Q4 2014 Earnings Call

Company Participants

- Eugênio de Zagottis, Director-Investor Relations & Corporate Planning
- Marcílio D'Amico Pousada, Chief Executive Officer
- Unidentified Company Representative

Other Participants

- Irma Sgarz, Analyst
- Joseph Giordano, Analyst
- Luciano Campos, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Raia Drogasil Conference Call to discuss 2014 results. The audio for this conference is being broadcast simultaneously through the internet and the website www.raiadrogasil.com.br/ir. In that address, you can also find the slideshow presentation available for download.

We inform that all participants will be only able to listen to the conference during the Company's presentation. After the Company's remarks are over, there will be a Q&A period. At this time, further instructions will be given.

Before proceeding, let me mention the forward-looking statements that 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 operating factors could also affect the future results of Raia Drogasil and could cause results to differ materially from expressed in such forward looking statements.

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

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

Marcílio D'Amico Pousada

Thank you. Good morning, everyone. Welcome to Raia Drogasil results presentation for the fourth quarter of 2014. As always, Eugênio will present the highlight of the business and just before the Q&A, I'd like to stress a few points about the year. Eugenio, please?

Eugênio de Zagottis

Hello, everyone. Welcome to our conference call. And after two very challenging years, we're very happy about 2014. This was an exceptional year for the Company and we are very happy about what we achieved. But more than that, I think we're optimistic about the future considering all the seeds, we planted in the year.

This is the first year that we operated as a fully combined company fulfilling the vision that really guided the creation of Raia Drogasil pretty much three years ago. And there was a vision of really sharing assets (2:58) we believe are unique in our industry across two of our brand, Raia Drogasil, that are in the iconic brand in the Brazilian retail environment.

And the result of that was very positive for us. We achieved a lead in execution. We achieved a lead in customer service and we also achieved a lead in value creation for shareholders.

Now, to the numbers. We ended the year with 1,091 stores. We opened 131 stores in the year and closed another 11. We achieved R$7.7 billion gross revenues. We grew 18.5% versus 2013, 11.4% for our same-store sales.

Our adjusted EBITDA reached R$506 million, which is a margin of 6.6% record for the Company and the EBITDA increased 42% versus the previous year. We had a net income of R$270.4 million adjusted, 3.5% of margin. And another highlight is that we had both positive free cash flow and total cash flow in the year for the second consecutive year, so we're growing by reinvesting our own resources that we generate in our operations.

And the results of that is also that the return invested capital we achieved is 2%, a lot of the return invested even though we achieved a very high growth rate with a lot of our stores, we had maturity.

It's important on page four, to look at 2014 also in perspective considering the history of the company and the organic growth strategy that we have pursued. We need to look at 2002 where I would say our growth journey, which started probably about then, 2002. We back then had higher growth rate as we combined 10% of the nominal revenues with those of last year.

We don't have to go through really remote times and even if we get back to 2007, the year in which Drogasil became a public company. Back then, I mean, we had R$1.8 million in revenues combined Raia with Drogasil and 409 stores.

So, we increased the number of stores, pretty much by three times and we increased the revenue by more than four times in the seven-year period. I think it's not an exaggeration to say that two-thirds of the company we have today were created in the last seven years under your very eyes (5:42) as a public company.

If you look at the combined EBITDA in 2007, we have R$70 million and now we reached R$500 million (5:52) in EBITDA. So, it's a really – I can give this test a very strong capacity this company to create value by growing at a robust pace, adding new stores. We were very returns driven mentality and achieving the productivity increases step-by-step.

One thing I'd like to highlight the organic growth that we had last year. Specifically, we increased 131 stores, 51 of those will open in the fourth quarter. This is something that we don't consider ideal; we want to get a more staged opening through the year although with significant challenge considering the level go up involving licensing store.

We also closed 11 stores and reopened four previously suspended stores that we had brand colored or rebranded. Right now, 32.5% of our stores are still undergoing maturation.

On page six, I think the highlight here is that we enter last year, five new states in the Northeast. So, we entered in Bahia three years ago. We have now 21 stores in Bahia and we have some stores opened next years, but in a single year, we reached five additional markets: Sergipe, Alagoas, Pernambuco the new market here, Paraíba, and Rio Grande do Norte.

We are now in 17 states that account for 89% of the Brazilian pharmaceutical market. So, as we go forward, entering new market, we'll be less and less a part of our lives and less and less relevant to our growth and I'll say increasing share in existing markets now is the name of the game; doesn't mean that we cannot enter any further markets for sure without a distribution center in the Northeast, which we will only have by the beginning of next year.

We cannot even dream about new markets. Our existence in the Northeast is already a major challenge and after we have a distribution center in the beginning of 2016, maybe we can reach other markets but that's not as relevant as it was before.

As I mentioned, growing shares is the name of the game and growing shares we did last year. We increased share, national share to 9.9%, 50 basis point increase and we increased our market share in every market in which we operate.

So, Sao Paolo was a big highlight. We increase 100 basis point, actually 1.1% percentage point in Sao Paolo following a year, which we have lost the market share in the market. This is our biggest market. These are the main markets in the country. So, growing 1.1% of shares through the year, I think is nothing short of great.

And we also grew in other markets, southeast, Midwest – another area of explosive growth. South and the northeast where we have already 1.5% of market share. We increased revenues last year by 18.5%. In the fourth quarter, our revenue growth reached 20.4%. So, really a stellar quarter I think you may agree with that.

Our mature stores revenue growth for the year was 6.5%, a very good level, probably will be higher end of what we strive to do which (9:30) our mature stores will grow 5.5% to 6.5%.

And 8.2% in the first quarter, we have a great number. Of course, that being quite favorable calendar also helps here but I think this is not a number that we should see very often but we are happy when we see it.

On Page eight, I think one of the highlights of the quarter, once again, was gross margin gains. Our gross margin in the year increased by 80 basis points and in the fourth quarter, increased by 90 basis points. We have to highlight here the fact that 2013 numbers were tarnished by the new tax regime.

We have opted out the new tax regime in the end of 2013 so we operate to 2014 on a fully normalized level. I think we only lost maybe 20 bps in the first quarter but there's not much for the year.

So, out of the 0.9% gross margin improvement in the quarter and 0.8% in the year, something like 0.4% comes from opting out an unfavorable (10:42) tax regime. Another highlight for the quarter was a 4.3 daily improvement in cash cycle. In fact, it remained flat over the whole year and so did receivables but we were able to increase accounts payable base in the fourth quarter so this had a profound impact on cash generation.

We achieved, I'm talking page nine, total expense dilution in the year of 40 basis points and a 50 basis point in the fourth quarter, particularly in the fourth quarter, we have the provisioning of corporate bonds payments that was 30 basis points below the average of the year.

What happened here is that we overprovisioned in the beginning of the year, so the second semester, we'll have lower. And artificially lower, I would say, bond provisions. So, the total expense dilution was 50 bps but really I think, 20 bps is economical, 30 bps it's an overweight in the first semester and underweight expense in the second semester.

When you look at corporate expenses, which is a 20 bps dilution in the year and a 40 bps dilution in the quarter, which you net out the bonus situation of being 10 basis points. And very substantially, we diluted 20 basis points in the year, and 10 basis in the quarter.

It's important to mention here when you look at the year, the fact that we have stores, lower staff for the third quarter helped the year number. But in the fourth quarter, our staff level were absolutely normal, so the 10 basis points were real improvement and they were driven by a very strong revenue level that favored expense dilution overall in the quarter.

With that, we achieved an EBITDA, on page 10, of 6.6%, 1.1 percentage point margin expansion over the previous year. So, this is a record level for the company and one that makes us very happy about. In the fourth quarter, we reached 7.1% of EBITDA so plus 1.5% versus fourth quarter 2013.

Something that I want to highlight here is the 131 stores we opened during the year, plus stores that we haven't yet opened that are already booked in the operation expenses, they dropped our annual EBITDA by R$26.1 million. So, if we have to open new stores because we only saw bad news from the stores opened because they were highly concentrated in towards the end of the year, so in average, EBITDA was not achieved during the year.

But with zero expansion in the year, we would have an EBITDA of R$532 million. I say that to underscore the limitation of multiple driven valuation, I mean, when you do a multiple analysis over R$506 million, we are really assuming the business cost will be negative forever and that we won't see any maturation from existing stores and that's absolutely far from the reality. So, when you think about the potential improvement in margin and the longer term maturation – I mean, the main – the level – I don't think the main, but the first impact that directly from the stores opening the year, and it's a meaningful one.

So, that 1.1 percentage point EBITDA improvement and growth and adjusted net income improvement of 80 basis points. We have increased in our effective tax rate by 30 basis points because of the profitability we achieved. In the fourth quarter, we had 70 basis points net income improvement, but this was heavily penalized by a tax increase of 60 basis points.

What happened in the first quarter is that we booked some known deductible expenses that ended up inflating for this quarter only our tax rate. Of course, the tax rate would be higher because the numbers are higher, but, not this higher.

And another highlight here is that our non-recurring expenses, they were below R$10 million while least year, they were around R$50 million. So, when we report numbers without any adjustments, we don't -- which we don't like to do, because we believe that adjustments are fair and necessary to the said economics of the business. I mean, our profitability is completely escalated.

Cash flow is on page 12. As I mentioned, I mean we had a free cash flow generation and a total cash flow generation that were both positive for the second consecutive year. We generated an operating cash flow after working CapEx R$326 million versus R$287 million in the previous year.

We invested R$271 million considering new store, renovations, infrastructure, reducing and so on. We have a bigger investment number than in the previous year in which we have invested R$237 million. So, we generated a free cash flow of R$ 55 million this year versus R$51 million last year.

The improvement here is slight despite the fact that it could be operational results were much better. What happens here is that under the global tax regime, we recovered taxes so when you look at the other assets and liabilities line, we had an R$85 million positive effect versus R$ 5 million negative this year. There was a one time that helped last year's cash flow. This year, we go back, we had a similar level of free cash flow by about (16:53).

And even though we pay R$ 41.5 million in interest on cash flow, there we pay R$ 10.6 million to the government of deduction of the interest and on capital, we bought back R$21 million in shares, we still generated R$3 million positive total cash flow. So, we are investing with our own resources and this has a profound impact on the ROIC, on the next page which reached 15% in the year.

I think it's a very good level for a high-yield company and, obviously, as we keep growing, as our margins keep growing out and the operations mature, our ROICs will accelerate in the future.

If you compare the company, before the merger, if you take the sum of Raia and Drogasil on a standalone basis in 2011, let's remember that there'd be – the merger was concluded in end of November of 2011. We achieved, so far, 41% increase in store count. Even this despite of store closing and in the initial two years after the merger, we closed a significant number of stores to – that we deemed as redundant. So, net store increased 41%.

We entered in three years eight new states that account for 11% of the Brazilian pharmaceutical market. Our gross revenue reached 62%, an average of 17.2% a year and our EBITDA grew 86% through the period. This is an EBITDA margin growth of 90 basis points between – and if you think about 30 basis points per year, it's a big improvement, but it's not a huge number.

But the beauty is that even a moderate market expansion like that that we saw in the past negative, because it was concentrated in the year that if you look on an average, it was moderate ever since to the merger. And I think you can continue at a similar level, I don't know if it's 30, 20 or 10 basis points in the future.

But we believe we will deliver moderate margin growth when you combine 17% in top line growth with 30 bps of margin improvement per year. And I'm not implying exactly the number we see going forward, but these results in EBITDA increase of 86%. So, nearly double in three years and that's a big number.

On page 15, talking about shareholder return, I mean, if you look since the IPO, those shares – those investors that invested seven years ago with the Drogasil share and the capital share ever since, they achieved an average total return of 24.9% for the year – sorry, 23% per year and a total of six and a half years.

And those leads back to the high IPO four years ago and maintained their shares to this very day, they achieved a total return of 25% per year for four years. So, we're talking private equity kind of return for a large public company.

In 2014 alone, the total return to shareholders were 72.4%; 71.5% came from the share appreciation and the difference came from distributions. Talking about distributions, I mean, we booked last year a total of R$ 74.6 million of interest on capital. So, this number provides fiscal deductibility in the same jar.

We paid net R$41.5 million last year in interest and shared service. In addition to that, we also paid to the government R$10.6 million in interest and on capital deduction with taxes relative for that number.

Now, for 2014 onwards, we are changing our distribution policy. Because this year the company is in a different line in terms of profitability, in terms of cash generation, we feel comfortable to take a next step to enhance shareholder returns. So, the new policy would be the higher 30% of net income there has been our longer term policy and the maximum legally allowed limit for interest on our capital. One that maximizes our deduction, maximizes total shareholder returns.

As an example, had we applied the same policy in 2014, we have distributed – we have booked around R$4 million in addition of interest and on capital. This increased distribution really starts now as we are proposing to the general assembly a supplementary interest on capital relative 2014 of R$29 million.

I mean, this actual distribution is actually booked in 2014 and 2015 and uses the total limit of the deductibility for 2015. But over the two years, we are using existing profit reserves from 2014 to do that. So, the R$29 million should be booked as looking – we booked now and should be paid in May together with 2014, the second duration (22:33) 2014 interest and on capital. So, I think, this is an important step forward in terms of enhancing shareholder returns.

I'll now pass it on Marcilio to highlight what we had promised for this year versus what we accomplished and our strategy going forward.

Marcílio D'Amico Pousada

Okay, hello, the important thing about 2015, I mean, I'd like to talk about (22:54-22:59) the execution. We did everything well in 2014 and we would have to do the same in 2015, okay?

And we when look at report what we promised and what are accomplished, what we delivered for this year, what we did – we promised a sustaining growth with financial discipline. We opened 131 new stores, not easy to open stores, the regulation environment in Brazil is terrible. Find good locations, very difficult, also opening stores, only for opening stores is easy, but opening good stores in good corners is very difficult to do and training and equipment for the team is very difficult to do and we did very well during year, which helped us to grow in revenue, 18.5%. And revenue growth of 18.5% is easy, but revenue growth of 18.5% together with better EBITDA margin, very positive for results also.

The number that you liked a lot is mature store growth 6.5%, is very execution driven, I mean not only about the competition environment but also about the cannibalization natural for discounting business that we had a little bit cannibalizations in markets and growth – grow the same rate as (24:18) is very, very good for business, okay?

Also, we achieved the business gains that we promised for value improved the integration helped us a lot, the and is virtually for integration (24:31) as one year which all the company together year and now with help of the logistic system helps us to improve the environment for the business.

It's not easy to remember the business by now in the past that this helped us to build the operating method our record net promoter score, we have the net promoter score, go up and go even higher and we will have stuck to and delivered both numbers; the best numbers ever. We have the best number in store count and you start to reduce the employee turnover in the last quarter 2014.

All these operational methods help us improving the financial methodology. We started diluting expenses because we are operating better our business, our cash cycle is better because the operation level is convenient and call this our virtual cycle which is (25:26) in our operation go better in our results, okay?

We did also the Omni channel. We launched drogasil.com site, Drogasil will implement a new e-commerce ERP and we also established a new national channel for Telesales. This is very good for us because helped us to get this company ready for the future. We know in the future the customers if they want to buy on internet and pick the items in the stores; we have plans to be ready for this in 2015.

So, the other good point that we did in 2014, we have created the incentive alignment. We have today 24 Directors of the company, Directors and Vice Presidents that are shareholders of the company. This is very, very good to align with Directors, the shareholders long-term issue.

The next page, I'll show you the challenge for 2014 and 2015 in the next steps, okay? We did also – we disclosed there are a new strategic planning in 2014. The new strategic planning has four different pillars. The number of pillars is to grow organically while opening 130 stores this year, of 2015 and we are planning to open 104 (26:51) stores or a little bit more in the next four or five years. We really believe that is the best way to consolidate markets (26:58) and we really know how to do that very well.

Developing new formats. We know that entire brand – the brand is very, very strong in A and B class. We know what we have to reach the C class, the new class in (27:17) which is very important for our business and for the market. We are planning to develop the market value for the next few years, not only the Farmasil brand but we will try to achieve the higher brand in Raia Drogasil branding in new market channels.

And we know that (27:39) the items for the customers is a very important task for us, then category management is important for our business to help with not only shopping experience but to help the results in gross margin and pricing (27:52) and we – understanding customer behavior is very, very important for us also because 78% of the customers, we know the customers very well. We can identify (28:03) the customers. The use of this data for us is very, very important. Then we closed our partnership with Dunnhumby. Dunnhumby will help us to present the category management and experience for the next few years.

We are looking also to improve our working or HR people process. We are working very, very soon to working better profit in our team. We have right now 3,000 employees. Of these employees (28:38) this is very, very important for we know that when you know have these guys try not only exceed our customer experience but also to develop the new leadership for the company's future. We know this is very important experience for all these employees the opportunity to grow together and work together with Raia Drogasil (29:04-29:07) of productivity.

Add these two points together to increase shareholder returns is like the financial discipline that we have right now in the company and the financial flexibility like the strong balance sheet (29:22), we know how important is this in this kind of environment in Brazil right now. We look for the cash every day, and know this is important. We put all these together while working to stay increasing the shareholder funds in long-term view.

And finally, I go again to dedication. You work with this agenda. With no profit – 100% profit in long-term view but we focus also in education and continue to grow without (29:38) and meet our customers need. We really believe that we will continue to win the competitive advantage for the company that we could make it with the margins year after year.

Let's go to the presentation again and after that, we go to the questions and answers.

Unidentified Company Representative

Okay. Thanks. I'd like to highlight some of the activities in our investor relation calendar. One of our main priorities as we improve our operating processes as we integrated our accounting in area and back office was to reduce the window of reporting.

So, starting 2015, on every quarter from between first, second, and third quarter, we will report our intermediate results during the following months. So we report the first quarter in April 29. We report the second quarter on July 30 and we report the third quarter on October 29. For the annual results, of course, we need value more time, we report on February 18. So, it's basically in the same kind of timeline we did for an intermediate result that we kind of – we've been using for our final reporting.

Another date that we have set and it is a date that I think you should take notice and think about it is the Raia Drogasil Day. We do it on December 4, in the following day of one of the main one – one of the largest Brazil equity conferences this year. The time and venue to be determined, still to be decided but most likely it will be on the same venue of the conference, so who all come to conference can stay the next morning, probably, for our Investor Day.

And finally, the next conferences that we are scheduled for are on March 3rd and 4th in Brazil, Merrill Lynch Conference; March 17 also in Brazil, Deutsche Bank on CEO Day, April 2nd in Brazil, the UBS Consumer Round Table in São Paulo. And then abroad, we will be May 11 and 12 in London, the Santander Conference and May 13 and 14, New York, will be Itaú CEO Conference.

And that's all we have prepared so we like to go for your questions. Thank you very much.

Q&A

Operator

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

Q - Joseph Giordano {BIO 17751061 <GO>}

Hi. Good morning, everyone. Thanks for taking my question. First of all, congratulation on the strong results that you reported once again. So, my question here is on the expansion plan. So, you have this goal of opening 130 new stores throughout 2015, but when we look back and you reported that on your Investors Day last December, it seemed that you had nearly 50% of the contracts for the new stores already in-house. So, I would appreciate if you could share how the new contracts are moving and what's the status at this moment. I believe you should be above the threshold at this point.

A - Eugênio de Zagottis

Joseph, thanks for the question. You were right. Back then we have 50% of the contracts already set. Right now, we have around 90 contracts already set and we are ahead of our targets. So, the only thing is that we are still in February and if we were – this is actually staged a couple of months ahead, maybe we could call for more. But right now, we still keeping with the 130 guidance but we recognize there is some upside risk.

I think the contracts will not be the problem for opening more stores. The challenge will be the timing for opening, engineering, preparation and all that and mainly people with a few that comfortable on those dimensions and we indeed have more contracts than expected in our hands. There is no reason why not to open more stores.

A - Marcílio D'Amico Pousada

And I think that the number one challenge is people, for sure. But the number two challenge is the regulation. It's very difficult for now to make valuation (34:28) to open the stores.

Yes. The time between signing contracts and opening a store has increased this time as the process will become more and more bureaucratic. So, having 90 contracts now is great but it may or not be enough to go beyond 130.

Q - Joseph Giordano {BIO 17751061 <GO>}

Right. Right. So, I understand that like the focus remains on organic growth, but last year, you made like the acquisition of some points of sales from Santa Marta, right? So I'm not sure how are like the smaller mom and pop chains are performing at the current environment. So do you see any opportunity in the near future to do a similar acquisition like some players may go under?

A - Eugênio de Zagottis

Well, we believe that the economic environment, which bodes a lot of challenges for whoever is leveraged. Let's remember, I come from Raia. I know how this operates with leverage, in a tough environment. Although, I recognize that without that we will not be here today as part of this combined company. But the reality is that, the environment in which the cost of debt is going up that availability which is tightening for retailers who are leveraged life becomes a nightmare. It's a big challenge to extend lines. Sometimes they have to artificially increase numbers by boosting gross margin in a way that's not supported by the market. We'll have a lot of wholesalers who are also leveraged and we will have capacity – the extra cost and the smaller availability of lines to their customers.

So, I think we can see probably positive reflexes on the players like us who are self-financing and who have the cash flow to go forward to invest and do whatever is needed. Having said that, I think the likelihood of doing any M&As by any chains, I think is very small. It's never zero. Whatever is presented, we analyze, but I think it's small when you realistically, when you look there are very few chains that we like the assets. And when you don't feel comfortable in the store sometimes it means that even though there may be cash generation, but you can question if that's sustainable or not for the longer term. The cost of growing organically is much, much lower, so it's a much higher return proposition growing organically versus buying someone.

Growing organically, another – has disadvantages, the investment is completely publicized and diversified, so if 130 is the (37:21) we'll screw up a couple of those. But overall, they net out and be very good.

When you buy a large chunk of business, it's almost like you're putting all your chips in and the – if you do it right, congratulations. But if you don't, you have a big problem in your hand and integration it's always a distraction; they can derail the execution at the 1,100 stores that we operate.

So, deals like we did (37:47) I mean, is to increase that are only buying stores. We can analyze and there is a matter of quality and numbers, but doing real acquisition of their drugstore chains, that won't happen.

Q - Joseph Giordano {BIO 17751061 <GO>}

And another question here, while we look at the generic penetration and you say it is kind of stable on a year-on-year basis. Do you expect like any improvement because likely when you said that there's an important gross margin driver as well, not just HPC, so if you could share it could be great some extra color here.

A - Eugênio de Zagottis

Joseph, I'm sorry the quality of the line is not that great. Can you repeat the question?

Q - Joseph Giordano {BIO 17751061 <GO>}

So, when we look at the penetration of generics it looks kind of stable even though we would expect it increase slightly, and also drive a little bit higher gross margin, so if you could comment on the trend for generics penetration it will be great.

A - Eugênio de Zagottis

Sure thanks. Well, generics has been largely stable. The pipeline for new generics launches is far from amazing. We're seeing almost a dry pipeline. So, Brazil is ahead of the global curve in terms of patent expiration, so the products in Brazil like Crestor, for example, that has already expired and even though in the U.S. and Europe, it's still patented.

But, as a result, I don't think we have any help from the marketplace to grow generics. Having said that, as we execute better, it may be the case that we can lightly expand year-after-year.

I don't expect any major shifts, but maybe we can expand an extra bit of couple of basis points per year. If the marketplace (39:36). And when you talk – when I'm talking about the category management, maybe this helped us into the generic presentation in the future. But not right now, okay, you can this in 2016 or 2017.

Q - Joseph Giordano {BIO 17751061 <GO>}

All right. Thank you, Eugênio.

A - Eugênio de Zagottis

Thank you.

Operator

Mr. Luciano Campos from HSBC would like to make a question.

Q - Luciano Campos {BIO 16181710 <GO>}

Hi. Good afternoon, Eugênio and Marcilio. My first question is about the average basket of the shoppers that is something that I have been following for some time. And I'm interested how strong it has been, actually evolved double-digits in this quarter. Can you elaborate a little bit more on the dynamics behind this average basket? What's going on here? If it's – if you can also like separate a little bit the effect of pricing involved on this? That is my first question. Thank you.

A - Eugênio de Zagottis

Thank you, Luciano. I have to admit that this is a number that I report, but I don't like to report, because I think it can be a misleading number. Because what happens is that over time, we are increasing density in the markets and our stores will service consumers' around a kilometer, 1.5 kilometers. But what happens is that the consumers who are closer to the store, they are much more loyal, consumers much more heavy standing because of they are better served by the stores.

So, when we open a new stores or even when a competitor opens a new store, we see that radius. What you see is that the consumer going (41:24) to our service, but that they live nearby the new store to be opened, ours or someone else's. They migrate. So, sometimes, you can see a store losing 10% of consumers, but only 3% of revenue where these consumers are not as important. So, the result that you see is that the number of tickets goes down, the average tickets goes up.

It's an effect of increasing in-saturation in the market. We have stores that we look 10 years ago. They are much better stores now that they used to serve a much bigger number of people with smaller tickets. So, I don't think we can read in the number much about our merchandise efficiency or about the consumers' pocket. I think it's a side effect of increased penetration of drugstores in the marketplace.

A - Marcílio D'Amico Pousada

Thank you, Luciano. It's Marcilio. May be the project that we will start right now, it can help us extend loyalty and it can increase the share of wallet for the customer in the future. We are expecting good results in 2016 and 2017. And maybe increase more significantly, but we don't know right now.

Q - Luciano Campos {BIO 16181710 <GO>}

Thank you, all right. I think – I understand your point, Eugênio, about the metrics. It's just, with these average numbers that we have, that's something that has been very impressive. One thing about this basket or actually, let's forget about the basket but talk about the pricing, we have a few events that are kind of predictable in terms of higher taxes for some lines of cosmetics. We have a very important pressure in terms of electricity cost that is, something that affects the whole industry, not only Raia Drogasil and I would expect that somehow to be reflected in prices. Have you seen already that phenomenon to start or it's something that we'd be observing only starting the first quarter?

A - Eugênio de Zagottis

Luciano, thanks for answering the question. I think you're talking about the fiscal fee inspection increase. This is an increase that has a slight impact on our business, because it also mostly categories that are not costs like makeup, for example, like perfumes and things like that. Yes, it's like, we think there are a couple categories affected and what happens is that we will see – we are seeing or we will see manufacturers increasing their prices for us and for everybody and we will obviously pass those increases for the consumers. I don't exactly – I cannot exactly tell you how many manufacturers have or not started doing that. But it's normal that if it hasn't happened, it will happen and it will go to the prices and life goes on as usual.

A - Marcílio D'Amico Pousada

This is correct talking about the IPI and not about fiscal fee. Sorry.

Q - Luciano Campos {BIO 16181710 <GO>}

Okay. Last question, it's about strategic planning and also a little bit with something that you mentioned in the Portuguese call in terms of being able to eventually accelerate a little bit, the opening now in the – along the year like having a little bit more openings in the beginning of the year versus like a more back handed curve that you had in 2014.

I just wanted to know how it is evolving in terms of hiring people. How expensive that continues to be if there is any sign of a softening in the labor cost? And connecting that with strategic planning, how do you see like some metrics like employees per store evolving as you apply or as you search for efficiencies in your strategic plan? Thank you.

A - Eugênio de Zagottis

Okay. So, thank you very much. In terms of people cost, of course, there over time you have to increase labor cost, but they don't come necessary from hiring. I mean, this is a big country. We find people that we need to staff the stores.

The challenge they have is that in a strong economy in which we have – we had until recently full employment, people have a lot of options in life. So the turnover got very challenging for us and for every retailer in the country. So the challenge was not on hiring, the challenge was in retaining people.

But the labor pressure financially doesn't come even from that, it comes from the fact that over the year we negotiate with unions just like the 30% of labor is unionized and every year we have seen real wage increase. Already last year because of – being the beginning of the crisis, it was a lower real wage increase than normal and we believe this year we could see that again.

But I think it's very unlikely to see labor cost going up below inflation or at inflation. But I think we can have less acceleration and then we can have deceleration versus what we saw in the last few years.

In terms of accelerated openings, what's crucial here is that when we concentrate 50 stores to be opened in the second and the succeeding quarter, like we did in the fourth quarter, the energy that takes for the whole organization is very big and there are some side effects that are difficult to measure, but we wanted to prevent that.

Having said that, it's not easy and every year, we start on a softer basis opening store. What we are doing is we have set internal targets for the whole company, not only we have a target of opening 130 stores, but we have a monthly target that is opening X stores per quarter. So, let's say that if we do just like what we do last year, people would have a partial achievement of the target.

So, in order to achieve 30% of the target, they must open every quarter the (48:04) openings. So we're aligning incentives to try to move the process, but we recognize it's not easy to do. If you can repeat the last question you made and now I go lost.

Q - Luciano Campos {BIO 16181710 <GO>}

Just that trying to connect this topic with your strategic planning, when you look at your number of employees in the store, for example, and as you seek for efficiencies. Would that change overtime or would it be kind of the same right now? How would you look for efficiencies in that sort?

A - Eugênio de Zagottis

That's a very good question. During last year, for – for probably the three quarters, because of process gaps we had a slightly lower number of new stores that we acquired. In the fourth quarter, we got in level with what we think is the optimum level of people per store given our current processes.

I mean, taking people from stores is very easy. Taking them without destroying the value is a real challenge because what happens is that our head count and struggle reflects the kind of profits we have. So, the only way of really reducing the staff per store without destroying value needs to change the process and needs to make processes more efficient.

If you can service people 10% faster in the checkout and 10% faster at the pharmacy counter, for example, I'm just throwing a number here, you probably can see either a 10% lower employee cost or a 10% faster service that should represent in any way a positive increase to the company.

So as we mentioned in 2011, 2012, and 2013 – sorry, 2012, 2013, and 2014, the whole focus of the organization was important in achieving the best standard of execution in both brands and we are almost there but that is – that means that we're not creating anything new.

We are just getting the best practice among high end overview and applying that to the whole company. And you will hear in the – we are exactly at this stage, clearly forward, our goal is really to push the envelope for execution, to really better execution. So we have a taskforce taking place, analyzing processes, mapping processes, understanding things a little bit better in terms of CRM positive executions and so on.

And with time, we will see improvement in our platforms that will make the consumer lives easier and that will give biggest opportunity for our stores. We'd be able to serve the people at the checkout, at the pharmacy counter X percent faster than now. If the improvement will go to the labor cost or to grow – if you go to the customer service and the – we will see – (51:12) but in one way or in the other, this should be value enhancing.

Q - Luciano Campos {BIO 16181710 <GO>}

Good. Thank you, Eugênio.

A - Eugênio de Zagottis

Thank you.

Operator

Mrs. Irma Sgarz from Goldman Sachs would like to make a question.

Q - Irma Sgarz {BIO 15190838 <GO>}

Yes, hi. Thanks. Most of my answers were already – most of my questions were already answered. Just a very quick follow-up question or two. Any impact that you're expecting from the fiscal measures that are being announced that have been announced in the MP that was published overnight given that you weren't included in the payroll tax relief that was announced earlier this year. And that was rediscussed earlier this year, I would imagine not, but just to confirm that this has no impact for you?

And then secondly, any outlook on the expected price increase, I think the CMED is due to announce its plan for its annual price increase that will come due on the first of April or, I think, they typically come out with that in March. So, I was wondering if you had any early reads or any thoughts on potential level of the price increase for regulated drugs this year? Thank you.

A - Eugênio de Zagottis

Irma, thank you for the question. The last one is very funny, because we've been reading about these two years, because we got kicked out of the labor tax – of our tax – social reduction – social price reduction. So, we have been kept out of that benefit, enjoying that benefit for only three months in the very beginning and now we find that all of a sudden the government change the rules and what was a reduction in social charges for those contemplated is now an increase in social charges. And now we're very happy because we are not part of that.

So, life is very funny sometimes.

A - Marcílio D'Amico Pousada

Its funny (53:18).

A - Eugênio de Zagottis

(53:20) So, you know sometimes you get kicked off, a reason that makes you very happy one day to the other. Then for the prices, we don't know yet what's coming because we have a higher CTA (53:36), I think it's reasonable to expect a slightly bigger price increase that we saw last year.

But – I mean, we are in different times right now. It's the government that is doing a lot of things in the economy but one of the virtues, I think, is the one you don't want to artificially mess with prices, so we have reason to think that we will have not the inflation, (54:01). (54:02) but we don't expect it. But a higher number than what we saw last year and if it's higher, this would be very important for the second quarter.

Q - Irma Sgarz {BIO 15190838 <GO>}

Thanks very much.