Y 2021 Earnings Call

Company Participants

- Eugenio De Zagottis, Corporate Planning, IR and M&A Vice President

Other Participants

- Joseph Giordano

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to RD People Health and Well-Being Conference Call to discuss its 4Q '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 informed 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 would 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 the 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, IR, Corporate Planning and M&A Vice President; and Fernando Spinelli, Investor Relations and Business Development Director.

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

Eugenio De Zagottis {BIO 7193695 <GO>}

(Technical Difficulty) 2021 Conference Call. I would like to start by saying --sorry I have technical problems here. So I'd like to start by saying that 2021, by any criteria, was an amazing year for the company. We were able to post very healthy top-line growth driven by a very successful expansion, was always 240 stores opening. Our gross revenue reached BRL25.6 billion, 21% growth with 12.4% for mature stores. We posted margin gains both for the contribution margin 70 bps gain, 29% growth. The same holds for the adjusted EBITDA, 7.1% margin with 26% growth, and also for net income with 3.1% margin and 31% of net growth.

In addition to that, despite the fact that the company has invested very significantly during the year in all the new strategies and this is true both when we talk about G&A, OpEx or when we talk about CapEx that we posted in the year pretty much a neutral free cash flow. So it was minus BRL26 million only of free cash flow supporting all the increase in CapEx, supporting all the operational pressures that we had because of the new programs that we have. When you look at the total cash flow, then it's more negative, but this is true because of higher payout to shareholders as well as M&A related to startups to build our ecosystem.

So all these investment in the new strategies of the company have produced amazing results already in the first year. If you talk about digital, we did BRL2.1 billion in revenues coming from digital channels, 79% of growth and ended the year with 9.2% of digital penetration. When we talk about the marketplace, we launched the marketplace both at Raia and Drogasil apps. We already have 300 sellers, 80,000 SKUs listed in the marketplace, so (inaudible) from the marketplace. Now, the challenge for us is rolling out -- now really the challenge for us is scaling up the marketplace.

And finally with the health platform, we launched Vitat. Vitat was constituted based on the acquisition of a start-up name Tech.fit, that startup had already several programs in terms of lifestyle, weight loss, nutrition, et cetera, exercises. So, we were able to leverage these assets and launch the platform with 150 free programs focused on wellness and obviously this year we'll transition Vitat to more towards chronicities, customers with higher -- customer lifetime value with more complex diseases for that should help them take care.

So when you look at the year from any perspective, this was an amazing year. If you focus on the quarter though, obviously, this was a challenging quarter because of inflation and it's important to understand the inflationary trends through the year. When you look at the average inflation of the year, that average inflation was just slightly above the average price increase allowed by the government. If you could -- if you look at our mature stores growth which was 12%, was even higher than the overall inflation for the year.

So on an annual basis, inflation was not a problem. But when you look through the year, we saw completely different trends in the first semester and in the second semester. In the first semester with the price cap increase ahead of inflation and mature stores growth even further ahead, we had tons of operating leverage, expense dilution, margin increase, et cetera. In the second semester as inflation kept rising, we ended the inflation way ahead of the price cap increase of the year. And I had of the of the mature-store growth of the year. So obviously we have a short-term pressure related to inflation that somewhat happened in the third quarter, it happened significantly in the fourth quarter and need to happen again in the first quarter.

But when we talk about the structural strengths of the business, we are absolutely confident that this would be right here because the price will be adjusted in the second quarter of the year, end of March actually, so we should have a great second quarter with tons of inflationary gains of inventories and these price increase will get our revenues balance versus the current inflation that we have. So, express dilution will be normalized. So the trend for the year is a good one, the last year was an amazing year, but the recent quarter, especially this quarter, they were challenging in terms of margin perspective.

Well, talking about our expansion, we ended the year with nearly 2,500 stores. We opened last year 240 stores. We closed in the year 49 stores. Let's remember that in the previous year, we almost didn't close any stores, because of the uncertainty provided by the pandemic. It was difficult to know if the store was doing poorly, because of the pandemic or if there was a structural trade. So, we were very conservative last year.

If you look at the average number of store closures for the two years, we did 30 closures a year, which is exactly in line of the average for the company and this is a healthy number, just a fraction of the stores closed are recent stores or maturity stores. The bulk of them, they are related to portfolio optimizations that we have there. When we look at our stock portfolio, 70% of the stores are mature, 30% of the stores are still undergoing maturation. And finally, we retreat the guidance for this year of 260 new pharmacies. And we are maintaining for the year, the same kind of diversification we have had both in terms of demography and in terms of geography, both aspects.

When you look at the profile of the recent expansion, last 12 months expansion, it's obvious how different it is from the history of the company, even though it has maintained the same, if not better returns. There's a huge focus nowadays in entering new cities. So last year alone, we entered in 76 new cities, so we're talking 240 stores. And those 240 stores, obviously there were a lot of existing markets, but 76 new cities that we entered through these openings.

And when we look in terms of income profile, when you look at the total stock portfolio these days, 33% of the stores, one-third is our premium stores; two-thirds, they're either hybrid or popular stores. But if you look at the last 12 month expansion, only 12% are premium stores, 88%, they are either hybrid or popular stores that we have opened. So we are entering more and more the B and C class and there are still some opportunities in the A class, but obviously they are less a part every year of our expansion.

When you look at the returns, we are doing internal -- (inaudible) internal rate of return is around 25% these days. Let's not forget that we have always focused on 20%. We look at this figure net of cannibalization and cannibalization these days is way less than in the past because there are more new cities with zero cannibalization and less stores in highly populated areas by us. Here, we can understand the geography of the expansion.

And I'll start by saying that if you think about Sao Paulo, the state of Sao Paulo, which is our main market where both Raia and Drogasil brand were born, we opened only 20% of the stores in the state of Sao Paulo, 50 over to 40. This is a number that's been reducing over the years. So there is less cannibalization more and more. And Sao Paulo is our most populated market, but this is the state of Sao Paulo. If you're talking about the city of Sao Paulo, we did only something like 5% of the expansion in the city of Sao Paulo. So and if you look at the A class areas in Sao Paulo, it's almost nothing. We're already pretty well populated and the focus has been more in new cities in the countryside and even within the city of Sao Paulo in B class and C class areas. I mean, our presence is a national one, we completed this map, we are now in every single state. We entered in Roraima, Acre, and Amapa during the year. So, we are now in every state and I think what's very particular about our expansion, is the fact that we are swimming in the blue ocean wherever we go, because we have the brand set in virtually all these markets. We grow with the same return expectations all over Brazil.

We have an average revenue per mature-store of BRL900,000 per sore per month. And even if you look at our lowest market, in the lowest revenue market, we're doing BRL750,000 for mature-store. Actually, this is way above what the local income in that same market does. So it's easy to understand that we grow with the same returns expectation in every market and we've very similar revenues per store wherever we go. We are now a truly national brand and this is why we have so much blue ocean where to swim. If you compare with our competitors, I mean, our competitors, they have like a blue lake somewhere in the native market where they still can open stores and probably with decent returns. But when they look outside of those markets, I mean, this is a huge red ocean, bloody ocean with huge entry barriers. And even at these regional pockets, where they have the brand consolidated, if they overdo it, cannibalization becomes very high.

And at some point, the blue lake can easily become a red lake as well. So this is a huge difference between us and all the other competitors. I'd like to show also how relevant our presence is already in several markets. Obviously, 1,100 stores in Sao Paulo, that's not a surprise, but 350 stores nearly in the Northeast and close to 300 stores in the South. We are approaching 100, actually it's now 84 stores, but it'll be in the short term 100 plus stores in the northern region. So we're growing everywhere. The growth these days is not about the single market, it's about growing everywhere. And in terms of market share, we grew share on a share on a national basis with stability in Sao Paulo and gains in every other single market.

Talking about the top-line growth, I mean, as I mentioned, this was an amazing year at 21% top-line growth for the year. If you look at the quarter, we did 16.7% growth in the quarter. The difference between 16.7% and 21% lies in the fact that we had a very easy comp base in the second quarter because it was very soft last year in the beginning of the pandemic. In the previous year in the beginning of the pandemic and the fact that even the third quarter of 2020, was also another full quarter. So, we had a very easy comp base in the second quarter and somewhat easier comp base in the third quarter. Now, fourth quarter, we're looking at a normal comp base of the 4Q20. So, it's 16.7% which I think is a very good number.

When you look at our mix, the highlight has been OTC and this has also been absolutely related to the pandemic, a lot of seasonal -- not seasonal, a lot of items related to the pandemic like vitamins, masks, even COVID test are classified within OTC. So, this was by far the highest growth category.

Talking about our comps in the year, we did 12.4% mature store growth. Here, we see what I mentioned before in the second quarter, when the comp base was really soft, it was a staggering number north of 20%. In the third quarter, still with easier comp base we did 12%, now we are at 9% comp base, but we're comparing of absolutely normal quarter last year. So, 9% is a great number. It's 150 bps ahead of the price cap increase we got last March, but obviously, this is now below the current inflation, which is in excess of 10%. So this generates shorter pressures in terms of profitability.

It's important to highlight how we have done in terms of digital sales. So digital, I mean, we have had an amazing year here with a total of BRL2.1 billion in annual revenues, 79% growth over the previous year. We ended the year with nearly BRL600 million sales in the quarter, which means BRL2.4 billion annualized digital sales, still with 69% of growth versus the 4Q '20 and the digital penetration reached 9.2% in the end of the year. Why is this important? This is important because customers who become digital, they spend from 20% to 20% more versus what they spent before. So this means increasing the customer lifetime value and obviously this is very highly co-related with overall value creation for the company as well.

Our focus lies in the app. Obviously, we do well through the web as well, but the app is really the focus of what we do. Our stores, they drive huge digital onboarding. We have nearly 16 million cumulative app downloads already. But for me the main number is here, the number of monthly average users that we have compared to our competitors. This is the 100 RD we are comparing and then we see the fraction of the other competitors. So we have a much, much, much higher usage than any other competitor here. And obviously, we are a bigger company, so we're expected to do that. But if you look, our ratios in terms of how much times our revenues are versus these guys, there is an over indexation when we talk about the MAU of the app. So it's disproportion -- it's absolutely disproportionate here.

Another thing that we have to consider is that we are not as more regional player, we're a national player. We compete obviously in high penetration areas like Sao Paulo, South, Southeast, but we also compete in markets that are very recent to the company, that we have still limited density. In other markets like the Northeast the presence is good, but the usage of the digital, the habit is not there and we're forming. So as a national company, to be out playing all even on a relative basis to the revenues, to be over indexing versus every single (inaudible) so this is an amazing number. And if you look at the pace of the growth and the gap that we're opening, this is even more staggering.

Talking about gross margin. The gross margin was one of the highlights of the quarter. So, 28.5% of gross margin, this is an unusually high gross margin and there are couple elements in here. First, the mix is a very good one, because OTC is doing really well and this is a high margin category for us, there's a factor here. We are -- December was our record in terms of private label penetration. So, we reached very high private label penetration, 8.6% in the front store with 45% gross margin. So, there's a factor here, which is helping the gross margin.

And finally, because interest rates are higher now, there is also the adjusted present -- the NPV adjustment that helps these figures as well. Finally, when you talk about cash cycle, we ended the period of a great cash cycle of 55 days. This is a significant reduction versus the previous quarter, a 10-day reduction on a sequential basis. If you compare to the 4Q '20, this is a five-day increase, but let's remember that this was an all-time low number. So this is not a sustainable number. Our normal number for example is generally 55, 54, 56. So we have recovered since previous quarters and we are at total normal level for the cash cycle.

Before talking about margin, I would like to provide some details related to inflation, that explain what's happening today and how we see the year evolve and this has to do with some of the things I mentioned in the opening. So last year the average price cap increase granted by the government was 7.5%. This 7.5% originally was much higher than the base inflation. So, there was a real component here. So we started the year with a price cap, it was above inflation. And if you look at our comps in average, mature stores grew 12% from the year. So when you look at revenue growth versus inflation, it was even much higher than this. So, this provided for a very strong first semester in terms of operating leverage.

The problem is that through the year, the inflation kept rising. And at some point, the inflation became higher than the price cap increase and the inflation became even higher than the mature store growth we had posted. This is especially true in the fourth quarter and this will again be true in the first quarter of next year. So, we have right now, a very significant inflationary pressure because the inflation is way ahead of the price cap increase and even ahead of the mature store growth we're seeing. The good news is that in the end of February, inflation is to be similar to what it is today. So, we'll get in March a price cap increase based on this inflation, which very likely would be the full inflation.

Having said that, the inflation is expected to decline over the year. So, we expect for this year, a price cap increase ahead of inflation for the average of the year. So, there's an expectation of an 8.6% CPI versus something like 10.4% and 10.5% in expected price cap increase. So, we will recover the inflation, we'll have a recomposition that we will allow our margins to normalize. So we have a shorter pressure this quarter. We will have again a shorter pressure in the first quarter for sure. But then from the second quarter onwards, I think the trend is very positive. And with this kind of price cap increase, particularly in the second quarter, the inflationary gain on inventory should be very high, but this will sustain accelerated revenue growth, which will allow us to dilute the current inflation we see and to get back to the normal margins we used to have. So we are not worried at all about the short-term trend because we know that everything will be normalized from the second quarter onwards.

Okay. So when you talk about the margins, we look at the contribution margin. The contribution margin is a very important number for us because this shows the structural performance of the business because G&A is related to the structure of the company and we are upgrading a lot the structure of the company to support the new strategies, the marketplace, the platform, et cetera. So contribution margin is just gross margin less sales expenses. So this is the structural health of the business.

We increased 70 bps in the year and even despite the huge inflation we see today, we only lost 20 bps of contribution margin in the quarter. When we factored the G&A and then we look at the EBITDA, we reinvest the G&A to 30 bps for the quarter. So there's still a margin increase of 40 bps in the year, very significant EBITDA growth of 26.5% in the year. If you look in the quarter, then obviously we have a meaningful pressure versus fourth quarter next year. But I mean if you look on a sequential basis, there shouldn't be any surprises, because in the third quarter with much lower inflation that we see today, we're already suffering here and at 6.8%. So the 6.5 is a perfectly normal number for a company who had 6.8% of less inflation in the previous quarter.

So it's important to understand the recent trend and the recent trend is shown by the sequential numbers, not year-on-year numbers. So we did 6.5%. This is -- there is some pressure in the contribution margin as I mentioned, but the main pressure is here on the G&A. This is a mixture of inflation affect to the G&A, and also the investment in structure we have pursued to support the new strategy.

In terms of net income, we also saw a significant increase. The net margin amounted to 3.1, 30 bps margin gain in the year and even in the quarter, it was a better net margin than the previous quarter 3 versus 2.7, but obviously 60 bps below same quarter last year because of the inflationary pressures and because of the G&A investments that we pursued.

Finally, when we look in the year, we also have BRL41 million in non-recurring gains which are not factored in this adjusted net income. So we are very diligent when we adjust numbers and we are always, I mean either if it's a positive or a negative adjustment, there is no arbitrarity, it's always done really with a very, very consistent way. So sometimes we adjust non-recurring expenses, but very often we adjust nonrecurring gains just like we're doing this year.

Finally, cash flow and I think this was probably one of the highlights of the quarter. This is a year in which if you compare December with December, we have a cash cycle pressure because we had an all-time low of 50 days last year. So the cash cycle is artificially pressured. It's because the comp base there still it was very low. Still we had BRL800 plus million or BRL820 million operating cash flow. Our CapEx increased quite a bit. It increased about BRL180 million because of IT and other investments and still the business took care of that. And we had only BRL26 million of negative free cash flow. So it's a neutral operating cash generation here. Obviously, when you look at the total cash flow, then there is BRL570 million consumption, but this is based on two lines. One is interest on equity. So we increased payout to shareholders. And the other is that the M&As we were going to put together an ecosystem we spend on a cash basis close to BRL140 million already. But the operating side is absolutely pristine and absolutely neutral here. Finally, we have maintained the same leverage of the previous quarters, just slightly ahead 20 bps -- 0.2 ahead of the same point last year, but still a very, very good number, only 0.8 of net debt to EBITDA, which gives us all the flexibility to maintain the investment program we are pursuing.

Finally, we added BRL7.4 billion in value added, 44% of all that went back to the government, federal, state, municipal, BRL2.4 billion to our people, our 50,000 employees, 32% of the value creation here. Then we have third-party providers like landlords, et cetera, with BRL1 billion, and finally shareholders of BRL0.8 billion, 10% of the total.

When you look at our share performance, we had positive alpha in the year and positive alpha in the quarter. Obviously, we're talking about a tough year with the Bovespa falling 12%, and our share price was very close to neutral here.

The compounding power of this business is staggering. If your compare the current share price with the Drogasil IPO price or the high IPO price, the annual return we have been able to deliver have been amazing.

So, I would now try to summarize some of the aspects of the year and how we are looking to -- how we're getting ready for 2022. Before doing that, I would just like to highlight that Raia and Drogasil just completed 10 years of history in November. And obviously, I mean the capacity of the merged company to transform the business, I mean it was absolutely amazing. So if you look that some of the part 2011 Raia plus Drogasil versus what we are now, we were a regional player, we have presence in nine states, less than 800 stores. Today, we have 2,500 stores, three times more stores than before.

Our gross revenue in the sphere that was multiplied by 5x, reaching BRL25.6 billion and we did this with margin increases, our EBITDA increased 7x from BRL272 million, all the way to more than BRL1.8 billion. So, the last ten years were an amazing period for the company and we have done this with more traditional retail recycle based on things like category management, organic, store expansion. So it was really the basics of the retail execution that allowed for this to happen, initially getting Raia and Drogasil to have the best of both and afterwards, challenging where the best of both was not enough or what we could do better than the best of both and keep evolving, keep improving, and this is what drove this amazing value creation for our shareholders.

When we look for our next decade with starting now, we are looking at a very different and much more ambitious, but also much more complex (inaudible) than the one we had so far. So we have a new strategy, which is based on three pillars; the new pharmacy which is the classic retail execution powered by digital/omni channel and re-signified getting back to our roots in terms of healthcare having health in our stores.

So this is the traditional business reinvented, but then we have two new businesses that we are recreating, the marketplace which also feeds on the customer relationship, more than 40 million customers that we have, our digital assets like the apps, websites et cetera, and finally the health platform. So these three pillars are moving us away from being just a pharmaceutical retailer to focus here on integral health. This is still driven by the same purpose that hasn't changed of taking close care of people's health and well-being during all times of their lives. And we have a series of enablers where we are working on in order for us to make this very ambitious transformation. And by achieving this, we want to become by 2030 the corporate group that contributes the most towards a healthier society in Brazil.

In terms of these transformations, I mean here we have a highlight of the year and the highlight is what I mentioned in the beginning. I mean, this was an amazing year in which we delivered very robust growth with margin expansion and neutral free cash flow despite we were seeing a lot in the pharmacy and especially in all the new businesses marketplace and the health platform. So we opened 240 new stores this year and we maintain for 2022 the guidance of 260 stores. We are now open in seven states of Brazil. We reached the milestone of 50,000 employees. Our top-line grew 21% with 12% of growth from mature stores, 40 bps EBITDA margin expansion, net income growing 31% also with margin expansion and neutral free cash flow only minus BRL26 million despite 27% CapEx increase plus nearly BRL200 million CapEx versus the previous year to support all these new strategies and support indeed when we look what we accomplished here, especially in the pharmacy, but also in the initial days of this two new businesses, we are very happy with what we were able to achieve last year.

So digital channels reached BRL2.1 billion in the year, if we analyze the fourth quarter, BRL2.4 billion. So, RD digital is already the six or seven largest drugstore chain in Brazil, and the penetration reached 9.2% by year end. Why this is important? Because a digital customer spends more than they spent before. So, this has been a driver for this amazing comp growth that we produced in the year and for future comp growth that we expect to produce.

The 16 million downloads, Raia and Drogasil are respectively the number one and number two online pharmacies in Brazil. If we were separate company, we would be number one and two. And obviously, when you look at the monthly average users in the app, it's far above anyone else. We have 1,500 health hubs that performed a very active role during pandemic, more than 4 million rapid assets, nearly 200,000 COVID immunizations in partnership with municipalities and even for general vaccination, we have tripled the number of stores providing the service. So we should accelerate a lot into 2022.

This was year one of the marketplace, 80,000 SKUs, 300 sellers. The marketplace is built into the Raia and Drogasil apps already and we invested in Conecta La. This is a startup that has an amazing seller center. We have a minority check which is here and we acquired the rights to the code. So that Conecta La would become our seller center, and this will prove a lot how we connect to ourselves.

And finally, when you talk about the health platform, this was year one of the health platform. We launched Vitat, both the app and the brand, more than 150 free programs that we're offering the customer. As I mentioned the beginning, Vitat was constituted through the Tech.fit acquisition. Tech.fit had programs focused on nutrition and exercise. So, with the initial -- the initial execution of Vitat is very focused on lifestyle, but Vitat will migrate more and more towards serving chronic patients, patients who have a very high lifetime value, complex journeys, significant prescription needs and with obviously, we can fish within our data leg. We have 41 million customers, more than 5 million loyal customers and these customers will drive the growth for the health platform. So it started where the acquired startup was, but this is starting to shift toward where we want to be in the future.

Another highlight is the fact that we did seven startup acquisitions last year. We spent BRL200 million and we are building an amazing ecosystem and the challenge now is also getting digital ecosystem to integrate, provide for the interoperability between all its components. In the retail side, obviously, we have a winning portfolio of own brands. We have the two main drugstore brands in Brazil, Raia and Drogasil. And we also bought a start-up here, Conecta La, to empower our marketplace of an amazing seller center.

We -- last year was the beginning of Stix, which is our loyalty coalition with Grupo Pao de Acucar. So we have already 2.5 million customers who are enrolled at Stix, half these customers have already exchanged points for products this year. So this is a very important platform for large increase. We build organically our RDx [ph] which is our advertising platform. We're looking about digital advertising. We're looking about in store advertising solution. So we're in the beginning of RDx. RDx is already starting to help our profitability by driving advertising revenues. I mean, it's obviously in our platform, how powerful and important an advertising solution is. I mean, if you look at Amazon, I think Amazon does more advertising revenues than YouTube. Obviously, the example is there, MercadoLibre [ph] does it and we'll do that as well. For us, it will be very important, not only for the platform, but even for the physical world of our stores.

And finally, we became a healthcare company this year with several acquisitions. First, the Tech.fit acquisition that bought (inaudible) and merged them into Vitat. And the Healthbit acquisition, Healthbit is a startup that helps us reduce health claims for corporate clients as well as improving health outcomes for the beneficiaries of this client. So this is the entry door for the health platform to be offered in the corporate world for companies, health insurance, et cetera.

When I talk about access and (inaudible) to the prescription specialty, we have had Universe for a long time. This is our PPM, leading PPM in Brazil. We have had 4Bio which is the leading specialty pharmacy in Brazil servicing customers of health operators. And we acquired two more startups, Manipulae, which was in the end of 2020. This is an apothecary pharmacy platform. And end of year, we acquired Cuco Health, which is a company focused on adherence to the treatment. We want to get the team, the technology and put in place a much broader solution, bringing together not only a software that remind us, et cetera, but the dispensation, refilling the prescriptions, remembering the (inaudible) to get back to the physician. So when we integrate the dispensing side with the customer support, we can do things that can be very powerful here and Cuco will be instrumental for that.

And finally, consultation and diagnostics with these two amazing startups. Amplimed, Amplimed is an electronic medical record platform. It connects 20,000 physicians and other health professionals. It's not only the electronic medical record, but it's also the connectivity between the physician and the health insurer dealing. So it's (inaudible) ERP for the physicians. Amplimed is the data layer, the data repository for the whole platform that we put in place and the eternal that will connect our platform with physicians just carry consultations, telemedicine, et cetera.

And finally Labi Exames, this is a clinical (inaudible) startup omni channel. So it has 20 plus stores. It collects blood from customers or provide vaccinations at home. So we have a very powerful addition here to our ecosystem so that we can have our customers doing lab exams either directly at the Labi stores, maybe someday in our stores if we get the regulatory clearing which there is not possible or collecting those exams at home with Labi. So this is a very interesting ecosystem that it's starting to operate in an integrated way. This is the challenge for this year.

When you talk about challenges and opportunities for the year, so this is not a lot of new things here. I mean, it's the same things we are already doing, but gaining momentum that accelerated digitization of the relation of the customer going beyond 9% of digital channel penetration. In order to do that, we have to improve the experience in the app. We have to reduce delivery times in major urban centers. We want to bring new models involving customer retention (inaudible). This year will be very important to strengthen and scale up the marketplace. So the seller center who comes here, the plan for logistics will come this year. Not the logistic -- not the three pillar logistics itself. This is something that will have to do as soon as possible with this year. We're focused on having the logistic master plan for us to use our stores and our DCs for 3P fulfillment. We want our customer should to be able to collect tomorrow any 3P items they buy today, they can go to one of the store and collect with zero delivery charge. This is the dream. This is the main differential in the marketplace, this is the only channel that leverages the 2,500 stores we have in the best neighborhoods of Brazil partly, good experience, et cetera.

We will also advance with Vitat shifting from this lifestyle journeys to chronic patients with more strength and healthcare needs. We have also to integrate some of these solutions. Vitat today works already integrated with '21, Vitat spaces which is like the top version of our health apps, but we will integrate with that with every single health hub. We have 1,500 health hubs. And finally, when we talk about the enablers, who keep transforming our IT infrastructure, converting systems to micro services, could bring in the systems to the cloud, eliminating bottlenecks and development, testing of gold, accelerating releases, et cetera, and focusing more and more on our data science capabilities.

And finally, evolve into a digital culture, more higher focus on the customer, higher focus on using data, disseminating more the agile management model that we already have and finally, changing the culture, less hierarchy, more flexibility, which will be more collaborative, innovative and to foster the (inaudible) stake.

And finally, sustainability. This is something this is something very important for us. We unveiled in May last year our sustainability program, which we call, Walking Together. We have eight macro objectives and 35 goals for 2030, that if we are successful and we will be, we can be by 2030, the corporate group that contributes the most towards a healthier society in Brazil. Already this year, we set several targets. These are not all of them, but the main ones, things related to engaging our employees in health programs. So if you want to change society in terms of health improvement, we have to start from inside. We have to start with our employees. So we are ready getting success and doing better than the targets we set here. We set also a lot of diversity targets, especially related to gender equality. We did really well in terms of women in executive leadership, we did well in women operational leadership. The number is very good here, but we went slightly down in functional leadership. So this is something we have to have a look at.

And in terms of supply chain, evaluating all our critical suppliers and critical categories, we did better than we expected. In terms of waste management, we also -- we are also progressing towards where we want to be but not exactly there. So -- but the message here is, we have this ambition and we have a program of detailed metrics that we look for the long term but also for the short term and that we'll keep updating the market of them.

And finally, the beginning of this year, we became part of the Bovespa ISC index, which is sustainability index. They have 46 companies selected. We had tried previously for two years and we didn't get. Then this time, we are part of the sustainability index and we're very proud of that. This is a collective effort by the company.

So these were our prepared remarks. We are now open for Q&A. Thank you very much.

Questions And Answers

Operator

(Question And Answer)

Thanks, Eugenio. And now we'll start the Q&A session. The first question is from Joseph Giordano from JP Morgan.

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

Joseph, unfortunate I'm not listening to your question. It's a technical problem. I don't know if it is just with me here

Q - Joseph Giordano {BIO 20154008 <GO>}

Can you hear me?

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

Now I can.

Q - Joseph Giordano {BIO 20154008 <GO>}

Okay. I couldn't hear the last call, sorry. So, thanks for taking my questions. So like as you know it was my question so that's the reason. Anyway, so I have like three questions here. So the first one is related to the returns you mentioned. So you basically reaching IRRS north of 25%. My question to you is the following, right. So back in the day digital was not part of the equation, when you ran like at the store model. So basically we had like a 10-year sudden dip kind of model and we incorporated the cannibalization of this round new stores based on your data. How do you treat the digital now, when you're thinking about the expansion plan? And then the second question here is still on the digital and the expansion is, how does it change the working capital profile of the store, right. Because in theory, the addressable market of the store is expanded by its radius of influence, right within digital, since 50% of the orders are actually click and collect. So that's my first question.

Second one goes into like the chains. So about 60% of the market is composed of drugstore chains, you are by far the largest 14% market share nationwide but if you take just changed its like just about 25%. When we look at this outside Brazil and take the U.S. as a reference. We have changed like, we are 60% of the market, but basically, like a two or three chains. So, the drugstore chain side is much more consolidated on this front. So my question is, how do you see like this trend is shaping up in Brazil, and how digital can really accelerate this? Thank you.

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

Okay, Joseph. Thanks for the questions. And I mean, you're correct in the first question. So historically, we were looking at a internal rate of return around 20%. This has always been our targets -- it's still the target. The thing is we have been exceeding our targets and we look at this internal rate of return, net of cannibalization. So cannibalization these days is lower than in the past. So there is more marginality in the new store revenues than we saw in the past and this is driving these returns.

The fact that, we are opening a new cities, the fact that there's less growth in the A and B areas of especially A areas of San Paolo. The fact that the brand is already is more developed than it was in the past, in the new markets that we were. So these are all the facts that driving this. And digital is another factor here. We don't look at separate businesses, physical and digital. Digital is an accelerator of the store business. Let's not remember that 90% of the digital sales are fulfilled in the store. The 50% is Click & Collect, plus neighborhood deliveries, plus shift from motorized ship-from-store, 90% of all the delivery come from the store.

Digital without the stores, it doesn't work in our sector, as simple as that. So, the reason the digital works so well for us, because the store is the customer acquisition machine. We are not spending much money in Google, et cetera. The store is just an onboarding machine, this is when the customer learns about the app, downloads the app, starts using the app and the store is the fulfillment machine of 90% of the fulfillment happening in the store.

So, we suggest are not as something separate, but that is an accelerator for this strategy, because we have digital as a new demand driver, and because there's less cannibalization in the end of the day, the comps today are higher than we saw in the past. We talk about cement increasing last year 7.5. And the obviously we did 12% comp growth. There are two quarters that were very easy. So they made store the number, but even if you look today, 9%, it's more -- we're talking 150 bps ahead of the price category.

So obviously, the effect of digital in the comp growth is already self-evident in my view and we expect to have real growth on a recurring basis, driving our productivity forward. In terms of working capital. In the end of the day, I mean, the way we manage working capital is we have our algorithms and the algorithms look at the store, the recent store demand, and they adapt the number of items on hand of each item based on recent demand, they increase they can reduce. For this algorithm, it doesn't matter if it's a pure digital transaction. If it's a pure analog transaction, if it's a click and connect, it shows in the system as one unit.

So two units or three units, so our system is already, it's already incorporating all these trends driven by digital. Okay, and then to your last question, I think this is a good comparison. I mean all the chains in Brazil have pretty much what we changed having the U.S.. Obviously, I mean, when you look at this figure, the -- the opportunity for consolidation is self-evident here. Easy to be exactly like the west, the three chains would be 60% of the market maybe not, maybe not, but for sure, I believe there's a ton of space for us to gain share. I mean, we are a huge company 26 billion in revenues. But let us not forget that we have only 14% in market share. Even if you put the contracted market share gain from the maturation of the existing stores maybe this is 16, 17, I don't have any doubts that you go to 20% of market share. But at some point (Technical Difficulty)

So I don't have the exact answer, which is I don't have a clue where the number will be in one year, two year, five years. But the trend is a very promising line and this is something that we are very happy about. Thank You.

Operator

Thank you. The Q&A session is over. Now Mr.Eugenio will present the final messages.

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

Okay. So first of all I mean thank you all for attending this conference call. I'd like to summarize some of the things we discuss here. I mean first and foremost this was an amazing year no matter what metrics we look. This was a year with an amazing top-line growth driven by our solid Brazalian expansion of 240 stores with great returns driven by 12% store growth. Same store sales were excellent as well. So we are in brilliant top line performance.

These top line performance translated into very good margin growth. The distribution margin grew a lot. EBITDA margin grew a lot. Net margin grew, both in absolute terms and in percentage terms. And despite the fact that we are investing so much in new businesses that are still not producing pretty much any revenues.

In the end of the day, the free cash flow that we generated was neutral. So, we have a very healthy business, generating a lot of cash flow, allowing us to increase our CapEx, allowing us to invest in G&A and still have a neutral free cash flow in end of the day and still standing with a very healthy and low leverage ratio, despite the fact that we paid way more interests on capital and dividends than before and despite the fact that we invested on a cash basis, I think except like BRL130 million to BRL140 million in new startups. So the ability of the business to be profitable, to generate value in the future and in the present sorry and to fund the future.

This is I think one of the strongest points about the company. When you talk about the future, obviously the New Pharmacy is a reality. This is not a dream anymore. It is not future anymore 9% of our revenues are coming from digital on a annualized basis. This is already a BRL2.4 billion business. Our digital probably like the seventh largest chain in Brazil already and it will keep rising in the rankings. It's amazing what we did in terms of health services, how we're able to support the population during the pandemic before military tests. A lot of COVID vaccines, in partnership series advancing general vaccination with three times in main stores than we had before.

So this is, this is all happening this is today, marketplace and health platform of our future. I think marketplace is progressing well. We already have a pretty significant number of SKUs in the platform. We have I think 80,000 SKUs, 300 sellers already connected. We will now keep improving this execution by implementing the new seller center of the start-up we invested. We are devising as I mentioned before, our master plan for the logistics. So that we can do triple logistics just as well as we do one logistics in order to allow any customer who buys a triple item today to collect tomorrow at our store for free because we are using existing GC infrastructure, existing truck infrastructure.

I'm not saying marginal costs are zero, but I think with the assets we already have, they do allow us to be very cost efficient in this. And when you get the power of our capillarity covering 91% of the A class within a mile, high level of convenience, best -- in Brazil, easy parking, the great experience. Nobody has this kind of value proposition. They can now be translated to the triple. There may be other marketplaces. Okay, they have click and collect here and there, but nobody with the kind of capillarity we have, kind of proximity we have, kind of convenience we have. So this would be absolutely unique about our marketplace and we are exactly are now developing the plan to be able to implement this logistics over the next couple weeks.

It won't be easy, it won't be easy, it will take time. But I think what we can do here in the marketplace is transformational stuff and the same for the health platform. We inherited a lot of solutions from more like lifestyle things, eating well, exercising, et cetera. Now we're going towards the real chronic needs, integrate solutions with prescription, integrating of all our health apps. So it's a very and may be heavy B2B version of our platform. Then we can offer for corporations and health issuers, then and can help reduce medical claims while improving the outcomes of their beneficiaries.

So, we are addressing on all these fronts. There so much to do of course, but a lot has been done already. In terms of the short-term trends. Obviously, we had pressure this quarter. We will have pressure next quarter for sure. Because they flash the inflation gap was to be around, even if the inflation now stabilize are all 10%. We're still talking about a price cap increase that we had in March last year, there was much lower than that.

Our store comp are great, but not as high as inflation right now. But in the second quarter end of March, when the price gap adjustment happened and given the productivity factors that were already unveiled by the government, it's shaping up to be a full flush and are increase will be able to recompose inflation and to rebalance and re-dilute all our expenses. So we have no worries whatsoever about the year. I think this is shaping up to be a great year. Second quarter there'll be a lot of inflationary game of adventurous the price cap readjustment and will support us to at least maintain margins, dilute expenses and getting back to where we were.

So obviously, we all have to navigate the short-term pressure as well as we can. It was good to see gross margin growing and mitigating some of the pressure we'll see how it plays out in the first quarter. First quarter is challenging, because January is a vacation month, February is a short month. There's carnival et cetera. But when you go to the second quarter, we're back in business and nothing that is happening now is a surprise and nothing that is happening now affects the structural variation, potential corporate. So, thank you all for attending this call and thank you all for your support to Raia Drogasil. Bye.

Operator

RD's conference call is now over. We thank you all for participating and wish everyone a good day.