Q2 2017 Earnings Call

Company Participants

- Eugenio de Zagottis, Investor Relations and Corporate Planning Officer
- Marcilio Pousada, Chief Executive Officer

Other Participants

- Guilherme Assis, Analyst
- Joseph Giordano, Analyst
- Luciano Campos, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to RAD People,

Health and Well-Being Conference Call to discuss its first quarter of 2017 results. The audio for this conference is being broadcast simultaneously through the Internet in the website www.rad.com.br/ir. In that address, you can also find the slide show presentation available for download. We inform that all participants will only be able to listen to the conference during the company's presentation. After the company's remarks are over, there will be a Q&A period. At that time, further instructions will be given. (Operator Instructions)

Before proceeding, let me mention that forward-looking statements are being made under the Safe Harbor of the Securities Litigation Reform Act of 1996. Forward-looking statements are based on the beliefs and assumptions of RAD management and on information currently available to the company. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of RAD and could cause results to differ materially from those expressed in such forward-looking statements.

Today with us are Mr. Marcilio Pousada, CEO; Mr. Eugenio De Zagottis, Investor Relations and Corporate Planning Vice President; and Gabriel Rozenberg, IR and Corporate Planning Director.

Now, I'll turn the conference over to Mr. Marcilio Pousada. Sir, you may begin your conference.

Marcilio Pousada {BIO 16117399 <GO>}

Hello. Thank you. Good morning, everyone. Welcome to the presentation of the results the second quarter 2017 of RAD. As always, Eugenio will present the numbers and I will (inaudible) just some points about the results. Eugenio, please.

Eugenio de Zagottis {BIO 7193695 <GO>}

Hello, everybody. Thank you all for attending RAD's second quarter conference call. Obviously, this is a quarter in which we faced a very strong comp base from last year, the impossible comp base because of the inflationary gain on inventories. Obviously, we knew at some point this quarter come, we will have to face it, but there is no surprise in here.

Having said that, I think we achieved a very strong expense dilution that allows us to successfully navigate this pressure and turn that with a margin EBITDA that made us happy. So the highlights for the quarter, we ended the period with 1,506 stores in operation. We opened 54 stores in the quarter and closed another five stores. Our gross revenues reached 3.4 billion, 16% revenue growth with 6.1% retail same-store sales growth.

Our gross margin reached 29.4 platform, 2.1 percentage points decrease over the peak of last year, with 301 million of EBITDA, a margin 8.9% and 150 bps margin pressure from last year. Our net income reached 130 million with 4.1% of net margin and we had a negative free cash flow of 65 million, with 134 negative total cash flow.

On page four, as I mentioned, we ended the period with 1,500 domestic stores. We opened in the quarter 64 new stores and closed five stores. If you compare the full first semester with last year, we are exactly in the same pace and we reiterate the guidance of 200 gross new stores for this year.

Here on the right, we had this quarter, the greenest store base since the second quarter '13, with 36% of stores still in the growing maturation. So this provides a lot of residual growth in the future.

On Page five, we can discuss here our geographic presence. Of the 1,506 stores we had by the end of the quarter, 715 were Raia, 768 Drogasil, 20 were Farmasil and three were 4Bio. I will highlight here that we reached more than 850 stores in Sao Paulo and 115 stores in the Northeast. This is a story that started four years ago -- so four, five years ago. So, it's a pretty nice regional expansion.

Our market share grew consistently in four of the five markets where we operate. We gained 80 bps in national market. In Sao Paulo we gained 70 bps, in the Southeast we gained 40 bps, in the south 60 bps, and in Northeast 130 bps. The only market we lost share was in the Mid-west, because last year at the (inaudible) we had a competitor in Brasilia in a distressed situation without any inventories and so on.

So obviously that company was (inaudible) and now they have inventories. As much as we may be skeptical about the profitability and growth potential, but the fact that it now has inventories affects our growth. The great thing here is that we increased massively our revenues per store over the period and have been able to sustain the bulk of that revenue increase. So, for us, it's been very positive.

On page six, let's start talking about the revenue growth. We posted consolidated revenue increase of 60%, with 15% for retail and 47% for 4Bio. When we look at our mix within retailing, the highlight was the pharma categories, especially generics, which grew 17.7%, OTC 17 and branded 15.9, HPC grew 10.8%. There is an effect of the Zika virus anemia [ph] last year that we had. So we had a high comp base pressure in April, but structurally, HPC is not growing at the same pace of the rest of the mix. So there is an effect on the horizon that shows up here.

Page seven, when we -- our consolidated revenue growth, as I mentioned, was 16%, with 6.1% for same-store sales and 2% for mature stores. Here it's important to make a distinction. We had a very challenging month in April, when we had three holidays in a single month, which is highly unusual and affected the sales of the month in a major way. I mean, it looked like an Olympic month or a world cup month.

But the thing is, when we put together the average for May and June, numbers were completely normal. So we grew 17.4% on a consolidated basis, with 3.4% for mature stores. And it's important to highlight that the CPI is 2%. So mature stores is growing ahead of inflation. So obviously, the April effect is a one-time pressure that will normalize, maybe around 17%. So we are still foreseeing a healthy structural growth, with mature stores

growing slightly ahead of inflation.

Obviously, when you compared to previous quarters, we see a non-linear deceleration, but it's completely related to inflation. So if you're talking 17% growth with 3 of inflation, we're talking 14% real growth. I mean, this is very similar to what we did last year when inflation was 9% for example. So, it's a total normal number, with the exception of the calendar of April that generated a pressure here.

So, we had this big comparison based on last year, which we all knew it was an impossible base. So, our gross margins contracted by 220 bps this quarter. Of that contraction, 1.6% was in retail, due to a lower price increase. So, the price increase last year was 11.8, this year was 3.1, so (inaudible) was much lower and in 4Bio, the effect was even more pronounced, because 4Bio only gets the lower tier of the price increase, because there was no generics. 4Bio had an average increase of 1.4%, versus 11.8 last year.

of 1.4%, versus 11.8 next year. Next year not only the average was much higher, but it was linear (inaudible) and no generics. So, 4Bio pressured our consolidated margins by 30 bps.

And then there is an additional 20 bps in the net present value adjustment, because interest rates are much lower now. This is a non-cash effect, an accounts effect, so it doesn't affect valuation.

Here on the right, I mean, our cash cycle was 70 bps higher than last year. So, it's pretty in line and obviously the fact that revenue growth was more modest because of April, it affects also the cash cycle line. So, it's a normal kind of variation that you have from quarter-to-quarter.

On page nine, we talk about operating expenses, and this was really the highlight of the quarter and probably the highlight of the year. We achieved an unprecedented dilution of 60 bps in our operating expenses. I mean if you go back in time, just after the merger, we had three years of significant expense pressure, then years 2011, '12, '13. '14, '15, '16, we managed to maintain our margins on a more flattish basis.

So, this is the first time we are seeing a material expense dilution. And a great thing here, as I will highlight, is that this dilution is structural. And we can expect this dilution to be sustained going forward.

I think it also highlights the management capacity, the company's capacity to adapt its expense base in an environment in which revenues grew less than expense, in which the inflation was lower. So, I think it's a great achievement whatever angle we look from.

So, the detail here, what happens behind this dilution. So, we diluted (inaudible) expenses by 10 bps, acquiring fees by 10 bps, pre-operational expenses by 10bps, corporate by 10 bps and 4Bio operating leverage by half [ph]. So, that is a lift of 50 bps structural dilutions. Then we have 10 bps of logistics, 10 bps of marketing and 10 bps of electricity, which may or not repeat itself.

And then, on top of that we faced a major pressure in rentals of 30 bps. And what happens here is that two-thirds of our contracts they got readjusted in the second semester of last year when the IGPM had an average of 9.5%. Right now, IGPM in June -- in last month is at a negative 0.8%. So, obviously, as we move forward in the year and as we start renewing these contracts again, we will see this pressure falling down. I don't mean that there won't be any pressure or that we can dilute, it's not my point, but certainly if there is any residual pressure, it shouldn't be 30 bps.

So, as you can see from these numbers, this is a very solid and structural trend that we will carry forward and which should lead the way for continued margin expansion in the next two quarters.

So, getting back to page 10, our EBITDA margin fall from 10.4 to 8.9. So, we are talking 150 bps, which breaks down in 220 bps margin loss and this was the loss that was as anticipated. We all knew at this point in the second quarter of this year that we managed to mitigate the pressure with 60 bps of expense dilution.

Another way to look at the quarter's numbers is that, let's imagine this is a non-seasonal quarter, right. We got, let's say, it was a quarter with 20.7 or 28.8 of gross margin, which was the gross margin we posted over the last two quarters. If that were the case, our EBITDA margin would be 8.3%. 8.3% is a much higher EBITDA margin than we posted in three (inaudible) quarters, which was 7.4 and 7.6, which were very welcomed by the market.

So obviously we're posting a margin pressure versus last year. Obviously, there is some reaction from the sell side based on that. But in mine view, if you forget the past, and we focus on this quarter and what it is and what it means and what it implies forward, it's very nice margin. And just by comparing with the previous two quarters, even if we take 70 bps of the pressure, again, it's a much better margin.

The other thing is that the calendar effect that we had in April shouldn't repeat itself. So, on a structural basis, our revenues are around 17 -- are growing something like 17%. In the case of May and June, it was 17.4%. So the structural growth is an environment in which inflation is 3%. So with sound growth going forward with great expense dilution and with a solid normal gross margin that has nothing wrong in it. I think the trends as I mentioned is I expressed very positive.

Page 11, net income fell from -- net margin 5.4 to 4.1. So 140 bps of pressure driven by the lower EBITDA margin. We had a slightly negative free cash flow of 47 million in the quarter with the a total cash flow that was negative by 134 million in the quarter. Obviously, we had higher interest income, interest on equity than we had, for example, last year.

Finally, our share has significantly appreciated in the year. So we have, it's going up by 14.6% versus only 4.4 for the BOVESPA, also very good average trading volume of BRL91 million. So for those shareholders who invested in Drogasil IPO and we have several of them here with us, they have had an annual return on 28.7% and for those who entered the Raia IPO, we have also plenty of them here around, they have achieved 33.7% of annual return on their invest. So I'll now pass to our Marcilio and then will get back to Q&A session. Thank you.

Marcilio Pousada {BIO 16117399 <GO>}

Okay. Thank you Eugenio. (inaudible) page four, let's talk about this quarter. Always the new guys, and they ask us about what's the trends for 2017. We always talk to you that we don't know the trends for 2017, but we know that the second quarter will be difficult and this the second quarter. Okay. We know that the sales, when we have to the annual price cap, it will the number one challenge and you have another challenge with the April sales , which three long holidays in a single months.

Except this one, we know that we had a record quarter for us because, we know the new revenue growth that you expect for the future will be 17% and that for mature store will be between -- like the inflation, the same manner in the past. Okay, between 4% and 3% every month.

And we -- but what we have to look in this quarter. I think the expense dilution. This is the best, best part of the quarter. We worked since the end of 2015 in the labor. We worked to reduce the turnover, to training better the people, to work with the career for the people in stores, and also to change the staffing. And we are doing this, always looking for the NPS, the net promoter score that you have in historical (inaudible).

Looking for the customer satisfaction is good or not, and this helped us to reduce (inaudible), keep in the same record (inaudible). We are proud about the number and we know this number will be good for us in the future.

The other good expansion -- that's the expense, that the dilution is there in our operational expense. We open store, not like a crazy guys. We open stores like, every month there will be 15, 20 stores. A stable base will be 200 store in a years, with the same quality in the past. These help us also improve your (inaudible) opened stores and to dilute these expenses also, this help us.

The rentals that pressured us this quarter, we rate negotiated for more than 600 contracts and this will be diluting the next quarter we hope so, okay. But what's important for us also we are having many transformation initiatives coming. The new large (inaudible) with only Sau Paulo state to finish. We are doing this in the end of September and this is doing very well. And we know that it will help us more sales for the future.

We just entered with a new pricing platform to help us in HC and OTC items, help only (inaudible) the price Sao Paulo state to finish, we're doing this in the end of September and this is doing very well, and we know that it'll help us more sales for the future.

We should enter with new pricing platform which will help us HPC and OTC items, we change the price not only by stores, but also by store formats. This is completely new for our market and it will help us, not only this year, but mainly for the next year. And the new (inaudible) that we did also closed the (inaudible). We did more than 10 stores renovation, and are going to do 50 stores this year only (inaudible) this can help us for the sales in the future also.

We opened our store in Ceara, Fortaleza with this new format and it is doing very well. When you open Ceara, we are plan to close all (inaudible) for the Northeast area, an important region for us that we started in 2012 in this year (inaudible) this year. With all this plans and the expense dilution we are very confident about the future, and we know we'll have better results in the future also.

Now we're ready for the questions.

Questions And Answers

Operator

(Operator Instructions) Mr. Joseph Giordano from JPMorgan would like to pose a question.

Q - Joseph Giordano {BIO 17751061 <GO>}

So, hi, good morning everyone. Thanks for taking my question. I would like to understand a little bit more about the competitive landscape, right. So we see some of your competitors, particularly from the northeast coming to more extent to Sao Paulo region, to your core market, while you are growing on top of that core markets. So I'd like to understand how this is playing out? So if you see some refractions from competition in terms of pricing or things like that? Thank you.

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

Joseph, thanks for the question. I mean overall, we think the competitive landscape is normal. I think the only material change is obviously in Brasilia where we had a nearly bankrupt competitor without any merchandise, and they were acquired, they now have inventory. So obviously they recover some of their sales, but we still did really well on an absolute basis, on a competitive basis, then it's slightly better. But that's the only material change that the (inaudible) pharma was in deep distress now, and now it is much better.

Obviously, and we are not the only chain expanding. We have all the chains expanding. This is not new, I mean if you look back every time we have faced competition, so competition is not new to us. I think (inaudible) pharma going down. And obviously they are aggressive, they are opening stores.

But I think we have dealt very well with those, because these are markets especially in the Southeast, especially Sao Paulo and so on, where we have been for a very long time. We have the best locations, we have the best execution, we have very strong brand awareness. So we haven't felt any major -- and if you consider the size of Sao Paulo where we have 150 stores in the state, I mean the number of new stores opened is not material.

I think, for example, Marcilio was referring to the Northeast. What's happening in Sao Paulo is it's a great field for the company, because Sao Paulo is also supposed to be a tough market. We had -- it's the home market of (inaudible) , which is a change you expect. As for the PharmaKing, they are much before us and they have a very good well-entrenched presence there. And you coming late to the party, we were able to -- obviously we are talking four stores, we're talking one two weeks, so it's very early, but the initial numbers are very encouraging.

And I think they (inaudible) the strength of the execution of the format and of the locations. I think, the main difference there is that even though we're coming after everybody, we have two guiding locations that are better than our -- the one that our competitors have grabbed before us. And when we get those locations which are actually very expensive locations, but we have a format and an execution that where it can monetize that. So when you compound that kind of location with our execution forward we have the lowest stock out in the market. We have competitive prices.

We have competitive prices. I think our people are better trained. So, in the end, I think we are offering a better alternative for the consumer. And the consumer is coming to us even in a difficult market like that. So, obviously, the same also translates throughout two other markets in which -- on top of that, we have the advantage of being we the major chain like in Sao Paulo or being a first-mover, for example, the top of our facility. We have got ourselves a list of unit before. We've got ourselves a -- a list of unit before. So we have the best locations. We have the strong brand awareness. We have a great operation, and we are not feeling any pressure. I'm not saying that we cannot be successful. I think there is space in the market. I think there is still better including this back to them. But we are not paying the bill here, that's my point.

I got point. We opened stores in all location. People are important. We are doing much better to people right now than we did in 2012 tracking our order, because there is much more training back in Santa Catarina, Porto Alegre or even in other new states that's coming for the future.

Q - Joseph Giordano {BIO 17751061 <GO>}

Perfect. Thank you. And just if you could explain a little bit more on the efficiency gains on the expense side, what should we expect for the second half? You mentioned a little bit about utilities and rentals? So how should we see particularly the rentals line, right, because the IGPM is trending zero, slightly negative at this point? Thank you

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

Well, we are seeing a major expense pressure in rentals and I think these expense pressure will progress and fell down. I mean if you compare for the next quarter, I don't know how many contracts we have been negotiating, so I don't think it makes a big impact. But that impact in the fourth quarter, I think, is already better, that when you get your next deals all contracts renew, then it's totally better.

So my view is, of those dilution, I think we have a reasonable, like, 50 bps per built the high lease structure. The 30 bps that can we beat or not, we will see. And then there is rentals, which is pressuring 30 bps, and I think that pressure will start falling back. I don't necessarily mean that we dilute rentals, but I think it's difficult to dilute rentals.

But even if you have diluted pressure than now, the rest of the dilutions are enough to position us very well for margin expansion. When you think about the third quarter next year, our third quarter gross margin, I think, it will be 100 bps higher than normal, because of the residual effect of the price increase. I think even with that we had a fresh start as being similar and thus margin in the same quarter. I would expect to try to be around where we did last year, but obviously last year we had few a big residual of the price on the third quarter. While now to the -- structure and I further expect to have a very good dilution in the fourth quarter.

Our target is to try to defend the margin ratio in 8.5, 8.4 actually consolidated. I don't know if we make 8.4, maybe we do 8.2, 8.3, maybe even 8.4 is not out of the table. But the difference is, let's say the margin is similar or it's slightly lower, the main point is that, we did that margin last year, we saw very specific factor and no recurring factor, which was the price increase. Now we are doing kind of the same margin on a fully structural basis. So, I think it's a huge achievement for the company.

Q - Joseph Giordano {BIO 17751061 <GO>}

All right. Perfect. Thank you very much.

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

Thank you.

Operator

(Operator Instructions) Mr. Guilherme Assis from Brasil Plural would like to pose a question.

Q - Guilherme Assis {BIO 16143141 <GO>}

Hi, Eugenio. Hi, Marcilio. Hello, everyone. Thanks for taking my follow up question here. Eugenio, looking at the numbers, I would like to understand what is the dynamics in terms of the breakdown of the same-store sales, in terms of traffic, and ticket? I know that we had the bad comps or the tough comps from last year and also the price cap increase. But I think more specifically I would like to understand how is consumer behavior and how is traffic playing out given the low down on the macro front? I know you are in very resilient industry, but I would know perhaps mainly for the health and dairy products, if you are seeing lower traffic or lower -- or smaller basket for those kind of items, so can you give us any color on that?

And I think related to that, if you can also talk a little bit about any potential trades in terms of channel share? I

think you are losing market share to other channels like more discounts from (inaudible) or anything like that, more in the safety and the health and beauty products? Those are my questions. Thank you.

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

Let me -- I didn't listen to second part, but I'll start with the first and then I'll ask you to repeat the second part of your question. Obviously, if you look the average of the quarter, the volumes are negative, very much influenced by April, but if you look May and June, I don't have the exact figures in front of me, but I think, it's something like neutral volumes at mature stores with the effect coming from pricing. So it's kind of the historic effect we've always seen.

Obviously, an expansion like ours, cannibalizes existing stores to some extent and the volume cannibalization is much higher than the pricing cannibalization. So, in some of these mature stores, you don't look too much at volumes, to be very frank, but in mature stores, they are neutral in volume and their inflation for us that's a good number. And over

April and March or May and June, we got 3.4% from mature stores versus 2% from inflation, that for us is a good number. (inaudible) as I mentioned.

In terms of (inaudible) dynamic, I think HPC is still affected by ZIka virus effect of last year. But even without the Zika virus effect, HPC's is falling behind the rest of the mix. The second part of that, when we look at the upscale items like, makeup, like skin care, like hair care, they are doing really well, there is nothing wrong with them. So it's not discretionary purchasing affecting them, but we see issues on massive categories, things like diaper, things like soap, things like hair care. I think it's influenced by a cautious consumer, it's also influenced by a cross channel dynamics. And we're seeing supermarkets being very aggressive in some of those categories, so we have a challenge here.

In the end, I think the whole effect that you have from the launch -- new launch program, with exclusive offers for the whole chain, I think it will help us strike back on beauty, and eventually when the crisis goes on (inaudible), we may see during -- getting back July. But in the end we can't complaint about these (inaudible) we can't complain about the consumer, because I think (inaudible) plans from a structural basis we are very happy.

So, if you could repeat the second part of your question.

Q - Guilherme Assis {BIO 16143141 <GO>}

No, I think you already answered it. It was about the trade-off in channel, if you are seeing like perhaps you are losing market share to some more aggressive discounted players. I think you've answered that. So, that's clear. Thank you.

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

Okay. Thanks.

Operator

Mr. Luciano Campos from Bradesco will like to pose a question.

Q - Luciano Campos {BIO 16181710 <GO>}

Hi, Eugenio. Hi, everybody. Just follow-ups in two topics that you all guys already discussed. On the SG&A part, Eugenio, how would you overlay the labor reform to your expectations of SG&A as a contributor to your margins? I think perhaps 2017 is not timing -- there is no timing for that yet, but what are your views for that in 2018 assuming that the (inaudible) that we saw for the labor reform is not changed and it's CapEx as it is? That's my first question.

And second, back to HPC, based on your answer from the previous question, would you change anything in your strategy, would you try to reduce exposure to some basic HPC to increasing an order, is it part of the strategy already. Just two comments on that? Thank you.

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

Okay. Luciano, thanks for the question. So the labor reform is obviously positive. I mean, it gives us more flexibility in terms of staffing for example. But I don't have a, answer yet as far as what the impact that can be. We do study internally and trying to see what we can do, how we can improve, but its only positive.

A - Marcilio Pousada {BIO 16117399 <GO>}

Luciano, Marcilio here. I think labor is good for all the retail industry areas, a labor intensive business. Okay. And we know, but (inaudible) starts right now in terms of what we're changing and you can see (inaudible) not right now (inaudible). Not only in cost, but also in (inaudible) people working for us.

I think maybe next year, we more of aware about what happened with the numbers of all those labor reforms. But so far, very good trend for us.

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

It's good and we're working on that. On your second part in HPC, what happens is, I think we always try to separate what is strategy from what is short-term trends. So, I mean if you think about the mix, what we're doing, we are coming out of kind of a one size-fits-all approach and customizing our mix way more based on store format. The most visible part it's on the (inaudible) stores and then there we are entering this makeup with (inaudible) skincare, we are premiumizing hair care, but we're doing that because of opportunities, because of it -- not necessarily because the massive categories are not doing well.

Although obviously, it helps offsetting those trends. But at the same time, we have a huge initiative in popular stores in terms of improving our execution in those stores. And then our popular store is more popular. So on that aspect it goes to the opposite direction. Obviously, upscale stores are very much bigger than popular stores, but I do think popular stores is very important. We are getting a lot of learnings from some of you, from HPC, from our new stores. So we should start making our merchandising better and (inaudible) for every kind of neighborhood, for every kind of consumer.

Q - Luciano Campos {BIO 16181710 <GO>}

Okay. Thank you, Eugenio. Thank you, Marcilio.

Operator

Mr. Joseph Giordano from JPMorgan would like to post a question.

Q - Joseph Giordano {BIO 17751061 <GO>}

Hi, just for question. Thanks for taking it. Look at the capital structure of the company recently issued debt this strengthened the long-term position to finance CapEx. Having that said then and particularly assuming that your stores continue to mature at very healthy levels, should we expect a higher cash back to shareholders, so basically higher dividend in the short term? Thank you.

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

Joseph, thanks for the question. I mean sort of for us a zero capital structure is a neutral capital structure. As you know, we don't want to get to leverage the company. We don't believe in leveraging any (inaudible) like country like Brazil, especially for a high growth companies with a huge consolidation opportunity like we have. So I our growth demands us to have more flexibility and to be conservative. It doesn't mean that leverage has to be zero. I mean we have been doing 0.2, 0.3 and that's how (inaudible) if you get to 0.5, that's also a case. But we wouldn't (inaudible) and go ahead of 1-time EBITDA. So that's a part of our strategy.

In terms of future capital allocation , obviously, if we build 200 stores a year, after a while, it starts generating free cash flow. The question is how much can we link back all that free cash flow in the business for growth and for further opportunity. For example, the main initiative (inaudible) we're starting the roll out of some of these,

(Technical Difficulty) so from our view, it's a capital allocation prospect and nobody likes compensating the (inaudible) and correctly so, because it's too early.

(inaudible) capital. We just don't know how much capital. For example, as we have Drogasil, the new format depending on what happens, if those conversions if we see as a big -- a nice sales momentum, we can be more aggressive in investing more on renovations for example. So there are opportunities that may arise in that regard that will require more capital than we are deploying now. But let's say, if we don't see an opportunity to prudently invest that surplus, my answer is that we would increase distribution.

Q - Joseph Giordano {BIO 17751061 <GO>}

Okay. Thank you.

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

Thanks.

Operator

It appears to be no further questions. Now I'll turn the conference back to the company for their final remarks.

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

Okay first of all, thank you all for attending our conference call. I mean obviously this quarter marks the moment we all knew would come at some I mean obviously, this quarter marks that moment we only would come at some point, where we'll have to face the huge comp base of the second quarter last year. So there's no surprise here. This is something that we knew already when we did the last year that this quarter would arrive, and with a 11.8% of average price increase last year versus a low 3.0 something this year, obviously, that's impossible margin to complete, that was the margin peak and there is nothing wrong with the margin of this quarter.

What happens is that the margin we had one year ago was extraordinary, and it couldn't been repeated. For me, I think a lot of people get to compare only quarter- to- quarter and I think that's very myopic. I think obviously, quarter-to-quarter had its importance, but we to see quarter versus -- on sequential basis versus this quarter, and many quarters than anything understand what the quarter means on its own, and what it implies to the future.

I mean obviously, if this quarter was a non- seasonal quarter with no inflationary gain of inventory, our gross margin would be something like 28. 7 or 28.8, our EBITDA would have been 8.3% on an non-cyclical basis, 8.3 in an non-cyclical quarter probably means something like 8.5 on an annualized basis.

So in the end, we are now at a level of performance identical of the one of last year, but last year was absolutely driven by a non-recurring factor,

while this year it's fully structural. So this would pave the way for us to keep expanding margins as we go on. So we see the margins of this quarter with very favorable likes. I think probably defending from a big portion of the sales side.

And in terms of revenues, obviously, 16% is not a good number, but we take out these no-recurring effects on the April calendar, and look at May and June, 17.45% is a perfectly normal number in an environmental where inflation is 3%. Obviously, we used to do 24% with 9 of inflation. If you do 17 with 3 of inflation, we're talking similar number, just slightly below. We are growing 200 stores this year same as last year. So it's obviously very it could be slightly lower, there's no problem in that.

So we see 17% as normal for us, it is a number that works for the company. If you can do better, that isn't bad, but that's great. And we're working to create (inaudible) with new launch programs, with a Drogasil renovations, with pricing platform, with (inaudible) further initiatives that we have in place. But there is nothing wrong with the margin of the quarter and there's nothing wrong with the May and June sales drive.

So we believe this will pave the way for us to be in the gain next quarter, to be in similar margins last year when there was still a big positive residue from the price increase, and to expand margins from the fourth quarter on wards and paving the way for a great 2018, which is the most important.

So thank you all for your support.

And just before concluding, I'd like to highlight what we have plan in terms of Investor Relations. We have a big schedule ahead of us. First of all, we are issuing the third quarter numbers on October 26. I would like also to highlight the RAD Day in November 10, 2017 in the morning, here in Sao Paulo. I mean, this is the only opportunity you have to meet every senior executive of the company, in which we go beyond the numbers and we disclose the initiatives and the strategies behind them. So I'm sure that if you, if you take the time and the investment to come here and to attend, you will not regret it. I think we can give a lot of visibility on the things we are doing and much more color than a usual IR interaction can provide.

And finally, we have a busy schedules, time table, there are big conference schedule ahead of us. Two conferences here in Sao Paolo, the Santander Conference August 15 to 17, they JPMorgan conference, August 22nd. And finally to events outside of Brazil. We will be , (inaudible) in London at the Morgan Stanley conference, September 11 to 13, and also in New York, November 14 to 15, on Bradesco's Conference.

So that's it. Thank you very much for your support and for attending this call.

Operator

RAD's conference call is finished. Have a nice day.