Q4 2018 Earnings Call

Company Participants

- Eugênio de Zagottis, Corporate Planning and Investor Relations Vice President
- Marcílio D'Amico Pousada, Chief Executive Officer

Other Participants

- Joseph Giordano, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. At this time, we'd like to welcome everyone to RD – People, Health and Well-being Conference Call to discuss its Fourth Quarter 2018 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 slide show presentation available for download. 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. At that time, further instructions will be given.

Before proceeding, let me mention that forward-looking statements are being 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. Marcílio Pousada, CEO; Mr. Eugênio De Zagottis, Investor Relations and Corporate Planning Vice President; and Gabriel Rozenberg, IR and Corporate Planning Director.

Now, I will turn the conference over to Mr. Marcílio Pousada. Sir, you may begin your conference.

Marcílio D'Amico Pousada

Hello. Good morning, everyone. Welcome to presentation of results of the fourth quarter 2018 RD (01:53). As always, Eugênio will present the numbers. And before the Q&A, I'll talk about the 2018, 2019 progress for us and there's any stressing points about on our position also (02:00). Eugênio, please.

Eugênio de Zagottis

Well, hello, everybody. Thanks for attending our 2018 conference call. I'd like to start by saying that 2018 was a challenging year for us. Obviously, it was a year of softer growth with mature stores below zero and this has resulted in margin pressures that obviously affected our profitability. On the other hand, we have reached tremendous milestones in terms of our strategy. I'd like to mention, for example, we did a record expansion by opening 240 stores entered two new states (02:41). We were able to recover share through the year and we ended that in the fourth quarter with very high market share. We did a very ambitious price repositioning for the company, which obviously has had an effect on the softer growth, but I think positioned the company very effectively for the future.

And finally, I think we start with our very ambitious digital transformation. We launched, for example, Click & Collect for every single store, and I think we have more things being prepared for this transformation. We will be talking about all these things over the presentation. So, the highlight of the year here, we ended the year with 1,825 stores. We opened 240 stores and closed 25. We ended the year also with 12.9% of market share, a 90 bps increase, with stability in São Paulo, which is something that we are very proud about, because we face tremendous competition here.

Our revenues reached BRL 15.5 billion, an increase of 12% with 2.7% for same-store sales. Our margin totaled 28.6%. This is a 20 bps loss due to the 4Bio mix effect that if you consider only all unit paid, we managed to extend (04:00) our margins which were stable.

We did BRL 1,195.2 million of EBITDA, so an increase of 5.7% even though there is a 50 bps margin pressure. Our net income also increased by 7%. We consumed BRL 140 million of free cash flow and BRL 340 million of total cash flow, but we still have very low leverage from the 0.6 net debt to EBITDA to be more specific. And finally, yesterday, we signed an agreement to buy 30% of the capital of Onofre. This was an opportunistic transaction. I'll talk more about that in a moment. But this also has a very interesting strategic value in terms of accelerate (04:40) transformation. We'll be talking about that as well.

Okay, page 4. I think here we can see 2018 under historic perspective. As I mentioned, we reached 1,800 stores. When we did the merger in 2011, we had less than 800 stores. So, over this period, we did 1,000 new stores and the fact that our EBITDA increased from less than BRL 300 million to nearly BRL 1.2 billion is the main evidence over the quality of the expansion. The only way we were able to expand our profitability rate is because these 1,000 new stores are the very least as good as the 800 legacy stores that we had back then.

On page 5, we can also talk about market share. So, our store share has been increasing bit by bit (05:44) 2.3% store share this year. But when you look at market share in terms of revenues, despite the fact that we had softer grow last year, we still managed to gain 40 bps for the average of the year and we still managed (06:00) when the year was a 9 bps gain in the fourth quarter which was very, very substantial and which points to (06:12) power price repositioning. We can also see on the right in the chart the gap that we have over the rest of the market in terms of revenues per store which is the main driver of profitability in this industry.

On page 6, we ended (06:35) 1,825 stores. We opened a total of 240 stores in the year, closed 25 stores and ended the period with 35.6% of the stores (06:49) maturation.

On page 7, we can give more color on the expansion. I think the first message here is that, we entered two new states last year. We entered Maranhão with nine stores in the Northeast and we entered Pará in the North region with 19 stores. We have at least 10 more stores in Pará to open in the next months. With the demise of Big Ben, there is a huge opening for us in Pará and we are committed to become the second brand in the state and the reference brand for the A class. This is going really well. We have tremendous profitability in that market.

With these two new states, we have total 22 states where we have our brand position. This represents 98% of the Brazilian pharmaceutical market and in all the states we have (07:35) the new state. We don't have a mature brand yet, but we have tremendous initial results that point to mature store revenues in line with the rest of Brazil and whatever we have a mature operation. We have very similar revenues for store. We have very consistent profitability for store. So, this growth platform is very unique in the market. We had bad debt. We have seen tremendous pains in the past when we started moving out of São Paulo, but regardless of how difficult or easy each market was for us, today there is no more pain. This is our growth platform that has supported 240 store openings every year. This is what we did last year. This is our guidance for this year.

I also like to highlight that if you consider the Northeast and the North regions, we have been the latest frontier for expansion. We have more than 230 stores already in those markets that has been developed over the last few years. Here on the right, in terms of market share, we ended the year at a very high point. We've gained 90 bps (08:36) share in the fourth quarter. We are able to maintain the share in São Paulo despite the increase from Patricia we faced (08:43) I think this is a prowess (08:49) for the company, we are very proud of this ability. It wasn't like that through the year. We were losing share over the year. But, as our new pricing strategy started working and as time (09:06) to allow the results to happen. We have managed to do it over the market share we lost through the year and then the year with stability. And then, now we have the market in a significant way (09:21).

On page 8, talking about revenues, we increased our total revenues by 12% in the year. This is 11% retail growth with 37.3% growth for 4Bio. In the fourth quarter, we registered very decent performance with 14.1% total growth of which 13.1% is retail; the rest was done by 4Bio. Here on the right when we look at the mix, there is a very clear separation. We have seen the tremendous performance in the front shop, both with OTC and HPC, especially with OTC, there were switches in the market. The early switches outside, because there's more to come, that has helped a lot in OTC. So, OTC we did 18% growth in the fourth quarter, 16.6% in the year. And then, the other interesting aspect is that, we already see generics catching up with Branded. The picture we've seen through the year has been generics way behind Branded, which was a consequence of the strong price investment we give in generic.

So, early on we saw a lot of price reduction and the volume was compensating that to provide for something around zero in terms of generics growth. As time elapsed as we had more time for the strategy to prove itself correct, we are at a point in which there's still a relative price pressure, that the volume growth has been so huge in generic that we already see generics revenue catching up with Branded revenues.

So on page 9, we can talk about the comps here and we're coming from an all-time low 3Q 2018 of 3.2% negative from mature stores and now we've reached 0.6% positive. This was the best quarter of the year in terms of comps, which is a result of the sequential improvement through the pricing strategy, as well as, from the fact that our comp base is getting easier as we move forward. So, our expectation is that we will start the year where we ended, but over the next quarters, this comp should move up, so that we can – if we're successful, we'll end the year with the fourth quarter around the inflation of growth inflation something like that. This will be a consequence of continuous sequential improvement as well as easier comp base as the year progresses.

On page 10, we talk about margins and working capital. The total gross margins for the year went down by 20 bps which is a second 4Bio mix effect or 4Bio growth factor with lower gross margin, so there's a mix effect. But the retail gross margin has been flat. So the paradox is that we've had so much in pricing, but we still defended our gross margin. This happened as a result of a combination of things. I mean first we had a lot of price improvements in the front-store. We implemented a new pricing platform. Addition to that, we improved purchasing terms like we try to do every year, so this also helped and then there is (00:12:34) factor that also relates to the cash cycle, which is the fact that we had done a lot of opportunity buys to take advantage of such opportunities and this helped us maintain the margins.

The consequence however is that the cash cycle has grown by four days. So as we enter in 2019, the margin that we have in the year, the gross margin we expect for the year, has to do with the ability to maintain this kind of opportunity by then. It's too early to know if we'll be able to maintain the same level of opportunity buy to maintain the gross margin. There is additional risk that with less opportunity buy with the normalization of the cash cycle, we could see some gross margin pressure in the year. This is something that we are [Technical Difficulty] (00:13:27) as we move forward.

On page 11 we talk about the expenses which has been the main source of pressure. We saw 50 bps pressure in the fourth quarter, 20 bps from personnel. This is a direct consequence of loss of operating leverage. We have 20 bps rental pressure as well. In the end of the year, (00:13:44) reached 9% or 10% so we'll see tremendous pressure in rental renewals and then we have 10 bps of logistics pressure. We opened new DCs. We opened so many stores in Pará, which is right now an expensive shipping cost because it's so far away. So this pressure of logistics 10 bps and also 10 bps from new stores. We ended the year for lot of stores ready to open in 2019, more than the previous year and this has also pressured our expenses. Then we saw a 10 bps dilution that helped mitigate those pressures due to lower variable compensation and a 20 bps dilution from the 4Bio mix effect. 4Bio as I mentioned has lower margins but also has lower expenses. So the growth helps on the expense side and harms on the margin side.

On page 12, summing up, our EBITDA for the year totaled nearly BRL 1.2 billion. We're talking BRL 311 million in the fourth quarter, which is a 5.7% increase over previous year; so despite a 15 bps margin pressure, we saw a nominal EBITDA growth in the year and when you look at the retail EBITDA despite the pressures that we faced, we're still taking about 8% retail EBITDA with one-third of the stores yet to mature. So I think it shows the robustness of the business. And then 4Bio had BRL 17 million of EBITDA last year, it's a lower margin but the volumes are growing very fast and the numbers we have in 4Bio are better than any expectation we might have had when we (00:15:26).

On page 13, we talk about the net income. We did nearly BRL 550 million in the year and BRL 155 million in the fourth quarter, which is a 7% net income growth versus the 4Q 2017 and then we had 10 bps gain on the net margin in the quarter. We've moved this quarter, a significant number of non-recurring expenses. The bulk of these is related to increase labor contingencies. This is comprised of labor claims sued in previous years. What happened is that with the labor reform as there are less new claims made against the company, the speed of the (00:16:24) has increased and this has made clear that our provision was insufficient. So we revised the criteria. We have now much more conservative criteria. And then there's a pressure of BRL 0.7 million related to claims of previous years, which were adjusted in the quarter. There is also a pressure in the quarter related to claims of the year, but this is business as usual. So this is not (00:16:48).

Page 14 we had free cash flow consumption of BRL 140 million in the year. And a total cash consumption of BRL 341 million, but assuming in a healthy, very low leverage of 0.6 net debt to EBITDA.

Then on page 15 obviously our share price has fallen 36%. I think there was also a peak when it reached 90%, but still in a preferred year the share price followed. The way we look at this, I mean what concerns us is not the share price. What concerns us is the performance of the business. We tried to do the best every day in terms of long-term value creation and we believe that if we write, the share price will show up, and will show on the long-term. We will not manage it or driven by short-term price pressures or even short-term price gains on our shares.

Okay. So this is what we have prepared. I'm passing to Marcílio to summarize the year and talk about next year and I'll be back to talk about the Onofre acquisition. Thank you.

Marcílio D'Amico Pousada

Okay. Thank you, Eugênio. Okay. Let's go to page 16. We'll talk a little bit about 2018, okay. It was a challenging year for us, but when we talk about this challenging year, we have to talk about cycles. We always talk about this kind of cycles in our business. If you look into our history in the past, I always have an assumption down in this business, okay.

I have a good numbers to show (00:18:14) pharma numbers that offers – opened for the competition. They opened, if you look in the left, in January 2018, 546 stores. In January 2019, they opened only 327 stores. This show for us the cycles happened in 2018. The market opened a lot of stores to compete against us and just so far during the year.

(00:18:45) also tried to reduce the price in generics. We know how important generic market for us, and reduced all the – then we lose only 50% in margin, and the number one problem was expenses. Very difficult to the group's expenses when you grow the matured store below the inflation. But we did a very good several milestones – good stretch milestones for us. We opened 240 stores, when you look in 2013, when you opened 100 stores, (00:19:11) bring for us openings of 12 months business, 240 stores opening 200 stores, in a such a good shape, good stores and nice stores there to open a store to serve the customers also.

We are in 22 different Brazilian states. We are almost in all the Brazilian pharmaceutical market but what's better here. 86% of our stores is located in a 1.5 kilometers to eight customers then we not only needed in the good states in Brazil, but we are in the (00:19:54). We increased our share. We invest a lot in generic. It is good for us. Generics always is in the best was not the main strategy, but stuff – but main strategy right now. We learned a lot with this. In generics, we saw a lot of (00:20:19) you increase, reduce the price, the number if all this starts to grow, it is good for us about the future. And we (00:20:29). We closed new strategic plan. We started working 2018 and improved and closed in August 2018. And the main driver for this strategic plan is that customers increases (00:20:41) the digital in the center of the business.

Looking at the market, we never see our last competition like this year, but you are much more stronger when compared with the competition this year than the past because we closed the year with 1,825 stores in 22 states, but you have 31 million active customer in our data base. We reduced together with balance sheet with our numbers clearly for us a big difference between compared – our numbers with a competition numbers. We are much more stronger right now than looking for last year.

Let's go to page 17, talk about 2019. Our guidance for new stores will be the same. We are opening 240 stores. We have almost 170 contracted signs for us here. The same number that we had last year. Okay. We have enhanced the popular format. We know this is important for our future. This is important for GPD growing, GPD pacing 240 stores per year. We know that it (00:21:44) year, we know that if you do that with a higher (00:21:49) as a brand, it is nice for us. We are change and using five stores in the very well efforts, will be more stores in the popular formats for the future also.

When we talk about the new strategic plan, we talk about the customer centric strategy, okay, but not only customer-centric strategy. We're looking for digital stretch. We know the omni-channel customer buy more for us, the omni-channel customer buy more with frequency and buy more in the averages also. Then we're planning to increase the numbers of the (00:22:25) this year, I hope to which 2 million omni-channel customers in the end of this year. We have right now 400,000. It should be a big challenge for the company we are doing this right now. We started to work with (00:22:42) right now and we started to work more with diverse analytics.

We know that important for our results, for our EBITDA margin to increase the numbers, they grow the company, they mature stores. We'll believe in the end of this year we start to grow again the matured store above the threshold, a little bit below penetration. Why we do that? Because our topic is cycles. The competition starts dropping, started in last year. And we came to reach the average GDP. All the investments in generic we did in 2018, we don't have to do the same in 2019.

The other project we're working directly on the team is to reduce the expenses. We know that it is a very good business in 2016 and 2017 and we needed to do better right now (00:23:35) the expenses to all the partners together in proprietary. And do we know that if you used a (00:23:47) to take the decisions for the company, you can make it less expensive through to stick in our business. We had a consultant company to help us do that and you can see the results of being this recued expenses not in this year but maybe 2020 (24:04).

Right now, Eugênio (24:07) the Onofre acquisition and then we'll be here for Q&A. Eugênio?

Eugênio de Zagottis

Okay. So before talking about the rationale and the structure, I'd like to give an overview of Onofre. Onofre is a very traditional drug store chain in Brazil, which was acquired in 2013 by CVS. Last year, Onofre reported BRL 480 million in gross revenues, but it's important to mention here that the company has very negative EBITDA and net income. So we're talking about a turnaround here obviously and also there is no financial leverage involved here. Financially, Onofre has a very healthy balance sheet, although there's a big challenge in terms of profitability, as I mentioned. We're talking about a chain with 50 stores, 47 of which are in São Paulo and e-commerce represents 45% of the revenues. So one of the main motivations of why we did the acquisition remains to accelerating the digital strategy and I'll talk about that in a minute.

And the other aspect here is that despite the relatively small size, because it belongs to CVS, Onofre is a fully formal company with very well-structured back office and very high compliance status. It's very difficult for us to have an opportunity to do more acquisition with this kind of characteristics. Generally, the smaller companies they're not audited and what you find when you do a due diligence that can be very scary. That's not the case here.

Then talking about the deal structure before elaborating more on the rationale. This is a transaction that is not involving disbursement by the company. So we're basically getting the company without any payment. The final numbers obviously will depend on working capital and other adjustments, so obviously there's a target working capital. If the working capital is higher, then we have to pay back some. If the working capital is lower, then (26:06) pay more. But basically the expectation is that we don't have to make any disbursement to get this company. So we're get the company basically for free. A company with no financial average, but the reason is obvious. This is a company with very negative EBITDA and we have to turn it around.

Also in deal structure, we don't have to approve the General Assembly because we're talking below any threshold that would require us to do so. The deal closing will depend on CADE. This is a normal process. We believe this is a safe transaction, but in the end CADE is also who is the auditor (26:48) responsible for approving that. In our view, this deal should take three to four months to close depending on the time CADE will take to analyze it. And finally, there is an existing arbitrage of CVS and Onofre against the previous owners. This arbitrage will continue being managed by CVS and we don't have any interference in the process. We don't have any downside and we don't have any upside from the arbitrage. Every gain or every loss will belong to CVS.

Then on the next page we can talk more about the rationale. I think, first and foremost, this is an opportunistic turnaround transaction. So, again, it's a company losing money that we are getting without paying any price, but we have to turn it around, we have to trust from (27:43) the negative EBITDA in positive results and we believe we have the capacity to do so, but simply by plugging Onofre into our structure (27:55) supported by corporate structure, supported by our DCs, our IT, our management, I think this is enough to create a relatively fast turnaround. So in the end, the reason why we're able to get the company such a stable transaction is that we are maybe the only company or one of the few companies who have the resources to do a quick turnaround here. But in addition to the opportunistic side, we believe this transaction accelerates our digital strategy and I'll detail that in a minute.

In terms of the network, it's a small network, but it's complementary to what we have. I don't think we are – I heard the questions yesterday about cannibalization, and I don't think is an issue here. Just like with Raia and Drogasil, this wasn't an issue. Obviously, we will never open these 50 locations from the ground-up in this neighborhood where we have already a good market share. But these stores, they (28:52) with sales there and we are talking about healthy levels of sales. So there's no problem if you have a store selling 800,000 and there is a nearby Onofre store selling 600,000. There is no cannibalization here. Obviously, if we grow that store from 500, 600 or whatever it is, let's say, we had BRL 100,000 more or BRL 200,000 more in new revenues by using our brands, by leveraging our execution over the additional revenues there could be cannibalization, but still I don't know half the revenues will be new revenues, half the revenue growth will be new revenues.

So the stores right here is a very similar logic (29:34) to Raia Drogasil. No problem having two stores side by side to preexisting stores side by side with each other as long as they are healthy (29:47), okay? And another aspect here has to do with the fact that by doing this transaction, by interacting with the company, by doing due diligence, I mean, we learned that the company has very good people. CVS was successful in building the chain there and we believe there are a lot of people there who can help us here, people who bring complementary skills. Because of our growth, every year we are growing, we're increasing our corporate structure, so we can get people from Onofre. So I think that the talent side is also nice to have in this transaction.

Then we I talk about e-commerce, this is one of the most favorable aspect of the transaction. We are talking about a company that is one of the leaders in e-commerce in our sector. So this transaction more than doubles our digital revenues. Onofre has higher e-commerce revenues than we have. The idea is to maintain the Onofre brand in e-commerce. So this acquisition allow us to increase our fulfillment scale, which has an obvious impact in terms of fulfillment cost and (31:03) has always an obvious effect in terms of reducing the labor cost. So this helps us a lot in going forward for digital strategy.

I think there is a big opportunity here because Onofre is focused in São Paulo even though their website is national, they only have opportunity for São Paulo and (31:23) so we will be able to take Onofre nationally by leveraging our distribution structure in all those markets where we operate, so there is no need to see upside here today.

And finally, Onofre's e-commerce is very complementary to what we do. That's what Raia and Drogasil are focused on omni-channel. So we're talking about more and more customers doing (31:45) customers buying from stores to be delivered in one hour. So, in the end, what this means is that progressively our e-commerce price for Raia and Drogasil will be more and more similar to the store price. So this omni-channel offering that we have today is based on the convenience. Onofre's playing is on the opposite side of the spectrum. Onofre is a pure-play Internet-bred, obviously have 50 stores that will be capitalized (32:10) that omni-channel was never really a possibility there. But Onofre is positioned as a pure-play e-commerce player, which is price-driven. So, cheaper price, but that's convenience. So, you buy today, you pay less, but you only receive the products tomorrow.

As I mentioned, as we do more and more (32:34) more and more omni-channel and hence our price will transition for Raia and Drogasil towards the store prices. The pure play price segment is a segment that (32:49) high. But Onofre allows us to fill that gap. So we will maintain the Onofre brand position in price, which is obviously a lower margin business, but we believe we can create value, we can generate positive profitability by doing that while allowing Raia and Drogasil to move faster for the omni-channel proposition, which, as I mentioned, is convenience-driven proposition. So I think it's a very complementary aspect into the acquisition here.

And finally in terms of the stores, we are taking 50 more stores. They will allow us to gain some more scale and they allow us to again capillarity. The quality of the portfolio is good. It's very complementary. (33:28) São Paulo and obviously there are stores who lose money and we will have to close some of the stores. We haven't decided yet on the branding strategy. Obviously, for e-commerce, we maintain Onofre brand, but for the store we will still like to decide on if we maintain or not the Onofre brand, how many stores we maintain, how many stores we close. So, as we signed the transaction now, we are now moving towards developing a detailed integration plan so that day one after closing, we can act fast and we can convert the negative EBITDA into positive EBITDA.

Finally before Q&A, I would like to just to point on some highlights for IR. We will publish first quarter numbers on April 29; second quarter, August 6; third quarter, October 29 and we have three scheduled investor conferences, two in Brazil, BTG Pactual next week in São Paulo; on April 2 and 3, Bradesco Conference in São Paulo; and finally May 15 and 16, the LatAm CEO Conference (34:46) that Marcílio and myself will (34:50).

So these were our prepared remarks and now we will go to Q&A session.

Q&A

Operator

Mr. Joseph Giordano from JPMorgan has a question.

Q - Joseph Giordano {BIO 17751061 <GO>}

Hi. Good afternoon, everyone. Thanks for taking my question. So I have a few ones. So the first one is related to the M&A strategy. So, like, it seems that this deal was kind of an opportunistic one, so I'd like to understand like what's the mindset of the company towards further M&A in the future, so if you're actively looking for that?

My second question goes into the e-commerce strategy. So you mentioned that even like being smaller Onofre online operations are actually larger than RD's. So I'd like to understand like what they do different from you, particularly in terms of restricted products. And also it would be interesting to understand like if you have any target in terms of like online orders here for your e-commerce site.

The third thing would be on the pricing platform, right. So we saw kind of flattish margin on the retail side, but we had some investments in certain categories. So like, first of all, how this pricing platform helped to cushion further margin pressure and how we should be looking at it in the future.?

Lastly concerning private label rights, so if we'd think about like expanding to new categories further, how the penetration is evolving toward this year as you focus on strengthening your competitive positioning? Thank you.

A - Eugênio de Zagottis

Okay, Joseph. Thank you for the questions. I mean, the first thing is that until recently, the whole focus was on organic expansion. We were ramping after 240 stores and obviously we had neither the time nor the energy to look into and speak about M&A. We're now at a point in which we have stabilized 240 stores that was the number for next year. That is the guidance for this year. So, obviously, we are much more open and looking at M&A. We look at a lot of potential opportunities. I mean, you don't have (37:16) an idea of how many transactions come early, but our bar is very high here. So what we are hearing enough is that we're talking about the company that have – it's fully formal, (37:27) level of compliance and so on. So it's very unusual to find a small, medium-sized asset with this kind of credibility in terms of the numbers, in terms of (3:747). So what I'll tell you is we are open to do selective M&A whenever we think it makes sense.

I think another good aspect of this strategy is that there will be a big learning and I think if this – if Onofre, the integration is successful, as we believe it to be, (38:09) very encouraging. So, for example, we have 50 stores in São Paulo. We'll have the chance to – we know how much they sell. We'll have the chance of understanding how much value we can really add. So under our operation and maybe under our brands, if we learn that a store that sells 500 becomes 700, these can give us the encouragement to be more aggressive in M&A in the future. We will learn also how much – we don't think there will be huge distraction, but we think there will be some, but depending on how tough or how easy it is, we can also build more confidence for new deals in the future. So I think it's a very good timing to (38:49) more acquisition like this that in addition to create value, in addition to deliver a positive acceleration of our strategy will also allow us to learn and maybe to be more aggressive in the future.

In terms of e-commerce, 45% of Onofre sales was e-commerce. So we're talking about something like, what, BRL 230 million, something like that. This is more than two times what we do with RD. So, let's remember that RD is two brands, Raia and Drogasil. So brand by brand, Onofre sells three times more than either Raia or Drogasil. Obviously, it's a different strategy. Onofre won't be an omni-channel strategy, as I mentioned before. It will be a pure play, price-driven strategy, but it adds up the pitching scale, it adds up to delivery density, we'll be able to leverage our buying terms (39:52) for Onofre, we'll be able to expand this delivery service nationally (39:58) Onofre is basically only São Paulo. Raia and Drogasil is much more national. So you can see the relevance of the business Onofre has built (40:04). So we believe we'll have a stronger asset to carry forward with a lot of synergies to extract on the e-commerce side.

Then your third question was on pricing. I think one of the elements that helped us this year was by implementing a new pricing platform from the front-store. So, this was very important for us. This year, we have another price initiative. We are conducting a pricing project (40:33) for the pharma side. So, we're defining a much more structure, analytical and detail proactive pricing strategy and then we use artificial intelligence to be able to react to price movements. It's easy to see that with 1,800 stores, thanks 14,000 SKUs, it's impossible for the human eye to catch every movement. So with artificial intelligence, we can see a lot of movements in terms of competitive price changes, in terms of molecules (41:07) that have gained or lost share (41:09). So these are elements that refuel our pricing decisions and therefore to help either increase margins or accelerate growth. In either way, we increase the gross profit and that's what we want to do.

And finally, private label is progressing very well. Private label is already more than 5% of front-store sales. We have new launches that will be very important in the coming months, like the (41:33), for example, it's a very high volume category. We have a lot of categories to complement. There is one brand which should be a new brand in the strategy. So, private label is in 5%, I'm sure it gets to 10% – 8%, 9%, 10% in a couple of years relatively quick, two years, something like that. And then we see what the future holds for us.

Q - Joseph Giordano {BIO 17751061 <GO>}

Thank you, Eugênio. Just taking the opportunity here. I just wanted to explore a little bit, the super apps and how does it play out within your digital strategy? I know you're a part of (00:42:17) but I wanted to list now like how do you see that in the future, probably it's a slight moment here now, but how do you see this trend here? Thank you.

A - Eugênio de Zagottis

Yeah, different question. Right now, have easy material, it's very low volume and I think this is benefiting for us with value proposition for the consumer. (00:42:34) can have is to have quick delivery of let's say your son has a short thorough, you need a medicine in half an hour and then have this very effective for that.

Our e-commerce strategy especially for our key segments which are chronic patients and mother is to go direct. So just as an example, when we started looking at (00:43:02) P&L instead of transaction or store P&L, the whole matter of the company changes. Our idea is that if someone is a loyal credit patient with high spending, this customer should buy from us in one hour with zero delivery fee. So if we are able to improve the value proposition for those chronic patients and other core segments, I don't think (00:43:35) can be more competitive than what we can do. We can deliver for free for them. We can apply any discount program they have, either loyalty card or PBM. So I think it's a much, much deeper value proposition, the one that we can give to our core customers, but obviously we can't offer free delivery for everybody. So there'll always be patients – there'll always be customers for home, how they could have a better value proposition.

Q - Joseph Giordano {BIO 17751061 <GO>}

Thank you, Eugênio. Okay. So I will just do another one. So thinking on the restricted products right, so how far are we from potential new orders, so basically going back to that strategy of increasing the pocket share within the chronic patient. So basically just like sending the order automatically? Thank you.

A - Eugênio de Zagottis

Okay. Well our agenda is really focusing on each strong patients and other core segments (00:44:31) of beauty products and so on. So the whole value proposition is (00:44:36). The way we see for example e-commerce until on offering was something like 1% of our revenues; 1%, 2% or 5% of the delivery doesn't move the needle. But what moves the needle is that if this 1%, 2% or 5% means the discussion represents 5%, 10% or 20% of my total revenue pool, and if this customer is engaged through a net that allow us to offer a much better experience and collect much more loyalty and value, this can be transformational. So our view is omni-channel. Omni-channel doesn't mean that the money will be made on click on collect or delivery. Although that could very well happen. But the goal is that over the whole lifetime of the customer, over the whole spectrum of channels with which the customer interacts, we believe that a connected customer will generate much more loyalty spending and value for us and will generate much better experience and convenience for that customer. This is the view that we have. And one or two or five won't change the needle, but value book overall what this customer buy, this can move the needle, and this can be transformational. We have set a guidance – not a guidance, a goal of increasing omni-channel customer from 0.5 million to 2 million by the end of next year. So we are thinking about exponential growth here and I think this is one year. Our mission is much bigger beyond 2019.

Q - Joseph Giordano {BIO 17751061 <GO>}

Perfect. Thank you.

A - Eugênio de Zagottis

Okay. Thanks.

Operator

It appears to be no furthers questions. Now I will turn the conference back to the company for the final remarks.

A - Eugênio de Zagottis

Okay. First and foremost, I'd like to thank you all for following our call and for your support as shareholders. I would like to summarize some of the points related to this presentation. I mean obviously 2018 was a challenging year with increased competition, softer growth, which led to market pressure that we lost 30 bps margins, for 50 bps if you put the buyer mix effect together, but still we have (00:46:53) with one-third of the stores, still undergoing maturation.

So I think we are in a very strong competitive positioning. When you do around us, what happens is that there was a lot of capital allocation in this market, a lot of companies (47:16) this also has an effect on our softer growth. But the result is that these – when the whole market invested so much capital, in a difficult environment with market pressures what we see is a huge leverage increases all around the industry. And this is translating in less openings and more closures over the last quarters. We have companies reducing their guidance. So, this means the beginning of normalization. This also means that on a relative basis with the kind of profitability, balance sheet and growth (48:03) maintain we had never been better positioned in our industry to keep leading the consolidation moving forward than we are today.

So, this is the key message that I'd like to be very clear. And in spite of the challenge of the year, we also had very significant achievements like the record expansion of 240 stores a year, this is a number this market has never seen and I don't know if any other retailer of any segment has ever opened so many stores in a year. Although we had (48:32) through the year, we ended the year at a very high note with stability in São Paulo which is a real achievement given the competition increase we saw and we gained in every other market.

We underwent a very bold price repositioning which we did and still manage to maintain gross margins and to lose only 4 bps of retail margin. But (49:00) changed our growth momentum. And I think we see the consequence through this year in terms of growth normalization and through next year, as I think we get back to normal. And finally, I think we started a very ambition digital transformation. I don't know any other retailer in Brazil who (49:14) 10 minutes, 15 minutes, half an hour. Every Click & Collect operation that we know of is today are more.

(49:25) already on the store. (49:30) in 10 minutes the product is probably ready for you to pick. We're now getting ready to launch Click & Collect for controlled medicines, which obviously will have an additional staff which verify the prescription. But still these are products that – it's generally difficult for the customer to find the whole inventory they need. People generally buy three units per product. A lot of these products are low turnover products that are difficult to find. So, for a customer to know, he can go in a store and do Click & Collect of a controlled medicine and being fully aware that he is finding the product and this is a much expedited process. This is tremendous value creation.

We also want to bring the additional information inside the store. We're moving the pain points of the customer experience, improving the shop experience that we offer to the consumer. And again, the view is, we can connect, where we can gauge if a connected consumer on a much deeper level than he can engage for normal consumer. So, a consumer who downloads the app will be able to do a little – to send reminders to take the pills in the morning, send reminders to issue the prescription. We'll able to offer promotions and these will increase the share of wallet on these consumers. These will increase the value we provide them. These will increase their spend with us. And the other aspect is that the assets that we have to support the digital transformation are absolutely unique.

We have more than 1,800 stores and a very staggering number is that 86% of the Brazilian A consumers live within a 1.5 kilometer ranges from our stores. So our stores, they are customer acquisition (51:11) machine. CRM, omni-channel is a customer retention machine. And then, multi-program, pricing, promotions, CRM and private label, these are value creation (51:30) machines for these consumer. So, I think we have 30 million consumers mid to high (51:36) consumers. This is the biggest database in Brazil combined with 86% of A-class people living within a 1.5 kilometer radius from our store. These are unique assets that will allow us to transform our business to create a new growth engine through these stores. So, I'd like to thank you again for attending the call and we will be available for you in our roadshows, conferences and even conference calls. Thank you very much.

Operator

Closing and disconnecting.