, who are all new Board members. So Sylvia Leao was already working with us on the People Committee. She has an extensive experience in retailing, so a very valuable addition here. And then we have three Board members who bring completely new competencies that are required in this new stage of the company.

Denise Santos, she is the CEO of the BP Hospital, Beneficencia Portuguesa Hospital, so very knowledgeable about both healthcare and someone who can help us among our strategy here. Then we have Cesar Gon, Cesar Gon is the Founder and CEO of CI&T. This is a Company who assist incumbents in doing digital transformation. So he understands every nut and bolt of the digital transformation, we're trying to do. So it is a very valuable addition to help us on this very, very difficult path. And finally, Philipp Povel, Co-Founder and Board Member of Dafiti, who is very knowledgeable about platforms, who also brings a new perspective to the Board. So, we have a much stronger Board, was much more diversified know how, and a governance who adds to the Company, and help us deliver this very ambitious strategy that we have ahead of us. There are other ESG improvements, like the five statutory committees strategy finance, people, health and sustainability. We have a permanent Fiscal Council and something that's very important. We are in rallying on May 18, 11 AM Brazilian time, with simultaneous translation, the new sustainability commitments of the company for 2030. So we have very detailed goals for our sustainability aspiration and we will unveil these on this date and on this time, with simultaneous translation for the -- with simultaneous translation. We'll have the members of the Board, we have members of the management, talking about our sustainability view and about the specific comments.

So I'd like to invite everybody to attend because this is a very important date for us and for the first time we as a Company have a sustainability agenda, who is very aligned to the business agenda. And I think we can talk more about this in this event.

So these were our prepared remarks, I'd like to open now for Q&A. Thank you.

Questions And Answers

Operator

Thank you. At this time we will begin the Q&A session. Mr. Joseph Giordano from J.P. Morgan. Would like to make a question. You may proceed.

Q - Joseph Giordano {BIO 17751061 <GO>}

Okay. I was on mute, sorry. So, hi, Eugenio, good morning. Thanks for taking my question and congrats on the results. A couple of questions here. So the first one is on the expansion plans, so now like the company will be present in all states of the country. So I'd like to understand, like how should we think going forward about the strategic acquisitions? So basically like, maybe both on dealing in one of the new states or even existing states, that would make sense for you, so if you guys evaluate that?

And the second one, as you see on the expansion, how should we think about the dual-brand strategy on the expansion plans for the Company? So we have like a two brand strategy, basically in Sao Paulo, (inaudible) the two brand strategy, but with very limited overlap. So if you could think about like -- okay, we are over and see we have like a very high-density on Drogasil, eventually like we introduced Raia and vice versa [ph]. So if this is something that makes sense for you guys in the short-term?

And the second question goes into the digital strategy. So we see a very relevant focus and you guys are investing much more than peers on this front. So here like I would like to think how are you seeing the evolution of the platform in terms of like engagement with the client. So, we saw the introduction of several content platforms taking place in your app. So like to understand how this is evolving, how like -- it's increasing like your monthly active users are in those platforms. And the second aspect is, how do you think like about the role of the consolidators we have in the market? So we have (inaudible) now have 400 shop, among others. So how do you see those guys playing out? And how do you think like the industry would shape out to actually embrace those guys, right? Because in general, they like they are -- there was that whole (inaudible). So how to like concrete this market and avoid this potential competition? Thank you.

A - Eugenio De Zagottis {BIO 7193695 <GO>}

Okay, Joe. Thank you for the question. First of all, Happy Birthday, I know today is your birthday, so I wish you all the best. As you are approaching a four [ph] year of existence. So you made several questions here. So let me start with the expansions less M&A part. So, as you mentioned, we are moving -- will be by year-end in every state in Brazil. In the end of the day, obviously these new states that we added they're very small states. So, they are not very material in terms of the total expansion. But I think it's a nice symbolism that will be everywhere. And obviously in the end of the day, we'll be able to have the 10 stores, five stores depend on the market. So the aggregate sum is a good sum.

Our strategy is an organic strategy. Obviously, I mean, there are a lot of M&A opportunities, we look at them, we analyze them. But in the end of the day, I'm very skeptical about direct store M&A. In the end of the day, it's very difficult for us to find assets that have a reasonable quality, that have a reasonable price. And every day, it becomes tougher, because we become bigger in those markets, the overlap is bigger, the fragility of those -- the performance of those stores is even worse as we enter.

So, I think the chance that we will do any moves, I think it's very unlikely. If you look, I mean, we have been successful in every market where we enter. And these more recent markets and more 4Bio [ph] markets, where we have more vulnerable competitors versus the ones we face, for example, in the South -- in the Southeast. These are our best markets, if you look the sales performance, the profitability performance state-by-state, our best performance is in the Northeast, North and Midwest, where we have these more fragile competitors. So we don't make -- it doesn't make any sense to buy anyone and as we get bigger and bigger, the overlap decreases and the sales performance of those stores that we could buy goes down, and they become less and less attractive. So, I think, its (inaudible) impossible, after all, we bought Onofre, not that long ago, but I think it's unlikely. Then you mentioned the dual-brand strategy. And we have an over -- a meaningful overlap in Sao Paulo. This is the only place. In Minas Gerais, we have Raia in the capital Belo Horizonte, only in the capital and Drogasil only in the countryside. Then we have Drogasil, North, Northeast and Midwest and we have Raia in Rio de Janeiro and the South.

So, Sao Paulo is the only re-overlap that we have. But we also have to take into account, that Sao Paulo is the major market of growth in Raia Drogasil. Raia Drogasil are iconic brands in Sao Paulo. So we will maintain two brands is Sao Paulo. We heard those brands.

We had some pilots in some markets trying to build an overlap. We tried this in Goiania using, we tried this in Brasilia for a while. But we feel that, with the exception of Sao Paulo, where we have the luxury of only two such strong brands, the best model in the other markets having one brand and investing to make the rent stronger.

So in Goiania, we closed the high operation, we migrated starts Drogasil, same in Brasilia, same in some cities in the country side, where (inaudible) we have Raia Drogasil we became only Raia, in prudential countryside of Sao Paulo, Raia became Drogasil, so whatever it made sense to consolidate on a single brand we did. But we will carry on Sao Paulo, the two brand strategy and having two brands is amazing as long as the two brands are very strong. Bringing -- building a second brand from zero it's very, very difficult, and we will no longer try to do that.

Then -- okay, so this was the dual brand. Then you asked me about the digital. I mean, and so I think right now what we have in terms of the digital is the new pharmacy, gaining a lot of steam. So when you think about 7% to 8% digital penetration, this is very significant, not a long ago, this penetration was dismal and it's growing. So we grew initially during the pandemic, then exceeded, now it's starting to grow again. And this is very important because when we think about the marketplace and the health platform, I mean, these are 100% digital solutions. So we will have as many customers as we can onboard digitally through the new pharmacies. So this is why, this is such a high priority. I think we are evolving well. I think the new pharmacy already changes the engagement of this customer, the frequency of buying the loyalty just because we have a much higher convenience through omni-channel, that we had before. And I believe the process will specify as the marketplace becomes relevant. And as we launched the health platform, we will launch the NVP of the health platform still this year. But I think it will take time for marketplace and health platform to start making a difference. Right now, the focus is beauty, the new pharmacy and digitalizing the customers in the new pharmacy during the onboarding and building this new businesses. So that, by the time we have more and more digital customers this business can feed from this customers and then these are synergies that I mentioned can be got.

Finally, in terms of U.S. with the whole-off companies like Happy that do the last mile delivery. I mean, I think they have a role in the market. I think, they do a tremendous job in terms of getting fast service, and a very -- with a very good customer experience. And I mean, we're -- our strategy is open, is an open-ended. We work with Happy, for example, they're a good partner. But in the end of the day, we want to have as much as possible the direct relationship with the customer.

In our case of the digital sales, 90% are directly executed from the customer -- by the company. 10% came from Happy and these other guys. So, yes, they have a role, but we are not dependent on that. And in the case of pharmaceuticals, their mission is very different. Obviously, if you need a shampoo, if you need a deodorant and even an OTC medicine, they're very convenient, and they can deliver it very fast for you. But when you think about prescription, you need a more specialized execution, you need digital prescriptions to be processed, you need that you accept, that we have a lot of partnerships with manufacturers and special programs. We have partnership with payers, health insurers, companies, so it's a very specialized fulfilment. There are a lot of category, there are a lot of molecules like controlled medicines that we cannot do through a platform like this, you can only do directly. So in my view the specialization of the channel makes it very difficult for these generalistic channels to be competitive on the prescription side.

On the OTC -- on an OTC, I think, they can go, they can do a good job. And now our mission in terms of our fulfillment is to be as good as them, as fast as them. The fact that we have 2,300 stores that we have 90% of the A-class in Brazil within a mile of our stores allows us to be as quick as they are. Right now, I think they have a better experience than we have in terms of debt. I think our app has evolved tremendously, but I have to be frank, that to say that, our app today is not a state-of-the-art app yet. (inaudible) and other guy (inaudible). And our aim is to get there in two years. So, we are investing resources. We have a large number of squads [ph] working on. We are converting our systems to microservices. We have data sciences within the company, so we are in the journal, but these, they've started the journal much before us. But in my view, by the day, we have an experience in the app, that's comparable to this guy. That our business started shift from store, that today's mostly four hours, become mostly one hour. Then I think, we can -- we can have the most compelling -- the most compelling neighborhood operation all over Brazil.

Operator

Our next question comes from Mr. Gabriov Simions [ph] from Itau. You may proceed.

Q - Unidentified Participant

Hi. I'm sorry guys, I was on mute here. As you know -- thanks for taking my question. It's actually about your store formats. So in the past few quarters, you have entered an important endeavor to reach lower income customers, as we see in the profile of your recent store openings. And you've been very successful doing so. I would like to know if this change in opening profile was mostly related to your expansion into new regions? And if we should see a profile change going forward in any sense?

And also if you could pinpoint the main difference between the higher and lower-income formats, that would be very interesting as well? Thank you.

A - Eugenio De Zagottis {BIO 7193695 <GO>}

Okay, Gabriel, thanks for the questions. I mean, and you're correct, we are diversifying a lot of growth. Our growth is more and more not only geographically diversified, but also in terms of income profile. So, obviously when you grow this much in the Northeast, North and these are not as affluent areas of Sao Paulo. So, think about on operation in Pernambuco, Bahia, we have 70 plus stores there, especially Bahia. If you think about Bahia, maybe we have what 15, maybe 20, A-class stores there. The market, I mean, A market is very limited there. So we have -- after we did those initial stores, immediately we had to start going down in terms of income profile.

So, we started opening hyper stores and now we're opening a lot of popular stores. So yes, I mean, this is a larger number of popular stores are related to these new markets.

They are related to a lot of small features that we have entered. But they're also related to large cities like in Sao Paulo. If you look our footprint in the A areas of Sao Paulo, it's an amazing footprint. We have tremendous coverage, and if we open a store in (inaudible), et cetera, cannibalization is huge and the capacity of the start, we had marginal demand to justify the cost of capital is not there is any more. So, this is why the number of stores in the state of Sao Paulo is reducing quarter-by-quarter and the number of stores in the City of Sao Paulo even more so. If I'm not mistaken, I think we have opened last 12 months something like 12 stores in the City of Sao Paulo, 10, 12 stores. It's a very small number. And even the City of Sao Paulo, these 10, 12 stores, most of them are in more peripheric areas that complement our existing fund [ph]. So our growth has never been more accretive than before. In the past, we were doing a lot of store in existing areas that had great sales, but a lot of cannibalization, still they made sense on a net basis, but right now cannibalization is very low from this program. And we're still driving tremendous revenues per store in the growth. So if you look today, the internal rate of returns on the expansion is the highest we have seen in recent years. We always target a 20% real internal rate of return. We are in mid to high 20s right now, exactly because there is limited cannibalization. And we always look tremendous amount of cannibalization. A store that sells 800,000 as in month, it doesn't matter. It matters how much it adds to the pie. If it sells 800, but it cannibalizes 300, only 500 is new. And the return calculation is based on the 500. But starting the new margin that is having 600, 700, the zero cannibalization, 600 and 700 margin, this is why the internal rate of return is also growing.

So finally, you asked me about the differences in formats. I mean, in the end, we're talking about the same business. So these are like the differences in execution, things related to store look and feel, to promotion density, to generic mix to the materials and fixtures we use in the store. So the upscale store they are way more sophisticated. They have a more upscale mix. They have a nicer and cleaner store look and feel. The popular stores they are way more promotional way more signature, way more generics in the mix, simpler fixtures. So, but in the end of the day is the same business -- in end of the day it's the same economics.

Operator

Our next question comes from Mr. Gustavo Sendai from (inaudible). You may proceed.

Q - Unidentified Participant

Hi, Eugenio, thank you for taking my question. I have two questions here on the service front. First if you guys plan to extend the service portfolio you offer in stores in the short and mid-term. And if you do what kind of verticals are you looking for? And the second, is there a sales conversional metric or average spends for clients to go to those store to take COVID test or using kind of other service, for example. What can we expect on this front with the average spending in line with the company's average, higher capital rates [ph].

A - Eugenio De Zagottis {BIO 7193695 <GO>}

Okay. Well, thanks for the questions, Gustavo. Obviously when you think about the new pharmacy, there are two direct elements. One is the digital, the other is the health element. So we have a lot of new, new things that we are developing for our health hubs.

So we have an existing service infrastructure in the stores we've vaccinations, we added COVID tests, but we will start piloting health hubs, that I think have a much more comprehensive service than that, that are digitally integrated with the app, so you can schedule anything to the app, you can get the exams that you do either the COVID test, point of care, whatever that is, you can get the results and store that on the app. So there is a huge digital and healthcare integration that we are planning to take place on those health hubs. And students here I think will have some of these health hubs up and running.

Obviously, we have figures related to the health hubs usage. But we are still not making them public especially because the full health hub that we're launching is not up there yet. What we have today is an extension from the past. The full health hubs I think keeps to be much more compelling in my view. So we assume we already measured economics, but right now we don't share the economics, maybe in the future as the health hubs becomes more important and prevalent, we may decide to share those numbers.

Operator

The next question comes from Mrs. Irma Sgarz from Goldman Sachs. You may proceed.

Q - Irma Sgarz {BIO 15190838 <GO>}

Yes. Hi, just a quick follow-up on customer acquisition costs. I think you've said in the past that your stores are actually relatively cost-efficient way of acquiring customers, given that you ultimately you have -- you acquire customers through stores and then they transit to become omni-channel customers. I was just curious to what extent you're already seeing, now that you are sort of strengthening, I know in the beginning of what's going to be a multiple year journey, but to the extent that you're strengthening yourself as vertical sort of go-to place for health and sort of as a broader vertical ecosystem. To what extent do you see already customers sort of go in directly to your platform and not even having been customers of your store. And does it even, I don't know, you're very well penetrated across the country, and already have an impressive market share, but there is obviously still some 80% of the market out there. So, I was curious if it to some extent if there's even already examples of where it is becoming more relevant that you're getting customers that are coming directly online to you digitally. And that can maybe even inform part of your store build-out or is that just sort of not necessarily that relevant. Thank you.

A - Eugenio De Zagottis {BIO 7193695 <GO>}

Okay, Irma, that's a really good question. And I think the store is a hugely efficient customer acquisition machine. Let's not forget that, we have a business that is 93% physical, we open a store, the customers come. And they come to the store to buy like they had bought for the last 100 years in our stores on a physical basis. Then they learn in the store that we have our app, the digital on-boarding happens in there, then they started using this new channels, omni-channel, click-and-collects, ship from store et cetera, et cetera, et cetera.

So what this means is that, the cost of the store, the investment of the store is already fully absorbed by the regular business, but all of a sudden we have two new business for us to further monetize this customer. But I think the dynamic is not really okay us going to Google or Facebook and acquiring a customer, and then the customer from digital go into the store. I think the other way is way more effective. We think people come to us because of the store, then they get digitalized and then they start buying through the app, then they find out we have a myriad of sellers there so they become users of the marketplace, then they learn that we have a digital -- a health platform that can help them have better living, prevention, health promotion, disease prevention et cetera. So for me, this is how it works. Obviously we do some Google, Facebook et cetera, but in the end of the day, it's through the stores the customers will come. And this is the differentiating factor of everything we do. Most digital businesses, they have a nightmare acquiring customers. They may have a great product, excellent solution, experience, even the margin outside of the customer acquisition cost, it's pretty good. But by the time they put the customer acquisition cost it becomes a nightmare.

And we have an example at home, we bought tech.fit, which is becoming like the chassis for our health platform. I mean, amazing start-up, amazing digital solutions, amazing understanding of the customer experience. But the problem is getting customers for them was a nightmare. And we already have 40 million customers with whom we react -- we interact. And so with these existing customers we on-board -- we do the digital on boarding and then we will transfer them not only to buy from the new pharmacy, but also from the marketplace, but also by the -- to consume the health platform. So this is the leading combination, everything that we are doing here relies on the store. The stores is the customer acquisition machine, the store is the fulfillment machine, 85% of the transactions, the digital transaction happen through the store. The store will be the hub for 3P deliveries in the marketplace. Imagine the value of, you buying something in the marketplace and collecting in 1, 2 days in the store without a shipping cost, or using these existing infrastructure to deliver home at a lower shipping cost and faster time than what you used to. This is something that the large platforms can do. Customer acquisition for them is not the major issue because they have a huge spectrum of categories. So obviously they spend money, Google, Facebook et cetera, but they dilute over large scope of business. But these kind of fast fulfillment only with the kind of capillarity that we have, it's possible to do.

But comparing to any pure-play vertical platform, in the past we had like e-pharmacies, like net-pharmacy even Onofre and couple others. I mean this has been a huge failure, because the customer acquisition was a main barrier for them. And then the fulfillment cost was very high, because they didn't have the kind of capillaries we have. So the store is absolutely central to the business model we are developing. And finally, you asked me about market share. So we have a market share of I think 14%. Just with store -- just with store maturation and couple of more years of expansion, we are sure to get to 20%. But I think there is way more opportunity, not only because I don't think the expansion ends in 2 years or 3 years, I think it goes on with full steam. I think it's clear how we have reinvented expansion, how we have learned how to access popular markets, enter smaller cities, so I think there is still a tremendous opportunity for the expansion. And I think the combination within digital expansion will drive faster share gain than we were getting before.

Operator

There appears to be no further questions. Now I will turn the conference over back to the company for the final remarks.

A - Eugenio De Zagottis {BIO 7193695 <GO>}

Okay. So thank you all for attending our conference call. And just to sum up of some of the things we mentioned. I mean, this was a huge challenging quarter for us because of the abnormal comp base of last year in which we grew 25% top-line, not only because of the surge-in demand before the social isolation, but also because of the leap year. But still when we look at our mature store sales on an inflation-adjusted basis was absolutely in line with inflation despite this huge comp base. For us, there was nothing like as expected digital performance. I think it was a huge surprise for the company. We are way above budget, but the good thing is that this sets an amazing momentum for the year. The comps have been very good, the digital is accelerating, the price increase will allow us to do very, very well. With inflation, with the G&A increases we're doing to support the new strategic program. So I think the business is really structurally I don't -- it's in a very strong pace. And this is poising to be a very good year as a result of that. I think the most important thing is not the year, it is not the quarter, it's the long-term business that we're building, it's the combination of the new pharmacy with the marketplace, with the health platform, we are only in the beginning. I think we started to see the early effects of the new pharmacy. What supports these kind of amazing comps is digitalization no doubts about it. So this is already -- we're already harvesting what we planted on this regard. But I think we are only planting when you think about the marketplace, when you think about the health platform. This is still year zero of the marketplace, I don't know how next year will be, maybe next year starts to make a difference. This is only the pre -- almost pre-operational, but I have no doubts that the marketers will be very meaningful for our future.

So there is a tremendous optionality there, there is a tremendous optionality from the health platform. But obviously they have their own -- their own pockets of profitability. But rather than look at the vertical profitability of separate businesses, the beauty lies in putting all this together. In the end, this is all about increasing the customer lifetime value. We have 40 million customer with the highest shopping frequency in Brazilian retailing. And by adding the digital, these frequencies for the -- in the Spanish [ph] further increasing. By adding more and more products in the market, basically expand more and more, people start buying in the marketplace without even knowing they are in the marketplace. They don't have to know we are in the marketplace. They just come to us because we are a high frequency channel, then they find out we have this amazing offering. And then they find out they've to repeat, and then if (inaudible) marketplace. So this is a cycle that happens, but the marketplace frequency was up to the pharmacy as well, just like the platform frequency, would sum up [ph] -- the marketplace and for the pharmacy.

So in the end of the day despite of what we can achieve on a vertical basis on each of these three businesses, the combination is hugely synergistical, and in my view, this is a game changer for the company. This is not an easy strategy to execute, this is not a cheap strategy to execute. We have the financial commitment to do what it takes. We are enhancing our team, we are enhancing our digital area, we are enhancing our governance to support all these effort, but we are very optimistic with what we can achieve. So the previous 10 years of the original shareholder agreement have been amazing in a more traditional retail in USA [ph]. We still will build upon this traditional retailing side, but now we are adding a lot of platform elements to them, that I think will be transformational in the future. So thank you all for attending the call, for your support to shareholders. And our IR team are available whenever you need this. Thank you very much.

Operator

The RD People, Health and Well-being conference call is now finished. Thank you very much and have a very nice day. You may disconnect now.