Q1 2020 Earnings Call

Company Participants

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

Other Participants

- Analyst
- Fred Mendes
- Joseph Giordano
- Richard Dolhun

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to RD People, Health and Well-being Conference Call to discuss the First Q of 2020 results. The audio for this conference is being broadcast simultaneously for the Internet in their website, www.rd.com.br/ir. In that address, you can also find a 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 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 that'S currently available to the Company. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions because they relate to the future events and therefore depend on THE circumstance that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of RD and could cause results to differ materially from those expressed in such forward-looking statements.

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

Now, I will turn the conference over to Mr.Eugenio De Zagottis. Sir, you may proceed.

Eugenio De Zagottis {BIO 7193695 <GO>}

Hello everybody. Welcome to the Raia Drogasil first quarter 2020 conference call. This was a quarter strongly impacted by COVID, as all you know and, this is true both financially and from the operating standpoint.

Our main priority here during the quarter was safeguarding the health of our employees but also their financial security at a time of tremendous stress on the one hand; and then on the other hand becoming a safe harbor for our customers, so that they can come to our stores in full safety and know that we are there for any health care needs that arise. And I think we were successful in doing that. And we'll talk about more in further detail by the end of the call.

Financially what happened is that, we saw a tremendous peak in volumes during March, especially in the middle of the month when people were getting ready for social isolation, when they were buying all the stuff that they thought they would need to stay at home and protect from COVID. So this was a month of tremendous volume peak and that volume peak reflected on our profitability. So in terms of the highlights. We ended the period with 2,100 drug stores in Brazil, 39 openings and 5 closures in the quarter.

Our market share increased by 1.1 percentage points with 1.6 gain in Sao Paulo. We reached BRL5.2 billion in gross revenues, 25% of growth with 11.5% at mature-stores. Gross margins of 27.7%, 30 bps lower the same quarter last year. And thisall resulted in adjusted EBITDA of BRL369 million, an increase of 37% and a margin of 7.1%. The net income was BRL153 million, 45% of increase, 2.9% of net margin. And finally, we had a free cash flow consumption of BRL48 million with BRL40 million total consumption. It's important that I am referring not to IFRS 16, which I think it's very -- generates a lot of distortions in our figures. We are talking about the traditional accounting standard, which is the one that in our view best represents our financials. This is the one we use internally and this is the one that we can use to explain what's really happening in the business without the accounting distortions I already mentioned.

Next page. We ended the period with 2,107 stores. We opened in the quarter 39 stores, we closed 5 stores. 34% of our stores they were still under maturity, so they are not yet at their full potential in terms of sales and also in terms of profitability. And we are maintaining the guidance of 240 new stores in 2020. I think it's important to stress here that despite what's happening in terms of the disease and despite the short-term financial pressures that we will see in the second quarter, because obviously, we were seeing significant sales deceleration in the quarter and this will affect the profitability. And we can -- and this will -- we also have a peak in cash cycle and therefore in leverage. But still, given the comfortable margin that we have given the robust balance sheet that we have, we are maintaining our investment program intact. This is true for digital. This is true for our new DC in the South, and this is also true for the 240 stores will open next year -- this year. So there's no reason to change anything here. Obviously in terms of timing for the opening, there is a delay here in March during the peak of the volume. We postponed some openings because our DCs were already stressed and we didn't want to put further pressure on them.

And now in April because of social isolation, we have also stopped opening stores. But we believe in the second -- at some point in the second quarter, probably more and more May or June, we will start resuming the openings. And we have a lot of time within the year to catch up. And we have a very strong land bank already accumulated. Then our prospection activities they go on despite the virus. So there should be no problem for us to deliver these expansions.

On Page 5, talking about our geographic footprint. Out of the 2,100 stores that we have more than 1,000 are in Sao Paulo, as you know. But I would like to point here that we already have more than 300 stores in the North and Northeast regions combined.

In the state of Par alone, we have already 38 stores. This was our fastest expansion. And probably the history of the company and in Amazons, our most recent state, we have three stores. So we have a national platform. We have 23 states. We grow in every state with similar return expectations. We have similar mature-store EBITDA in all those markets. So despite the fact, there today the Brazilian market is pretty crowded that is no easy expansion anywhere in the country.

The fact that we have a national brand, the fact that we grow in each local market with the support of a pre-established brand makes all the difference for us. And it will allow us to keep expanding the current pace and the current returns we have seen. In terms of market share, we gained 1.1 percentage point nationally. We gained 1.6 in Sao Paulo and we gained share in every single market. It's important to mention that in our view these share gains are underestimated. This is due to the IQVIA's methodology. So the way IQVIA prepared their information they rely on large chains to directly in front of them every month volumes by store which they convert in prices and then in revenues. But for the smaller chains, they can't do that. They cannot reach every single small chain or independent to gather demand data. So they rely on wholesalers. But what the wholesalers inform is the selling information. It is the replenishment from the wholesaler to the pharmacy.

So at a time like this, in which we saw a huge pick in March, the whole industry aside, everybody was increasing inventories a lot. We are punishour figures that showed because of that because our figures that show the demand figures and not the selling figures. But for the smaller guys, it's the selling figures. We believe this normalizes over the next months, as the replenishment normalizes as well. But still, it's very clear that we're gaining share. And that's also -- as we shift to the next page in which we zoom only on the chains of our pharma, I think the message is even more clear.

If you look here on the top chart, I'm talking on Page 6, we see the gap between our revenue growth and the rest of Abrafarma's revenue growth. We're talking all the large chains in Brazil. So as you can see, our gap has been mounting since the beginning of 2019. We have been increasing this gap. But especially now with the COVID, we saw a further increase in the gap. So from the fourth Q'19 to the first Q'19, our top-line growth accelerated 4.7 percentage point from 20.5% to 25.2%, while the rest of Abrafarma which was growing on average 9.2%, it also increased by only 200 bps. So they are growing now 11%. So we see now that the gap is 14 basis points here is sorry, 14 percentage points here. It's pretty significant.

So it shows that during the crisis as we have a very strong supply chain capabilities, as we have 11 distribution centers where we can warehouse products, as we have direct access to manufacturers, so we have more than certain inventory than most of our competitors. And as -- we also have the balance sheet back up for what we're doing. So this was a period in which inventory levels went up significantly. We bought ahead because we know there could be disruptions and we wanted to be on the safer side. So we have the balance sheet to do it. We have the supply chain capability to do it. And so the gain here is pretty obvious.

And finally, when you look at the bottom, we're still growing ourselves alone more than the sum of the rest of Abrafarma. And what we expect in terms of the market is that a lot of these not everyone, a lot of players will hold the expansions because of their uncertainty, because of their financial situation and even because of mobility restrictions. We are able to maintain the expansion because we already have a nearly full land bank. But for companies who exhausted their pipeline in the end of the year by opening and now they start they almost start the year at ground zero, there is no way that even if they want to open the same number of stores they initially planned, there is no way they can catch up for this period in which prospection is much tougher to do. So this will be an important source of market share gain going forward, the fact that very likely we are growing if not alone, with only a small number of companies and growing more than anyone else in a market in which most players won't grow.

Page 7, talking about revenues. We saw top-line growth 25.3%. RD and 4Bio were pretty similar 25% for RD, 26% for 4Bio. But we saw a very profound mix effect within the retail sales. The highlight here by far was OTC which grew 46.4% huge seasonal volumes talking about things like vitamins, cough and cold, hand sanitizers and things like that. Also a pretty strong showing in generics with 30% growth. So both categories have escalated within our sales mix. Branded was a good 21.4% of growth, but then the most the toughest category for us was HPC, which only grew 14.4%.

In my view, this doesn't have to do with the economic environment or with income anything like that. It's just the fact that the shopping missions changed completely in the first quarter. People who came to our stores almost like preparing for war, so they were building up on inventories and everything that is essential. And they were just not thinking about HPC. Now that HPC inventories at household get exhausted, we are seeing HPC progressively increasing. But it is still trailing the overall mix and OTC is to still leading the overall mix.

On Page 8, breaking down here in terms of our -- this 25% in terms of our comps. Our mature-stores grew 11.5% and our same-store sales grew 15.5%. So this was heavily influenced by the COVID pandemic and by this demand anticipation as I mentioned. It is important to mention that as we fast forward to April, from April 1 to April 27, the actual revenue growth that we have seen is only 2.2% with a negative calendar effect of 2.8%, which means that on a normalized basis, we are now growing 5% instead of 20%, which should be the normal level.

So we are -- this whole ordeal is cositng us 15% of growth. This 15% derives, in the first place by the fact that the traffic both pedestrian and driving, is much lower today than it ever was because of the social isolation; the fact that 5% of our stores are shut down, these are all shopping mall stores, but still, we have -- we are operating 95% of our stores normally. So these factors they explain why we're growing only 5% in April. Obviously from a financial point in terms of margins, EBITDA margins we will see a big pressure on the quarter. But we believe this is only a transitory process. And probably already in the third quarter, we should be back to normal. This is what we believe.

Next Page here. Here we provide some highlights in terms of our digital development. So the number of cumulative downloads has increased very sharply from 1.2 million to 2 million downloads. So during the crisis, people want to go to the stores as least as possible. So there's a huge peak in e-commerce not only for us, but I would say for every sector, but us included. So way more people have downloaded our apps than normal. And obviously, there will be a positive Legacy here. Our digital sales have tripled in the quarter. But if we zoom only on March, they we have -- they have been multiplying by 5x. So this is the -- this shows the operating challenge there has been for us to fulfill all this demand. Early on it was very difficult.

Our call centers were saturated, but I think over time we have adapted and now I think we're providing a pretty reasonable service levels. It's not ideal, but I think we are not a reasonable service level. Early on it was very difficult.

If we take Onofre out of the digital growth, because there is an obvious comp-based effect, we didn't own Onofre in the first quarter last year, so the organic growth, which I think is the best number here, we have basically doubled the demand for the quarter. And we have basically tripled the demand for the month of March. So big numbers here. So digital channels as a percentage of total sales increased from 2.3% in the fourth quarter to 2.7% in the first quarter. But you reached 3.5% in the month of March. So what we're talking here is home deliveries, and what we're talking here is click and collect. So everything that comes from an app or everything that comes from a website.

And finally, the most important figure here. The percentage of revenues from digitalized customers has increased from 5.6% in the fourth quarter to 7.3% in the first quarter. So the way to read this customers who have adopted digital, they account for 7.3% of our total sales, slightly less than half 3.5% was through digital channels. The other 3.8% has been traditional in-store purchases. So when we talk about digital and the importance of digital, our transformational digital is -- it will be for us, this is not only because we have a new channel and will sell more in this new channel. It's because we'll sell more over the full lifetime cycle of the customer, the part who come in the store, the part who come in the store. Just as an example, the initial load of customers who migrated to digital, we measured that on the fourth quarter. Their trending had grown by 40%, meaning that they are way more loyal than before. They have way higher frequency of shopping than before. So just conceptually, let's say in one, two, three years from now digital customers account for 20% of our total sales. And these customers have had a spend increase of 20%. This would mean 4% higher sales and 1% higher EBITDA for the company.

So in the end, I think the percentage of digital customers will be much higher than that. But I don't have a clue to be frank what the additional spending will be. I don't know if it will be 25, 10, 40, but this can only point one direction. This can only point north for the company. So this will be a huge driver of value creation in the coming years.

On Page 10, our gross margin totaled 27.7% in the quarter, a 30 bps contraction versus same quarter last year, while our cash cycle has gone down by 1.5 days. It's important to mention here that if you look at the inventory levels, the numbers are pretty high. Obviously, fourth quarter is always high, because this is when manufacturers shut down. So every year, on a seasonal we end the year with high inventories. But we have maintained this level and it's much higher than we had early in the same period of last year.

So what happened here is that given the crisis, given the whole insecurity in terms of supply chain and so on, we wanted to play on the safe side. So we decided to anticipate our purchases much before the forward buying and to sustain a high inventory level, so that we can provide full service to our customers. And obviously, over time, when things normalize these inventory levels will be normalized. But from a cash cycle standpoint given the fact that the sales increased so much, it's been even improvement here, obviously also because the accounts payable has increased.

Next Page, talking about expenses. This revenue growth resulted in a huge operating leverage gains. So we -- our expense dilution improved by 90 bps. G&A has pressured by 20 bps. What we're seeing here is a trend and the fact that we are investing in digital. We are putting in place agile teams, analytics. We are going to the cloud and all these things cost money. So we are investing in our G&A structure. So despite the sales momentum we still see a 20 bps increase and this will keep happening. But on the sales expense side, we saw 100 bps dilution from the fact that we have the same expenses on higher sales.

Next Page. As a result, our EBITDA totaled BRL370 million in the quarter, 37% increase and a gross margin gain of 60 bps. So very, very strong quarter all over. If you look at retail, the EBITDA grew 36%, 4Bio even though it was very small comp base, it grew 141%. Obviously, next quarter, given the fact that we're growing around 5% instead of 20%, that will be the normal, we will see a big margin pressure in the second quarter. We're still talking about positive EBITDA for sure, but certainly a lower EBITDA margin. But again, it's transitory and we have a comfortable margin where to start from. We have a strong balance sheet and then life goes back to normal probably in the third quarter.

In terms of nonrecurring expenses, we booked BRL10.5 million. And BRL11.5 million actually came from a change in criteria for provisioning inventory losses. So historically, we have accrued inventory losses when we do inventory counts. So for the typical store, this happens every four months. So now what's happening is that we are estimating this interim loss between two inventory counts. So this is a one-time effect of BRL10.5 million -- sorry of BRL11.5 million. And then we had BRL1 million nonrecurring gain also. So the net was BRL10.5 million.

Next page, Page 14. 45% growth in net income, it reached BRL153 million, 40 bps net margin gain. And in terms of free cash flow, we had a free cash flow consumption of

BRL48 million in the quarter and total cash consumption of BRL41 million, which is way lower than what we saw in the same period last year. Finally, our share price has fallen down by 8.8% given but this is way lower than what happened to the IBOVESPA. So when we talk about alpha, we generated an alpha of 28%. I think these -- this figure shows the resilience of the company. We are seeing this resilience now as we keep operating almost normally in a time of distress, and we'll see this resilience play also in the coming quarters as things start to normalize from the mobility viewpoint. But then obviously we have a recession waiting for us despite the good initiatives that the government has had. So we will also see that under a recession, we tend to do pretty normally.

Okay. So shifting from the economics to what we are doing to support our customers, our employees and the society at large during this crisis. As I mentioned in the beginning we had two very important priorities here, two imperatives here. The first, safeguarding the physical and economic well-being of our employees and their families and a time in which a lot of informal employees are out of work. So we're talking wives. We're talking parents. We're talking a lot of people who help with the household economy. This is a very difficult time for everybody, but we have had a tremendous focus on that. So we are maintaining our job posts untouched, and we are preserving, we have preserved the remuneration of every single employee.

So even employees who are in a leave of absence, either because they have COVID or because they are pregnant or above 60 or have a fragile chronic condition, they are at home but they are still maintaining their full income. This is very important from us. In terms of preserving their health, we have adapted our operations. So we are -- limiting the number of people inside the stores at any given time. We have provided masks and hand sanitizers at every single store DC and headquarters. We have all our corporate people doing smart working like I am doing this call today from my house. And we have focused tremendously also on education for prevention. So maintaining their health is an imperative.

This is also true from the business viewpoint because in Italy, we have seen that there are a lot of pharmacies closed because people havegone ill. So maintaining their health is more imperative from us to our employees, but it's also a business imperative.

Another thing that we have done, we have offered every single employee telemedicine by the Albert Einstein Hospital, which is the number one hospital, the most prestigious hospital in Brazil. We have also provided telepsychology support. This is a time in which depression burnout, unfortunately, they are very normal. And whenever needed, we provide private hospital support for our employees. So whatever we have to do for them, we will do for them. And we also have established a relief fund. The company has capitalized certain amount, and we're employees to provide their contribution. And then there will be a company matching for every contribution. This is for employees who have very severe distress, economic distress at their household. So we'll be there for them.

So this is one dimension. The other dimension is really becoming a safe harbor for health access within the neighborhood where we operate. So obviously starts with a safe environment which was driven by all these measures that I already mentioned, in terms of traffic containment and so on, on the stores. We have introduced special hours for senior customers in the morning, so that they can purchase with the certainty that they are isolated from younger customers. I think this is very important given that seniors are the most vulnerable population in this crisis and our main customer base.

I think supply chain is very important because people know they can find in our stores whatever they need, and they are finding that at fair prices. We have not increased prices. We have been -- we had a very active role in proposing for the government to postpone the price increase, which I think was also another moral imperative, and then this was done. We are selling hand sanitizers in several -- in Sao Paulo at cost, which is an agreement with the state government. And we also have expanded services in the store. So we will provide immunization shots. We have partnered with state government to provide public immunization at our stores, and we are evaluating how to provide testing for the COVID.

Here we have to be very, very cautious because the quick tests that we talk about have a huge discrepancy in quality. And they are not the best test for a spot on detection of COVID. These are tests to know if someone had COVID, if they have their antibodies, and so they're supposed free to get back to work and so on. They only detect the virus after 10, 12, 14 days of incubation. So yes, a test like this misused is way worse than not having any test. So if we do it we have to provide to guarantee the quality of the test and to provide a very robust protocol for the testing. And we are also donating money. We have already made donations in chloroquine for several states like So Paulo. We have donated a basic for the population, and we are discussing at our board level a more structural donation in a more important amount, one that is supposed to leave a legacy, in terms of health care, behind.

We hope to have news on that over the coming weeks, but we want to make all we can do in support of our society. And finally in terms of having a broader support in health care, we are launching our website, a digital solution named Sade em Dia, which means daily health, which is aimed at supporting our customers and society general at these times of pandemic. So if you shift to the next page, we have the details of this digital solution. So what we do here is we provide telemedicine services. We provide psychological teleconsultations. We provide symptom checker through chatbot for the customer to know what he has. And we are doing already in Sao Paulo, this is still a pilot. This is very early days, and we're doing that in partnership with very -- with a lot of partners like Dasa, like Doutor Consulta, it's a very prominent Healthcare start-up, if I can call them a start-up because they are already pretty-established, Conezxa, Vitalk and several other partners.

So this is to allow whoever has the virus or has a chronic condition who needs to talk to the physician. They can do it from home, they can do it through our website. And we are not charging anything during the COVID crisis, and even our partners they are charging only costs during this phase. So this is another initiative to support our customers. I think and this is another way for us to have a broader role in terms of healthcare. We were given the digital assets that we have given the fact that we have 36 million customers that we can access, given the fact that we have 2,100 drug stores which we serve the 88% of the A-class within one mile radius from our stores, so we can use these digital assets, this capillarity, to have a much broader role in terms of health care.

We want to work with health prevention -- disease prevention with health maintenance even things like primary care now with Telemedicine. We also -- we sent a notice to the market yesterday about this. We are putting a structure in place to do that. We have a new Vice President, who was just nominated Bruno, who is leading all these digital efforts. And part of this digital initiative will be doing corporate venture capital, investing in health tech that can complement what we do. So this is something that will be done by Bruno's area in partnership with M&A, which is under my leadership. But I think this is the early days of a broader healthcare journey for the company.

And finally on Page 19. Economically, looking forward I think we will have, as I mentioned already our challenge in second quarter with much lower sales. So normalized levels right now for April are 5%. Maybe they're be better for May and June, hopefully. But still, we're talking about much lower sales. We're talking about loss of operating leverage. We're talking about significant margin pressure, but we will be still at positive EBITDA territory. And but this is something transitory. And I think in the third quarter, very likely, it normalizes.

We will also see a temporary leverage increase in the second and third quarter, because we have a very high inventory level. And as sales go down, cash cycle goes up. But I think this is only transitory and we are very well equipped to that. We have today 0.7 net-debt-to-EBITDA. We have BRL1.2 billion in credit card receivables that we can access at any given time. We have raised, just to be extra cautious, BRL700 million in debt from banks commercial paper et cetera to be super safe at a time like this. And as I mentioned we as to preserving our investment plans. We're still doing the expansion and so on. So I would expect our leverage to be somewhat higher than it is today for one or two quarters and then fall back in place by the end of the year. So there's no need to change any plans from the company.

But finally, I think this crisis, economically it will leave a very important legacy. The first aspect of digital. Our customers they are experienced digital. They are adopting digital. They are getting used to digital. They are downloading our apps. So digital will be not only in our sector all over retailing. Digital will be way more important when the crisis is over than when the crisis started and given the fact that we have been investing for a year in that. And that we are the leaders in digital in our sector, as digital demands become more important and as we are more ready than anyone else this becomes a very important driver of growth of customer acquisition loyalty spending et cetera.

The second just to complement on that. Despite the infrastructure that we already have in place, we are expanding our ship-from-store capabilities from -- by the end of June. We will do ship from store from 340 stores in 174 cities. So we have more than 90% -- cities. There is more than 90% of our demand with digital offering not only Click & Collect, which is already available, but also home deliveries. And we have also just introduced another service that we call neighborhood deliveries, which is available in every single store. And every customer who lives up to 300 meters from the store, he can call the store directly. He can send a message to the store directly and his store will ship to the house for free.

So this is something that will survive even after the epidemic. And we have been talking to customers about this service, the level of happiness and level of satisfaction of our customers service is tremendous. So this is another service that will increase digitalization of our customers, increase digital sales, and it's here to stay. So it's a legacy from the crisis.

And finally in terms of market share, there will be a strong legacy. I think as I showed in the Abrafarma chart, our share gains are accelerating given the balance sheet to support a difficult moment like this and given the supply capabilities that we have to maintain full inventories at a time in which there are supply chain problems in the country.

So these were the prepared remarks somewhat longer than usual because of the whole COVID ordeal. So let's go to Q&A. Thank you.

Questions And Answers

Operator

(Question And Answer)

(Operator Instructions) Our first question is from Joseph Giordano from JPMorgan Research. Mr.Joseph, you may proceed.

Q - Joseph Giordano {BIO 17751061 <GO>}

Hi. So, good afternoon everyone. Thanks for taking my question. I'd like to understand a little bit better, like how you guys see like your structured competitors in this context, right? So we see that supply chain is potentially an issue thinking it this environment, for the small guys, that they depend on wholesalers to replenish the stores.

So I like to understand how do you guys see the service level of your competitor is, particularly the ones within Abrafarma? And I'm thinking, right, on a more structured way and trying to explore more the digital platform and like the acceleration regulatory changes that we have been seeing over the past few weeks. So how do you see like potential opportunities to evolve your business model and maybe replicate a little bit more like what we see in the U.S. Pharmacy side with like major orders and digital prescription? And again, I think that has a potential consolidation driver as well as you have been seeing there between in early 2000s, let's say. Thank you.

A - Marcilio D'Amico Pousada

Okay, Joe, thanks for the question. As I told you, I think supply chain is a huge advantage right now. And I would say, three elements: The first is balance sheet. At a moment in which collection of accounts receivable is a challenge in virtually every sector, we are the go-to guy for all our manufacturers. Then we have AAA credit. They sell to us. We honor the invoices they know that. So there is a credit issue right now because a lot of wholesalers are reducing credit to small players or to players who they think may not survive the crisis and so on. So credit is the first point. We have completely differentiated credit.

The second because we buy directly, we drink clean water from the river while many of our competitors still have to drink dirty water from -- that comes from the wholesalers after we have done our purchases. Imagine the kind of shortages that there are now in terms of cough and cold medicine, C vitamins and things like that. And we are able to go to suppliers, buy before, buy big volumes and higher pool inventories and a lot of guys not having their inventories. And then there's also the fact that we have 11 DCs, that we have plenty of warehousing capacity. We just opened end of last year our largest and most automated DC. So the timing couldn't be better. So I think supply chain is a very -- it's a huge source of competitive advantage right now. I can't measure or estimate the level of stuck outs from competitors even because it varies a lot, but I'm sure that we are doing better than they are on that regard. So this is one thing.

In terms of digital, obviously, digital is advancing a lot. And obviously, the legislation had to advance a lot. So we're seeing these reflecting regulations for delivery of controlled medicines. We are seeing e-prescription gaining traction, because telemedicine is gaining traction, and telemedicine may be the best example mean, a lot of these regulatory grants so to speak they have been labeled as temporary provisional and things like that. But the thing is after you have a whole population using telemedicine getting used to that, we have small cities in Brazil where you have a physician there once a week. There is no way back with something like telemedicine. And likewise there was something like e-prescription and things like that. So obviously after the crisis subsides, we will have a regulatory dialogue with the government to try to maintain the advances that we've got. I don't know if we maintain every advance, but I'm sure we will maintain several of these advances. There is no other way. You can only go forward. There is no way back. In terms of e-prescription, I don't see prescription as a way to gain market share.

I think e-prescription can only work if it's an open platform. Nobody will prescribe if the only retailer available is RaiaDrogasil or a handful of retailers. So it has to be an open standard, and I think that will be the case. But then how each player uses the prescription data to its favor, it will be different. And then there's also the fact that e-prescription reduces mistakes. I mean, obviously, reading physician prescriptions and rightly understanding what we're supposed to dispense is one of the main challenges of health care not only Brazil but all around the world. It is ludicrous, but it's true. One of the mains is the single main source of dispensing mistakes is physician writing. So if you have an electronic prescription, we know exactly what we have to prescribe. There is less bureaucracy involved. So this is another thing that's starting to pick up and there is no way back.

We've reached the point of no return on all those things, I'll say.

Q - Joseph Giordano {BIO 17751061 <GO>}

Yeah. Just like I think about digital, I'm thinking on models involving like major orders and eventually new payment kind of models. So you have digital consultant model, YALO. So I'm not sure if most the guys are familiar with that. Certainly, it seems like things that could also evolve to that.

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

Yeah. So no, that's a good point. So you mentioned Yalo. Yalo is a product by Doutor Consulta. Doutor Consulta is a very close partner of Raia Drogasil. It's one of the two telemedicine providers in our digital platform. And they have -- so basically what they do is they have their own clinics. They have a huge layer of data and analytics that they use to manage the patients and disease prevention and so on. And they have a product named Yalo, which is like a prepaid product -- not a fully prepaid but partially a prepaid product. So a customer pays a certain amount a month, and then they have the consultation with Doutor Consulta for a fraction of the price. And they have also a big discount in exams. What we did was partner with them to expand through RaiaDrogasil, the prescription side of YALO. So we -- the consumer pays there is also a certain premium. And then they come to the store and they buy generics with 60% of discounts. They buy branded with 25% of discount. This is not a fully insurance type of product, because we're still selling at a positive margin, even though the profitability is the combination of premium plus margin. So it's not a full actuarial product. But it's something in the middle, and it's something that can be very important, especially to the emerging classes. It's still early days of the program. It's pilot, but I think, we are absolutely marching on the right direction.

Q - Joseph Giordano {BIO 17751061 <GO>}

Perfect, thank you.

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

Thanks, Joseph.

Operator

Our next question is from (inaudible) you may proceed.

Q - Analyst

Hi, Hello, everyone. Thanks for the call thanks for taking my question. I have a couple of questions actually. And first I would like to ask one of the things that I was wondering is that pharma is a stable segment right? And my question to you, Eugno, is why do you think that sales are troughing now after the initial spike with the outbreak of COVID, which is a little bit different from what we saw like in the food retail? That's the first question. I have another question, which is you mentioned in the call that RaiaDrogasil participated like in the discussion for the postponement of the price increase for the year, but this year, right? And the question is what do you think would be the impact on margins for the year of the postponement of the price increase?

And then the last question that I have is that some of the retailers that experienced lockdown, especially like the ones that are located in malls and for other products, not basic products, they are negotiating their lease contracts, right? I understand that RaiaDrogasil has just like 5% of stores that are closed. But has the company engaged in any negotiations with like the landlord's for a reduction in lease contract prices for the period? Those are my questions? Thank you.

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

Okay, Guilherme. Thank you for your questions. So I wrote down the first but I'm not reading that well. But I remember now. So you were asking about the demand right, that we had a peak in March but then a valley in April, and why that's different from Supermarket. I think the main difference is the size of the goods. So you do a supermarket purchase for a month and you have a huge physical volume that you have to store in your refrigerator at your home. There's no way you can go to supermarket and buy three months of demand. But you can go -- you can come to the pharmacy and buy three months of demand. Just as an example, with Farmcia Popular and also with controlled medicines, the government, on purpose, extended the expiration date of the prescription exactly to inform to incentivize people to buy in advance and then not to return to the stores for a while. And this is the correct. This is the right thing to do, by the way. So it's easy for we've seen in Farmcia Popular, our sales in March, they went huge increase, huge spike, because people were buying ahead of time. So this is something that I think by June will probably normalize. So this sales loss that we've seen, part of this is demand anticipation, but then part is convenience, right, especially when you think about HPC. HPC is a category which is suffering here. If we're talking only about OTC prescriptions, I think it will be very closer to manage. But OTC had a big drop, and OTC is absolutely related to convenience.

So people come to the store they have an impulse to buy stuff. They remember they need stuff. So it's not like prescription that people will buy in one way or the other. But the fact that, by far, it's easy to store three months of prescription, and it's impossible to start three months of fresh produce in your refrigerator, or even three months of normal food in your house. I mean I think this is a huge difference day to night here. So this is one thing. Then the second is price increase, right? What happens is that the price increase is simply being postponed by two months.

So the inflationary gain of inventory that generally happens in the second quarter April, May, June, it will happen in June, July, August. So it's just shifting. It's not being eliminated. What in the end this means is that when you look today, we are selling medicines at a price 4% lower than what we will be selling otherwise. So the impact that stays for the year is selling two months at a price 4% below what we would be selling. So it's just a transitory issue. But the impression is eventually, it will happen normally by the time the price increase happens. So that's not an issue. And then finally, the leases. When -- we want to be very socially responsible in a stressed moment like that. So what I mean, we're seeing a lot of people who are very well capitalized using every possible excuse to squeeze whatever they can do. This is not us. This is not what we do.

So do we have rental renegotiations? For sure. We have rental renegotiations where we have meaningful penalties. So obviously, shopping malls, there's no way we can pay a full rental for a shopping mall if we didn't operate for the month. So these are being negotiated. We have some extreme store like down -- like Avenida Paulista. Demand in Avenida Paulista, which is heavily dependent on commercial traffic has gone down by 70%. And these are heavy rentals. So in a situation like that, we are negotiating. But we are not using this crises as an excuse to delay payments to suppliers. If 00 for us to operate, even not using it as an excuse to renegotiate rentals if the impact is small and temporary.

Q - Analyst

Okay. That's very clear Zagottis. Thanks very much for the answers.

A - Marcilio D'Amico Pousada

Great, thanks.

Operator

Our next question is from Fred Mendes from Bradesco BBI. Fred you may proceed.

Q - Fred Mendes {BIO 17221617 <GO>}

Hello. Good afternoon, everyone. I have just one more question here. We saw of course a very strong market share gain this quarter pretty much across the board. That's mainly Sao Paulo. But just to understand the dynamics and the potential here, assuming that you hire folks more the A and the B class, how much more market share do you think you can gain particularly in Sao Paulo, again, without, let's say, focusing so much of these things? What's your actual addressable market here with the strategy you have today? Thank you.

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

Sure. No, that's a good question, and it's also very difficult question to answer. I mean, if you look in Sao Paulo, we have a market share. -- let me just get the exact number here. But we have a market share of 26%, and I have no doubt in my mind that this market share will grow. What happens and I'm not talking about COVID, I'm talking structurally. I think that's the rationale of your question as well. So if you think about the neighborhoods of A class neighborhoods, if you think Moema, Itaim, Jardins and all these nice places that everybody who comes to Brazil knows, our share there is pretty high. We have neighborhoods with 60%, 50%, 40% something along those lines. So obviously, when we're talking about the A class markets, there are specific gaps here and there. But overall, the level of density is already there. So in the A class, what we can do is add more stores as demand grows. And demand grows as people are getting older. So in Moema, two years down the road, people will be spending more than today because people be older and they'll be -- start taking more chronic medicines. So maybe in two years, we can open another store there, just to give an idea of how we think about these things. So this is -- but there, and there even in an A neighborhood, we still find gaps. But mostly, it's maintenance. But when you look at B and C plus, I mean, we are nowhere close to Drogaia Sao Paulo, for example, in terms of presence.

We have way less density and our market shares are way lower than that. So we still have a lot of room to grow in the B and C class. If you think about metropolitan region, for example, the A, Bs -- the Santo Andr, So Bernardo, So Caetano, I mean, Drogaria Sao Paulo has way higher share and way higher store footprint than we have there. So we still have a lot of room to grow in those regions, a lot of room to grow in Sao Paulo and in more peripheric regions. Where can the share go? I don't know. But for me, it can easily go beyond 30. But if it's 30%, 35%, then I don't know. But this is Sao Paulo, which is our native market and the most crowded market partly because we have two native brands here. We have more than 1,000 stores. In all other markets, it's way more comfortable than that. Just for you to have an idea, we have in Rio, what, maybe 120, 130 stores. We have 140 stores, 141 stores in Rio. Pacheco has probably 300, 350 stores. And I'm not meaning that we have the same number of stocks that Pacheco has because they are the incumbent there. We are not, but we could easily have 200, 250 stores. So this is just an example. Same thing about Minas Gerais. Just think about Belo Horizonte. Araujo has, what, 150, 200 stores there.

We have maybe 50 stores there. Again, we won't be Araujo, but we should be probably half the way. Same thing in the South with Panvel. Panvel is the leader there. They have, what, probably more than 300 stores in Rio Grande do Sul. We have, what, 40, 50, 60 stores. We have 45 stores. We have 45 stores in Rio Grande do Sul today. We should have here at least 120, 130, 140 stores here. So and we can move to the Northeast we can move to the North, and that's still going on. So I don't think -- and our expansion is nowhere close to finished.

Q - Fred Mendes {BIO 17221617 <GO>}

Okay. That's very clear. Thank you.

A - Marcilio D'Amico Pousada

Great, thanks.

Operator

Our next question, it is from Richard Dolhun from Westwood International Advisors Inc Richard, you may proceed.

Q - Richard Dolhun {BIO 16133267 <GO>}

Good afternoon, and thank you for taking my questions. First. I have three questions. The first is, you mentioned that you're not going to be taking advantage of leases or building owners, property owners to renegotiate leases. But what about on the M&A side? If there you see any smaller chains under pressure or anything like this would might you be doing some opportunistic M&A? The second question is on CapEx. I believe you stated earlier that the plan is still to roll out 240 stores during the year. Could you please confirm that? And could you tell me what the estimated CapEx number is for the year? The third question is related to expenses. You said that you had been doing a lot of support for employees and their families which is commendable. Can you quantify what that amount was in the quarter either as a percentage of SG&A or as an absolute number, please? Thank you.

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

Okay. Thank you for the question. It's Richard, right? I don't know if I understood --

Q - Richard Dolhun {BIO 16133267 <GO>}

Yes.

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

Okay. Thanks, Richard.

Q - Richard Dolhun {BIO 16133267 <GO>}

Yes.

A - Marcilio D'Amico Pousada

The first thing, I mean, you are right. I think we have a broader social responsibility in this crisis. In terms of M&A obviously I think the opportunities, we opened 140 stores a year, we don't depend on M&A, but I think we have proven with Onofre that we have the capability to do it and do it well when the opportunity arises. Onofre is actually a good case in point. We got 50 stores, closed 8 stores even before integrating. And in one month 42 stores were already integrated, already serviced by a DC, already supported by our corporate headquarters, already integrated to the accounting -- sorry, it took us one month to do that. And when you look at this, Onofre was bleeding a ton of money. And when you look today, those stores are very profitable because they sell more than before because our brand is stronger. Those stores have higher gross margin than before, because we buy better given our scale, and we have taken a huge chunk of G&A out of the system. So if there is an opportunity, we are ready to do. We can integrate, we have capital available, but out there are several stars here who have to align. So the first thing is that it's not any chain. You have to have a chain with some level of complementarity, and you have to have a chain who has a reasonable quality we have to build upon.

We can create as much value as we can. But you get something dismal, it's not going anywhere we need. We have to have a willing seller, and this is such a good industry for the good operators, that the best regional players they don't want to sell and if they did it would cost an arm and a leg. So we have to have a willing seller, and you have to have a price that makes economic sense. So if those stars aligned, we could do something like we did with Onofre. So that's your first question.

The second question about CapEx. Yes, we are maintaining the guidance of 240 stores. We're talking BRL600 million to BRL700 million total CapEx in the year. And given the fact that we have only a quarter of losses, we still generated EBITDA margin. We have today 0.7 net-debt-to-EBITDA. We don't see a reason why a short-term crisis should hinder our long-term strategy. So the crisis like these are actually an opportunity because we have the chance of growing when everybody else is retrenching and we're taking advantage of that. In terms of employee security and things like that. I don't think we have much in additional expenses.

Obviously the fund that we established, probably spending BRL1 million, something like that. It's not much money. In terms of donations we have spent right now, I don't know BRL1 million to BRL2 million. But certainly here, we'll do more, and we'll let everybody know when we do it. I think society expects that from us as a leading brand who works in health care, who has all the stores opening at a time when everybody is closing. I think we have to do something here. And mostly what I thought is maintaining employee income. There are for example, laws now in Brazil that if we want to have people working part-time and reduce their remuneration we could do it. So we're not doing that. We haven't done that, unless something very different happens. But right now, up to now, we haven't done that.

So you could see as an opportunity gain that we are foreholding in order to be there for our employees. I mean the role that our employees have in this crisis is absolutely off the charts I mean you have people going to work every day serving six patients every day with family pressure because they are running the risk of getting contaminated and contaminating their older parents and so on. So given the commitment we're seeing from employees that come from the purpose that they have, we couldn't do anything different here.

Q - Richard Dolhun {BIO 16133267 <GO>}

Understood. Thank you very much.

A - Marcilio D'Amico Pousada

Thank you.

Operator

(Operator Instructions) There appears to be no further questions. Now I'll turn the conference back to the company for their final remarks.

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

Okay, so thank you all for your presence. Thank you all for your support. I would like just to wrap up some of the points that summarize some of the points that we tossed. So obviously, this was a completely typical quarter, both financially but also in terms of changing the whole focus of our operation. And the focus was, first and foremost, safeguarding our employees in terms of their health and income. We talked a lot about that about the measures we took on the stores to prevent contamination, flow reduction -- sorry, traffic reduction, isolation corridors and things like that. And I also just stressed what we're doing economically, so I will not to repeat myself here. And then we are also becoming a safe harbor in terms of the health needs of our customers in the neighborhood where we are. So this also has to do with keeping the stores safe for them to come when they need, even though we don't advise people coming. We also have extended services like vaccinations. We have partnering with the state health authorities, we are discussing what -- how can we help in terms of testing, which we understand it's challenging but it's also very we established special hours for seniors to do to be able to control stores in safety if they need to come. Our supply chain has been instrumental in maintaining full inventory availability and maintaining fair prices not increasing prices just because there's a peak in demand for something. Talking about donations as well. And then I think we have done a lot of things in terms of supporting the e-commerce demand that are very important to provide convenience in a moment like this, preventing people to come from the stores.

So expanding the stores where we do ship-from store, managing our logistics to cope with the huge peak we have seen in the quarter. This new neighborhood service, which we deliver by free without charging a delivery cost within 300 meters for direct orders to the store.

So a bunch of services that support our customers at the moment when they need that the most. And I think this completely redefines our role within the health care value chain. I think we stopped being a dispenser of medicines to be someone who is actively working with prevention of diseases promotion of health and providing services et cetera. As I mentioned, the next quarter will be a challenging one with much lower margins temporary increase in leverage, nothing crazy, but certainly would be slightly North of one time, and net debt-toEBITDA probably for the next quarter or even next two quarters. But then after the events should normalize, it falls back in place.

So it's just a transitory thing. We are managing cash very closely. We have BRL700 million additionally additional money. We have BRL1.2 billion credit card receivables we can access at any time. But we -- overall, we're very comfortable, and that's why we are maintaining our organic growth. There is a legacy from this crisis, for sure. I think part of the legacy is what I already mentioned, us having a much expanded role in health care, not only on the services that we are providing that I just mentioned but also even the fact that we are launching a digital solution like Daily Health. So this is the embryo of something that would be much more important for the future, but we're very, very early days. We have an amazing capillarity. We have 2,000 stores. We serve 88% of Brazilian A class consumer within a mile.

The pharmacy is the link of the value as the cog of the value chain that has the highest frequency of interaction with the consumer. We are not tied to the disease economics like other agents in the health value chain. So certainly, we have a much broader role here. I'm talking about corporate venture capital investing startups that can strengthen our value proposition here. The second leg is digitalization. People are getting digital. They're adopting. They're getting used to. They downloaded our app, and digital is way more important today and will be way more important after the crisis than they have ever been before. And as a digital leader within our sector, we can only take advantage of this.

And finally this is a moment in which a lot of competitors are in very strong difficulties. Financially, they can't grow. They can't fully put supply their stores, and we are maintaining business as usual have huge inventories, full inventory availability and keep investing at a time like this. This is generally the best time for a company to invest as long as the company is able to have the financial means to do it.

So finally, I'd like to thank you all for your support. Thank you all for attending this conference. But more than anyone, I'd like to thank for our employees for the remarkable commitment they're showing in a very difficult situation, facing personal risk endangering, their families or having the risk of endangering their families by being contact with patients who may have the virus, but doing that because what we do is of uttermost need for society. So they are rising to the occasion. We're very proud of them, and we can only -- we can't thank them enough for their commitment. Thank you very much.

Operator

Closing and disconnecting.