Q4 2012 Earnings Call

Company Participants

- Claudio Roberto Ely, CEO
- Eugenio De Zagottis, IR, VP Corporate Planning

Other Participants

- Andre Stolfy, Analyst
- Howard Siegelbaum, Analyst
- Irma Sgarz, Analyst
- Jeffrey Fuhrer, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time we would like to welcome everyone to RaiaDrogasil's conference call to discuss its results for the Fourth Quarter of 2012. The audio for this conference is being broadcast simultaneously through the internet in the website www.raiadrogasil.com.br/IR. In that address you can also find the slide show presentation available for download.

We inform that all participants will be in a listen-only mode 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. (Operator Instructions.)

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 RaiaDrogasil 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 RaiaDrogasil and could cause results to differ materially from those expressed in such forward-looking statements.

Today with us are Mr. Claudio Roberto Ely, CEO; Mr. Eugenio De Zagottis, Investor Relations and Corporate Planning Vice President; and Mr. Gabriel Rozenberg, Investor Relations and Corporate Planning Director.

Now, I'll turn the conference over to Mr. Claudio Roberto Ely. Sir, you may begin your conference.

Claudio Roberto Ely {BIO 15364128 <GO>}

Welcome to the earnings presentation relative to the year and the Fourth Quarter 2012. Now, Mr. De Zagottis will run the presentation. Let's go.

Eugenio De Zagottis {BIO 7193695 <GO>}

Thanks, Claudio. Hello. Good morning, everybody and thanks for your presence in this conference call.

2012 was the first year of RaiaDrogasil operations as a combined company. We announced the merger on August of 2011, then we completed the transaction in November of 2011. And finally, last year we operated for the full year as a single combined company.

We ended the year with 854 stores in operation. We basically opened 101 new stores through the year and we closed another 13 stores.

We posted gross revenues of BRL 5.6 billion. This represents 18.3% annual growth over 2011. And that represented a loss of 11.6% for same store sales growth. Our gross margins reached 26.7% in the year, a 1.1percentage point margin increase. And we posted an adjusted EBITDA of BRL 326 million, an increase of 20% over the previous year, which represented an EBITDA margin of 5.8% during the year.

As for the Fourth Quarter, we posed an EBITDA of BRL 83 million, which corresponded to 5.6% EBITDA margin. And finally, net income was BRL 154 million, 2.8% of net margin.

On page four we see that 2012 was another strong year in terms of growth. And even though we had significant costs and expense pressures, it was still a year of margin expansion. When you look at our track record, and I don't think you have to look to the ancient period, but let's say if we get back to 2007 we see basically that from 2007 to 2012 RaiaDrogasil, we basically -- we more than doubled our number of stores in this period. We increased our revenues from BRL 1.8 billion to BRL 5.6 billion in only five years. And we increased our EBITDA from BRL 70 million combined 2007 all the way to BRL 326 million.

I'd say, if you think about it, I mean, out of the stores we currently open -- we currently operate, they have been open over the last five years. So half of this Company was build over the last five years. So I guess that's the main testament to the quality of the growth that we have had, that even though we built half this Company in the last five years, we still managed to achieve significant EBITDA growth and significant margin expansion over the last five years. And we believe we'll certainly see this trend going forward in terms of healthy top-line growth with margin expansions.

Last year, in page 5, we maintained our industry leadership, both in revenues and in store count, according to the Abrafarma ranking. And we built a difference in 10% in terms of revenues when compared to the second player in this industry, that by the date that we merged, they were pretty much the same size that we had by then.

And on page six it's also important to mention that last year was another significant year in terms of market growth, as the market grew 15.6%. Over the last five years our industry has been growing out by 15% a year. I would say this is quite significant. And even more important than that, real generic growth is far outgrowing supply in the drugstore industry. We have seen real demand expansion of 10.5% for pharmaceuticals versus only 4.1% of supply growth, meaning new -- the total number of drugstores is growing out by 4% in the last five years.

And if we look back only for the last two years, we have seen the number of pharmacies increased by 2.3% in 2011 and 2.1% last year. So in spite of the significant growth that has been pursued by all the top chains in this industry and I would say that has been quite relevant, that we still have seen supply growing way, way below demand. And this has been translated in a significant efficiency proven by the main players.

On page seven we delve on the main driver for the market growth that we have seen and I believe we are yet to see in the years ahead. The elder population in Brazil above 65 years old is growing out by 4% a year. The age of -- the speed for the population of aging in Brazil is also something quite remarkable. According to a study by the World Bank in 2011, Brazil is coming from 7 -- the elder population in Brazil is coming from 7% to 14% of the total elder population in only 21 years that have just started in 2011. In China we also see fast growth, the same type of aging would take 26 years to complete, but China is already in the middle of the process. So Brazil is actually beginning.

Then, when we compare to more developed countries, we see that it took almost 70 years for the United States to achieve the same type of aging. And it took more than a century for France to achieve that aging standard. So this is the main driver of the growth we have seen in the past and of the growth we will keep on seeing ahead. So I would easily state that we have two decades ahead of us of probably double-digit market growth. I don't know if it's 10, 12 or 16, but I wouldn't expect to see this market growing anywhere below 10% for the next 20 years. And as a result, you will see the annual per capita spending there in Brazil still quite low for pharmaceuticals growing a lot over the next few years.

I believe that demographics in this industry is way more important than the economy. We can never create improvements or considerations in GDP growth affecting our numbers from one (inaudible) to the other, from one year to the other. I believe our life is much more depending for us demographics, which is a long-term trend, and then on the industry dynamics itself.

On page 8, as I previously mentioned, I mean we are seeing the top 5 players accumulating significant share over the years. And since demand is outgrowing supply, basically what we have seen is that these top players, they are capturing a disproportionate share over the industry growth. So the bulk of the growth, as you've seen, is not taking revenues away from preexisting players, but it's capturing the lion's share of the market expansion.

So over the last eight years we have seen the top 5 drugstores coming from 16% to 29.3% of the market. And more than that, as demand is outgrowing supply, revenues per store for the top players is growing significantly and the gap, vis-a-vis the other players in this group in the industry is expanding at a very fast pace. So when you put together the scale benefits that the leaders are getting with the efficiency of having higher revenues per store, for me this is a very powerful combination and this is a (inaudible) for the authorization of the markets.

Paradoxically, last year we saw the top 5 players growing out by only 0.l percentage point. Even though RaiaDrogasil, from December to December, we increased market share by 3%. So what we are starting to see is basically some of the top 5 players, they're losing share and some of the top 5 players, including us, are gaining market share. But as a trend, we would still expect to see this figure going up over the next years.

Hygiene and personal care, as shown on page 9, last year was a year of significant growth according to (Abipac). And we don't have the full numbers for the year, but from January to October the market was growing by 18%. And should the markets have sustained that pace of growth, the Brazil hygiene and personal care market should have reached something like BRL 35 billion last year.

But more important than that, we keep seeing drugstore chains gaining market share at a significant pace, while drugstores are bleeding market share at a fast pace. So in five years drugstore chains came from 11.5% to 16.5% of the market, while supermarkets, they dropped from 59% to 52% of the market. So this is quite significant. So when we translate the share shifting in total volume gain, total revenue gaining, we see that the drugstore chains -- and this is not only top 5. This is drugstore chains as a whole. They have gone up by 126% on a cumulative basis over the last five years. So 17.7% per unit average, while supermarkets went up by only 39%, which is 6.8% a year, slightly ahead of (inaudible).

So we are in the middle of a format war in which the superior convenience and execution and shopping experience in the drugstore chains has translated in a massive share gain at the expense of the supermarkets. And I believe this trend is supposed to go on.

On page 10, talking now about the year that we had, we reached 864 stores by the end of the year by opening 101 stores and by closing 13 stores. Most of these closures are related to synergies, so stores that are underperforming and they are close to each other. And we are being able to close one store and driving volume to the surviving one. As of now, mature stores represent 65% only of the total store portfolio and 35 are stores that have yet to mature and they are relatively well distributed between year 1 and year 2 and year 3 stores.

On page 11 we -- the opening pace we had last year, the out-sale was significantly derailed from August to November due to the incorporation of Raia by RaiaDrogasil. Basically, we had to relicense more than 500 preexisting Raia stores, meaning reapplying for every single tax, operation or sanitary license. And also, the new Raia stores actually postponed so that they could be opened after the incorporation and they could be opened already with the new -- under the new company because, otherwise, we would have problems migrating to stores from Raia to RaiaDrogasil.

And after -- so we completed incorporation in the end of November and December was a very, very strong month in terms of new store openings. We basically opened 42 stores in the Fourth Quarter of last year and 29 in December alone. If you compare 2011, we had opened I think 18-19 stores only in -- 19 stores, actually, in the last month. And this year we opened 29 stores in December alone and a lot of those stores concentrated in the end of the year.

Needless to say, all these stores that we opened at the end of the year, they only posted during 2012 pre-exit, pre-operational expenses. And the negative results of the initial merger of operations. So they have been a significant pressure driver for our margins on the start up, but I believe they will be paramount for our growth and margin expansion to take place coming forward.

On page 12, talking about the market, I mean, the main highlight of the year was our entry into 3 new markets; Mato Grosso and Mato Grosso do Sul with 6 stores each, and then Bahia with 10 stores. Bahia is basically our entry point in the Northeast. Private sector is a growing market in Brazil, a big (inaudible) and frankly relevant market, where I think we'll build a growth story over the next 5-10 years there. So that's for me a major milestone for the Company. And in addition to the three new markets, we also opened 11 stores in Santa Catarina, a market we entered the year before. But a lot of stores came last year. So four new regions. I think that was a significant expansion that we undertook in the year.

Let's talk about market share. We added 0.3% of market share last year. We -- I would say the main highlight were Sao Paulo, where we reached 22% of market share. And we will still see our market share in Sao Paulo going up over the next few years because we have a lot of growth opportunities here to undertake. Spirito Santo was another highlight where our market share came from 9% to 9.7%, and Rio de Janeiro, where we came from 5.1% to 5.8%.

There were a couple markets in which, as a function of not opening almost any stores, we lost some share, like in Brasilia. If I'm not mistaken, over the last two years we haven't opened a single store in Brasilia, so we basically was going to less market share there than we had initially. In Minas Gerais the same happened. We haven't opened stores in Belo Horizonte lately. Then, I think there's only one market where we lost market share and that's because of operations, which was Parana.

Basically, our operations in Curitiba, I think they suffered as a function of our growth as we took people from Curitiba initially to operate our new stores in the countryside, then in Porto Alegre, then in Santa Catarina. And as a result we have an operation with a lot of people. They are probably not well prepared.

So we are now focusing a lot on that operation. We're starting growth in the south for better (inaudible) and we have an action plan there. And I mean, it's just one of the pains of growing, like the way we did. So here, I believe we probably went ahead of what we should have done in terms of development speed, but it's something that we will fix.

Then for the new markets, we reached already in the first month of December, 4.9% in Mato Grosso do Sul, 2.8% in Mato Grosso and 0.9% in Bahia (inaudible).

Talking about our comps, our total revenue increased last year by 18.3%. And in the Fourth Quarter we grew by 14.9%. The same store sales grew 11.6% in the year, 9.1% in the last quarter. Then mature stores grew 8.1% in the year, which is a very, very good number, and 5.3% in the last quarter. It's important to highlight that we had an unfavorable calendar that impacted our comps by 1%. So on a level playing field, so to speak, mature stores would have grown by 6.3%, which I think is a reasonable number, and same store sales would have grown by 10.1%.

And another point is that, as you may remember, in 2011 we started the year with softer comps, especially in the case of Drogasil. Then those comps went up on a quite significant way in the end of the year. So when we talk about 8% of mature store growth for the year, we had the benefit of a relatively weak comp for most of the year, but then on the First Quarter we have seen a very robust comp of 8.1% on the Fourth Quarter last year. So both because of the strong comp base of the Fourth Quarter and because an unfavorable calendar, I believe we had sort of a deceleration taking place on the Fourth Quarter. But for me, it's a healthy and robust Fourth Quarter as far as comps.

As we enter now in the First Quarter of the year, the comping is a factor and the calendar effect, they will be even (inaudible) because we'll start now comparing almost with an impossible comp of 10.8% for the mature stores that we achieved in the First Quarter of last year, and we have a calendar effect of 2% in the First Quarter; not only because we didn't have a leap year this year as we had last year, and also as Easter is starting in March, this is also negative for sales. So for sure we will see tough -- we'll see sort of weak comps being posted on the First Quarter of this year. This has also been contributing -- contributed because of the weather, inclement weather in Sao Paulo, a lot of rain.

But I believe as we enter the Second Quarter with a good calendar and with a reasonable comp base, I believe our comps will start getting back to normal. So if our long-term trend for mature stores is inflation plus 1, so inflation plus 2 last year was north of inflation plus 2, I would say this year it could be inflation to inflation plus 1 for the whole year, but not for the First Quarter for sure.

On page 14, talking about product mix, generics were the highlight of the year, where generics grew for the year 25.6% versus 18.3% for the whole company. As a percentage of the total mix, generics went up from 10.5% to 11.2%. And in the Fourth Quarter from 10.8% to 11.2%. Hygiene personal care was also -- gained share in the year, 29.4% to 29.7%. And in the last quarter, 30.6% to 31%.

On page 15, talking about our gross margins, we posted 1.1percentage point margin increase over 2011, mainly due to the cost synergies achieved as a function of the merger. When we compare the Fourth Quarter, we grew the gross margins by 0.9%, even though we still have the negative effect from the new tax regime affecting our margins.

In the Third Quarter, as you may recall, the tax regime provided a negative pressure of 0.8% of total revenues. And we have managed to negotiate half that pressure and to pass them back to the suppliers who generated that loss. So -- but, we still have embedded in our numbers a 0.4% transitory gross margin pressure due to the new tax regime.

So as we are now approaching a period in which we have BRL 100 million in all the tax credits to recovery and that was the single reason why we added the new tax regime. Probably through the Second Quarter, that recovery should be over. And we are at a point where either we manage to balance this remaining 0.4%, either by negotiating with our suppliers or maybe if something changes in terms of tax calculation, but most likely, if none of that happens, at some point, probably in the Third Quarter, we'll probably go out of the tax regime. So we'll see. But this is a pre-operation pressure that should be recovered in the second semester of the year. But even with 0.4% of margin pressure due to the tax regime, we still posted a very good 27% of gross margin due to a very strong quarter in terms of trade allowances.

In terms of trend, I don't think we could assume 27.1% plus 0.4% as the 27.1% is a very strong number. But I think it's -- it could be likely that, after the taxes are fully recovered, we could be somewhere north of 27%.

In terms of cash cycle, we had a very cash consuming first half of last year. We improved remarkably that on the Third Quarter of the year. And now, we have a slight cash cycle pressure here, especially due to the fact that Raia was being incorporated by Drogasil. We added an inventory buffer as a safety precaution in case that the changing -- the fiscal advantage would prevent us from receiving products from suppliers. So we increased our inventories to support the transition. Then that wasn't even required because everything went alright, but it's something that we will balance and we'll get back to levels of say similar to those of the Third Quarter.

This gross margin was the great news of the year. For sure, the villain was sales expenses. Over the whole year we increased sales expenses by 1.3%. And in the Fourth Quarter that increase was 1.4percentage points.

So on the right we depict the main sources of sales pressure in the year. Payroll was the main factor, 0.6%. Part of that payroll is people deployment. Then, there is a more structural component, which is real rate increases. I believe payroll and rental also went up by 0.1%, and the Fourth Quarter 0.2%. Rental is absolutely structural as the real estate market is appreciating a lot and our rentals are going up as a consequence. So both rentals and payroll, I don't think they can be reversed, although I do not expect us to have the same level of pressures that we had last year.

But then, we have another part of expense pressures that I think are very transitory and they are pretty related to our growth. One is logistics. We have had -- over the last three years we have come from 2 to 7 distribution centers. This year -- last year alone we had the 2 new distribution centers, one in Rio in the beginning of the year and the second one in the countryside of Sao Paulo, which is our largest distribution center anywhere. So we had 0.2% of logistics price increase in the year and 0.3% in the Fourth Quarter. But the good news is that we do not need any new distribution centers either this year or next year. So over these two years I would expect to see logistics expenses getting back to where it was. So for me, this was really transitory.

And even more transitory than this is the pressure exerted by new stores of 0.2%. What happened is that a lot of our store openings last year, they took place in new markets where it just takes longer for the store to be open because we have to hire the people, we have to train the people. (inaudible) takes longer because there's a learning curve to be understood. But this year already, as we're not developing any new markets and as the bulk of our stores will open in mature markets, and also as this year our store development program is starting very strongly on the First Quarter, they'll be very balanced through the year, we will see, I think, a big improvement taking place. So much less pre-operation expenses because we're opening in markets where it takes shorter to open.

And the second part is that all the stores will be open in the first semester of the year. They are expected to be positive by year end. So while the 40-something stores that we opened in the Fourth Quarter of last year, all they gave us was pre-operation expenses and initial negative results from the first month of operation. So I believe the pressure from the stores will be much softer this year.

On page 17 we got a good level dilution in G&A, 0.3% in the year and in the quarter because as a function of our management unification. I mean, first -- I mean, we have some redundancy and, second, we're limiting new admissions. Not that it's completely zero; sometimes you need a new admission. But we believe we'll still have fat in the system. And this should be another year of very little new hire and another year of (inaudible). So when you think about margin expansion this year, I mean, for sure G&A dilution is important -- is an important component of that.

On page 18, talking about EBITDA, we posted an EBITDA margin increase of 0.1% in the year. That came from BRL 270 million to BRL 326 million. So it's a significant improvement in the year. And in the Fourth Quarter we lost 30 basis points of EBITDA margin. And here it's important to highlight that the calendar effect alone, as it represented 1% of total sales, pretty much explains this difference.

So under a same kind of calendar, our EBITDA margin would be in line with last year. So 0.3% is completely explained by 1% revenues. (inaudible) times 87% of gross margins. And that -- on top of that we also had gross margins pressure of 0.4% after the tax regime. That should be reverted in the second semester. We had -- even though it was mitigated by a strong quarter in terms of trade allowances, we had logistic expenses of 0.3%, which should be diluted in the next three years, and new stores pressure of 0.2% that should be diluted this year.

Another interesting way to understand the pressure that the new -- that the store opening program provides on our numbers, is to see that -- as you can see that the results, only out of 776 stores we had operating in the end of last year, so take the profitability of those stores and -- less the full journey of the Company, I mean, we would have had BRL 350 million of EBITDA. So we lost (BRL 225 million) EBITDA in the year only due to the new store openings.

So this is great in terms of future growth because the new stores will start now working and they'll start maturing in some time and then we'll see them becoming a source of profitability increase. But on the shorter term, on the year they have been opened, I mean, all we see is negative -- is bad news.

On page 19 we have a net income of 2.8% in the year and 2.2% in the quarter, which was impacted by financial expenses of 0.6%, both in the quarter and in the year. And this is basically due to the fact that we had a lower net cash position this year as a function that we employed cash to grow, than we had last year.

On page 20 we posted in the year no recurring expenses due to the integration of BRL 41 million. In the Fourth Quarter alone those expenses accounted for BRL 27 million. So BRL 14.6 million was integration expenses, then BRL 8.2 million or BRL 8.8 million were accounting alignments, basically some procedures that were still calculated different ways for some allowances for Raia and Drogasil. Then there is a small -- some tax write-offs that -- also differences in tax calculations across the companies.

And finally, BRL 3.1 million in the quarter came in from the closure of stores and the closures of higher corporate centers. So this is basically asset write-offs. And there's also BRL 12 million that doesn't goes go to EBITDA, it goes straight to the P&L, which is a write off of accumulated losses that Raia had. So as Raia was incorporated, that BRL 12 million had to be written off. But we have already started in December to book goodwill.

So in terms of (inaudible), December has already been backed up by goodwill but, in terms of cash, we'll see the impact on the First Quarter. Because basically in the First Quarter we're paying the taxes of the Fourth Quarter. So as we started booking goodwill amortization in December, we will see already in this First Quarter BRL 3.6 million in tax shield. So this was the cash savings in the First Quarter. Then from the Second Quarter and onwards, pretty much until the beginning of 2018, we'll see BRL 10.7 million tax shield per quarter, total goodwill tax shield will be BRL 235 million until 2018. So this is great news in terms of cash.

On page 21 we generated BRL 270 million in result of some operations. We consumed BRL 189 in working capital and BRL 258 million in CapEx. So we have (inaudible) cash flow to financial growth of BRL 168 million in the year.

On page 22, considering the share price we had yesterday by the end of the day of BRL 21.46, we see that the shareholders who invested in Drogasil (inaudible) 2007, they have accumulated an annual -- an average annual return of 26%. And the ones who invested in the Raia (inaudible) in 2010, they have accumulated an annual return of 36% in this period.

Finally, before turning to Q&A, we are proud of several accomplishments in this year as far as the integration of Raia and Drogasil. We did the management unification in the very beginning of the year. Several of our processes like purchasing, like corporate planning and now payroll, they are already integrated. We achieved significant cost synergies by negotiating with our suppliers. We have selected and prepared those systems for a rollout starting this year. And we did the incorporation of Raia by RaiaDrogasil, which I believe it's a (inaudible) effort as we had to relicense more than 400 stores and those licenses have all to be ready on a single day.

And now looking forward to this year, we are starting the First Quarter with 36 new store openings. This is an impressive level of store openings in the First Quarter. We are benefiting not only from having pushed stores last year to this year, because every single year before this year we built our pipeline pre-mergers. We moved forward with the new store. So our stores were -- our new stores were mostly open at the end of the year. So this year a good side effect of the incorporation is the fact that we started the year with a strong pipeline that will allow us to open stores on a much better paced way through the year and have all these stores that have been opened, they'll be open the first semester of the year turning a positive profitability before the year ends.

So 36 stores are already open in the First Quarter of this year. That's quite significant. And so, that for the last six months, both Fourth Quarter and First Quarter we have nearly 80 new store openings. I mean, this is an impressive level of growth for us.

We'll see this trend -- I mean, pushing our numbers coming forward, but of course that, as we move to the First Quarter of 2013, by having 80 new stores around, this will be a significant cost pressure because every year the First Quarter is pretty much a clean quarter as far as new store pressures. So if 80 stores open in the next six months we'll see a massive pressure in this First Quarter, but also we'll see a much better number going forward from the Second Quarter onwards as our openings will be more paced and as we'll see the initial stores helping with profitability before yearend.

Another thing to take into consideration regarding the First Quarter is that we have a gigantic comp rate as last year our mature stores have grown by 11%. So this is an impressive level of growth. And of course, that when we compare our revenue growth this year with what we saw in the First Quarter of last year, of course we will see small numbers. But we believe that as the Second Quarter progresses and as the Company normalizes, we will see then good comps coming forward.

We also will have in the First Quarter an unfavorable calendar of 2% of total sales. So this basically means that only the calendar effect will bring the margin pressure of 50 basis points in the quarter. So for sure it will be a tough and pressured quarter, but I believe from the Second Quarter onwards we're very optimistic; not only because we'll see the comps going back to good levels, we have this year a price increase already set by the government of 4.6%, which will provide a very strong margin quarter as every year in the

Second Quarter we have inventory gains on our -- inflationary gains on our inventories. So we have a higher (inaudible) than last year so this should translate in a high gross margin that we had last year. Then we'll see also the benefits of the paced openings.

So looking on the long term, we believe there's a significant growth opportunity (inaudible). I think the Company will see four years or five years down the road we'll be a much, much bigger company that we see today. We believe we will have margin expansion along the way, both because of productivity and because of maturation of -- partial maturation of stores at least.

But a growth trajectory like this is subject to quarter volatility. You cannot grow in the way we are growing without having quarter volatility. There are some stronger quarters. There are some tougher quarters. And sometimes people get tempted when they see a strong quarter to over-project for the next 10 years. Or when they see a tough quarter, to under-project for the next 10 years. I think we should be measured on both instances. And I think structural, the opportunity that we'll have, I think it's tremendous and that remains not only for the next years ahead, but even to this year, especially after the Second Quarter.

So this is all we have and we'll now open for Q&A.

Questions And Answers

Operator

(Operator Instructions.) Our first question comes from (Andre Stolfy) with AG Capital. Please go ahead.

Q - Andre Stolfy

Hello. You mentioned the unprecedented level of store openings for the First Quarter in comparison with the recent history of the Company. Do you feel confident that you may overcome the guided 130 stores for the year?

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

Thanks for the question. No. We do not believe we'll go beyond the 130 new stores this year. I mean, in terms of openings, for sure that could be possible, especially as we started strongly and especially as we have already more than 100 contracts signed for the year. So in terms of property development, yes; but in terms of our operations, I don't think that would be healthy.

As I mentioned before, what we saw and could achieve this year is quite an evidence of what happens when you overstretch your growth. So we learned our lessons and we'll have to be measured in the way we go. So it will be very good to be paced in our openings from the Second Quarter onwards, not only because of expense pressure, but because of the quality of the operation.

Q - Andre Stolfy

Okay. Thank you very much.

Operator

Our next question comes from Irma Sgarz with Goldman Sachs.

Q - Irma Sgarz {BIO 15190838 <GO>}

Yes, hi. Thank you for taking my question.

Just two quick follow-up questions from the earlier Portuguese call. Firstly, the higher tax rate on your P&L in this quarter, was that -- am I right to think that this was connected with the writedown of the accumulated losses on the tax assets from the accumulated losses at Raia with the incorporation and this was a non-cash effect? That's my first question.

Then secondly, I was curious to hear whether you're seeing any pressures in terms of either rental expenses as you're opening new stores or just in terms of even finding the point of sale in terms of key money, whether there is anything that is changing there. Thank you.

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

Irma, thanks for the question. You're right. I mean, the right thoughts that we had of the accumulated tax losses, it decreased a lot the effective tax rate in the quarter. Then, if you see -- we don't (inaudible) like the accounting quarter earnings. I mean, it was very low, so the tax also represented that. And also, I mean, this is completely non-cash event, so it's only an accounting effect.

As far as the property development, I mean, we are very happy with the quality of the stores we opened last year. And the quality of both of the stores we have opened so far and of the pipeline that we have for this year.

When you look at the market overall, we have rental pressures, but the stores that we are getting -- I mean, we are very diversified in terms of regions. So sometimes you'll see strong rentals, but we are always doing retail calculations. And regardless if the rent is high or low, whenever we decide to open a store it means that we are confident that we can provide the same level of returns that we have targeted for over the last years.

So there hasn't been any limitation nor capacity to grow in terms of property development. And I think rentals, for the new stores, they haven't been much of a problem. I think they had been a problem for the preexisting stores, because then the number is already built into our profitability and, as they go up, they pressure our numbers, so that's for sure.

Q - Irma Sgarz {BIO 15190838 <GO>}

That's very helpful. Thank you.

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

Thanks.

Operator

Our next question comes from (Jeffrey Fuhrer) with York Asset Management.

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

Hello.

Q - Jeffrey Fuhrer {BIO 5720651 <GO>}

Hi. Yes, so I have a question which is more a broad question. I'm looking in your company and you're not any more a small company. And what I see is -- I'm failing to understand the relationship between the expectation of growth and your return on capital. Because what I see is that on a per-share basis, on a GAAP basis, we are down in last two years in terms of GAAP earnings per share. The dividend per share is down. And what I'm trying to understand is that, if you need -- you have grown a lot through capital transaction with issuance of shares with -- at Raia and Drogasil. On the tough side of the merger, I'm wondering what was the benefit so far per share; per share, not as top line.

And I think that what people on the buy side need to know is, in order to sustain this growth, you need a return on capital employed, which is high. And you're not a small company anymore so, yes, you're growing. But if you keep growing you're going to need -- if you want to have a very high return on capital employed, you're going to need external capital again. So that's my question. Where should we expect and how can we understand the return on capital to sustain this growth story?

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

Jeff, thanks for your question. You are right. I mean, there is an absolute tradeoff between growing and short-term returns. I mean, you cannot underestimate that. I mean, just to show that, for the last year we had a new store CapEx around -- only the stores opened in the year of BRL 130 million. And those stores, they charge financial interest; those stores, they charge depreciation; and yet we have an initial negative result of BRL 25 million in the year.

So it's impossible to balance a growth process like the one we have with short-term numbers. We believe in return maximization, but our investment horizon I would say is quite long. When you see the opportunities that we see in the markets for organic growth, for consolidation, for the aging of the population, we are not trying to maximize the short term.

But something that we pay a lot of attention to is to be able to financially sustain the growth that we have. So we had last year a year of cash consumption. For sure that -- the fast growth has been financed by the equity raising, but going forward -- and I believe that -- even by the end of this year, I think we are getting very close to being breakeven in terms of cash consumption.

So for sure, the first semester of the year we'll still need cash, but likely when you see the whole year we probably will be either neutral in cash generation or even positive. Let's see. But (inaudible), I think it's quite (inaudible) confident to state that. And for sure, then when you go and think about the next years, it'll be -- we'll have cash generation. But the dividends per share would be low and the consolidated returns will be low because we (inaudible). We have 35% of our stores, they are fully paid for as far as investments, but they are very far still from their potential. So this is how we look at that tradeoff. So we do not (irregard) returns. We pay a lot of attention to returns, but there's a time window that we are looking at. It is a couple years and not a couple quarters.

Q - Jeffrey Fuhrer {BIO 5720651 <GO>}

Thank you.

Operator

Our next question comes from Howard Siegelbaum with HNC Capital.

Q - Howard Siegelbaum {BIO 17609560 <GO>}

Hi. Thanks for taking my question. In terms of the 36 new store openings in Q1, I'm wondering if those include the 26 stores in Goias that you had acquired.

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

Thanks, Howard. Yes. They include. I think the bulk of the stores, they have already been opened. Actually, yesterday we opened more than 10 stores there. I would say half of those stores that were located in regions that were complementary to where Drogasil originally was present. They have been opened as Drogasil. And the other half, they have been opened as Drug Raia. So this is really Raia's entry into Goias. And for there we have very strong asset quality. I mean, even though today was the first day, the couple stores that opened in the morning, I mean, they show good coverage for today -- for yesterday. It's still too early to call anything on that day. We have to look probably in a couple weeks and months. But that's an expansion which we feel very confident about because the quality of the stores that we have (inaudible).

Q - Howard Siegelbaum {BIO 17609560 <GO>}

Okay. Thanks. So my question was a follow-up to the question asked by the gentleman at York. And that's in terms of return on invested capital. If we thought about your return on invested capital, it's stripping out the stores that you opened this year and the net operating assets that you would attribute to them in terms of the inventory, the receivables, the PP&E. What type of return on invested capital would your core business have done? Thank you.

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

Well thanks for the question. Again, I mean, when you think about consolidated returns, I think we are at a stage because -- because of the pace of the growth we are having, I believe we'll still see our consolidated rise in pressure for quite a while. But for me, what's important to think of is about marginal returns. Whenever we take -- we open new stores, the type of modeling that we do we look at 10 years of free cash flow for the store. We assume, like, front and back after 10 years. And our threshold is a real internal rate of returns north of 20%.

So we are very confident that the store addition that we are doing will be significantly fairly weathered over the longer term. But again, when we see a year in which we are (inaudible) on CapEx, these stores they charge depreciation, they charge interest and they take out BRL 25 million of EBITDA. I mean, there is no good consolidated returns that you can see in the shorter term with (inaudible) like this. So our investment horizon is not the quite -- or is not the -- it's longer term. And we feel absolutely confident that we'll see in the longer term the consolidated returns going up.

Another thing that's a more technical thing is that when you look at our -- when you look at our invested capital, because our merger was not a purchase, it was basically only a share swap, the number is also penalized by the goodwill. So different from an acquisition we really pay for the goodwill and therefore, you have to be charged for the goodwill. We haven't paid our goodwill. We've -- our transaction was 43% of the highest store and 57 (inaudible). They could have done -- we could have done that at BRL 1 billion or at BRL 100 billion. So that's an artificial accounting fact that you also have to take into consideration when you calculate consolidated returns.

Q - Howard Siegelbaum {BIO 17609560 <GO>}

Great. Thank you.

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

Thank you.

Operator

(Operator Instructions.) There appears to be no further questions at this time. Now I'll turn the conference back to the Company for the final remarks.

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

Well thank you all for attending this conference call. Thank you, -- thanks to our shareholders for the support that we have seen since Raia (inaudible), since RaiaDrogasil -- at RaiaDrogasil and, finally, since the merger. And I mean, we feel absolutely positive that we are in a very positive trend in which, when you look at the Company 4 or five years ahead, we'll see a much bigger company, we'll see margin expansion. And even when we look at this year, especially from the Second Quarter and onwards, we're still positive that we'll see a good year with margin expansion.

So thank you very much and we remain available for all of you, for visits, for conference call and all other type. Thank you.

Operator

Thank you very much for attending today's presentation. You may now disconnect.