

## Q1 2011 Earnings Call

### Company Participants

- Claudio Roberto Ely, CEO, IR Director
- Roberto Listik, IR Officer
- Unidentified Speaker, Unknown

### Other Participants

- Alaina Anderson, Analyst
- Unidentified Participant, Analyst

### Presentation

#### Operator

Good morning, ladies and gentlemen. At this time we would like to welcome everyone to Drogasil's First Quarter 2011 results conference call.

Today with us we have Mr. Claudio Roberto Ely, CEO and Investor Relations Director; Mr. Ricardo Castro de Azevedo, Finance Director; and Mr. Roberto Listik, Investor Relations Officer.

I would like to inform you that all participants will be in a listen only mode during the Company's presentation. After Drogasil's remarks there will be a question and answer session for Company analysts. At that time further instructions will be given. (Operator Instructions).

Today's live webcast, including both audio and slideshow, may be accessed through Drogasil's website at [www.Drogasil.com.BR/IR](http://www.Drogasil.com.BR/IR). The slideshow presented by management today is available on the website in the Investor Relations section.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Drogasil management and on information currently available to the Company. They involve risks and uncertainties, because they relate to future events and, therefore, depend on circumstances that may or may not occur.

Investors should understand that conditions related to macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

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Now I will turn the conference over to the CEO and Investor Relations Director, Mr. Claudio Roberto Ely, who will begin the presentation. Mr. Ely, you may begin your conference call, sir.

## **Claudio Roberto Ely** {BIO 15364128 <GO>}

Good morning. Good afternoon. We thank you for all for attending Drogasil conference and call and webcast for the First Quarter 2011. At this moment I would like to transfer the presentation to Mr. Roberto that he will handle the presentation please. Mr. Roberto, proceed.

## **Roberto Listik**

Thank you, come Mr. Ely. Highlights to be covered in this conference call, first, we ended the First Quarter of 2011 with 343 stores, in our relation of five new stores. Second, same-store sales growth of 4% and sales growth of 13.3% in this First Quarter 2011.

Third, net profit of BRL11.5 million. Addition of BRL20.2 million in the First Quarter 2011. That resulted in EBITDA margins of 4.1% of gross sales or 4.3% of net sales.

Please next slide. The subject is gross revenue sales. We closed the First Quarter 2011 with gross sales increase of 13.3% over First Quarter 2010. It amounts to BRL63.9 million.

On March 2011 average monthly sales per store was BRL561,000, 21.1% above IBRA Pharma [ph], the Brazilian drug store chain association. Monthly average sales per store without (inaudible).

The average ticket for the Brazil was BRL39.7, an increase of 3.3% over First Quarter 2010. And receivable method was 65% cash.

We closed First Quarter 2011 with 343 stores. And now we added five new stores, present in six states and 88 Brazilian cities, with two distribution centers.

This First Quarter 2011 represented sales area growth of 17.4% and a total area of 45,200 square meters.

Please next slide. Same-store sales growth increased in the First Quarter 2011 in comparison to First Quarter 2010. Criteria [ph] stores less than three years represented 24.4%, or a variation of BRL11.4 million. Stores more than three years represented 1.7% or a variation of BRL7.1 million. In the period total same-store sales index growth was 4%.

The comparison basis for (inaudible) index in the First Quarter 2010 had a growth rate of 20.2%. The growth rate for maturing stores did improve the same pace. So (inaudible) First Quarter 2010 with 47.1%.

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Same-store sales contributed into revenues sales increase with 287 stores. And total amount of the BRL18.6 million.

Please next slide. In this slide a static picture of new store openings and portfolio of stores (inaudible) of age. This is presented on (inaudible) Fourth Quarter 2012.

At the end of First Quarter 2011, 69% of our stores are stores with more than three years of operation, comparatively to 63% in the First Quarter 2010. As we may observe, 55 new stores inaugurated in 2010, (inaudible), mainly at the Third Quarter 2011.

We should emphasize that monthly averages for Drogasil is computed to the Brazilian Drugstores Chain Association, IBRA Pharma [ph], monthly average sales is 21.1% based March 2011.

This sale comparison criteria applied on March 2010 represented 37.6% above the Brazilian Drugstores Association monthly average sales.

Please next slide. Gross sales breakdown. In this slide measures segment that belong to Drogasil sales breakdown [ph] highlighting this First Quarter 2011. Drogasil once more presented nondrug segment increased intra [ph]-revenue sales weeks on total sales of BRL162.7 million.

Another highlight in this First Quarter 2011, generic drug sales increased their share and the sales mix by 90 BPs compared (inaudible) on total sales of BRL55.3 million.

Please next slide, drug market share. The comparative match March 11 over March 10, Drogasil closed with a drug market share of 4.5% nationwide. We registered drive marketshare increase in Brasilia, Espirito Santo. And drug marketshare point in Rio de Janeiro.

Store openings in this First Quarter 2011 were two stores in Espirito Santo, one in Goias, one in Minas. And one in Sao Paulo. Espirito Santo with 12 stores in operation starting as of July 10, of 2009 registered a 7.6% drug marketshare.

Please next slide, gross margin. The criteria is comparison to gross sales revenue. Gross profit increased BRL12.1 million year-on-year. And gross margin dropped 40 basis points in comparison to drug sales. This reduction is originated by (inaudible) established by Sao Paulo state tax authority as of January 1, 2011 intra [ph] drug segment.

The (inaudible) moved from 33% or 38.2% to 49.2%. And 68.5% for (inaudible) similar on OTC drugs. This increase as regards (inaudible) is mitigated by inventory level at the end of fiscal year 2010 with 57 days. Nondrug segment increased in the sales mix of 180 basis points.

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Consider the compounded gross margins with other operating income, mainly cash market on store space rentals, gross margins posted on the expansion of 50 basis points year-on-year.

Please, next slide, SG&A. The calculation criteria is addition of selling, general and administrative expenses and Board fees. SG&A expenses increased BRL24 million and 230 basis points compared to gross sales year-on-year.

In this quarter still represents pre-operating expenses related to new store openings, mainly 17 stores concentrated during the last 60 days of the previous year.

Please next slide. The subject is net profit. Net profit totaled BRL11.6 million in this First Quarter 2011. In this First Quarter interest income increased 103% or BRL2.6 million. We ended the First Quarter 2011 with net cash of BRL122 million. And net worth of BRL602.4 million.

Please next slide. The subject is EBITDA. EBITDA margin dropped 140 basis points year-on-year on total BRL22.2 million. In this First Quarter 2011 SG&A increased due to pre-operating (inaudible) of (inaudible) related stores mainly concentrated during the second half of 2010, contributed to this performance.

Other operating income considered only cash markets and store space ramping. For example, an expansion of net 90 basis points year-over-year.

EBITDA inventory days at fiscal year 2010 end. Nondrug segment increased in Drogasil's next mix. All of that offset the IBA [ph], (inaudible) markup increase in the compounded gross margin.

Please next slide. (inaudible) of working capital. Next two slides being assets of Drogasil working capital. The graphed criteria is unit in thousands. We ended fiscal year 2010 with 57 days inventory sales, 24 days at distribution center and 32 at store level.

In fiscal year 2009 we ended with 51 days, 24 at distribution center and 27 at store level. First-quarter 2011 (inaudible) 73 inventory days. They eight days of distribution ended and 34 days at store level, 13 days above First Quarter 2010 end. The inventory days increase is originated by forward buying to drug price adjustments.

Please next slide. Working capital it is not (inaudible) that we mention that Drogasil pharma retail sales were 55% cash in this First Quarter 2011. In this First Quarter additional working capital represented BRL70.5 million, or 13% of gross sales.

Cash cycle represented 73 days increase, or 17 days year-on-year. This increase is originated by inventory days increase, as explained before. And related tax credits to recover that added three days in comparison to First Quarter 2010.

Please next slide. On March 28 we celebrated 76 years of Drogasil business. We ended the First Quarter 2011 with 1,400 employees more than First Quarter 2010. And inaugurated five new stores. Our sales have increased 17.4% over First Quarter 2010.

To shareholders we accrued interest on capital of BRL8.1 million in this First Quarter 2011, 29.5% superior to same period 2010.

With the (inaudible) general meeting approval, complementary dividends of BRL3.3 million were added to interest on capital (inaudible) and accrued in 2010 by Drogasil. So turning [ph] BRL28.9 million or (inaudible) out of 32% in 2010.

In fiscal year 2010 we started to pay interest on capital during the same fiscal year accrued. Where accrued for first; and Second Quarter were a credit to our shareholders and December 2010. Next, May 31, we (inaudible) credit dividends on interest on loan capital of BRL14.3 million that we accrued in 2010.

As I proved to you earlier, increase in stock liquidity, particularly for Drogasil DROG3 since January 2011 is part of (inaudible) portfolio for ICON Consumption Index, a new index developed by the Brazilian Stock Exchange, the IGCT Corporate Governance Trade Index.

In May we have been added to the new index, Brazil Broad-Based Index, as well small-cap index. Drogasil has presence in six Brazilian BOVESPA indices.

We remain available to take your questions and comments. Thank you, very much.

## Questions And Answers

### Operator

Thank you, sir. The floor is now open for questions. (Operator Instructions). In case you are following the conference call via webcast, please click on question to the host to send your question to the Company's executives, recalling that each participant can ask just one question. Please hold while we poll for question.

Alaina Anderson, William Blair.

### Q - Alaina Anderson {BIO 4893045 <GO>}

Thank you for taking my question. My question is regarding the theoretical markups, or the IEA that was introduced in Sao Paulo. Could you explain better what that is and how we should expect it to impact margins going forward for the rest of the year?

Then my second question is regarding marketshare. From your presentation, from the press release it looks like you lost marketshare in most of your major regions. Maybe you could talk about competition or what is affecting your marketshare in major regions?  
Thanks.

## A - Claudio Roberto Ely {BIO 15364128 <GO>}

Good morning, Alaina, thanks for the question. First of all, what is this IGA and how it is related to the operation.

The VAT advance that was established back on 2008, basically in order to collect this tax in advance there are some theoretical markups developed by each Brazilian state tax authorities.

In Sao Paulo's case, they were until January 1 this year, 33% and 38.2%, intra-drug drug segments. As of January 1, they moved. Basically this theoretical markup means that on top of the net price established by the supplier, he applies this markup. And collects on top of that the tax rate -- the state tax rate, which is in Sao Paulo's case is 18%.

To refer with examples about that, in our Investor Relations website there is a presentation -- by the way, it is the last presentation that we developed. There are three examples of generic drugs and two branded drugs that were exactly at 33% and 38%. And we explained in very detail what is the impact.

Summarizing, or making net net, if we apply our 100 days analysis this represent, or could represent, potentially up to (inaudible) 2.3% up to 2.7% in margin -- in margin impact.

The conclusion that we get from the First Quarter is that Drogasil could manage that in a very efficient way by two reasons. The first one that we ended the fiscal year in 2010 with 57 days of inventory. So we passed the month of January and part of February with the previous price in our inventories. So for the remaining part of the First Quarter we had to, of course, face these new theoretical markups.

Second, we mitigated this impact also by establishing via the ways of cash marketing and store space rentals to mitigate this impact in our compounded gross margins.

Ahead, what we may face ahead. As you know, the drug prices are adjusted on March 31 - each March 31. So we took advantage of this, or we took the opportunity of this drug price adjustment to also adjust our ways of discounting to end consumers. Now we may say that this is already the impact of these gross margins are managed in our efficient way by Drogasil.

Your second question is related to drug marketshares. I think that in some regions we are expanding our drug marketshare. But as we don't -- we cannot also forget the impact of these distortions that we have on IMS data collection.

But, anyway, what we may understand that in the regions of Sao Paulo and Minas Gerais, we have not expanded the number of stores as we did in other regions. From the 57 stores that we have inaugurated last year, most part of this inauguration is related to Brasilia and Goias. We didn't expand in Sao Paulo so much as we did in other regions -- Sao Paulo and Minas.

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We are starting to do that, especially concerning Minas, in this year. If you -- currently Drogasil as of today have 346 stores. And so far we have inaugurated two new stores -- three new stores in Minas Gerais. So I think that explains also that we have placed more effort in other regions than in this consolidated market that we have in Sao Paulo. I hope I was helpful.

**Q - Alaina Anderson** {BIO 4893045 <GO>}

Yes, thanks.

**Operator**

(Operator Instructions). Alaina Anderson, William Blair.

**Q - Alaina Anderson** {BIO 4893045 <GO>}

Just a follow-up to the marketshare question. Understanding that you have expanded more in -- outside of Sao Paulo and Minas Gerais, the information that you have in the press release shows that the drug retail market grew, I think, 18%, while drug sales at Drogasil were up 10.5%. So can you talk about how you normally grow in relation to the industry? Is that industry statistic relevant for the market? Because it seems to imply that you're getting outpaced by the market. So I just wanted to clarify that.

**A - Roberto Listik**

In fact, the data that I put into pharma -- about the pharma retail is concerning the Brazilian Drug Stores Chain Association. This is related to the overall pharma retail, not only drugs.

In this comparison what is established that the pharma retail in Brazil during this First Quarter 2011 presented a growth of 18.9%. Drogasil's sales increased only 13.3%. I think that this is what you are referring.

Yes, I think that this comes to back to our base of comparison. This is very particular to each company. In the First Quarter 2010 we presented sales growth of 26%. And we are comparing a very strong basis. We have a very hard comparable between Drogasil sales in this First Quarter 2011 compared to last year.

In fact, if you look at the full number -- the full (inaudible) statistics, we are behind in terms of sales growth. But, again, we had to be reminded that we have a hard comparable from Drogasil to last year, (inaudible) quarter 2010.

**A - Claudio Roberto Ely** {BIO 15364128 <GO>}

In the First Quarter we increased 26% of revenue (inaudible) related to 2010. In the first nine months of the last year we increased 18%. At the end of the year we were an accumulated 16%. It means that while comparing -- have a comparison with the most stronger quarter that we have in the last year.

I'm sure that in the next quarters we had covered the participation of the market. Okay. At this time the market increased, I don't know, probably 20% or -- it increased more in the last year. And the base of the comparison is so high.

**Q - Alaina Anderson** {BIO 4893045 <GO>}

Okay.

**A - Claudio Roberto Ely** {BIO 15364128 <GO>}

Thank you. Thank you for the question.

**Operator**

Nick Dennis [ph], Pickpack [ph].

**Q - Unidentified Participant**

Maybe it relates to your previous points. But the same-store sales at your mature stores, again, is this purely base effects playing out or is there a change in the competitive landscape or some other factor at play here?

**A - Claudio Roberto Ely** {BIO 15364128 <GO>}

It is the first reason. In fact, concerning same-store sales for mature stores what happened is that, first of all, we are dealing with monthly average sales, they are in general for Brazil already higher than our peers. As I mentioned this March 2011, 21.1% above our peers.

For the mature stores this is the monthly average sales for Drogasil. The mature stores, they present already 20% above our average. So we are dealing with a monthly average sales per store -- mature stores almost 40% higher than our peers. So we are dealing with a basis of comparison extremely high.

There is no reduction. So answering your question. This is more related to the first part of the question. This is not related to losing traffic or losing the competitive landscape prices to our competitors or our peers.

In fact, we are gaining really with our established sales. That is really difficult to add. And why it is difficult to add? We have to understand that 72% or 73% of what we sell is drug related and it has a price ceiling on top of that.

**A - Unidentified Speaker**

Again, we have a comparison with the First Quarter. In the 2010 is for the higher growth that you have in the last year. (multiple speakers) 26% [ph]. In this year, this month, this quarter, things are changing because now the same-store sales is higher than the growth -- the same-store sales is much more higher than in the First Quarter. But the reason



because in this quarter they grow in the last year is much lower than in the First Quarter (inaudible) the comparison.

This is the reason because we are sure that in the end of the year we started -- we entered the year with a same-store sales at around double digits -- low double digits, 10% or 11%. Much more higher than the First Quarter this was for.

### **A - Roberto Listik**

One comment and that, why we have this expectation is exactly in this slide that we posted, that we do have boosted the same-store sales index the ramp up of the stores inaugurated in fiscal year 2010. The majority of our inaugurations took place during the second half of last year.

### **Q - Unidentified Participant**

Thank you.

### **Operator**

(Operator Instructions). Alaina Anderson, William Blair.

### **Q - Alaina Anderson {BIO 4893045 <GO>}**

This is just a follow-up to the last question. Most of your inaugurations took place in the second half last year. And it sounds like the comp comparable base is much easier in the second half as well. So when you look at your full-year expectations for total sales and same-store sales, how do you think about the mix or the weighting of the second half and the full year?

Do you think that the second half should be a% of the full year or most of the full year? How do you think about the weighting of your performance?

### **A - Roberto Listik**

Concerning the same-store sales, as mentioned before, exactly we expect -- and it is already indicated for the Second Quarter, an increase on this compounded same-store sales in next quarter Drogasil.

And by -- naturally, by incorporating these new stores that were inaugurated last year, we do have the sales growth (inaudible) of the same-store sales bringing with them their (inaudible).

So in total for the year what we may expect is double-digit -- but a low double-digits for same-store sales growth at Drogasil in between time up to 11%. This is our expectation. It makes sense by what we are seeing in terms of ramp up revenue core [ph] from all the stores that we inaugurated last year.

Concerning the total revenue sales growth for Drogasil, I think that we have done a revision with most of the Southside. I think that some of them already started to publish these new estimates for fiscal year 2011, now fiscal year 2012. We have revised these estimates. And the consensus that may arise you have a very good indication for Drogasil total sales growth.

Answering your question straight, we are approaching for this year something in between 15%, up to 16%.

**Q - Alaina Anderson** {BIO 4893045 <GO>}

Okay.

## Operator

I am showing no further questions at this time. We will go ahead and conclude the question and answer section. At this time, I would like to turn the floor back over to Mr. Ely for any closing remarks.

## A - Roberto Listik

Well, in the name of Mr. Ely and all the Directors, we would like to thank for joining this conference call and webcast of Drogasil. As usual, we remain available for any further questions, information. And welcome you to visit our operations and keep posted about our developments via our website and by calling us.

Thank you, very much, bye-bye.

## Operator

Thank you, sir. Thank you, to the rest of management. This will conclude today's Drogasil First Quarter 2011 results conference call. You may disconnect your lines at this time. Thank you.

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