Q3 2021 Earnings Call

Company Participants

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

Other Participants

- Eugenia Cavalheiro
- Gustavo Senday
- Irma Sgarz
- Renan Prata

Presentation

Operator

Good morning, and welcome to RD - People, Health and Well-Being Conference Call to discuss its results for the Third Quarter of 2021.

The presentation can be found on RD's Investor Relations website, ir.rd.com.br, where the audio for this conference will later be made available. We inform that all participants will only be able to listen to the conference during the conference presentation. After the company's remarks are over there will be a Q&A period, at a time further instructions will be given.

Before proceeding, we must mention that forward-looking statements are being made under the safe harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of RD's management and on information currently available to the company. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions as they relate to the future events and, therefore, depend on circumstances that may or may not occur. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of RD and could cause results to differ materially from those expressed in such forward-looking statements.

Today with us are Mr.Eugenio De Zagottis, Investor Relations and Corporate Planning and Vice President; and Mr.Fernando Spinelli, Investor Relations and Business Development Director.

I'll now turn the conference over to Mr.Eugenio. Mr.Eugenio, you may proceed.

Eugenio De Zagottis {BIO 7193695 <GO>}

Sorry, I was muted and didn't realize. Hello, everybody. Welcome to the Raia Drogasil third quarter conference call. I'd like -- just start by saying that today is historic day for our company. This is the day of our 10th Anniversary. 10 years ago, we established Raia Drogasil. The journey early on was not the easiest, but I think that by applying especially in the initial years a more traditional retail recipe. I think we were able to transform the company create a lot of value, leverage the synergies and get the best of Raia Drogasil and keep the company evolving.

I think this day is not the different, in the sense that we are recreating company. So, we were talking back then about a new company being created. Today it's a company being recreated as a traditional retailer being transformed into an omnichannel healthcare platform. So, this is just as new I think today, as it was back then. And we have the same excitement to start this journey that we had back then. And hopefully, the same fortune, again the same kind of value creation we're able to create ever since.

So, back to the quarter. I mean, we ended the period with 2,414 stores. We opened 52 units and closed 12. We gained significant market share 110 bps on a national basis. We reached 14.3% with gains in every single region.

Our gross revenue in the quarter totaled BRL6.5 billion, 21.2% growth and this is 2% mature-store growth ahead of inflation, 2% real growth. Contribution margin and I'd like to start by saying that for me this is our most important metric, because it's the one, who manages -- who shows structurally how the business is performing.

We had a contribution margin of 10%, and this is a 10 basis points expansion versus the same quarter last year, and a growth of 22%. So, we're talking here gross margin minus sales expenses. So, this is the ongoing performance of our assets. Then we had an adjusted EBITDA of BRL446 million, 6.8% EBITDA margin, and 12% growth. Net income of BRL174 million, 2.7% net margin, and a cash flow generation in the quarter, there was positive free cash flow BRL73 million and negative total cash flow BRL22 million.

On the next page, we can delve more in detail about the expansion. We opened in the quarter 52 stores and closed 12 stores. By the end of the quarter, 32% of these stores were still undergoing the maturation process. We have recently in our Investor Day reiterated the guidance of 240 store for this year, which we are fully on track to deliver and expanded the guidance next year to 260 stores. After five years at this same regular pace, the strong performance that we have achieved give us the confidence to take another step and open 260 stores.

We have entered a lot of small cities. So, on the next page, we are now in 453 cities in Brazil. It's clear by this chart on the left how different expansion is today versus early on. If you move from 2018 to 2019, we were opening something like 30 new cities a year, now we're opening something over more than 60 cities a year. So, it's an expression that has less to do about over-densified markets and more to do about expanding our presence into new cities, into new market, obviously there's two markets, so we can add a lot of stores and we have done so.

And we're doing this with the same returns that we have been proactively or slightly better returns. If you look our internal rate of return this year and last year is around 25%, in previous year is around 20%. We look at this new stores on a net basis, because there's generally cannibalization. So, we do the IR calculation based on revenues, net of cannibalization. So, just for example, it's very easy to open a store in the neighborhood of San Paulo, Rio et cetera, very easy to open and say selling BRL1 million per month. But in the end of the day, when we look BRL300,000 have been stolen from other stores. So, a store like this is only adding, let's say BRL700,000 per month. It's okay.

When we open a store in new cities, smaller cities B Class and C Class neighborhoods, very often the gross sales is lower than what we do in this more traditional areas. But on a net basis, because there is not cannibalization in new cities or there is weighing less cannibalization in existing city, in popular areas of existing cities. On a net basis, we are performing about the same.

So, the internal rate of returns don't change regardless of city income et cetera. And it's easy to see also how different the demographic profile of the expansion has been. So, A stores starts focus on A Class customers. They represent 30% of the stores opened last 12 months versus 39% in 2018.

The opposite is happening to popular store the increase of 20 to 29 and hybrid stores that increased 41 to 58. So, we have more and more serving the expanded middle class in Brazil. We are more and more reaching new frontiers for us to bring our execution. When you look at the full portfolio, 33% of the stores are A, 45 hybrid, 22 are popular.

Next page. So, I started by saying, this is the day of our 10th Anniversary. And by the year end, I think, there's another milestone that will have been achieved, which is becoming a fully national player. So, we are opening stores still this year in these three missing states, more states in the north, where we don't have an operation, but we're in the verge of being there, and we will end this year with 2,500 pharmacies present in every Brazilian state.

We are not the only player to be present in every Brazilian state, but we're the only Brazilian player to be solely making money, while delivering high returns, while delivering higher revenues per store, high profitability per stores, regardless of the market, regardless of the region, regardless if it's new or it's in an already developed market. We're the only player able to do so.

And we also the only player to have an expansion in which 22% is happening at home, 78% is happening outside of our native markets, with increasing returns as I mentioned earlier. So, this is very unique and it depicts the capacity that we have to develop new stores, to locate them correctly, to operate these new stores, to consolidate our brand and to create tremendous value by doing so.

Market share was another highlight in the quarter. We gained more than 120 bps in national market share, it reached 14.3%. We've gained in every single region. So, Sao Paulo reached 26%, 90 bps growth in a market, where we're not adding these many stores like before. So, this is for me really impressive, and obviously digital has a lot to do with this share growth that I'll talk more about later.

Southeast, we gained 70 bps. Midwest we gained more than 400 bps. Midwest is a different story here, because the State of Goias is the only state in Brazil without advanced tax collection. So, there's a lot of merchandise going in and out of the state and it's very easy for the share to get under or over report.

And what happened is the same quarter last year the share was in the report. So, this 13% is not the normal share. So, this is unlike a distortion in accounting by IQVIA. But still, it's not 400 bps gain, but for sure it's more than 100 bps structural gain here. Just like in every other market. In the South, we 140 bps, in the Northeast 120 bps, in the North 100 bps.

When we look -- when we break down our revenue growth by category, OTC has been the highlight, with 30% growth. Obviously the pandemic has a lot to do with the strong performance in OTC and the lower performance in hygiene personal care. And we have also done really well in generics, where that we have grown 23%.

And then, we have the comps here. So, as I mentioned before, the top-line consolidated growth is 21%. But when we look at the mature-stores, we're talking 12% mature-store growth. This is 200 bps above the average CPI, which is very high right now. And this is about 500 bps more than the price increase that was granted earlier this year.

So, it's an amazing performance and without any shadow of doubt, this is a performance that is driven by their omnichannel strategy that we have been pursuing. When you look at digital channel penetration, this quarter we did BRL561 million in revenues. So, if we analyze this, we are around BRL2.3 billion in annualized revenue at this running rate.

So, our digital alone is the number six or number seven player in Brazil already. So, I think this is a pretty remarkable figure. But digital penetration increased once again to 9.2% and this is absolutely crucial for our strategy and I'll show later why this. The number of app downloads is increasing a lot way faster than any other player in the market. We reached 14 million cumulative downloads and we have more than 400 cities, with motorized from store deliveries on top of 100% of the stores are click-and-collect and neighborhood deliveries. Okay.

So, talking about the gross margin, we have a gross margin of 27.8%, which was flat versus last year. And we have our cash cycle that has been constant with the -- sorry, it has been declining already over the previous quarter. It's in line with the previous year, but this is still a high cash cycle. Our members structurally is more like the 55, 56. I'm not guiding, where it's going, but for sure, this number is going further down in the next quarter. But it's already going down, but it has to go down more.

When you look at selling expenses despite of the inflationary pressures that we have seen in the market, given how fast inflation has been going up, the high comp growth that we have posted that has allowed us to generate operating leverage to mitigate inflationary pressure. So, we have diluted 10 bps of sales expenses in the quarter and this is for me, a very good result.

So, in the end of the day, we're talking about the 10% contribution margin, 10 bps increase versus last year and a very solid performance. This is the structural health of the company. This is where we see how we do structurally, because this is how the stores are performing. Obviously, considering the transformation process we are undertaking, there is a lot of pressure in G&A. Our G&A today is 3.1%, 60 bps growth versus last year.

If you look back three years, it's 100 bps G&A growth. And this is not money being thrown away. This is investment in infrastructure to deliver our strategy. So, when we increase, we're talking about managing people, we're talking about spreads, we're talking about analytics, we are talking about going to the cloud and all types of IT infrastructure investments that are taking place.

I believe that from now on this figure should start, should be stable. And in the future it should go down again as the marketplace, as the digital health platform really start creating value. But it's been an investment that has been absolutely necessary to do what we are doing. So, when we look at the EBITDA margin, I mean, obviously this 60 bps G&A increase results in a 60 bps EBITDA margin decrease. But again, when I talk about contribution margin, which shows the structural performance of the business, it's a slight expansion and not pressure. So, this is very important.

I mentioned inflation and I'd like to show more details about this. As you know, we have an annual price increase happens in March every year, that is very important to the outlook of the year. This price increase that happens in March is based on last 12 months' inflation in February.

So, if you look back what happened this year, we had a 5.2% less 12 months CPI in February, and the price increase was 7.5%. So, we got -- a price increase that looked really good and looked way ahead of inflation. The problem is inflation started growing at a very strong pace ever since. When we look at the average of the year, the projections point to 7.5, which means that the price increase was exactly in line of inflation, but with good news in the first half of the year in which inflation is below the price increase. And with that using the second half of the year in which inflation is ahead of the price increase too, because of operating leverage, we have been able to manage our sales expenses and to maintain and slightly actually expand store productivity.

When we first -- when we look forward to next year, they projected inflation for February 2022 is 8.7. But because inflation is expected to go down, the projected CPI for the year is 6.6. As you know the price increase that granted by CMED is a function of these inflation number, plus or minus our productivity factor. This productivity factor has a lot to do with the FX rate and other cost factors affecting pharmaceutical industry like electricity.

So, in my view, I'm not trying to predict this number, what the fact will be, but it looks very likely that the price increase will be above inflation. So, this will entail us to get an inflationary recomposition, which will be very supportive of a good performance for next year. But still with this kind of pressure, we have been able to hold our own and we have been able to maintain a very good contribution margin.

Here we have an EBITDA reconciliation shows that we have BRL1.2 million in non-recurring expenses. And finally, an adjusted net income of 2.7% and a net income in absolute terms of BRL174 million. The free cash flow in the quarter was positive BRL73 million, exactly because the cash cycle has gone down. So, the working capital consumption was very low here. It was actually positive.

But when you look at the total cash flow was slightly negative BRL22 million, but it includes BRL73 million of share buyback to support our store, our stock-based programs and our financial expenses and et cetera. All-in-all despite the fact that we still have a cash cycle above what's normal, our leverage is very comfortable, 0.8 net debt to EBITDA, net debt totally BRL1.3 billion.

And finally, when you look at the share appreciation, I mean, in the year, either if you look at the quarter or the full year, we are negative. And -- but we are doing slightly better than the IBOVESPA. So, we're generating some Alpha in the quarter as well as in the year. But for me in a year in which we have -- in the day in which we have our 10-year anniversary, it's important to look back and see what we have done since the merger.

So, if you look how we're doing today, I mean, we have since December 31, 2011, we are exactly seen that we generated a total shareholder return of 22.4% per year, which is, I think remarkable performance. And our aspiration is to keep delivering these type of returns going forward, as we are embarking a completely new phase for the company, as we try to become a digital health platform.

It's important looking back on what we have done over these years. So, we see that the number of pharmacies we have opened, the company operates has tripled in this period, the revenues have been multiplied by 5, EBITDA has been multiplied by 7, just like the market cap has been multiplied by 7.

So, it's obvious that this is a tremendous value creation coming way more from performance, then from multiple since EBITDA and market cap are performing well. They both grew in the same order of magnitude. So, this period here was not without pains. We had our moments of pain. I would highlight early on integration pains, I'll highlight 2018, when we had to invest in prices and we positioned our generics. But obvious, so it's never a straight line, but I think the value creation trajectory, I mean, it cannot be disputed. And our aspiration is to keep creating value in this new face of the company just like we did originally.

So, wrapping up in terms of our performance, I think, it was a very good performance in the quarter. I think the structural elements were very robust. Top-line growth of north of 20%, mature-stores grew 12%, 2 percentage points ahead of CPI and something like 500 bps ahead of the average price increase. Market share growth was very material with gains in every region and our expansion is fully on track to deliver to 240 stores this year and 260 stores next year.

In terms of margins, we got a contribution margin expansion and the pressure in EBITDA was fully driven by the investments we are doing to support this transformation process. And finally, there is an effect of inflation in the quarter, but there is a good -- an important recomposition expected to happen next year.

Talking about the strategic elements of the execution. I'd like to highlight how we have evolved in the new pharmacy. So, we have today 9.2% of our total retail revenues coming from digital channels. Number of downloads has followed this the angle of this curve. We have now $13.7 million. That was increasing at a very good pace, and as you know, the store is the crucial element for execution.

The store is where the customer acquisition happens. This is not Google, it is not Facebook, it's not Instagram, it's not TV Globo. The store is where we onboard the customer, when they learn about the app, when we persuade them to download the app, when they use the app, install and later on when they are at home. And the store is the basis for our logistics. If I'm not mistaken, 85% of all our deliveries are executed by the store. It's either click-and-collect, which happens 50% of the orders, given the quality of our popularity, more it's a neighborhood delivery or it's a motorized delivery. So, the store is there. The store is the differential of what we're doing. You can't compare a pure-play platform to an omnichannel platform, it's completely different.

And here in the bottom, I would like to highlight, why digital is important. I mean digital is a separate channel. Obviously, we could look and think about how this channel adds to the global P&L. But in the end of the day, this is not about the channel. This is about the customer lifetime value. This is about the fact that the customer, who gets digitalized buys way more often than a customer, who has not been digitalized, and buys much higher ticket as well.

So, we see here in the bottom, when they look at the overall company, we have 41 million active customers, 5.3 million of which are what we call loyal customers. And when -- these loyal customers represent close to 60% of our total revenues. But the loyal customers, who are also digital customers and we're talking 50% of the digital of the omnichannel base, they represent 85% of the digital revenues.

So, here on the right, I think, he gets self-evident the importance of digital. Our customer, who is not a loyal customer has an annual frequency of 4.4x. This customers who become loyal customers, they come to us 22x during the year. So, the first battle is driving non-loyal customers to become loyal customers, because spending goes from -- it's not spending. Spending increased even more than this because the ticket is also growing in tandem with the frequency.

But loyal customers, they buy way more frequently than non-loyal ones, and one they become digital at a loyal digital customer buys nearly 40x a year. While a loyal analog customers buy only 22x. So, as we digitalize the customer, we increase the frequency of the customer, we increase the lifetime value across every channel, not only in the digital channel.

If we look at our digital channel, our digital channel is profitable, but has lower margin than the normal channel. We have some more lower gross margin, we have some expenses related to digital, but still are very profitable and healthy channel. But when you look at the whole, the whole equation, when you look at the whole picture, I mean, this channel is very highly accretive. So, in the end of the day, the customer even if the channel is slightly less profitable, when the customers buy digitally, when the customer -- a lot of the times, the customers coming to the store, a lot of the times the customer is doing a click-and-collect.

So, in the end of the day, we have been able to maintain our profitability, our contribution margin and absorbing the fact that the channel margin is lower over a much broader relationship with this customer, which also involves the store. So, the importance of digital itself evident here. Digital is not amended itself, it's a means to an end, which is to drive loyal, to drive frequency from 22x to 40x a year.

And finally, we have also advanced during the pandemic in services. This is the number of COVID tests we have performed. Since the beginning of the pandemic there have been more than 3 million COVID tests. Obviously, now as the pandemic is easing up, the number is declining, but what matters here is not the COVID tests itself, it's the culture of service that stays.

Just like digital, we got an initial peak on the second quarter of last year, and then exceeded initially. But then we grew again, because it changed customer behavior. Here is the same story. The customer is learning that he can -- the pharmacy can help him take care of his health, his or her health. The customer can perform services with a high standard of execution and the customer can trust our execution. So, this is the beginning of a culture of healthcare in the stores. It's way more important than COVID -- than the COVID revenues themselves.

Marketplace. I mean, this is the year zero of our marketplace. This is an MVP, who is ready for barely a year. We have higher operating on every digital asset. Drogasil is just starting to get the marketplace. So, it's not even fully operational for the chains. We are growing significantly number of SKUs and number of sellers, and the challenge from now on is scaling up the marketplace and developing services to our sellers, having a better understanding of the center, and more importantly offering the same kind of omnichannel logistics that we have in a 1P operation.

I ask a lot of investors -- a lot of investors asked me, why would a customer switch from Mercado Livre, Magalu or whatever digital platform to buy at our marketplace. And it's a very easy answer. The customer doesn't have to switch. He's already with us, or get back here. We have 39x a year frequency for the digital customers who account for 85% of our digital sales. These are the marketplace customers; they are ready for us. They are already buying from us with a very high frequency. So, it's a matter of them finding the product with a good app, with a good merchandise execution, with a good omnichannel logistics.

The aspiration here is similar to the 1P aspiration. Imagine a customer, who buys today, a 3P item, being able to collect this item tomorrow from us in many stores without paying any delivery fulfillment fees. Who else has it? Nobody has it.

We're talking about Click & Collect for the marketplace. We're talking about Click & Collect in the best corners of Brazil. I'm not talking shopping more stores. I'm not talking pedestrian stores in poor areas of the cities. I'm talking about prime AAA real estate, with great visibility access, parking et cetera. So, I think by the time we integrate the logistics, we will have absolutely unique value proposition in our health care marketplace.

And finally, we also launched Vitat, which is our omnichannel healthcare platform. It integrates healthcare Super App, which is based on the apps that we bought from Tech.fit. So, there's two apps, which are standalone apps for specific functions like nutrition or exercise, but then we have divided that, that integrates with a journey perspective all these activities. We have already more than 60,000 active subscribers that we inherited from Tech.fit, 2.5 million downloads, 2 million users accessing our digital channels, more than 150 health programs across all the apps, more than 40 health programs.

If you look only the Vitat App there's already revenues -- recurring revenues coming from subscriptions here. And this helps Super App, there's all these programs will start having teleconsultations and will be fully integrated with more than 1,500 health hubs located in the stores. So, the customer will be able to schedule services, they'll be able to have their health wallet. So, you do a COVID test or a hemoglobin test, whatever test they do, they'll have their health history in the palm of their hands within the app.

So, this is the beginning of something that I believe can be very important for us. Today almost everything is free, but we have very clear hypothesis on how we monetize this platform. We're talking a lot B2C, but so much can be done on the B2B2C world, helping corporations and having their employees live a healthier life, taking better care of themselves. So, I think B2B2C will also be important for Vitat in the future.

So, these were our prepared remarks. Now, let's go to Q&A. Thank you very much.

Questions And Answers

Operator

(Question And Answer)

Thank you Mr.Eugenio. We'll now proceed to the Q&A session. The first question is from Eugenia Cavalheiro from JPMorgan.

Q - Eugenia Cavalheiro {BIO 20781536 <GO>}

Hi, Eugenio, thank you for the call and for taking my question. So, first I'd like to comment a bit on the margin front. So, you mentioned in the previous call that you believe the current level of G&A should remain for a while and then start to be diluted again. So, could you give us a bit more visibility on when do you expect this dilution to come? And what levels so should we expect the historical level of G&A to come back?

And the second one regarding additional initiatives. So, you have a very strong number of your sales coming from the digital platform. Could you give us a bit of a breakdown by region, so if there is any region, where the digital platform is a bit more stronger than in others and where could you have room for improvement? Thank you.

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

Eugenia, thanks for the questions. I mean, in terms of G&A, I'll talk conceptually, I don't -- I can't give any guidance here. But we have been increasing G&A. Our G&A in three years has gone up 100 bps, and it's funny because everybody asking me about 100 bps on margin up and down, nobody asked me what happened that 100 bps of G&A went up.

And it was not on purpose. There's no way we can create a digital transformation, create a digital health platform, marketplace, et cetera, without revamping our technology infrastructure, our management team et cetera, et cetera, et cetera. And so, we invested, but the good news is that our store generating operating leverage, which mitigated this investment. You don't see in the margin. This kind of pressure aligned with the G&A increase.

I believe, we are already at a moment in which the G&A has peaked. And I believe in the shorter term, it should remain in the same ballpark. And I think further down the road, as we start seeing more digital acceleration and start seeing the GMV from the marketplace and digital platforms really becoming material. I think the trends for the number to go progressively down. It won't move down 12%. [ph] I think it will be a progressive process.

But in the end of the day, we are a company, who has a very long-term perspective in everything we do. We are focused on value creation. We are not focused on the quarter margin or the annual margin, not that we disregard, not that we don't want to have the best quarter or year possible. But if we have to spend ahead to create value longer term, we do it without thinking twice. So, this is what's happening here. And we're fortunate to have a group of shareholders, who identify with this long-term vision.

In the end of the day, the company chooses its shareholders based on how it manages its strategy. We have always focused on the longer term and we have always been attracted by investors, who think likewise and who are here for a longer series. And I'm very, very fortunate to have shareholders with us, who were with us in the high IPO, and some of them in the Drogasil IPO, others early on after the merger. So, we have not to mention the three reference families, including the two founding families, who have been with this company for in the case of my family for more than 100 years. In the case of the Pires family for more than 80 years, in the case of Galvao family for more than 30 years. So, this gives us this perspective that allow us to create long-term value as opposed to play a short-term market gain that we see so often happening.

So, can you repeat your second question? I wrote down out, but I'm not understanding my own writing. Sorry, Eugenia.

Q - Eugenia Cavalheiro {BIO 20781536 <GO>}

No problem. So, the second question was, if you could give us a bit more visibility on the breakdown of the digital sales per region. So, if there is any region, where the digital sales are stronger than other? And where you see room for much improvement?

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

Awesome. Thanks. That's actually a very good question. Yes, the answer is absolutely, yes. Because I mean, let's put in perspective. We are not a regional company, who is only in a single market. We are a national player. There are so many markets we have entered recently. There are lot of cities that we have just barely entered. We have markets in which we are very mature and have high share of the markets in, which our share is still developing. So, your question is absolutely correct. The assumption behind your question is absolutely correct.

There are very high level of discrepancies in digital penetration. Our top markets -- in our top markets, we have digital penetration, which already north of 20%. And not only Sao Paulo, we have actually market higher than Sao Paulo, if you talk about Sao Paulo, Porto Alegre, Belo Horizonte, Rio De Janeiro, especially these four markets, the digital penetration is north of 20%. Then we have markets in which we have below 10%, if 9% is the average obviously, there are lot of markets more reset. They don't have any pragmatic digital culture yet and we're starting to create that have less than 9% than 5%, 6%, 7%.

So, there's a huge opportunity, which is having these markets in the lower -- the low penetration catching up. And as a result, the overall penetration is increasing. If we zoom in Sao Paulo, Rio, Belo Horizonte, Porto Alegre, et cetera, in the A areas, it's even higher than 20%, in the C areas it's lower than that. So, it's not an even penetration. And this is a reason why you cannot compare our penetration with that of a regional company, who is only relevant on a single market, who already has a very high share and coverage in a single market. It's completely different because we are national player, but we see that the numbers are moving up in a very good way.

Q - Eugenia Cavalheiro {BIO 20781536 <GO>}

That's very clear. Thank you Eugenio.

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

Thank you.

Operator

The next question is from Renan Prata from Citi.

Q - Renan Prata {BIO 22185872 <GO>}

Hi. Good morning, everyone. I just want to get a color a sense of how sales is evolving during October? And if you should see in the next quarter, the same penetration level, as we saw in this current quarter, or maybe in a higher level, given the Black Friday? Thanks, guys.

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

No. I think generics is performing well. And we believe obviously that we should be growing. Obviously, we had early on very steady growth. I think, if we look from last quarter on a sequential basis that's a good growth and we expect to see more growth in the coming quarters. And so I think yes, this is happening in this quarter. Thanks for the question.

Q - Renan Prata {BIO 22185872 <GO>}

Okay. Thanks.

Operator

The next question is from Gustavo Senday from XP.

Q - Gustavo Senday {BIO 21097459 <GO>}

Hi, Eugenio. Thank you for taking my question. My question is regards to the new shareholder agreement. If you could give us more color on the role of the referenced families going forward now that there is no longer a lock-up in place? Thank you.

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

Okay. Thank you. I mean, we have a new shareholder. Let me just get back in time. When we did the merger that's resulted in Raia Drogasil. We have four groups of shareholders coming together under the same roof. And the Raia shareholders and the Drogasil shareholders, they didn't know -- they barely knew themselves, when we got together. We got to know each other, I think one or two weeks before the signing happened.

So, it was very important for the stability for the company to have a lock-up in place, because the lock up guarantee that we have everybody in the same boat. So, we don't know ourselves, we don't have a history together. But we are locked up, if one gets drowned, everybody drowns together. And I think this was very important for us to get where we got for us to navigate well, during the initial pains of integration, navigate the cultural clashes we had early on, and there are cultural clashes in every merger of equals in the planet. I can guarantee that.

But because we had unity at the shareholder level, whatever happened at the management level was always solved. And we had these amazing success. So, we had this 10-year cycle in which we had 30% or more of the total shares of the company under a cap. And this is an absolutely unconventional structure. I don't know how many companies in the market have a lock up strategy. But it was instrumental early on. We are now entering a new 10-year stage. We have a shareholder agreement in place for 10 years. This shareholder agreement brings -- maintains together the three families, who have been for many decades ahead in this company.

The founders of Natura, they are no longer in the shareholder agreement, but they remain shareholders. Their intent is to remain shareholder. They have brought a representative. He's still sitting in our Board, and he's not going anywhere. So, we're still very close to them and they're still very committed shareholders. The intention is to staying with the company. But considering their choices, life cycle et cetera, they are not prepared to sign a 10-year commitment like the founding families have done and that's natural. But it doesn't mean they're going anywhere. So, we're starting this new cycle with 10 years of relationship behind us and we don't think we need a lock up for us to be aligned.

We have 10 years of amazing success working together. And we'll go on. Nobody should doubt for a minute the commitment of these families. It's obvious that the kind of strategy that we're pursuing right now is a strategy that is renouncing to shorter margins. Our G&A shows that very clearly. This is absolutely not the strategy of a group of shareholders, who are interested in leaving the company, it's the opposite. We are committed for 10 more years with the company and we have our shareholder agreement that supports us in doing this. But lock-up is no longer necessary, just like we don't see lot of company, in any other company and just like it was necessary early on because there was a risk.

Q - Gustavo Senday {BIO 21097459 <GO>}

That's clear. Thank you.

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

Thank you.

Operator

The last question belongs to Irma Sgarz from Goldman Sachs.

Q - Irma Sgarz {BIO 15190838 <GO>}

Yes. Hi. Good morning. Thanks for taking my question. One question I wanted to just come back to, I think it's been sort of regularly asked on these calls, but and I think I know the answer but I wanted to just sort of check the temperature and how are you thinking about organic versus inorganic growth. I think historically you've said that organic growth has been at least in the physical stores, obviously it's different for new apps and you pieces into the ecosystem. But what -- I think my question is more about the physical store world. And what do you historically obviously said is that the organic growth has been sort of your main choice mostly, where it's been more accretive? But I just wanted to sort of hear how you thinking about that?

And then the second question regarding the macro backdrop that we're seeing in Brazil at the moment, obviously you have incrementally increased your exposure to the hybrid and the popular or sort of lower middle -- the middle class and low middle-class store formats? And in those stores, are you starting to see sort of pockets of weakness in terms of consumers may be shifting away from certain products or brands? And how are you trying to counter or help the consumer in this context? What choices are you making, whether it'd be pricing or private label or other things that you can do?

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

Okay. Thanks for the question Irma. And I mean about your initial question, I think you are right also in your assumption. I mean, we pray in the church of organic growth. We are believers in organic growth. We do organic growth in our industry better than anyone has ever done and we keep doing that. When we grow organic, we cherry pick each location. We cherry pick the distance from this store to the pre-existing stores. We optimize -- we minimize cannibalization.

We optimize marginal revenue aggregation from this store, and we're doing that with increasing returns, not decreasing. Our internal rate of return this year and last year is around 25%, historically it was around 20% it has grown, because there's less cannibalization today than there was in the past. And I think we also be more efficient in terms of new store CapEx things like that. So, we will keep on growing organically, obviously if there are M&A opportunities, we look at every opportunity don't have any doubts about that. Every acquisition I think in the past under our eyes before they pass under anybody else's eyes. And whatever acquisition we have not done is because we chose not to do.

But occasionally, we have done it. Onofre is a prime example. We had a company with very good locations in our core market, small size easy to integrate. There was also other assets that we -- in Onofre that we thought was interesting. We bought and integrated and we did it. So, we know how to do M&A. We're fully prepared to do M&A, but it's difficult to believe, there'll be much M&A going forward in the core area, in the expansion, in the traditional new store growth, because what assets has the kind of revenues per store that we have. What asset has the kind of locations that we have? What assets has the kind of people that we have? You don't find others.

There are few good ones in the market, which would cost one arm and two legs. So, the -- generally the good assets are not for sale. The assets who are for sale are the bad best. It's always like this. This is almost an universal rule of thumb in our business. We are in a great industry. Great companies don't want to sell. The shareholders want to be around on a very long-term basis for all the good companies in the market.

The companies in trouble are the companies looking to be sold. Generally, they are new entrants. They are private equity investors, who have had a terrible experience and who have failed to create value. So, this is like cleaning dump, others have left behind. So, we're not going there. But when you think about healthcare, we are more open than that.

I think the chance that we will -- the reality that we need assets who are -- can play, who -- which we don't have at home and can accelerate our strategy. I mean, this is already showing up. We bought Tech.fit for -- as their foundation for Vitat. We have our debentures looking at a lot of other things. We bought Healthbit, which will help us drive our healthcare platform into the B2B2C world. We bought Manipulae, which is a apothecary pharmacy marketplace to complement our offering.

So obviously, some deals have been very small. Other have been, I don't know, I think right now no deal has cost more than I don't know BRL50 million or BRL60 million. But let's say, if there is an asset that we think are highly complementary and cost BRL200 million, BRL300 million, BRL400 million, BRL1 billion. If we believe it creates value, we believe it plugs well into what we're doing, there's no reason why we couldn't do it.

In terms of the macro, I think the obvious influence of the matter has been inflation. So, I showed inflation chart. We got good news in the first semester because the price increase was ahead of inflation and bad in the second semester. Because inflation is now ahead of the price increase, but I believe it will recompose next year because the average price increase we have will be very likely higher and maybe significantly higher than the average inflation for the year.

In terms of demand. I mean, this is an out-of-pocket category. This is an essential category. So, it's very difficult for us to see. We have even in C stores to see very different behaviors than we saw. Not to mention, that the expansion into the C class has been gradual. It's not like we bought a C class asset today, and there's a turnkey. It's easy to see now. When we did this before, it's gradual. So, I don't think there's anything to be worried about.

Q - Irma Sgarz {BIO 15190838 <GO>}

That's great. Thank you very much.

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

Thank you.

Operator

The Q&A session is over. We now return to the conference call to RD's executives for their final remarks. Gentlemen, you may proceed.

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

Okay. So, I would like to sum up some of the things we have been -- we said in this conference. I mean, first of all, the quarter performance, I think, it was really good. All the structural elements are very strong. We see strong top-line growth more than 20%, we see mature store growth of 12%, 200 bps ahead of inflation. We saw store contribution margin slightly expanding. Market share growing up very fast.

So, all the fundamentals are there, we chose to invest in structure to pursue a new strategy to develop new businesses. And this is natural, but that doesn't affect the core business. And we are driven by the longer term margin, not by any bumps, because we just now have a high G&A than before. So, I think this is part of life. And this is something that we have the luxury to do, given the strength of our structural performance. And we believe that this will create a lot of value going forward.

We are seeing a lot of advancements in these new businesses. I mean, digital is no longer about the future, digital is taking place today. Digital is what accelerates our top-line growth. Digital is what's increasing so much the frequency in spending of our core customers and we will keep accelerating digital and digital keep accelerating the comps. And the comps will keep accelerating the store contribution margin. And then when the new business start picking up also the G&A will be going down. I believe the G&A now get stable, but eventually it has to go down. It's just a matter of giving time for this to new businesses to perform.

In my view, in five years this business will be material, in 10 years this business will be transformational. This is the definition that I used in the Investor Day and I think without going into any formal guidance, is the best way to define how we're thinking about that. So, we are very focused on this new strategy. I believe it is transformational. It's easy to think new pharmacy marketplace on our platform on an individual addictive basis -- additive basis, but for me, it's not an addition, this is a multiplication. This is a platform effect. A customer who comes in from the new pharmacy will be able to find the marketplace and we'll be able to use the digital platform. A customer coming in the digital platform, not only allows them the digital platform to make money, but they'll buy in the marketplace and in the pharmacy. So, it goes.

So, the combination is way stronger than any part individually. I think everything gets very accretive as long as the customer lifetime value goes up. And this is what's happening already in digital. Digital is enhancing the overall 1P lifetime value. By the time, we get marketplace and platform up and running, I think, this lifetime value goes further on and on. And I think this is absolutely transformational.

And finally, I cannot close this call without thanking our long-term shareholders for your trust and support over these periods. As I mentioned before, it was not without bumps. We had our bumps early on during the integration, we had bumps in 2018, when we had to invest margins. These transformation implies margin investments as I mentioned, nobody asked me, but we increased 100 bps of G&A in three years. But people don't see it, because the stores are performing and we're compensating this with operating leverage. But it's not a linear journey. This is the message that I want to give. And I again, I think the company chooses their shareholders based on how it acts, based on how it communicates. And we have the luxury of having a very loyal shareholder base. Our several shareholders, since the Raia IPO, since the Drogasil IPO, since the early days of the merger many, many, many shareholders.

It's our cap table is almost a boring document to look because it doesn't change much especially on the top. And this kind of trust in our execution, in our strategy, in the commitment of these founding families, with the business for the long-term that allows us to deploy the strategy through what subject to the same kind of quarterly pressures. A lot of companies are -- because they have short-them shareholders sitting there. I don't know if you have the luxury to look the long-term, as we are able to.

So, you guys are absolutely part of this journey of this success and we hope to stay together for the next stage. Obviously, the stuff we're doing now is not what families, who are milking the cow to go away and do this is things that our people, who are here for the long term and who are trying to recreate a company to evolve into a completely new stage, but a very exciting and a very promising one. So, thank you very much.

Operator

RD's conference call is now over. We thank you for your participation.