Q2 2016 Earnings Call

Company Participants

- Eugenio De Zagottis, IR & Corporate Planning VP
- Marcilio Pousada, CEO

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 Raia Drogasil conference call to discuss the Second Quarter of 2016 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 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 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 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 operational factors could also affect the future results of Raia Drogasil and could cause results to differ materially from those expressed in such looking forward 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 will turn the conference over to Mr. Marcilio Pousada. Sir, you may begin your conference.

Marcilio Pousada {BIO 16117399 <GO>}

Okay. Thank you. Good morning, everyone. Welcome to the presentation of the results of the Second Quarter 2016 of the Raia Drogasil. As always, Eugenio will present the slides of the result and then after that I'll talk (straight) about the results. Eugenio, please.

Eugenio De Zagottis {BIO 7193695 <GO>}

Hello, everybody. Welcome to the Second Quarter 2016 earnings conference. It's with great pleasure that we present record results for the Company. And this was the best quarter ever since 2007 when Drogasil became a public company. We ended the quarter with 1,330 stores in operation. We opened 58 stores and closed two stores in the quarter. We reached gross revenues of BRL2.9 billion, 26.1% of growth and 14.5% same-store sales growth at the retail level.

Our gross margin reached 31.6%, a 1.3percentage point increase. Our EBITDA reached BRL305 million, this was a margin of 10.4% and a 100 basis points margin increase. We posted adjusted net income of BRL168 million, 5.7% of margin and an increase of nearly 41%. We presented a negative cash flow of BRL1.6 million for the free cash flow and BRL80 million for the total cash flow. And finally, we increased our store opening guidance for 200 stores, both for this year and for next year.

On the next page, talking about our store development program. As I mentioned, we reached 1,330 stores in the quarter. We opened 58 stores and closed two stores. Year-to-date we have already opened 97 stores. So pretty much half of the year's program is always delivered. So -- and when you look back to the last 12 months, we have opened a total of 196 stores.

So the point here is, we have been able not only to accelerate our store opening. But also to better balance it through the year. So the 200 stores that we are promising is no different from what we have been already doing over the last 12 months.

Another thing to mention is that the quality of the new stores we have opened in the last 12 months -- and we have been tracking that very closely -- has been outstanding. These stores are posting higher revenues than expected. And as a result, they will deliver higher internal rate of return than the one we assumed when we signed the contracts. So all of this give us the confidence to boost our earning guidance and the idea now is really to do 200 stores a year. That's certainly the number for this year, don't expect any more stores than that and we believe we should do that again next year.

In terms of the store portfolio, 34% of the stores at the end of the quarter were already -- were still in maturation. This is one of the -- I think the largest number since 2013. But if you look only at the year one store, the greenest part of the portfolio, over 15% of stores we see new ones. So this is the youngest portfolio in the history of the merged company without any shadows of doubt.

Page 5, talking about our geographic presence, I mean we -- of the 1,327 Raia Drogasil stores, 642 were Raia, 685 were Drogasil including here 20 Farmasil stores. We ended the quarter with 779 stores in Sao Paulo, this is an amazing presence. And the best thing is that we keep seeing more and more opportunity to increase this figure.

We have already 79 stores in the Northeast, this is an amazing success story. And now with a DC just opened nearby Recife, we are very eager to keep pushing the Northeast. And another important thing here is that by the end of this month, we will be entering another new market which is the state of Tocantins in the northern part of Brazil. So when you look in the chart, you have DF and GO, switch to there on Goiania, Tocantins is the state just on top of it.

It is more a state. But I think it's another step for the Company towards building a business share in the Brazilian market. And talking about share, we grew it in a very meaningful way during the quarter. We reached 11.5% of market share, a 1.6percentage point increase. I'm talking here comparable market share, the one that excludes the stores added to the base recently. So it's a comparable figure.

Sao Paulo now increased 1.9percentage points to 23.5% and the Northeast increased 2.1% to 3.9%. In all the other markets, we have also increased our market share to 7.4% in the Southeast to 14.4% in the Midwest to 5.9% in the South.

On page 6, we posted consolidated gross revenue growth of 26%. Raia Drogasil delivered 24.5% revenue growth in the retail level, while 4Bio posted amazing 113% growth, more than doubling the size of its operation since same quarter last year.

When we analyze the sales mix, we have increased hygiene/personal care 0.2percentage points and decreased generic by 0.3percentage point. It's important to mention here that the sales tax for generics was reduced from 18% to 12% in the end of the First Quarter and this caused the price reduction in generics; that is very good because it maintains our gross profit. But when you look the revenue share within our sales mix, obviously it affects and generics has fallen 30 basis points. But the important thing is that on an unit basis generics is doing very well.

And I just -- I was just mentioning 4Bio, I think this number it shows I mean how correct our strategy was to buy the company. I mean it's -- another thing is that this was an acquisition in which we didn't find any negative surprises, we didn't find any bad contingencies, we didn't find any bad practice. Everything that we expected happened and that's not usual in an acquisition.

So the point here is the quality of the company we bought, the quality of the founding shareholder who is now a partner, who is now the executive, still leading 4Bio. I mean I think this speaks a ton about that.

And Raia Drogasil has been able to help 4Bio financially by strengthening the capital structure. We have been able to restore supply credit and to open doors to new suppliers and to new products and this is a lot for 4Bio to fulfill its full potential. 4Bio is benefiting tremendously from new product launches like Sovaldi, the blood buster hepatitis C drug that was launched this year.

4Bio is strengthening its presence with (inaudible) in a market structure that resembles the managed care market in the US. So here the bulk of 4Bio sales is to help insurers who are the repayers through the certain based company, family management. So it's very much the same trends you look in the US in a company like (Diplomat) or even with (inaudible), for example, who have this management as well.

Next page, talking about same-store sales, the total revenue growth for the quarter was almost identical to the previous quarter, 26.1% versus 26.3%. When we compare same-store sales and mature store sales growth, it was a very good number. But slightly below the previous quarter. And let's remember that the First Quarter saw a lot of non-recurring seasonal effects, things like a surge in H1NI and early flu season. So there were a lot of seasonal effects that obviously didn't repeat themselves now. But it's a very good number.

It's interesting that -- as I mentioned, it's a smaller number in the same-store sales level. But it's the same number on the total sales level. And that's because we have opened way more stores in the first semesters this year versus last year and these stores they only figure in the consolidated revenue growth. 4Bio's growth also helps the figure to be similar to the previous quarters. All these figures in the year are impacted by positive calendar effect of 0.9% in the quarter.

On page 8, our gross margin reached 31.6%, a 130 basis points increase on the back of inflationary gains. So the prices went up by 12% and we were able to build a very sizable forward buying. So our inventory was very high. So we benefited tremendously from this price increase. So this was a very meaningful boost for our figures.

We also have here a negative 4Bio mix effect of 20 basis points. 4Bio has lower gross margin. So its growth penalizes the Drogasil gross margin. Here, on the right, our cash cycle increased by two days, driven by a four-day inventory increase. We have here a combination of factors which are transitory effects. First is, we still have some inventories from the forward buying. So inventory is higher because of that. Second, as we opened a new DC in the Northeast, this new DC also provided a slight pressure for the cash cycle.

And third, we bought so much products in the previous quarter in terms of -- like insect repellants during the Zika and dengue crisis that we have now very big inventories and this inventory should fade away as well. So nothing to worry about. But there's a slight cash pressure in the quarter arising from two days more of cash cycle.

Page 9, talking about expenses, total expenses were 21.2% of revenues, 30 basis points higher than the 2Q 2015 -- second Q 2015. But absolutely in line with the previous quarter. So total expenses have been flat since the 3rd Q 2015.

The main pressures we saw in the quarter were on market expenses, 20 basis points -- and this is a choice. So we're reinvesting a part of our gains. Also, 20 basis points in asset write-offs, we have already written off nine stores in the quarter that should be closed in the next quarter or two versus only four or five stores next year in the same quarter. So that's a 20 bps pressure.

Then 10 bps pressure in logistics from the new DC, 10 bps in labor, 10 bps in energy and 10 bps in new store pressure. The new store pressure has been smaller than we anticipated because the quality of the program has been better than we expected.

Page 10, here we -- as we see the EBITDA increased 39% to BRL305 million in the quarter, a 100 basis points EBITDA margin increase. If we consider only the 1,235 stores that we had in the end of last year and fully attributing to those stores the administrative expenses and logistic expenses, we would have had an EBITDA margin of 11.1%. So the EBITDA could increase from 305 to 317.

So we have here BRL12 million, roughly BRL12 million in new store pressure for the stores we opened in the last six months and pre operational expenses of the stores which we are preparing to open.

Looking only Raia Drogasil, only the retail level, we reached an EBITDA of 10.5% and an EBIT of 8.2%. 4Bio we reached an EBITDA of BRL7.5 million. This is higher than last year's EBITDA. So in one quarter we did more than we did in the full year of 2015. The margin was 8.4% and the EBIT was 8.3%, then it's higher than Raia Drogasil.

It's important to mention here that because 4Bio has much smaller inventories and because physically those inventories in terms of unit they are much, much smaller since they have very high prices, we have been able to double 4Bio's inventories during the forward buying. So the inflationary gain effect here is completely disproportional. As a lower margin business, 4Bio has always to leverage buying opportunities whenever they present themselves. It could be forward buying before the price increases, it can be sometimes opportunity buys. It has a disproportional importance 4Bio when compared to other store base.

Page 11, our net income reached -- adjusted net income, BRL170 million -- BRL167.8 million, 40.6% increase and a 50 basis points margin increase. This margin increase arise from an EBITDA growth -- an EBITDA margin increase of 100 bps, less income tax increase of 40 bps due to the higher profitability. The reported net income reached BRL157 million, 44.6% growth over the previous year. The only difference between the two is that we have been adjusting the goodwill, amortization, which is a cash effect. But doesn't show in the reported net income, only in the adjusted net income.

Page 12, cash flows, we had a slight negative cash flow of BRL1.6 million in the quarter and a negative total cash flow of BRL80 million in the quarter. This is higher than last year in spite of bigger results from operation figure. The main reasons here are, first, higher investments, that's the good part, investments increased from BRL81 million to BRL112 million as not only we are opening more stores this year. But we are opening them much earlier than the First Quarter, it's a bigger difference.

But the main effect here was really the cash cycle. Obviously, last year was a very low figure as we had reduced the cycle. And after three years of cash cycle reductions, we can no longer expect to keep reducing cash cycles every year.

So just the normalization of the working capital, just by maintaining the cash cycle, there will be a much bigger working capital investment -- with the increase two days cycle, which is even bigger. But this part is transitory. But the point here is that even without this transitory part from now on the cash cycle burden -- the worse capital burden, sorry, will be bigger than (inaudible).

Finally, talking about our share, we generated year-to-date a shareholder return of 78%. Considering the average annual return since Drogasil's IPO, we have reached an annual return of 30.8% since 2007. So very high number for a very long time -- and it's 38% from where we invested in Raia's IPO since 2010. And these are big numbers and much bigger than what Target average, for example, generates.

So I will now pass you to Marcilio and then we will be back to Q&A. Thank you.

Marcilio Pousada {BIO 16117399 <GO>}

Okay. And thank you again. In the slide 14, we now show how we work with the inflation management and how it's difficult to work with inflation in Brazil. We know that there's price increases every year, then we work very strongly with every team here. We tried to increase the inventory, we tried to keep all the operations in the same level before they increase the price, which helps us a lot in the all the results of the year. But help us in this record result in this quarter.

What happened with the customer when we keep the high price? We had a big change in the mix, then all the customer starts to buy more brand -- low brand drugs and also more generics also. This show the negative 2% in the mix effect.

And the inflation gain also helped the competitor, the competition and we know that more warning price in industry markets and we work towards that (inaudible) run also. And all the then (inaudible) work has not helped us to pass for this point right now.

What's important here? We work only for the long term. We know to keep the market share is very important for us. Then we make all this equation, which is high inflation to help us to keep the market share and gain some market share after this high end prices.

In the next page I show how we work the guidance for 2016 and 2017. We had a problem here in the past; we know that we opened stores just in November and November a big amount of store every year. We know this is a mistake for our business and is a mistake for process. We still -- we need to change this and we work very, very strongly to increase the contracted (pool) since 2015. We work also -- and send back all the process to retain their license to open the stores and we work very, very closely in how to solve the process with the human research department, how to hire, train the credit people to serve the customer and open.

Then we sanction the store guarantee for 200 stores in this year and next year. Better than 200 stores, we are going to open 10 to 20 stores per month. We have been looking for stabilizing this process for the future. The good news here is that the stores to open with the outstanding performance and we're looking only for corners with high inventory in the stores and the people ready before they serve the customers in the stores.

Then what will happen, what they are doing right now, what are our changes right now to read this inflation in the inflationary environment in Brazil also. If you look at all the -- few retailers in Brazil, I think that people are working in sales, expense and talk with the banks. As we have a very good (inaudible) here in Brazil, we will not need a lot for the sales and for the banks. But we will have to look very, very strong with expenses -- and far good initiatives to help us with the expenses for the future.

First of all, with labor, we have to do some turnover and the all (premise) or staffing also to help to reduce the cost in labor part of Company. Well look for the rentals -- relocate their rentals not only for the market price right now. But to keep the deal as a proxy for us for the future also. We know that it's important to negotiate the rents in every time for the next years also.

We look very, very close also the electricity costs as I know the electricity cost is the number four expense for our business. We are changing the led lamps, we are opening stores only with the led lamps. We are changing air conditioners, all the air conditioners in the stores also. And in logistics, we hired the (Falcon), Falcon is a consultant company here in Brazil that works very, very strongly big companies like (Ambezi) and Falcon starts to work in our distribution center to help us to understand how we can bring more productivity in the distribution centers.

We didn't believe all these agendas can help us in the results part in our future. This together with this number (inaudible) and then also help us in trying to changing in the (inaudible) launching easier.

Now, we can go to the question-and-answer session. Okay and thanks so much. Thank you very much.

Questions And Answers

Operator

(Operator Instructions) Joseph Giordano, JP Morgan.

Q - Joseph Giordano {BIO 17751061 <GO>}

I have a few ones. So the first is like the growth that made surprise of the best results. So I saw that you gained share pretty much all over. So I just wanted to understand if you're seeing like different growth patterns into the different regions. So basically I'm trying to understand if you're seeing customers more pressured here or there and if this should be a major decision driver on where you should focus your expansion?

And on top of this, if you could comment on the competitive environment on a regional basis, that will be also great.

Then my second question would be related to the ongoing discussions related to the new OTC rules in the county. So basically you would be expanding to new pathologies and molecules, the right of being sold in the front store. So I just wanted to understand how this should help sales and in dragging traffic? Thank you.

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

Joseph, thanks for the questions. First of all, obviously in different regions they have different growth trends and it's difficult to give a lot of color because our competitors also listen to our conference call and also read the reports.

But what I can tell you is that I think Sao Paulo is delivering healthy growth and most growth is coming from outside of Sao Paulo. I think over the next two or three years we have seen a huge convergence between our operations. We used to have a bigger gap between Sao Paulo and the rest and the rest has been growing in a very, very strong way in our base. We think there's more similar revenue per store levels across all regions.

Obviously -- I mean we saw more competitive activity. Some of our competitors who were in deep trouble, they had a breath of fresh air as this price increase helps everybody in the sector and not only as. So in specific markets we had more promotion activity. And here we think about attacking and defending. So whatever necessary we defend our position, we definitely reduced our prices, whatever needed and at this time needed. We also strengthened our marketing expenses to focus on some markets where we saw extra opportunities. So we always manage our business as a portfolio, understanding where the opportunities and the threats are and addressing each of them as needed.

In terms of our expansion to build 200 stores a year, we don't have much of a luxury of cherry picking. We're opening all over the country. Obviously, Sao Paulo should be the main block of stores and I think Northeast should be the second main block of stores. But then we should open more stores in Rio, more stores in the Midwest, more stores in the South. We're looking in new markets. We're just entering Tocantins, as I mentioned, in the end of this month. I mean we obviously will look for new markets. So it has to be a combination.

Finally, the last question of Giordano's question, I mean on the OTC switch. And (VISA) just passed a new regulation establishing the ground rules for pharmaceutical (to) switch from prescription to OTC. The Brazilian OTC market is a very poor market if you compare to the US and European markets. I mean a lot of products that in the US or in Europe they are OTC, in Brazil they are still prescription products.

I mean I can mention as an example -- Naxin, for example, you cannot nowadays find Xenical, also as an OTC Xenical as an OTC -- in Brazil it's very limited and we haven't seen switches for probably more than 10 years.

Now, what VISA has determined is that specific categories that have been in the market for more than five years which have a very high safety profile -- if one brand within a certain active compound applies for a switch and the switch is granted, then all other brands of the same active compound will be forced switched to OTC.

This is very good for us because, first of all, we have more margins in OTC than we have in prescription. Prescription is one of OTC business. OTC is a consumer business. So we have a level playing field when negotiating for supplies.

And second is that switches are generally followed by direct-to-consumer advertising and this can build demand for this category and help all of our sales growth. So this is a great trend. But it's very difficult for me to give you a grasp on the magnitude of that. We'll have to wait and see.

Q - Joseph Giordano {BIO 17751061 <GO>}

Perfect. And lastly I like to ask one extra question if I may. So the mid of this year when the new health minister took over, one of the things that he mentioned was that like he would revisit the benefits granted to the population and part of it would be reviewing the Farmacia Popular program. So I just wanted to understand if you have any color on what's going on there and if it could affect, let's say, like including pathologies, remove out diapers? So that would be great. Thank you.

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

Well we don't have any specific comments from the new government. Obviously, the government is under a huge budgetary pressure. Farmacia Popular, it's a very meaningful expense. I think Farmacia Popular was over time transformed in a very populistic way; for example, there's a lot of products advanced (inaudible), which doesn't make any sense at all even economically or in terms of rationalizing new range of products.

But it remains to be seen what the government will do. I don't know if the government will cut products because it's a very sensitive program. Last year we had a major reimbursement hit just like it happens in the US and Europe. But the thing is you must realize only 1% of our revenues.

So this mega reimbursement cut that's not that meaningful overall number. But for the program it is meaningful. I don't know if the government will do more cuts. If they do more cuts, the number of pharmacies willing to serve -- to be involved in the program will go down because smaller players cannot afford anymore Farmacia Popular. We can and we will go on. But others can't. So there's a possibility to more investment pressure. But that could be the case of co-pays being introduced. So we have to see that. Obviously, the government has to do something about it.

Q - Joseph Giordano {BIO 17751061 <GO>}

And it's a small portion of sales. But can you give us a grasp of how it passes traffic into the store or if it's like a negligible still thing?

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

I mean, frankly speaking, this is a program that everybody has the program. So I don't think the program is attracting much traffic with this. I think -- one thing is if we -- let's say if we opt out of Farmacia Popular alone, yes, remove traffic, because the other guys will be doing it. But -- let's say if the program still needs to exist, I don't think that's an issue on their volume. And --

A - Marcilio Pousada {BIO 16117399 <GO>}

But we really know that it's a good program and we need to -- we want the government to keep this program active right now, okay, help us, help all the different competition also. It's good for the customer and brings the customer -- a little bit for the stores also.

Q - Joseph Giordano {BIO 17751061 <GO>}

All right. Thank you, Eugenio and Marcilio.

A - Marcilio Pousada {BIO 16117399 <GO>}

Thank you, Joseph.

Operator

(Operator Instructions) Luciano Campos, Bradesco.

Q - Luciano Campos {BIO 16181710 <GO>}

Just one question -- I mean it's actually one topic here, which is your gross margin, which is pretty high this quarter because of the effect of the price increase and your ability to accumulate product with the old cost and sell for new price. The first part of the question is about this because you have this new distribution centre, I would like to understand your capability of taking advantage of this strategy in future years, how that change because of the distribution centre and if any other thing that affects your ability to take advantage of this strategy? This is the first part of the question. Thank you.

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

Luciano. So let's talk about the new DC. Opening new DC -- adding capacity, it's something that will happen every year. Depending on the market, it will be either be a new DC or it will be, let's say, an expansion of an existing DC, making it bigger or a further automation of an existing DC. This is what we are doing in Sao Paulo.

In Sao Paulo, obviously we are opening a lot of stores. We have three DCs. Doesn't make any sense to run a fourth DC or fifth DC there. So what we're doing is we're putting techno -- we're pushing the envelope in terms of the DC's technology so that decreasing the fees can support more and more stores being added. So every site has to be different depending on the situation.

In the Northeast, a new DC makes all the sense because we were very far away from the region. We were shipping from Goiania, which is very, very far. Over there is very bad freeways. We have to rely on wholesalers more than we would like. So having a new DC in that region has a couple of impacts. First of all, we improved the reliability of the logistics. We will be shipping everyday to Pernambuco and Paraiba. We will be shipping three days a week to all the other states in the Northeast. So our lead time falls back dramatically. The frequency of shipping and replenishing and the lead time falls back dramatically. So we will provide a much better service level in this region and this should translate in more growth.

In the case of the Northeast -- for pretty much every state when you ship from out of state, we have a tax penalty. So in Pernambuco we already will be able to improve our markets by having a DC there. There is a good chance we could do it in Bahia by next year. Obviously, if you think only logistics, then we could wait longer. But Bahia is also a big market for us and removing this tax disadvantage is also very important. So it's a combination of factors. But I think the first and the foremost factor is this better service level in the stores.

Q - Luciano Campos {BIO 16181710 <GO>}

But Eugenio, does it help you to take more advantage of -- suppose that -- I don't know how likely that is, it doesn't matter -- you have another nice price increase next year and you take advantage of the same strategy that you took advantage this year. Does the change that -- of the number of cities and capacities help you to meaningfully take more advantage of that same strategy?

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

I don't know if I fully understood you. You are asking if having more DCs help in forward buying?

Q - Luciano Campos {BIO 16181710 <GO>}

Help to take advantage of this strategy of buying products before the price increase to sell them thereafter. So that's what helps the gross margin in the Second Quarter of every year.

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

No. That's absolutely true. We always work with some level of -- I don't have in the system -- I mean that's because of --

A - Marcilio Pousada {BIO 16117399 <GO>}

No, no, that's because of opportunity buys like forward buy.

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

So for example, this year having a DC was very, very important for us. At some point we were anxious if the DC will be up and running in due time to do it. Because if -- let's say, if you open a new DC in a couple of weeks, the forward buying would have been smaller than it was. So it's definitely important.

Q - Luciano Campos {BIO 16181710 <GO>}

Okay. Second part of the question, Eugenio, is about those revenues that you have when you rent part of your shelves or space for a company, for a pharmaceutical company to advertise their brand or -- I just don't know the name in English of that. So that's what I'm explaining it this way. That it's also something that the more it is, the better it could be your gross margin.

So can you tell us about the prospects of that particular type of revenue especially now that you are expanding your guidance for openings and changing eventually or it seems like, for example, the average size of the new store. There could be an opportunity to have more of those revenues. Can you address specifically the effects of this type of revenues as a potential changer for your gross margin in the future. And taking advantage of the question, in your aspect that you think it would be worthwhile looking at when thinking about your gross margins long time -- long-term? Thank you.

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

Luciano, you are talking about trade allowances. Trade allowances are a very important part of our margin. I mean the -- for example, money that they pay for preferred merchandizing like along the terminals and displays, like that, sometimes also to advertise on tabloid, exclusive offers. So that's an integral part of our margins and a very important fact.

We don't treat them as a separate component. So every year we -- in the end of the previous year or the beginning of the year, we shift it for all our key suppliers. We give them the reference in terms of what we did them to grow, how much we expect to grow. We discuss our margins. We discuss how the margin will be deployed between invoice and trade allowances, what initiatives we have to do together, what opportunities are on the table, what problems we have to fix. And that's an integral part of that.

So as we are growing more than expected -- and that's to not only the number of stores. But also in revenues. I mean naturally the trade allowances will fall in line. But I wouldn't see that as extra margins. I would see that as maintaining the margins as a whole.

Q - Luciano Campos {BIO 16181710 <GO>}

Okay, Eugenio, thank you.

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

Thank you.

Operator

Guilherme Assis, Brasil Plural.

Q - Guilherme Assis {BIO 16143141 <GO>}

I would like to discuss a little bit about the run rate of opening 200 stores. I know you delivered that already in the last 12 months. But I remember in the past that when we discussed this you mentioned that one of the bottlenecks was to find pharmacists and sales people to fill out the new stores. My question is how have you assured to deliver this kind of growth in the last 12 months and what is the plan to be able to circumvent this bottleneck in the next two or in the upcoming years? That's my question. Thank you.

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

Guilherme, thanks for the question. I mean first point is the bottleneck is not always the same. I mean the bottleneck change from time to time. When we overstretch growth generally people become the bottlenecks. Sometimes the bottleneck can be financial. Sometimes the bottleneck can be market capacity. Sometimes the bottleneck can be construction capacity.

I would think that right now people is not the bottleneck because, first of all, we're talking 200 stores over a 1,300 store base. So percentage wise we're not talking about anything crazy. And secondly -- second, we have tremendously reduced our employee turnover. So we are retaining more and more candidates for promotion. So right now -- and obviously it's something we pay attention and we have always to work to make sure it continues as such.

But right now that's not the bottleneck. We are also increasing the training programs. We are offering new programs. We are using distance learning to do that without increasing cost. So that's not the issue now.

I think until now -- let's say, from the 150 to 200, the issue was construction and (negativization). So we have been working with our engineering area to strengthen the area, to improve the processes. Negativization is the same thing. So that was the bottleneck. Before of that, the bottleneck was contracts. So already in 2015 we accelerated our contract signing. So right now I think everything is falling in place.

And obviously from now on I think the bottlenecks to further increase would be the market capacity to absorb. And if that's the case -- I mean that's a natural bottleneck, one cannot remove. But we have to get a better understanding of what 200 stores means. So obviously the number for the year is 200 stores.

We're not playing a low number to make it. We're really putting the number we believe. It's the same thing for next year. We're really working for 200 stores. And after two years doing that, then we'll get to an understanding if we can or if we can't evolve. We don't have any idea right now. So I would assume 200 stores going on.

A - Marcilio Pousada {BIO 16117399 <GO>}

And Guilherme, we invested a lot of money in last two years to improve the human resource department. We know right now we have the right thing to deliver 200 -- people for 200 stores. Not only people. But good quality people in the stores to keep the same level that we have in stores right now in the stores in the future. They will know how to hire, how to train, how to prepare, how to promote all the guys to assimilate in the stores.

Q - Guilherme Assis {BIO 16143141 <GO>}

Okay, that's clear. Thank you, guys.

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

Thank you, Guilherme.

A - Marcilio Pousada {BIO 16117399 <GO>}

Thank you.

Operator

(Operator Instructions) It appears to be no further questions. Now, we return the conference back to the Company for their final remarks.

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

Well thank you all for attending this conference call. I would like to share with you our Investor Relations schedule for the next month. This is on page 16 of the deck. So we should publish the Third Quarter results on October 27th. We have already defined the schedule for the Raia Drogasil Day. It will take place November 25 in the morning. Be at Sao Paulo at Hotel Unique, the same place we did last year. We will have translation. So we would again invite everybody who can come to be here and get to know better the Company, get to talk with all our key executives.

It's the only time in the year when we bring the whole team and put them at the disposal of investors. So take advantage of that. We have requested over the years that we cannot -- unfortunately, we cannot attend. So this is the opportunity.

Then we have scheduled investor conferences. We have I think three conferences in Brazil, August 15th and 17th the Santander conferences in Sao Paulo. Then we have August 23rd the JP Morgan conference in Sao Paulo. And September 21st the UBS conference in Sao Paulo. Then between September 12 and 14, we'll be in London, Marcilio and myself, for the Morgan Stanley Latin conference.

Now, just before letting you go, I mean just to summarize I think what we have seen this quarter and how we're taking the Company going forward. I mean this was a record quarter in the history of Raia Drogasil as public company. So since the Drogasil IPO in 2007, we had never posted a double-digit quarter margin.

Obviously, there are seasonal effects that we have in every Second Quarter and transitory effects also, because this is not a typical Second Quarter. This is a super charged Second Quarter with a 12% price increase that we shouldn't -- we won't see it I think anytime soon in the future. So first of all, please remember in the Second Quarter next year the only certainty the margin will fall. And it will fall for a good reason. It will fall because this year was great.

I mean you can look at the graph, half full, because this was a great year, or half empty. We looked on full. It's good that we this positive trend this year. We won't have it every year. But it's good when that happens. But in the end of the day what matters is not the Second Quarter margin or even the average annual margin. It's the margin at yearend on the remaining quarters that it's the starting base for the next year. So that's where we see productivity. So well, next year's of our margin, I don't know what will happen. Obviously, we lose margin on the Second Quarter.

Can we find compensation and find the margin? I don't know, it's not easy. But there is a great chance that the margin would be in between this year and last year. And if that happens, I mean that's not a bad thing. It's happening because we have a specific benefit in the quarter and not because a problem. But the remaining quarters, we should grow the margin. This is what matters; this is how we're measuring the success here.

Another point here is that this price increase generated side effects. We had changes in customer behavior, that was very clearly -- very clear. Then (inaudible) showed its value. So the (inaudible) allowed us to understand to the left more in detail what was happening to the consumer.

So this became a more careful and price sensitive consumer, not because of the crisis. We still affirm that this is a defensive business and our numbers I think show that, that a 12% price increase makes the consumer wonder and look for alternatives. So customers were more price sensitive, demanding more discounts.

Another thing is that some of our competitors who are in a bad financial shape in this crisis, all of a sudden they had a breath of fresh air. We're not the only ones benefiting from this price increase. The whole industry and some rivals. Obviously, we do a bigger forward buy. We have the capital for that. We have the supply in excess to do that. But the quarterly inventories are being appraised by everybody. So everybody had to some level these kinds of gain.

So we saw also more commercial opportunity, more promotional opportunity by suppliers. And what we did is defend our share. So we did tactical price reductions where -- and to the extent needed to defend our share and in some markets we attacked like using our marketing strength by growing OTC and by fighting the moment. This has to do -- we follow our philosophy. Our focus here is to create long-term shareholder value.

We're not trying to -- it's amazing to have a double-digit margin quarter like this. It's amazing to break a record. But in the end that's not what matters. What matters is the long-term. Everything we do is for the long-term. All the decisions you take they are not trying to maximize the margin now. They are trying to maximize value in the long-term. So we need -- very often we have increasing price and increasing margin. But when we need to defend we will be here and we will do it and we demonstrated that in the quarter.

Obviously, we're not talking about anything huge here. But obviously we could have had a slightly bigger part if not for a bigger market investment and also if not for defending our market. But we do what's right for the long-term. So this is the kind of company that we decided to invest and this is how we think about the business.

But again -- I mean structurally the Company is in a very strong shape. We have very robust execution. Our execution has been improving. We're not happy yet. We have many initiatives in place to become even better, to service the customers even better. And we're also seeing a great sales momentum. We had a great quarter and we're seeing an amazing July as well. So all the structural plans are in place and we're doing several value enhancing initiatives to become not only bigger. But also better.

So we are on track for a great 2016 and we are already preparing the Company for a great 2017, for a great 2018, for a great 2019, for a great (2012) and so on. So again, thank you all for attending the call. Thanks all our long-term investors who have been with us and trust in our execution in the difficult days and also in the beautiful days. This is very important for us.

We acknowledge the pressure they have suffered in the past during the merger. Life is not a straight line. I mean life is more serious. So we have better partners, sometimes (inaudible) but be sure that we are walking -- actually, we are running in the right direction, one way. Thank you very much.

Operator

Thank you. Raia Drogasil conference call has come to an end. Thank you for your participation. Have a nice day.