Q2 2015 Earnings Call

Company Participants

- Eugenio De Zagottis, Corporate Planning and Investor Relations Officer
- Marcilio D'Amico Pousada, Chief Executive Officer

Other Participants

- Felipe.Cruz, Analyst
- Joseph Giordano, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Raia Drogasil Conference Call to discuss its Second Quarter of 2015 Results. The audio for this conference is being broadcast simultaneously through the Internet in the website, www.raiadrogasil.com.br/ir. In that address, you can also find the slide show presentation available for download.

We inform that all participants will be only 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 Raia Drogasil management and on information currently available for 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 accrue in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Raia Drogasil 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 D'Amico Pousada

Hello and good morning everyone. Welcome to the presentation of results of the second quarter of 2015 Raia Drogasil. As always, Eugenio will present his slides of the results [ph]. And before the Q&A, I would like to touch some points of the results. Please, Eugenio.

Eugenio De Zagottis {BIO 7193695 <GO>}

Hello, everyone. Thank you all for attended our conference call. This was a record quarter ever since we came public, with Raia Drogasil in 2007. So, -- we ended the quarter with 1,142 stores in operation. We opened 38 stores, we closed 5 stores. We achieved gross revenues of 2.3 billion, an increase of 23%, 14.7% for same-store sales.

Our gross margin reached 30.5%, a 1.9 percentage point increase. And here, it's important to note that this is a highly seasonal quarter in which we realized inflationary gain on investments because of the annual price increase on pharmaceutical products. So, this is not the usual quarter. We did 217 million of EBITDA, a record margin of 9.5%, a 200 basis point increase versus the same quarter last year. We did 119 million in adjusted net income, a record margin of 5.2% adjusted, and then increase of 61%. And we posted positive free cash flow of 37 million for the quarter and a cash consumption of 29 million total, considering interest and considering especially interest on capital base, which was quite substantial in the quarter. And finally, we are very happy to announce the association of 4-Bio to the acquisition of 55% of the shares of the company that we position higher than the view in the high growth strategy with telemarket.

On page four, as I mentioned, we ended the quarter with 1,142 stores, by opening 38 and closures 5. I think the main point here is that, we are getting ready to accelerate our expansion starting in 2016. So, we opened 57 stores in the quarter, and if you look last 12 month as a whole, we opened 141 stores, that's more than the guidance. It doesn't mean that we opened after the whole year. It's finished that to have exceeded the guidance.

The idea here is first to streamline the openings through the year to take some of the peak of the first quarter. And just after we are there more balanced, then we will be speaking about more stores. There's a lot of work being done for that to happen, but that should start in 2016. And finally, 33.1% of our store portfolio consisted of maturing stores by the end of the quarter.

On page 5, we highlight the geographic presence. We are present in 17 states that account for 89% of the Brazilian pharmaceutical markets. Of the 1,142 stores, 554 are Raia, 588 are Drogasil and Farmasil, only 27 from [02:04] Drogasil. And we highlight here that we already have more than 660 stores in Sao Paulo and we already have more than 50 stores in the Northeast, [02:17] 53. And then, mainly the highlight of the quarter is really the market share gain that we posted. We gained 0.8 We gained 0.8 [02:32] in percentage point in national market share.

This is, if I'm not mistaken this is the highest growth I think we have ever reported when compared to the previous year. So it's pretty substantial and this was done by operating in a very robust way with very high quality of moreover the latest and exploiting the weakness of competitors who will have high leverage in the economic situation like this, where the interbank exchange rate reached 14%, where the trademarks expected is very challenging. So we have a lot of regional competitors, some large chains, some medium sized chains, some small chains, who are reducing inventories, who are reducing employee headcount in the stores and who are increasing prices, and we did the opposite. We are increasing inventories, we are increasing service and we're taking full advantage of that.

In Sao Paulo, we gained more than 200 basis points that's an impressive number. We stay constant in rest of the Southeast. For example, you'll barely did look extraordinary units arise [ph]. So they are the best at the moment. The main reason why we haven't grown as much yet and we gained more than 100 bps in the Midwest, 0.90 bps in the south and then we reached 2% of market share in the Northeast.

We have grown our revenues in total by nearly 23% in the quarter. Same-store sales grew to 14.7, well mature stores have grown 10.5%, which was a remarkable number, but let's remember that we are comparing versus the weakest quarter of last year. So we are comparing here quarterly which reported 4.2% mature stores sales growth. Of course, this is also relates to the fact that in 2Q '13 and that hasn't been really good.

So, the comp base is important when you look. We don't expect to do it again, double-digit mature stores growth, but the sales trend has been very solid, very good, very robust and we expect to keep posting very good mature store growth, then mark it [ph] double-digit, double-digit shows the figure. Our gross margin reached the quarter 30.5%. If you compare it to last year, it's nearly 200 basis points of increase. And if you compare to the first quarter of the year, we're talking 170 basis point increase and there is a very clear effect of the price increases.

We have an inflationary gain, which takes place every second quarter, because the prices go up for the whole market, in a few more weeks, sometimes less than that. And then we have other inventories at hand.

So, as we sell older inventory with the higher price, we do an extra margin then as we will plenish our inventory, rates [ph] at a higher cost, the margin will be back to normal. And we accelerate this process by moving forward by. And our (inaudible) this year was really massive to take advantage from the sizable price increase around 6% and for the fact that we have logistics capacity for [00:10] this is fully integrated. So there is a big operating efficiently behind leveraging such a big price increase.

Another highlight was cash cycle reduction. We've gained 5.3 days in cash cycle. We gained one day inventories and we gained 4.6 days in accounts payable. What's happening here is that we have a lot of supplier who are not selling as much as we wished. So we are taking extra inventories to help them meet their numbers. And they are more than financing for the extra inventory. So we -- this has helped us reduce cash cycle in a very fast way and we can never underestimate how important cash cycle is in a business like this. So this is something that has happened for the second in a row and we're very happy about that.

Finally, when you think about expenses on page 8, on the left, the picture you see is one of the big expense pressure. When you look at our expenses in absolute numbers, how fast is the business growing, there are more stores every quarter, but still it's a big expense growth. If you think about our budget, our expenses are way above what we had forecasted because of inflation.

Having said that, because we have got such good metrics for growth in the quarter, end of semester as a whole, we have been able to maintain our expense control. So not by having low expenses but by having high sales. So sales expense have remained flat at 18.2%. Our comps have helped tremendously to offset pressure such as electricity, such as rentals and others.

The [02:03] we will start now in the third quarter because the salary increase in Sao Paulo, where most of our stores where our headquarter and most of it is still will be very high this year, because inflation so far is 9%. And then on corporate G&A, there is a 10 bp dilution also because of good sales momentum. But that's something here to know the fact that both in the 2Q15 and in 2Q14 both basis are inflated by 20 basis points.

In the second quarter of '14, what happened is that we had all the provision, variable compensation which were compensated in the second semester. So you look where we have 2.8 in the second quarter than 2.3 in the third and fourth quarter. This year, what happened is that, we have some tax that were done in the quarter and there also one-time that account for 20 basis points. So the variation is correct, but this number should come lower in the coming quarters.

And as a result of all of that, we achieved an EBITDA of 217 million, a margin increase of 200 basis points, a total EBITDA margin of 9.5% and it was mostly gross margin gain of 1.9, and then a modest dilution of 10 basis points. If we consider our profitability, taking into account only the stores that increased by the end of last year and considering that those stores logistics and administrative expenses meaning we are taking out the pain from newly opened -- recently opened stores and stores in the opening process, our EBITDA would be 9.9%.

Of course the effect displayed here is not the maturation effect. The maturation effect is much bigger, we have 150 basis points of maturation potential -- of EBITDA potential if the whole portfolio was fully matured, but here the difference of 9.5 to 9.9 is just a short-term pain of the stores opened this year are in the process of (inaudible).

Adjusted net income on page 10, will increase by 120 basis points. Part of the increase going back to the (inaudible) in the form of taxes. So the tax rate is bigger as the margin gets upper, then as the reported net income is 1.2% higher than last year.

Page 11, talking about cash flows and here, I much prefer the year-to-date vision, because the -- where you finish in one quarter that affects tremendously how we do in the other. But if you look at six month '15, we generated more than 300 million resources of operations versus slightly more than 200 million last year. We did an operating cash flow after working capital of 147 versus 56 [ph], we invested 141 versus 123, and we had a positive free cash flow of 6 million in the semester versus 56 million negative for semester last year.

As I always say, any point in time you compare to December is a known fair comparison, because we have a cyclical cash cycle reduction in the fourth quarter, the quarter is the best case cycle of the year. So having positive free cash flow competitive best point in the year I think tremendous and we certainly pointed the fact that this will be another year of positive free cash flow generation. When you look at total cash flow, it's negative 53. Specialty service, we paid 64 million in interest on equity, so it's actually a good thing.

And then looking at our, the performance of our shares, product share price as a consequence, it's not, it's not in the goal itself, it's a consequence of the company performing well but we are very happy that the share price has performed tremendously this year. But the most importantly, as we go out and view [ph] those investors who bought shares with Drogasil in 2007 have maintained their positions. They have achieved so far 28.4% annual -- average annual returns. And those who invested in 2007 had the higher (inaudible) have achieved annual returns of 35%. So which is really more than private equity renewals [ph].

I'll now pass to Marcilio to wrap up on our numbers and then I'll get back to talk about the 4-Bio acquisition.

Marcilio D'Amico Pousada

Okay. What's actually been designed in '13 [ph] what's important here was that the Raia Drogasil's record as I've told you that what's good for our business, I mean, the retail [ph] will be the very important cycle of the business. For us, the second quarter is actually (inaudible) and retail's normal business. And we are well prepared this year. We worked very, very strongly and we have (inaudible) that did help us with this good results.

I think the first one the cash which we mainly view, we created in 2013 had daily clear we bought about -- both my financial team and my commercial team, working together trying to understand what this shows in the cash and all that slippage in the cash and try to anticipate any change in the cash.

Then even with a more dividend we are giving, that money [ph] this year, we had managed to buy better to negotiate better design [ph] because we have the money in cash and we know how to negotiate this, it helps us a lot.

The second point here is the liquidation [ph] we still have a good cash consumed in this quarter. Our turnover number improving a lot. This help us in the -- sell brand [ph] to the customers because it achieved much better prepared before they sell to customers. The stock out numbers are also the best (inaudible) also. We have the merchandise in the store to help the customers. All these index you can see the EPS score, I think (inaudible) they actually bit a (inaudible). Then you have the money and you have this technician, then you have the good results, these are the points. We know in the retail, cash is the key and there maybe as a (inaudible) part of business. If you have both, you have control you can reach a very good numbers on the market to help you.

In the next page, I'll show you our future. What was (Technical Difficulty). When you have the inflationary pressure, which comes with the cost we had the difference between the (inaudible) in the second quarter and third quarter, because inflation caused -- we have all the inflationary price in the second quarter, but you have all the inflation that caused in the third quarter. It will be a charging for us how to manage in these (inaudible) very, very strong and it's getting better that from shifting [ph] the guidance to us the labor in stores that how the employees work in the stores and as they are working, where our closing implement then how is possible to increase the sales better than the inflation.

Okay, we know how to increase the average (inaudible) how to increase the customers using the stores now, that you can review in the next quarter. But if you look for the long-term the best number that I like to say here that the opening store where the new leased ones. We opened in this semester 67 stores, if you look for the less than same semester in 2014, will be 47 stores, dropping 29% more stores this year than last year if you compare the semester. This is very, very important for (inaudible) and show that we are working to trying to increase the number of the new store in the future.

With low slight increase in the number of stores and focus on the four strategic pillars for the company. What are the pillars. We have the organic expansion, all the organic expansions we're looking for in the standardized formats for the stores -- biggest store is more stores as far as for the low income people, multichannel stores how to work -- work very, very strong in category management and CRM. If you're looking this four strategies if you know it's important with these four signs, if you're keeping the focus is the question.

For the question that -- main pillars is process difference and the more important for the company is people. We need to train in preserve the people for the future of the company. Right now Eugenio talk about 4-Bio, we never heard about the 4-bio. 4-bio is the insight of our strategy, also to look for category management and the CRM, because we know is important to sell all the merchandized and equipment needs and follow the (inaudible). Eugenio de is going to talk about 4-Bio.

Eugenio De Zagottis {BIO 7193695 <GO>}

Okay. Well, those who follow us more closely know how skeptical which is to add about acquisitions and how organically driven we have been and 4-Bio is actually a big thing for us, and it's a transaction that has a different magic and for others where it's making a term of service. We have look whether it's specialty. As a crucial strategy that at some point in the next 5 or 10 years would be required. I mean, this is the fastest growing segment in the world that has a very tight fit which will do.

So at some point this would happen. And why it happened now is because, when 4-Bio was presented to us, we felt very compelled and motivated to resolve that. Because we're talking about a very unique company, we're very well managed company and a transaction that will allow us to have that very important segment of the industry. starting day one at a very good point, is a very good execution and then we have been able to add on to create further value on top of that.

So this is a strategic acquisition that field that we have, it's not the usual more of the same kind of acquisition, but we don't want to do and we're still remain -- we should remain in the business that our belief does not change that's the point here.

So let me give you an overview of about specialty retailing for those not familiar with that. I think that three pair of words here that will describe what specialty retailing and we are talking a combination of high-cost, high-tech, high-touch. So these are products which are expensive, these are products which are highly technological, generally biotech very innovative most of the brand and patent protected products and this is the project that requires a much deeper involvement with the consumer who here is called patient and not consumers, then the usual -- than we know our usual sales process.

So these are projects that require special storage because of pay purchase, special handling, special transportation and special administration. Sometimes it will appeal, but sometimes the consumer must know how to inject himself. There is also a big need on support services like adherence management like side effect management like waste management and things like that.

So this is where the high-touch comes into. Products here are centrally dispensed and delivered to the patient's house. We sell them on the drug stores and demand here is generated sometimes from the patient, sometimes from the physician, sometimes for the payer and most is the combination of all the three okay, and in Brazil, in some categories, the cost is paid by the patient, just like in our core market and that's the case of assisted reproduction, gynecology, endocrinology, it's very unusual for health operators to fund to pay the bill in these segments. However, oncology and immunobiology, by law health insurer of health operator actually has to cover and pay the bill for the beneficiaries of the plan. So there is a big portion of this industry, that works just like the US which is oncology and immunobiology. And here the payer is the main -- client is the main demand driver. But this is (inaudible) excuses because we have to get to the customer, we had to deliver the results and you have to provide these services for him to take full advantage of this treatment.

That's an overview of 4-Bio. 4-Bio established in 2004 in Sao Paulo. The current, the former (inaudible) CEO of the company is Andre Kina, a guy who worked six years in Procter & Gamble before becoming an entrepreneur and before opening 4-Bio. So, 4-Bio was opened with the high, with the correct mindset in terms of quality, in terms of formulization from day one, it's a big difference from a lot of other players in the industries.

4-Bio, according to the IMS is second largest specialty retailer in Brazil. They had revenues of BRL126 million last year, 80 million, first semester of this year and growing 40%, well they grew 40% in the first quarter, they have grown over 40% over the last three or so years. So it's not a big business, but it's not difficult to see it become a BRL1 billion business with this kind of growth. And another thing is that, 4-Bio's leverage, 4-Bio lost a few million in that and leverage has been a constraint for the growth. They have challenges in terms of credit with manufacturers, in terms of these entry levels.

And so just taking out these failure, we will reach a significant growth -- further growth for 4-Bio. Even though it's the number two player in Brazil, it's the leader in oncology which is by far the fastest growing segment, assisted reproduction, immunobiology and gynecology. And one of the most important thing is that there are three leading players in the industry. Number one is Oncoprod, a company that belongs now to McKesson which belongs to Celesio. And then McKesson has just written off and announced the decision to sell. The number two is 4-Bio, the number three is through pharma specialty which is managed by Amerisource-Bergen with the Arch Med brand and the beauty here is that for this is the only pure player, the only player who is only specialty retailing, because the other have a higher wholesaling component than retaining component. And it's the only retailer among the top three, that is a national company. And we believe Brazilian companies in the Brazilian market can be way more agile than foreign managed companies. I think this holds true in retaining this should hold true in specialty retaining as well.

For a great expertise in patient services to highly recommend brand among specialty physicians and payers. And also very important as well structured and managed company even though it's a small company it has been audited by a Big 4 auditors for quite some time. It has ISO 9001 it's the only claimed (inaudible) certification. It has been awarded for two years among the great places to work (inaudible).

Then on page 17, the rationale for acquisition. First, this is the bolt-on acquisition, highly complementary to fill the gap (inaudible) and we believe that adding our SKUs and capability to the message 4-Bio, we will be able to design the specialty retailing in Brazil. So our aspiration is to lead the consolidation of the market which is fastest growing client pharmaceutical industry in the US eight of the top ten stores were already specialty in Brazil is two foot behind but I think it was time Brazil will -- will follow the similar path.

Another thing is that, even though this is the market that we have been looking for quite some time are entering organically for this is not -- was not an option. They are high-entry barriers here and it will organically provide a huge distraction. Here we are associating we are partnering two companies already to establish it's already well managed and then we can now add value to that with minimal distraction hope to make sure that doesn't give the way it was from our core strategies.

With 4-Bio high as we become the only full service drug store that can provide patients, physicians and payers, with all pharmaceutical needs. We believe also that because we're the only drug store by having our normal product and specialty drugs that we can reinvent the relationship with the manufacturer we can change the level dialog. This is the most crucial contents [ph] for manufacturers. This is where the money is, this is where they are making money, this is where we are investing in R&D and this the business which brought us a very high complex delivery chain to the patient to make sure the patient takes the drug and the drug works and deliver the expected outcomes.

So if you are able to provide different services and to further (inaudible) I think it was like that benefit to our drug users. And finally our efforts and capabilities can change the rules of the game here. For example, we can leverage our brands in our stores to originate demand at the -- more than thousand higher in Brazilian [ph] stores. And for that to be serviced by 4-Bio. We can -- you remember that we have proprietary BBM [ph] that services, a lot of companies, the companies in Brazil and also some health insurance.

We can exploit those relationship to supply products to them as well. And finally, we can leverage the national brands and popularity to help and grow and even to provide on-site services, on selected stores, for example, that positive change, all those specialty players who don't have the same popularity, won't be able to do. We always look around the roads [ph] for the best installation, I mean, for that CVS [ph] is the absolute leader on the healthcare market in the US, just as I think which is the best player in the (inaudible) in the world. And there is a strong information in the CVS, it is expanding and has proven that the combination of stores PBM specialty ROE and we are following the same path here, we have the same belief here.

And to conclude just with summary of the transaction. We acquired now 55% of the company, we are raising capital by BRL13 million, so that all this continued the company debt on the company's debt to let us have the fund the grow and to invest whatever needed. There is also secondary acquisition of 11 million, 50% in cash, 50% in treasury shares, so there is no dilution, we paid with treasury shares.

And the reason we bring cash, we'll share this here is not because of cash management or anything like that. It's because we weren't Andre Kina, the Founder and CEO of 4-Bio to have a meaningful interest in Raia Drogasil, we want to be aligned on both platforms, not only on 4-Bio. There is a five-year (inaudible) we can sell 20% a year. And that price adjustment based on the actual 2015 EBITDA, but there is a cash flow adjustment. At the second tranche, we probably do in 2021, we have a portion in Andre's share. Andre has shares and (inaudible) has a good option on the service shares. And the valuation is based on pre-defined multiple applied on the average of the Basel 2018, 6012 and the average net debt for 2020. So although we're talking about multiple years, the whole valuation here was based on internal rate of return. We think multiple and those -- is not a good way to value things. The valuation is based on internal rate of return, but these are multiple presentation to make the transaction and the second semester actually of both the years.

And finally, there is a shareholder agreement -- partnership governing of partnership and there will be (Technical Difficulty) to the second semester and actually and that is one of the main assets we are acquiring and (Technical Difficulty) has a vast majority and finally, the closing subject to certain precedent conditions, but I'll say that trivial conditions due diligence are already fully developed for deals.

The most important condition is CADE approval and we don't see any issue, because the concentration is very low. Just for (inaudible) 4-Bio (Technical Difficulty) revenues only about 25% of the revenues are only the projects that overlap with us and the combined share is about 10%. So there is no reason why (inaudible) going forward.

Finally just before passing to your questions. The highlights of our IR calendar. We will publish the third quarter of October 29. We have made a commitment that we're keeping of publishing quarter in single and following month if possible, we even want to be more aggressive like (inaudible) to publish it before we are actually publishing now. And the fourth quarter then it's a full year is somewhere since along their audit. So it's February 18, 2016, but we're also giving with clear version always this year.

I would like to invite you all for the Raia Drogasil Day, it will be on December 4, in Sao Paolo in the morning. And this is the same week, where there is the Markets Day on Monday and there is JP Morgan Conference on (inaudible) days of the week. So if you could wait to wish to consult and we expect to make this a great event.

So we can provide you with a (Technical Difficulty) with a number of patients, gives you a chance to know what people we actually do (Technical Difficulty) operation. So it's an opportunity that I highly recommend you guys to take (Technical Difficulty). And then the next conferences we'll do with August 18 Brazil Consumer Health Checkup JP Morgan, Sao Paolo, September 14 to 16 Morgan Stanley in London. We may do a (inaudible) after that, September 22, UBS Healthcare Day in Sao Paulo. November 17, Citi Consumer and Retail Conference in Sao Paulo. So, I conclude with this. And let's move for the questions. Thank you.

Questions And Answers

Operator

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

Q - Joseph Giordano {BIO 17751061 <GO>}

Hi, good morning everyone. Thanks for taking my question. My question is most likely in the competitive environment. So, I really want to understand what you're seeing from your competitors as, we have been able to see like a very strong growth pace, very successful store openings and on top of it like, significantly better procurement terms. So if you could comment on how this competitive environment is helping you at this moment? And if you feel like any deterioration on certain specific regions, which are offering some opportunities for you, it would be great. Thank you.

A - Marcilio D'Amico Pousada

Joseph, thanks for the question. I think the crisis helped to separate, further separate the companies to execute better and who have the resources to invest and we'll deliver services to consumer with quality for the ones who don't. Because when the time is not good, everybody can have money, everybody can open store, but it's really on the top (inaudible) the difference building up. I mean this is the market that's growing a lot, it remains growing kind of 40% per year.

The market driven by new joint organization not driven by the economy, very defensive market and if the future are competitive as well, we are not the only ones who have this market and then other players do also, take advantage of this characters and they'll discuss the (inaudible) in market.

Having said that, why was leverage now being held, because when you have an interbank exchange rate of 14% a year and because companies that have to pay spread over that. The credit market is tightened. Life becomes very difficult. So we see a lot of companies, reducing investments, taking people out of the store, reducing inventories and there will be opportunities I mean they will be opposite I mean there will be transactions (inaudible) they reduce headcount, we increase it and we are taking advantage of them, and I think the market share we had posted, these are testament to that.

None of the companies is in distress, but there are several companies in distress. There is one company clearly in distress among the top five. There is another company who is not distressed, but it's feeling the leverage, taking their ability to grow and when you grow below top 4, 5, you see many companies, there is a company in the Midwest region (inaudible) So we have -- they are in the verge of that. So we have so many different realities, when you look at different companies and different geographies. But even if you consider our main competitors, the ones who don't have much leverage, the once who perform well we are still performing well. I don't think anyone in the industry rather than us has grown 22% this quarter, and we'll grow more than 20% in the year.

So of course, that cash is a great driver of separation, but execution remains another driver, actually (inaudible) I mean, cash is king, execution queen.

Q - Joseph Giordano {BIO 17751061 <GO>}

Okay. Just a follow-up on another question, if I may like, we saw very, very strong growth pace as you mentioned like cost also that you had like an easy account base. So if you could like comment a little bit how you saw July performing that would be great? Thank you.

A - Marcilio D'Amico Pousada

Month-by-month, we are really happy for it first. The trend is really good. We are not decelerating even a bit, but of course, that when you compare to last year, the comp base attribute that. So let's say, it's a flat line this year, the last year's line was below and falling, it's obviously how that affects the number. So we still expect to prove strong comps. I don't want to be specific, but I mean, if you look the previous quarter, I think we can be indicative to (inaudible). I don't expect to do double-digit in any quarter or that is a calendar effect or anything exceptional.

But still I mean, every high single-digits I think that's possible this year and then when see how we do -- how does this industry can meet a high or (inaudible).

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

But July was another remark.

Q - Joseph Giordano {BIO 17751061 <GO>}

Okay. Thanks Eugenio.

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

Thanks.

Operator

Mr. Felipe.Cruz from Itau BBA, would like to make a question.

Q - Felipe.Cruz

Good afternoon, everyone. So my questions are more related to margins. The first one, more in the short-term. You mentioned that we should see expenses growing as a percentage of revenues in the second semester of the year, if you could give us kind of how much you expect this pressure to be in the second semester if you don't do anything in regards to gross margin or improvement in average ticket or clients traffic. What would be the expected pressure on SG&A in the second semester of the year that you are expecting. And the next question also on margins but more on a long-term view. You've been able to increase substantially your gross margin since 2007 and we are reaching at levels, close to 30%.

Additionally, you're talking about starting to open or accelerate the opening up of new stores. How do you see the balance between gross margin expansion deceleration over the next year or not? And pressure from opening more new stores going forward in 2016.

A - Marcilio D'Amico Pousada

Okay. (inaudible) thanks of the question. First of all, I mean, the main difference between the first quarter and the second, second half of second semester, we have labor increases taking place in July and this accumulated inflation is around 9% now.

We still don't have the figures negotiated in labor, but for sure they would be substantial. It's very important to do the real (inaudible) because the higher the inflation, the bigger the separations in the second quarters. The second quarter is when we see the good news of inflation. So big inflation, bigger (inaudible), it is amazing margin the rest of the year especially second part, second semester is when we see the pain, but the two are inter-related. So basically we will involve to give a big inflation where we hedge to give through result to give through the next two quarters.

So, but yes, the gross margins should get back to normal which is pretty much what we believe in the previous various [ph] quarters. I think the expenses -- I don't want to get into the specifics, but I think expenses will grow as a percentage of revenues, it's impossible labor increases for that not to happen. But, I mean if you maintain a good gross margin momentum, and if you maintain a good sales momentum, the main action for that shop inflation is not a core value, it is the high growth as long as we can keep revenues, they doesn't have to be double-digit, (inaudible) to keep very growth and good margin momentum. I think the numbers should comply.

I would expect that the next quarters to be similar to the previous quarter, I'd say. If you look at last 12 months, we are at an 8% of EBITDA margin. I expect to maintain 8% for this year, but with a higher inflation pressure than we had in the second part of last year. So that's our efforts and -- then depends on their gross margin growth depends on where sales growth will go, growing like we are growing helps a lot. And looking forward we think -- let's say if you maintain the current margin for the year, we are basically jumping from 5.5 to 8 until this, it's huge, they'll expect that in the future, expect that to any (inaudible) for years something like that, we'll be happy with that last year, we'll see how it's happens.

Our margins had grown every year over the previous years since 2007 no exceptions. And there is no reason why we shouldn't grow. In an inflationary economy, you see sales expense pressure then you also see higher gross margin because every retailer has to deal with pressure. The thing is the biggest (inaudible) in gain that we have, the biggest, the expense dilution based on this first performance that we have. The least price increase we have to do. So, when gross margin -- when buying and purchases generating gains, when the sales is good, we also still have to increase the pressure and become more competitive in the results.

Like companies who have to increase pressure to some extent, one way or the other, we believe it will be -- it will be able to manage successfully. I think inflection is -- inflation management has been the key product so far and we are keeping good result. And then (inaudible) people is very important for our business, okay. We have a long term approach to here, we know how important people to serve the customers also. Then we are looking right now the connectivity of this people (inaudible). You can seek better results and people (inaudible) 2016, 2017. Right now, I will be the leaving only had pressure in the (inaudible).

Up to 55 (inaudible) looking towards its people better to serve the customers.

And finally, your question about new stores. First of all, we don't expect much pressure from new store. I mean, let's remember that this is the third year in a row, we opened 130 stores. So we are basically -- we'll basically get back to a more constant percentage kind of growth that's where we want to go. We don't know 9, 10, 12, 13, 15, then time will tell. But we believe that given the size of the business, the increase in expansion that we will do and given also the improving performance we have seen year after year. In the beginning, I did a low, if it was luck or if it was a learning curve, more than what we have been dealing with the learning curve tool [ph] as our strategic outpacing the previously opened stores.

So, I don't see an expense pressure. But I see a huge value driver for the company. We are not looking only for rocking store, we are looking for corners [ph], looking for good store, for good returns to our user point. We know that we can open more than 130 [ph] sometime government that will, but we have to open good quantity and quality stores. This is the point, which good return for the company also. I think is a positive to say that. We will manage our growth I mean, first of all, I can bet with you that we're the only chain in Brazil who is opening more than more than 100 stores or have an opened -- we expect to open 100 stores that have two, three much better directed with the every single store on site.

No one does it, with also our competitors, no one no exception in the rule and let me talk about those small chain. No large chain with large growth prospects thus as we do. We are obsessing about the quality. We are not minimizing rental, we are maximizing returns. We want the best locations with no confession. We have analyst capabilities and they're marketing the intelligence to drive our store location to define where we want to grow to estimate, what's the potential for store on a certain side.

And we have been upgrading our expansion is that (inaudible) gone past so this is my third year opening of 30 after the couple of years opening 100 after year in opening 60, 70 and so on. So for us to do more than 1/3 it's a big thing. It's not just like that, it's okay, just a little more and that's no or whatever it is. It's really above putting people in the feud and increasing our team to bring more contracts, building a bigger difference so we can manage total regulatory different licensing requirements, longer mobile and contract licensing requirements and that we can balance more through the year.

We have the P&L in place, really to manage every activity (inaudible) doing multifunctional project to open a store, to make every area comes together and mix the date that we don't get in the schedule to make sure we can form x more managers per year. So we had been preparing for that and we started seeing that from next year. So it's been done on a very planned and sustainable way.

Q - Felipe.Cruz

Thanks for the answers. Thanks.

A - Marcilio D'Amico Pousada

Thank you.

Operator

Our next question comes from Mr. (inaudible) from Brasil Plural.

Q - Unidentified Participant

Hi, good afternoon, everyone. Thanks for taking my follow-up question from the Portuguese call. So in the Portuguese call we exploit a lot about the gross margin and the current market outlook and the growth potential and the speed of growth. So I think that it will be beyond that and taking into consideration, the acquisition of 4-Bio. Do you think that this could be the first move in Brazil towards a more integrated model such as we are seeing happening in the US and in Europe for a longer period of time in the past. Do you think that this was the difference and that could make sense in the future.

A - Marcilio D'Amico Pousada

Thanks for the question, (inaudible). I'm hugely skeptical about vertical integration, about wholesaler and the retailer integration, I think wholesale is a very difficult business in brazil. Is that low or negative type of business. And I think that future for a retailer is very different from (inaudible) for a wholesaler. The wholesaling is about cost, is about taxes and it is about logistics and credit. Retailing is about customers, is about service, is about assortment, is about location, it's completely different.

All these years we had good retailers, I would never hire myself or my seniors, a wholesaler, never in my life, but I also we didn't hire any of my wholesaling partner as a retailer. So I think it's very beautiful. Having said that, when you think about horizontal integration, when you think about putting together a direct stock with physical stores location where we can generate demand, where we can fulfill demand.

Specialty, having a structure has to help generate demand and to fulfill demand That both can integrate and finally for especially for the (inaudible) of the specialty business that is (inaudible) third-party pay out, we see them every quarter. We have the two pieces or we have been a retailer for 110 years in one brand, 90, 80 years in the order. We have had the PBM for 16 years, it's nothing new. And now we have a specialty business. So the three fit together really well.

So there is a big CVS inspiration. We want to -- as I mentioned we look around the world and we've learned with our peers around the world, we have a huge respect for companies like Walgreen's and Walgreen's and CVS, (inaudible) Canada and we travel, we look, we learn and we have always said that whenever I think about front store (inaudible) by far of inspiration in the pharmaceutical part CVS is our inspiration. And we are taking the elements that's working and making the move.

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

And then we only acquired for 4-Bio likely customers also. 4-Bio lovely because it's help to share because we know that the same we need like we are having a call from your company. We're looking for several (inaudible)customers user point only customer never a company.

A - Marcilio D'Amico Pousada

Maybe one of the main difference is about a retailer, manager retailing business and a wholesale or managing our retailing business that the numbers for as a consequence. Well, they also in the wholesalers want to make the number they meant to like the specific data of inventories and they get that. These are the inventories a consequence of your assortment, of your demand per store, of the sales level you want to have. So we look at the customer, we want you -- we look at the service level we want to provide the first one everything else is a consequence.

Q - Unidentified Participant

Okay. All right, makes sense. Okay, thank you guys.

A - Marcilio D'Amico Pousada

Thank you.

Operator

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

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

Great. Well thank you all for attending the conference. To all our shareholders. I mean, our different gratitude from Spain we'll first to do that times are now to be good times. I think over the longer-term we have never liked it whoever has chosen. And when you look at the perspective they have in the next 15 years when we see the huge market growth because the sweet spot of aging is taking place in the next 15 years and nothing will be less in 16 years.

When you think about the capacity that this company has to create value and to exploit new trend be a strategy with different clients for the reason in addition to that, I think we are very ready to take advantage with a monumental opportunity that presents ahead of us. Then thinking about our short-term, I think inflation management is crucial. We built a big impression I hedge for the year. So we work at the summer we accumulated food and now we are ready for the winter.

Okay. I think as long as we have great things for sales, the winter won't be as hard. We can dilute the expense to some level and then of course, even if there's some expense pressure and there will be, although we are picking the second quarter, but we should be okay in line with our previous quarters. Okay. And other crucial thing here is cash discipline as Marcillio said. I mean we are managing working capital in a very tight way. We are taking opportunity of opportunistic purchases and further financing our business and we are generating more and more cash, we're even paying more and more interest on capital, and we have the ability to forget the capital markets in terms of accessing to getting money and do our job and delivering to customer, delivering to the shareholder. So we have little resources for that. And because of that we have been variable in are keeping able to exploit competitive weaknesses. So I think that first time is highlight a difference from the good and the bad players.

And finally there's another pillar here which is strong retention that now is getting down more customers. We have very low stock-outs, the net promoters score is improving and we have a very good number of people in the store. The customers appreciate that. And as a fact, I mentioned we are preparing to accelerate the expansion. We have increased prospection, we are already generating more and more and more contracts so far these contracts had gone do all buffer. So our first announcement was bigger than it was one year ago.

So these will allow us to face different licensing requirements more bureaucratic and the best way to put it licensing requirements and even to have a more flattish opening pace through the year. If opening more stores means opening more stores in Q1, Q2 and Q3 that's something we can do, if it means open more stores in before (inaudible).

So this is the (inaudible) that allows us to streamline the process through the year. Then we are also working on our PMO on bringing all the areas together to make sure we don't fall back on schedule for our opening, and working a lot on the people's side to make sure we have able managers to take those additional stores. So again that's all, and appreciate all of you. Thank you.

Operator

Thank you. Raia Drogasil conference call is finished. Have a nice day.