

Q3 2017 Earnings Call

Company Participants

- Breno Toledo Pires de Oliveira, Chief IR Officer and Treasury Director
- Claudio Bergamo dos Santos, CEO, President of Pharma and Director
- Unidentified Speaker, Unknown

Other Participants

- Alexander Reid Robarts, MD and Head of Latin American Consumer Staples Equity Research Team
- Franco T Abelardo, Equity Analyst
- Gustavo Piras Oliveira, Executive Director, Head of LatAm Research. And Latin America Consumer Analyst
- Irma Sgarz, Equity Analyst
- Joseph Giordano, Senior LatAm Healthcare Analyst
- Luciano T. Campos, Research Analyst
- Marco Calvi, Analyst
- Maria Paula Cantusio, Banco de Investimento S.A., Research Division
- Robert Erick Ford Aguilar, MD in Equity Research
- Tobias Stingelin, Director

Presentation

Operator

Good morning. Welcome to Hypermarcas Third Quarter of 2017 Earnings Results Conference Call. Today with us we have Mr. Claudio Bergamo, CEO; and Breno Oliveira, CFO and Investors Relations officers.

We would like to express that this event is being recorded and that all participants will be on listen-only mode during the company's presentation. After Hypermarcas's remarks, there will be a Q&A session for investors and analysts where further instructions will be provided. (Operator Instructions) We would like to mention that questions can only be made through the telephone. So if you are connected via webcast, you should email your questions directly to the IR team at IR@hypermarcas.com.br.

Today's live webcast may be accessed through the company's Investor Relations website at www.hypermarcas.com.br/IR. We also would like to inform that remarks made during this conference call are forward-looking statements such are subject to known and unknown risks and uncertainties that could cause the company's actual results to differ materially from those set forth in the forward-looking statements.

Now I'll turn the floor to Mr. Claudio Bergamo who will begin the presentation. Mr. Claudio, you may begin your conference.

Claudio Bergamo dos Santos {BIO 16015846 <GO>}

Good morning, to everyone. Welcome to our earnings results conference call regarding the Third Quarter 2017. During the quarter, Hypermarchas did (continuity to its) strategic plan of organic growth with profitability and cash generation.

In terms of sales, the net revenue of Hypermarchas increased 17.7% during the quarter vis-à-vis the same quarter last year reaching BRL 954 million. This result reflects the progress that we've had in demand for the company's products as well as the recovery of the portfolio during the Second Quarter of BRL 35 million.

Through the last nine months that ended in September, net profit was 11.8%. In quarter in terms of sell-out demand and the products of the company increased 12.6% according to the data of IMS Health. This is a growth of 1.5percentage points above the market, which increased 11.1%. We would like to highlight that business of brands that include the units under prescription grew 13.3% in terms of demand or 3percentage points above the market, which grew 10.3%. We would highlight during the quarter review, Alivium analgesic and Skincare.

And in operating terms, the EBITDA of the continuous operations totalled BRL 292 million during the Third Quarter, representing a growth of 14.3% vis-à-vis the same quarter last year, also totaling a margin of 30.6% of net revenue. Year-to-date the EBITDA reached BRL 960 million. This represents 35% of the net income and now our company is on the right path to achieve its guidance of around BRL 1.2 billion of (nominal) EBITDA throughout the year of 2017.

The growth of the operating results, we have a net income in continuous operation of ('16) 19.3% regarding the same quarter of 2016, BRL 219 million, representing BRL 0.35 per share. Year-to-date the net income was BRL 710 million of the continued operation, representing a growth of 49% vis-à-vis the same period last year.

The company ended the quarter with a net cash position that was positive BRL 742 million after distributing BRL 822 million in capital that ended in July, which places it in a good position to continue proceeding with the results, distribution policy for shareholders. As our net asset is high, the company (studies to use) an instrument of interest rate over on capital to continue distributing capital to its shareholders.

The innovation remains as one of the main points to focus on the company that recently opened a new Innovation Center that will contribute significantly and to be more assertive in the launching of our products to accelerate the expansion of the company's portfolio in its 3 business units.

During the quarter, the expenses with research and development reached the level of 2.5% of net income, an increase of 6.5% vis-à-vis the same quarter last year and our

innovation index corresponded to the percentage of net income that is a result of products launched five years reached 31.4%, the greatest percentage registered in the history of the company. The company studies (inaudible) and will initiate a new investment cycle in its operational center to increase capacity.

I would like to give the floor to Breno Oliveira, the CFO, that will give you more results before Q&A session.

Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

Good morning, to everyone. When we go to Page #3 of our presentation, we can see that growth of net revenue was 17.7%. We would like to highlight prescription and consumer health. The Second Quarter we had orders (inaudible) above BRL 36 million. Adjusting these factors, the growth would have been 13.4%. The gross margin was 74.6%, a drop of 0.4percentage points vis-à-vis the same quarter of 2016. But aligned with the gross margin of the semester this year, marketing expenses represented 26.7% with a drop of 1.3percentage points this year. We had marketing actions better distributed when we compare it to last year.

Year-to-date marketing expenses are at the same level of revenues of (26%) . Now sales expenses increase represented 12.7% of net revenue. And this is a growth of 46% with research and development that represent 12.5% of the net revenue. Now G&A increased 0.5percentage point with a percentage of net revenue because they're more representation of corporate expenses. And after the sales of the business of disposable products, we would like to highlight that comparison is challenging because the Third Quarter these expenses reached the lowest level since 2015.

The other operating expenses of BRL 15.5 million were impacted mainly by tax contingencies. And with this, the EBITDA of the company totaled BRL 292 million, a growth of 14.3% and a margin of 30.6%, a drop of 0.9percentage points explained mainly by the assessment and other operating expenses.

Financial result, we have a financial revenue of BRL 9.4 million when we compare it to BRL 0.7 million during 2016, the profit of continued operation was BRL 219 million, an increase of 23%.

(inaudible) now are discontinued operations. Here we have BRL 42 million negative, mainly because of price readjustment regarding the sale of disposable products and non-cash expenses with writeoff of assets that were not part of the transaction. So the net income was BRL 177 million, a drop of 12.4% vis-à-vis the Third Quarter of 2016.

Now the following page we can see that cash conversion cycle was 126 days, 10 days (lower) for working capital as a percentage of net revenue ended with 40.7%, very close to the interval observed during the past quarter. We would like to remind you that as of this quarter, we are showing days receivable. This is a metric that we believe (inaudible) that is very close to reality. Then the gross revenue that was $\tilde{A}c\hat{a},\neg\hat{e}$ this is cash flow from operations. It was BRL 175 million during the Third Quarter compared to (inaudible)

because an advance payment with media regarding the programs of football of Globo of 2018. Excluding this, our cash flow from operations was aligned. Now year-to-date excluding this effect, the growth of operating cash flow was 10%.

Now free cash flow was BRL 105 million, impacted in addition to the BRL 50 million from Globo TV, BRL 23 million regarding price adjustments. And the sales of disposable products. Excluding these effects, there is a growth of 12% in this metric. On Page 5, we will talk about the net cash position. It was BRL 740 million after a reduction of capital of BRL 822 million.

I would like to thank everybody for your attention. And now we will start our Q&A session.

Questions And Answers

Operator

Thank you very much. We will initiate our Q&A session for investors and analysts. (Operator Instruction) Mr. Robert Ford from Bank of America would like to (inaudible) the question.

Q - Robert Erick Ford Aguilar {BIO 1499021 <GO>}

I believe that you mentioned your own capital. What are the most important decisions to consider interest rates over your own capital?

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

I will answer this question. As Claudio mentioned, the interest rate (over own) capital is one of the alternatives that we are assessing. Now that we are distributors of dividends, I believe that it is an interesting alternative. It is a deductible expense and the greatest limiting factor of this case to pay out would be the application of one tax over the net assets. Our net asset value is BRL 8 billion. Considering TJLP that would be 7%. This would be a limit of BRL 560 million. And with the tax (inaudible) of this can have a positive impact of net income of BRL 190 million. That would be 34% more or less. So this is something that we are studying. Nevertheless, it is a radical possibility.

Q - Robert Erick Ford Aguilar {BIO 1499021 <GO>}

You mentioned the new CapEx cycle for production. What amount are you bearing in mind to increase this capacity?

A - Unidentified Speaker

So as a matter of fact, as we have seen during the quarter, we had a very significant increase in volume. And because of the conditions, the market macroeconomic conditions, with the drop of inflation and the drop of interest rate and (inaudible) improvement of employment indexes, there is a possibility of increasing volume, to continue increasing volume. Nevertheless, we have to prepare ourselves for this new cycle. I believe production lines are reaching a bottleneck point. So we are assessing and

we are studying this new investment cycle to increase capacity. And perhaps we will improve our volumes for products that can be sold in the market. We still do not have an accurate number. But we're talking about a trend that is being assessed currently. And I believe that we will analyze this again and we will give you more information the next quarter.

Operator

Luciano Campos from Campos would like to pose a question.

Q - Luciano T. Campos {BIO 21177595 <GO>}

My first question is precisely about new sale volume that was observed during the quarter. We saw that the market reacted better and I would like to know how you see the market. Something we got in competitiveness, especially when we talk about generics, because you didn't mention this unit that this is an area that has also increased its sales. And I believe that now you're receiving more contribution from generic products. This is my first question. And the second question for Breno would be if the level of G&A of BRL 47 million has reached an adequate level? Do you believe that this will increase more?

A - Unidentified Speaker

Luciano, generics products, this is an area that is performing well. It has grown. It is growing above market level. And when we analyze our generic business only in molecules that we deal with, I believe that we rank second. Now when we see it as a whole, we are constantly assessing it between Eurofarma, Sanofi. And we are probably a company that has greater potential to work with new molecules. Therefore, there is a positive prospect because our coverage where we are present we are performing well and there is potential to embark in new areas. Generic represents 12% of the company and you have to put it together with similars. And here the trend is not as solid as with generics. In average, both with together, we're properly positioned. Now regarding the G&A, I believe this is the level that we've observed in the past quarters if we see the average of this year is BRL 46 million more or less. And the (inaudible) for this to increase together with inflation. We are doing our best to diminish our structure. But this is the level of the company. We have to remember that last year G&A was shared (amongst) the operations of pharma and diapers. Now we have a structure with less sales as a percentage of our revenue. Our target is more or less 5% of our net revenue.

Q - Luciano T. Campos {BIO 21177595 <GO>}

Just to follow up Claudio on your answer, when we see the available data of the quarters of 2017, we can see an improvement of average price in generics. Have you observed any improvement in regarding the competition profile when we see generics, or do you believe that it's as tight as it has been in the past?

A - Unidentified Speaker

We haven't seen an improvement. I believe that it is a highly competitive market. And now the key success factor of our market is to have low costs. So despite the constitution on

performance with generic is good, mainly because we have a highly productive plant of large scale concentrated in only 1 place. Therefore, we have a very good operation. So to compete in this market, you must be in the lowest cost position. And we are fortunate because we have it. Therefore, we can grow above the market with profit.

Operator

Mr. Marco Calvi from ItaÃfÂ° BBA would like to pose a question.

Q - Marco Calvi {BIO 19854632 <GO>}

My question would be regarding the level of accounts receivables. The one that was gross revenue minus discount, when we see receivables increased a little bit more. I would like to know what the scenario is regarding debt lines, wholesalers if you are giving a greater timeline to them, or do you see this as discount over gross revenue?

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

This is Breno. We prefer to see Ã¢â¬â we prefer to discount Ã¢â¬â the gross discount because this is what we are going to receive from our customers, the discounts. They're competitors of ours that do the gross revenue based on the price table as this has varied during the Third Quarter, we're using this metrics of days gross revenue and net discount. Our gross revenue Ã¢â¬â we don't believe that this metric is the fairest metric. So it grows. When we see the days it grows a little bit regarding the Third Quarter from 123 days to 126 days, a drop during the Third Quarter. When we see accounts receivable, it increased along with the net revenue. It grew around 18%. When we compare it to the Third Quarter of 2016, we see no pressure and no change regarding the working capital.

Operator

Next Gustavo Oliveira from UBS would like to ask a question.

Q - Gustavo Piras Oliveira {BIO 15129435 <GO>}

I would like to better understand the growth dynamic that you are projecting with branded prescription was 13.3%. And to understand the impact of the margin, the margin has shrunk quarter after quarter, not so much the gross margins. And these products tend to be more profitable. And following the same thought, now when we have samples of prescription products have been dropping year-by-year. So actually branded prescription is sensitive to your investment. I would want to understand that what is happening because this dynamic is not clear to me? And the second question here I have for Claudio to understand the innovation index you have a record level of 31.5% in the future. What target do you believe would be sustainable for the company?

A - Unidentified Speaker

Gustavo, I'm going to start from medical prescription. Now free samples, they compete with production, with finished products. So part of our decision to increase our production capacity undergoes this. I don't know if you are aware. But free samples are

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accounted when they're produced, not when they're delivered because of taxes. So sometimes you could do less. Therefore, you account less. When you produce more, you account more. This doesn't necessarily mean that there is a lack of free samples for the doctors. But because we use this rule of IFRS taxes, I believe that it suffers volatility in the accounting books as it competes with our products that are in production, in certain moments it is not produced and this can be an indicator. So in this line there are 3 factors you believe that this oscillations is more connected to the samples and production. And it is more connected to free samples in absolute value it continues growing. Nevertheless when we think about free samples, its growth isn't so proportional. It is very important I would like to highlight something here that matches your production question. When we reach an index of 31%, we had a lower index in the past. We have defined the target that is 30%. We exceeded this target this quarter and now we created a new target that's 35%. I believe that if the company is able to maintain 35% in a continuous and constant fashion, this will be a great strength to renew the portfolio and medications have a very clear cycle. So the first 2, three years that has a higher growth rate. So the average age of our product line it drops because of the highest index of innovations. And the trend is to be able to grow above market because you have a greater portion of your products in growth stage when you compare it to the average of the market. So the consequence of all of this is that you need to invest in innovation. We've already done it. You have to invest in plants. This is something that we're starting now. And you have to invest in marketing to launch these products that we have investments in marketing. That has been strong this year. Mainly, it's no novelty that we closed a package with TV Globo. That is the best package in terms of media in Brazil when we see our figures, because today we are in position number one. If I am not wrong, we are the greatest (inaudible) in Brazil and also within our budget. Next year, we will consider also our medical prescription. And based on our results, we will be able to do, that we have done in gradual fashion with an increase of cash. That is our target. So of course, our criteria undergoes innovation production and undergoes marketing and also point-of-sale. That is something that we have already done. So if you think on the main pillars of growth in the market that is our target, I believe there we already have a very solid foundation regarding our innovation infrastructure. The business development, innovation. We also have business units very great sales force with new restructuring. We have come from a strong cycle of investment. We will continue with marketing media. We will intensify global. We will embark in a cycle of medical appointments and also a new production cycle. Everything takes place simultaneously. It's a coherent and the indicator of innovation is of utmost importance. Next year, we will launch a number of products in all business units. You will be able to follow this process. During the past six months, we launched Alivium gel capsule. It is an absolute success. There has been one of the factors that has helped us to grow above market. Our dermocosmetics line, very good, we have a strong growth rate, 65% of innovation rate because it is more mature than other companies. And as a consequence, it has grown a lot. We have products that were launched 2, three years ago that are still on the path of growth like Estomazil, Doril, migraine. So when you have a portfolio of products, you have that are mature, the ones that are growing, the ones that are at their peak. And ones that are declining. Most of our products are in the growth stages and mature. And in the past, we had more mature and declining products. Therefore, you have less products that put you on the line. So I believe that it is a process that we're carrying out. We will continue doing this. And this gives us good backup, especially for a demanding market because we believe that this is a market that is demanding product. So our cash has been very good because of this as well.

Q - Gustavo Piras Oliveira {BIO 15129435 <GO>}

Okay. Just a follow-up. The gross margin, I don't know. Breno, can you talk about the gross margin.

A - Breno Toledo Pires de Oliveira {BIO 17653260 <GO>}

The gross margin you can see quarter-after-quarter, there are things that affect like new plants, a mix of products sales. So there is a variation in the quarter. But we can see that throughout the year. We are very close to the same gross margin. So we are not observing a major trend in terms of gross margin.

Operator

Mr. Tobias from Credit Suisse would like to ask a question.

Q - Tobias Stingelin {BIO 18290133 <GO>}

I would like to know if you could talk about the growth of sales in terms of volume and price amongst the three categories. This could help us to have a better idea. Your growth wasn't very strong. Now it has sped up. So the question is the current growth was very specific because strong launching of product, or do you believe that this is a new trend that we will see growth rates along these lines? Then I would like to understand something -- I would like to understand more about your marketing strategies.

A - Claudio Bergamo dos Santos {BIO 16015846 <GO>}

Tobias, this is Claudio. When we analyze growth and when we eliminate the backlog of the Second Quarter, as a result, we have 13.4% as you can see. And the sell-out growth was 12.6%. So statistically speaking, they are very close to each other. The question is if we can maintain the 12.6%. And I go back to what I mentioned. This is to more a function of our internal capacity to execute and to be able and to have success. The market is in a range of 8%. We do not realize. But I believe that the process will be 12%, 13% the success. If the company will be able to sustain this growth above market that is our target the company is geared towards this target. And as I mentioned in the past question, we want to preserve our innovation indexes at higher level of success for launching. Of course, there's no use in developing something and not launching it correctly. And do it in a cost-effective way to generate value to the shareholder. This year we have been able to do this, specifically this quarter. As I mentioned, we had the effect of higher percentage due to the launching of Alivium in dermocosmetic products. We will have other stories like dermocosmetic and Alivium planned in the future. This is for next year. And here the matter is if we will be successful when we deploy this. So basically this is the variable that we have to take into account. So the launchings were very positive. And I believe that the trend will continue very similar during the Fourth Quarter. We always have to remember, we have been very transparent. We always have the sell-in, sell-out effect. The information has to converge throughout a longer period. So during the quarter, we had a sell-out effect that was higher. This acts a greater sell-in. Sell-in recovered its portfolio. But yes, there was a great impact. When I mentioned Alivium, this was a very assertive investment. Our product is superior to that of the competition. The propaganda is good. The advertisement was good. The distribution was good. There are number of factors that

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converge towards being successful, pointing on the planning. So today as a company we are the greatest player in the (inaudible) molecule. This is a very relevant molecule in the world, not only in Brazil. So the entire strategy on this product we are reaping the results. We are now reaping results by chance. There was something done in the past and now we can see the results. So this shows us that we are accumulating a track record that is very important. That is something that gives us success. We are thinking about other movement. And this is the focus of the company with the lead that there is a great potential in Brazil from bringing novelties to offer, better products with greater added value to the consumers, patients, doctors. And this is our drive now. That is our strategy. And if we maintain this strategy, we reap the results.

Q - Tobias Stingelin {BIO 18290133 <GO>}

What about the marketing? How can you account this? Is there a curve throughout the year or the quarter, or a quarter where we will have more expenses? How do you account this?

A - Unidentified Speaker

These packages you pay them upfront. So we had BRL 50 million this quarter, BRL 50 million the upcoming quarter. And BRL 100 million during the First Quarter of 2018. So the package with banners and football are BRL 200 million. Our investment was BRL 140 million. And with the package -- so you have to see how you use this for competencies. This package has a characteristic that is good for us because the strongest thing of these packages are the insertions of 10 seconds. And 5 seconds during the vignettes. And these vignettes you can rotate the brand every 10 days. As we have a number of brands, we're going to plan which brand will be used. And we will see Engov, Epocler, Estomazil, Lacto-Purga, Tamarine these are summer brands. You also have Benegrip, Coristina, Doril, Melhoral. And other brands that are winter brands. Therefore, we plan throughout the year and see which brand we will announce according to the period. Neo QuãfÂmica brand also Benegrip did well. And we (inaudible) number of brands and a number of moments to give them greater visibility. We talk a lot about digital people. When it comes to football everybody goes to the TV. For example, yesterday Corinthians just lost from Ponte Preta and this was ãçâ,~â€œãçâ,~â€œ and SÃfÂfo Paulo won from Santos. And I am anti-Corinthians as a SÃfÂfo Paulo supporter. This is going to be the first time I'm going to support Ponte Preta. Let's not talk about soccer and supporters.

Q - Tobias Stingelin {BIO 18290133 <GO>}

What about your contract? Is it valid? Until when?

A - Unidentified Speaker

No. It's valid throughout the year.

Q - Tobias Stingelin {BIO 18290133 <GO>}

How do these contracts work?

A - Unidentified Speaker

You work with Globo TV and then they give you preference to renew your contract every year. And you have a right of renovation who last was (SICARDO, Elektra. And Johnsons) . And we -- us and Unilever signed contracts and the other four groups remained. I really don't know what companies they are , ItaÃfÂ°.

Q - Tobias Stingelin {BIO 18290133 <GO>}

So you're going -- you paid BRL 50 million. Now you will BRL 60 million during the Fourth Quarter and BRL 100 million during the First Quarter of 2018. You have to pay them in advance.

A - Unidentified Speaker

Yes. You have to give them a payment in advance. And we include this in our accounting. We received BRL 50 million of penalties in our cash flow. And like next year, for example, we will pay BRL 100 million during the First Quarter and we won't pay anything else throughout the year. So as you use, you account it. And then you match it with the payment in advance.

Operator

(Operator Instructions) Irma Sgarz from Goldman Sachs would like to pose a question.

Q - Irma Sgarz {BIO 15190838 <GO>}

I have two questions here. Number one would be the accounts payable, there was a comparison year-on-year of 30 days, I would like to understand this better. I know somebody asked something about working capital. But I really don't know if you answered this specific part. And the second question, during the Second Quarter you talked about ongoing negotiations and potential acquisitions, licensing. And I believe you clarified in the past we had licensing for third parties would not be an option. But there were negotiations for potential negotiations for new molecules. I would like more information regarding this point.

A - Claudio Bergamo dos Santos {BIO 16015846 <GO>}

Irma, I will start with the second question and then I will give the floor to Breno so he can mention accounts payable. Our area of business development since the beginning of the year has become much more active. We have a stand in the CPHI in Switzerland. ItÃ¢â„¢s the only Brazilian company that has a stand in Switzerland. We have had greater demand. And so from the business development, we have new opportunities to buy new registries, to buy new molecules. And new opportunities of acquisitions can emerge. But these are acquisitions that will be very small acquisitions, share picking, you have to think less on acquisition and more as if you're buying a product. We are not focused on the large acquisitions. We want to complement our portfolio. And this is part of our innovation process because we want to continue in the line focusing on innovation, something that we already have. So business development is part of this. But we are very active. We are analyzing a number of things. Many opportunities have emerged of distributing brands of third parties. We are not going to do it because as a CEO to generate value to our shareholder I cannot use a product of a third party. We have our

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result in the short term and in the future they say this product isn't used. They transferred to another person. So what am I going to tell you is if we are very opportunistic with our product. So everything that we do belongs to us. It's (inaudible) stored. You will have a rented or you're not going to refurbish a rented house. You're going to retrofit it if it belongs to you, not if it belongs to somebody else. What are you going to do? Rent a house and give it back to the owner retrofitted? No. The same thing happens with business. We are accounts receivables with our suppliers depends on the level of stock. The level of inventory varies so here we have 34 days and the past quarter 33 days. There is a variation. And we have a long payment term. So when we include stock, the supplier growth most because we consume inventory quicker than what we pay. So there is a variation. But we always see everything ad-hoc. And when we see the average of the last year, it's around 30 days. And now it's around 34 days. So this is how we generally analyze this internally. So we're not very concerned with supplier days because inventories also drop and this then influenced a greater sales during this quarter.

Q - Irma Sgarz {BIO 15190838 <GO>}

And what about the inventory levels? Are you comfortable with your inventory levels?

A - Unidentified Speaker

I would like it to be higher. There was a sales peak here and our inventories dropped in relative terms and this is something normal.

Operator

Mr. Joseph Giordano from JP Morgan would like to ask a question.

Q - Joseph Giordano {BIO 20154008 <GO>}

Two very brief question, the first one, piggybacking on Irma's question regarding the inventory. You said that you have a slightly higher stock. I would like to know if you have a (fee rate risk) , because apparently the sell-out demand it's surprising the company. And my second question is to understand the channel. Channel there will be greater growth, will be big networks, medium sized network, small networks?

A - Unidentified Speaker

Joseph, in terms of (fee rate) , part of what we are considering to increase capacity is part of the aspect of reducing risk. During the Second Quarter we faced a situation where we had a backlog. And we are strongly working even with new teams in the operations areas. So we're able to eliminate this because we do not have a situation like we had during the Second Quarter. And for those there are a number of ongoing initiatives for our operating areas. Nevertheless, as I already mentioned, this allows us to increase certain levels in the medium; and long-term when we think about Brazil. We need an increase of structural capacity. Let's say that during this moment, we're making efforts to gain productivity and efficiency in the future. We will have we want structural gains and if we maintain the trend of volume increase. Now regarding channels, that was your second question. The day we divide in 3 major channels, 1 would be the network channel, the medium-sized channel. And mom-and-pop channels. The medium channel is the one that

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grows most. The second that grows most is the network channel. And the third would be mom-and-pop channels. They are correlated with the economic situation. I believe that smaller channel is connected to CD, medium is BC. And big networks AB. Perhaps in the future we will have a change in this network. But today historically in hindsight the medium channel is the ones that is growing most.

Operator

Maria Paula Cantusio from (BB-Banco) would like to pose a question.

Q - Maria Paula Cantusio {BIO 18652439 <GO>}

I would like to talk about the gross margin. You mentioned that it has been stable during the year. There was a drop during this quarter. You said that it was because of the mix. Could you elaborate a bit more on the BRL 35 million in sales transfer from the second to the Third Quarter? Do you have more brand in medication or generic medications (inaudible) see the future? Can you imagine a gain of gross margin for the Fourth Quarter considering the acceleration of sell-out, sell-in. And together with the stability of the dollar exchange rate?

A - Unidentified Speaker

Paula, the backlog that came was a little bit distributed amongst all products. It wasn't concentrated between in any divisions. Today we believe that we have reached a certain level that is stable of gross revenue. We have not received any type of pressure for increasing cost that go above the price/cost. So we are relatively stable. In the short term an improvement in gross margin should be a result of the increase of production and of our installed capacity. But it is a limited effect because today we already operate at very elevated levels in terms of capacity. So I would say that this is a variable that has been stable and I see no trend towards volatility.

Operator

Mr. Alex Robarts from Citibank would like to ask a question.

Q - Alexander Reid Robarts {BIO 1499637 <GO>}

I would like to go back to the question of the corporate deleveraging that you had during the Second Quarter. And here you have the gross margin and there was an effect on the gross margin. Again, when we see year-on-year, we believe the trends could be different. But focusing on the Third Quarter year-on-year, I believe that the dollar should have helped you with the cost in dollar. With the growth of revenues, there should have been an operational leveraging. And here we have 50 basis points. I was expecting a different level. When you see the cost of inputs, they were stable in dollars. Was there something regarding production, packaging that could help us? That would be my first question?

A - Unidentified Speaker

Alex, if you could better explain your question because I really did not understand it.

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Q - Alexander Reid Robarts {BIO 1499637 <GO>}

The question pose in a different way, the consumption in dollars, you have said year-on-year there should have been a positive effect on the margin. And with the growth above 2% year-on-year, there should have been some type of leveraging so that the gross margin under these conditions should expand itself. Nevertheless, there was a drop in the gross margin. And it dropped 50 basis points in the Third Quarter. The gross margin dropped because of packaging, production? If you can help me to understand why there was a drop on the gross margin.

A - Claudio Bergamo dos Santos {BIO 16015846 <GO>}

I think Breno already explained what happened with the gross margins. No. It had nothing to do with \hat{A} , \hat{A} number 1, the gross margin when, for example, there is an increase in production, the product goes to the inventory. It goes to the CPV after it goes to inventory. Therefore, there is (redundancy). You have to see things in the long term and more structural way. And Breno subsequently can give you more details through our relations with investors. Now second question will be guidance, BRL 1.2 billion for the year. To reach this guidance we need a drop in the EBITDA during the Fourth Quarter.

Q - Alexander Reid Robarts {BIO 1499637 <GO>}

(inaudible) this is a moment to increase your guidance or you will see what happened during the Fourth Quarter and then we will talk about your guidance.

A - Unidentified Speaker

Just to clarify, our guidance is around BRL 1.2 billion, around, not exactly, BRL 1.2 billion. So it's around BRL 1.2 billion. So we believe that we don't have to change our guidance because this is an indicator, just approximately around BRL 1.2 billion.

Operator

Franco Abelardo from Morgan Stanley would like to ask a question.

Q - Franco T Abelardo {BIO 17416219 <GO>}

Just a follow up regarding the guidance question. I understand that around BRL 1.2 billion. But can you imagine this guidance will be reached with no problems, or do you believe you will have expenses and a margin pressure that will allow the guidance to be around BRL 1.2 billion, not exactly BRL 1.2 billion? And what about the margins for 2018? I don't know if I understood correctly. If you have BRL 200 million in expenses with Globo TV, we're talking about a bit more of 1% of increase of expenses with market. And also there will be an increase with expenses with doctor's appointments. When we see the margin 2018, is it possible to think on the stable margins to be able to offer with marketing purchase, or do you believe that you will receive pressure during 2018 that will change your margins?

A - Unidentified Speaker

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Franco, let's be very careful before we jump to conclusions, okay. When I talked about Globo, 25% of our marketing investments, think there are other media that we work with. And we -- it doesn't mean that if I increase Globo, I'm going to increase everybody. So we have a number of ways of how we deal with our budgets. So this is why we always bear in mind organic sustainable growth so we can provide results to our shareholders. I believe you're jumping the gun. And things do not work this way. I don't want to anticipate the future. You have to trust on us. You have to trust us and you have to trust that we're managing things properly. Let's not also jump to the Fourth Quarter. As I said in my opening speech, we reached BRL 160 million in EBITDA that is 35% of the net income. And I believe that in the national market, we are a benchmarked compared to other companies that we are constantly tracking. And I believe that the company is on its way to reaching its guidance of BRL 1.2 billion. But if there is a material variation, we would announce it. But this is not the case.

Q - Franco T Abelardo {BIO 17416219 <GO>}

Let's see if I misunderstood you. So the increase of the marketing expenses with Globo will be offset with other marketing lines. So if you give us a guidance now, there will not be an expressible relevant growth in expenses with marketing next year. Is this what you're trying to tell us?

A - Unidentified Speaker

We're not talking about our guidance of 2018. We will give the guidance of 2018 as we always do during the First Quarter of 2018 when we announce our February results.

Q - Franco T Abelardo {BIO 17416219 <GO>}

Can I ask another question regarding growth. You said that the market will grow between 8% and 10% and you said your brands are growing above this level. The expectation for next year has grown, has accelerated after the Third Quarter (inaudible) growth of 11%. So do we expect a slowdown of the markets. But do you believe that either markets will represent 2-digit growth? Even the market doesn't grow as much, do you believe that either markets will continue growing at the same level?

A - Unidentified Speaker

Franco, we do not do guidance top of mind. We do not anticipate to expectations. We talk about past and current things. We will communicate our guidance during the First Quarter of 2018 as we do every year. I do not want to say anything beforehand.

Operator

Okay. Thank you. Our Q&A session has come to an end. I would like to give the floor to Mr. Claudio Bergamo for his final remarks.

A - Claudio Bergamo dos Santos {BIO 16015846 <GO>}

I would like to thank everybody for participating once again. Our Investor Relations area is at your disposal to clarify any questions you may have. Have a very good day and a very

good week.

Operator

The Hypermarcas conference call has come to an end. We would like to thank everybody for their participation and please have a good day. Thank you very much.

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