Pague Menos
Conference Call Transcript – 3Q21

Operator:

Good morning, everyone, and thank you for waiting. Welcome to Pague Menos' conference call to discuss the results of the 3Q21. Today with us we have Mr. Mário Queiros, CEO, and Mr. Luiz Novais, CFO and IRO of the Company.

We would like to inform you that during the Company's presentation, all participants will only be able to listen to the call. We will then begin a Q&A session when further instructions will be given. If you need any assistance during the conference call, please request the operator's help by pressing *0.

We would also like to inform that the conference call is in Portuguese and will be presented by the Company's management, and for the English conference, there will be simultaneous translation.

This event is also being broadcast simultaneously on the Internet, via webcast. Any questions sent through the platform will be answered later by the IR team.

Before proceeding, we would like to mention that any forward statements made during this conference call are based on the beliefs and assumptions of Pague Menos' management and based on the information currently available to the Company. These forward-looking statements involve risks and uncertainties because they relate to future events and therefore they depend on circumstances that may or may not occur. Investors and analysts should understand that conditions related to the macroeconomic context, the industry and other factors could also cause results to differ materially from those expressed in such forward looking statements.

I will now turn the conference over to Mr. Mário Queiros. Please, Mr. Mário Queiros, you may proceed.

Mario Queiros:

Thank you. Good morning. Welcome to Pague Menos' conference call. The 3Q21 was marked by a resumption in our expansion. We opened 25 new stores, well aligned with what we had promised, about 30 stores per quarter, in line with the guidance for 2022 with 120 stores.

Due to the inertia of the expansion process, some stores in 3Q had to be postponed to 4Q. So we will have an atypical quarter. In October only, we inaugurated 16 stores, and we reiterate the guidance of 80 new openings for 2021.

Another achievement of this quarter was the increase in our digital channels. We reached 8.5% of share in our total sales, a more than 70% increase compared with 3Q20. But we are going to hear from Mr. Novais, our CFO. He is going to give you more details about the numbers of this quarter, and then I will come back and talk more about our digital strategy, our health hub and innovation in Pague Menos.

Luiz Novais:

Good morning. So let us start the session of our 3Q results on page number four. Mario already anticipated two of the highlights, and here we have eight of the highlights that we considered important in this quarter.

Our operational indicators keep improving, reflecting very positive financial results. So the eight highlights, the first one, as you heard from, the share of our digital channels reaching 8.5% of the total sales of the Company, a 3.2 p.p. increase year over year. The market share has its third consecutive quarter of growth. The NPS is at a historical mark of 76. Our EBITDA is growing at 7.4%.

The expansion is also accelerating and gaining momentum. We inaugurated 25 stores in 3Q. Stockout rate at an all-time low, a 45% reduction year over year. Gross margin, 100 bps higher than 3Q20, and our ROIC is also 20.9% up year over year. That is why we are very optimistic about the future.

Here on page number five, we have the photographs of some of the stores that were inaugurated in 3Q. In October only, we inaugurated 16 source. So we are reiterating our guidance of 80 new openings this year in 2021.

These stores are performing really well, and on slide number six, we have some of the indicators of the new openings that we have. So in addition to the 25 stores that we inaugurated the 3Q, we have inaugurated another seven in the 1H21. So here we have some of the indicators of these 32 new stores. Of the 32 new stores, 97% of them are stores inaugurated in the North and Northeast of the country, 84% of the of the stores in classes B2 to C and D, very in line with our purpose and our strategy. These are stores that we are inaugurating in regions where we have a very strong presence, in micro markets where we have a lower market share, or even an inexistent market share. So now we are protected against cannibalization, so we can reassure you about that.

And the maturation curve, as we can see on the right side of the slide, is better in the first months of operation of the stores compared with the feasibility analysis that we conducted for each new site.

So we are only talking about 32 new stores, but we already see a very good performance of the new stores. And what is projected for these new stores is over 32%. So we are very happy with the initial period after inauguration of these stores, and we reinforce our guidance for 2022.

On the next slide, we have a very positive piece of information, the growth of our market share. We are in the second consecutive quarter of increasing market share. We reached 19.7% in the Northeast and 10.7% in the North, a 0.6 p.p. increase year over year, and we have a very strong prospect for the coming quarters due to the new expansion cycle that we talked about on the previous slide.

On page number eight, we have more information about our market share. Here, we see the evolution in the number of total sales for Brazil and for each of the regions of the country, number of stores and the average sales per store. And here, this is equalizing the prices of the chain.

So the market share is a market share considering volume. So in the first column, we have the growth in our total sales, a growth of 8.1% against 7.8% of the overall market, very robust growth rates, particularly in the North and Northeast.

And the last column, the column on the right, average sales per store, you see that the same-store sales of Pague Menos has been growing more than the average of the market in Brazil, which shows how positive our results are in the main operational indicators. We are going to hear more about some of them. Assortment, stockout, share our digital channels, all of these KPIs are helping us improve our average sales per store. That is why this indicator is so positive.

On the next slide, we see our top line growth. As we heard in the previous slide, we are growing above the average of the market, and our sales growth was very relevant, 7.4%, same-store 7.1% and mature stores, 6.6%. In our internal calculations, the weighted inflation rate of the past few months is 6.2%, drug and non-drug. So we keep growing, particularly in our mature stores, above the inflation rate, and the comparison base for this year is a little stronger. In previous quarters, the growth level was very robust, and we still have a very robust growth level, but the comparison base is now a little stronger.

Next slide, number ten. One of the main operational indicators that have been helping us improve our sales performance is the availability of products. Our sales team has been doing a great work to increase the availability of products, so the assortment.

We go from up a level of 7,900 SKUs available for store to 9,600 available per store in 3Q. And you do not see in this slide, but we are also reducing our stock loss rates. So it is a perfect combination of increased assortment, decreased stockouts and decreased stock losses, and this is helping us improve our sales indicators.

Slide number 11. Here we see our sales mix and private label. The positive highlight is the share of the generics category. We have reached 9.7% share of generics. This is due to some sales activities and CRM activities. We believe that our share in this category can reach 12%, so we still have a lot of room to grow, and that is what we are working on, of course, always respecting the prescription products.

On the right side, private label share, we reached 6.3% of the total sales of the Company with our private labels. Even with the growth in the total sales of the Company, we see more growth in this category due to some important launches that we had recently in this group of products.

And in services, we lost some volume, so we went from 3.3 to 1.8, but still at a are very positive level compared to 2020, and this is due to the decreased demand for covid testing. Vaccination is advancing, the pandemic is slowing down, so we have a slower demand for COVID tests. But we will give you more light about this category on the next chapter of this presentation.

On slide number 12, here we see some positive effects and negative effects. With the increase in share of our digital channels, the partnerships with health plans, these are movements that corrode somewhat our margin, but these are channels and effects that are very important to increase the loyalty of customers, and that bring an incremental cash margin to the Company. But we see this as a positive moment for the Company as a whole, despite this negative pressure on the margin.

And positive highlights, particularly due to generics and private label, as we saw in the previous line, we keep capturing the upside of the vendor management project and the stockout and stock loss rates are decreasing. So it is a positive combination of sales increments and gross margin increments. These are indicators that were very positive this quarter.

On slide number 13, we have information about sales. On the left side, we see sales expenses. We are at levels equivalent to those of previous quarters. Compared with 3Q20, we have a 100 bps increase because last year the government passed some provisional measures for covid, allowing companies to reduce the working hours of their employees. So the Company took advantage of these provisional measures of the government to contain the expenses during the pandemic, but now we are going back to normal levels in the coming quarters, after these measures were lifted.

We are at the same level, 18.8%, even with a very high inflation rate. So rental, salaries, these indicators are putting a lot of pressure, but we are controlling our expenses with greater productivity.

And for the new stores, since we are also comparing periods with store inaugurations and periods without store inaugurations, we know that in the first months of existence, our stores have a negative EBITDA. So they have a share in the expenses, which is higher than that of more mature stores, but we are still keeping the expenses at the same level, and this is very positive, which means that the stores are delivering even better results.

And on the right side, we have our expenses. There we have a 10 bps increase compared with 2Q. We are still investing in people, particularly our I.T. team. We have a group of developers here that is 40% larger than in previous quarters, and we also have some strategic projects in the Company that are helping us plant the seeds to sow the results in the future.

Just a comment. I think we have a technical problem with our image. But do we have audio? Unfortunately, you will not be able to see the slides, but you can hear the audio. The audio is still working. They are trying to fix the problem with the video, but we will continue with our audio presentation.

So on slide number 14, you see the evolution of our contribution margin and EBITDA margin. Here we are at the same level of 3Q20, and in the previous slide, we showed that in 3Q20, we had the positive effect of the provisional measures of the government to reduce expenses during the pandemic.

So excluding this effect, and excluding the effect of new openings that pulled our contribution margin and EBITDA margin 20 bps down, we are at a very positive situation and we are improving our EBITDA in our same-store and mature stores.

And in the previous light, as I said, we are comparing periods with store openings and periods without store openings, and when we stabilize the volume of store openings, we will be able to see this more visibly, and we are very optimistic about the expansion of our margin in the coming period.

On slide number 15, adjusted net income. We had a R$35.6 million net income in the quarter, and here we have two non-cash effects. One of them is non-cash depreciation, and the other one is cash income tax, but they are nonoperational effects that had a negative effect of R$20.4 million because the aliquot of income tax was much higher, the income tax rate was much higher than in previous quarters. So we are still with excellent net income levels.

And here we see the components of our net income variation on the right side, and we see what is contributing to the increase in the net income of the Company. And we hope these effects will normalize in the coming quarters.

Slide number 16, cash cycle and net debt. For the cash cycle, we finished the quarter with 61 days of cash cycle. We have more investments in stocks. We have a high investment in stocks to be able to support the excellent levels of sales of the Company, and also the good levels of stockout that we have right now.

We also have an opportunity of decreasing the distance between the payment term and the stock purchase term, which is now at 37 days. So we will be able to reinforce this cash position in the future, but we are at a normal position in terms of cash cycle, and also our net debt is 1.1x net debt/EBITDA.

On slide 17, this is the value generation of the Company. One the left side, we see the share appreciation. On September 30, we were 20 points, and now in November 1, we are more than 10 points above the target. On the right side, we see our return on investments. We see the level is over 20 points.

And the last slide of my part of the presentation is an important topic, which is the evolution of our ESG journey. As we heard in other quarters, we completed our materiality matrix. We have recently finished our 2030 vision.

(18:18 TECHNICAL DIFFICULTIES)

Mário Queiros:

We apologize for the technical issues. Let us continue with the audio presentation only. We are now at slide 20. We are talking about Clinic Farma, our health hub. We know that Pague Menos has been fulfilling its role in the health ecosystem of the country, bringing health care to millions of Brazilians.

We were the first chain of pharmacies to offer rapid testing in national scale, with more than 1.5 million covid tests performed. We also put our stores at the service of the municipalities, and we took part in the National Immunization Campaign. We donated respirators and hygiene kits to social organizations. We also fulfilled our commitment to maintain our employees and not dismiss anyone.

And our Clinic Farma was not restricted to our stores. Through our home care program, we went to the houses and to the companies of our clients, transposing barriers to bring them appropriate health care.

We witnessed in the city of Abaetetuba, in the inner part of the state of Pará, thanks to the work of relentless workers, we know that the pandemic is almost behind us, but the work of the Clinic Farma is becoming more and more relevant.

On the next slide, we see some of the highlights, such as tests for mass gatherings, covid testing for those who have been vaccinated and want to check whether they are already producing antibodies, and we are also printing the vaccine passport free of charge in our clinics.

On slide number 22, we see some of the indicators of clinic pharma. This quarter, we saw more than 0.5 million customers in our clinics, a strong growth year over year now. Quarter over quarter, we see a slight decrease because covid testing had its peak in March this year and is now declining due to the slowdown of the pandemic.

The adhesion indicator shows that of every 100 customers that visited our stores in the quarter, nearly five used some service of our clinics. This is a very good number because even with the lower demand for covid tests, the other services are expanding, and I will give you more details on the next slide.

And finally, we see our conversion rate. I always reinforce that Clinic Farma is a customer loyalty tool. Through personalized service and in depth follow-up of customers diseases, we can give them added value and raise awareness about the importance of adhering to the treatment. This quarter, we had 65% conversion. So 2/3 of the customers that use any service of the Clinic Farma bought a product on the same day.

On slide 23, we see the growth of our remote laboratory tests. In addition to the expansion of the number of stores that are offering this service, now we are also expanding the number of tests offered. In addition to the convenience and speed, the price is also more accessible for these remote tests.

Starting in 4Q19, the pre-pandemic period, we see that both for basic services, the dotted line, and the continuous line saw a deep reduction in the 3Q20 when the pandemic started, and now in 4Q21, we see that the demand for basic services impacted the pre-pandemic levels, and the demand for TLR is at a much higher level than the pre-pandemic period.

The red line is the demand for COVID tests specifically, and the reference is the 2Q21, which was the peak. And now we see a decline.

Still about our health hub, on the next slide, we some highlights of the quarter. In addition to the more than 500,000 customers seen in our clinics, and the continuous increase in TLRs, we saw our sales triple compared to the same period last year.

Also, our entering the B2B2C market through the homologation of our clinics for health plans, associations, companies such as Banco PAN, which started offering the services of Clinic Farma to their clients.

We had record breaking sales through these agreements and partnerships, with our customer loyalty tools, and this already accounts for 20% of our sales. Our telemedicine platform is another highlight, which has now more specialties. Nutrition specialists, psychologists and home care services, which are now available in three states.

On slide 25, we see our digital channels. As I said before, we had record breaking numbers this quarter with R$173 million in sales, which means 8.5% share of our digital channels. And on the right side, we see our digital channel market share measured by IQVIA. In digital, we reached 12.8% market share, which is more than double. This shows not only the relevance of our digital channel, but also the constant growth in the market shows that we are on the right track, and we are growing more than the competitive players.

On the next slide, while some are talking about innovation and disruption in the market, we are making this happen, and we are recognized for that. Pague Menos is in the Top 10 Most Innovative Companies of the Startup Awards 2021. The only one in retail pharmaceutics, among other innovative companies like Magazine Luiza, Ambev and Bradesco.

And our innovation hub, of which Pague Menos is the founder, also received an award and is among the top 10 in innovation hubs with companies like Uber Hub, Distrito, and other innovative companies.

We are now inaugurating the Pmenoslab, our innovation department, which is now independent and is promoting innovation in different areas of the Company. The greatest purpose of this hub is to improve the experience of our customers.

And speaking of customers, the last slide shows two customer satisfaction indicators. The NPS keeps improving, with record numbers; this quarter, we reached 76 points. And then the Reclame Aqui. We kept our RA1000 stamp and we improved our score. We are now at 8.5. These indicators showed that our growth is sustainable, and they reassure us that we are on the right track.

Thank you very much, and we can now open for questions.

Daniella Eiger, XP Investimentos:

Congratulations on your results, and thank you for answering my question. I have two questions. You talked to in your release about the performance of the new inaugurated stores, and they are in line with your viability study. I would like to know how this compares with the current stores, if the new stores are in line with the mature stores or better.

And the second question is about the rollout of the intelligent scale project that you talked about. We did not have that in our radar, so I would like to confirm whether this is a new project to optimize the initiatives that you are implementing, and that you are still seeing good results. And if that is the case, what is the estimated headcount reduction per store? I know that you are keeping numbers stable, but is there room for a reduction in the future?

Mário Queiros:

Hello, Daniella. Thank you for your question. I apologize for the technical problems that we had today. About the new openings, they are in line with the expected. We are doing a lot of predictive work before opening new stores, and this work has been shown to be very accurate.

So compared with the current stores, we are talking about five months. Only one store is already five months old. We have about five or six stores that are two to three months old, and most of these stores, 25 new stores were just opened. So it is very difficult to compare with our current stores.

We will continue to monitor this, and we will share this in future releases, what the performance of the new stores is. And as soon as we have a statistically relevant number that can be compared with the current store base, we will also be making this comparison.

Now regarding the workforce lever, the intelligent scale project, yes, it is another front that we are implementing to be able to increase the productivity of our stores. We did some remarkable work over the years, increasing our productivity and being able to reduce our main expense, which is the expense related with human resources. And then things stabilized, as you said, we have about 17 employees per store, and we believe that with the with the WFM, with the workforce management project, we will be able to improve our productivity.

I cannot promise you that we will be able to reduce our headcount in the stores. We need to understand how much we will be able to increase our productivity to be able to reduce our headcount, but now we are focusing on the quality of services offered to our customers.

Just like the NTS and the average tickets that have been improving, we know that we had a drastic dramatic reduction in the past year, so we need to do this very diligently, very consciously. And in addition to the tool, we also have a consulting firm helping us with this work related with people in our Company. But we do believe that this will truly increase our productivity.

And still about productivity, in addition to the workforce management project, we are also rolling out our new storefront system, that we call PDV. It is another tool that our I.T. team has been working on for more than one year, and it is being rolled out now in our stores. This is yet another front that will help us decrease the time of permanence of customers in our stores, improve the quality of the service provided and our productivity. So this is another platform that will be very important and already started being rolled out in our stores.

Daniella Eiger:

Thank you.

Ruben Couto, Santander:

Good morning. I have two questions. Looking at the average sales per store month after month, you had a very positive performance in the past two years, but now with the acceleration in your openings, it will be harder to follow because of the mature store effect. But what is the potential that you believe you still have in terms of operational improvements such as the digital channel and partnerships, private labels? What will be the level that will still pull your growth of mature stores up further above the inflation rate?

And the second question is about the working capital. The stock level at a slightly higher level, and with the expansion of your assortment, I think that is your target is 10,000 SKUs for store, so you still have room to grow in terms of assortment. Is this the level we should expect from now on looking forward, or will there be any relevant changes that we can expect in the future? Just to understand the reduction of the gap between stocks and suppliers.

Mário Queiros:

Hello, Ruben. Thank you for your questions. And once again, we are sorry for the technical problems that we have today. Let us start with your second question. You asked about the higher PME. You are right. Since we are investing a lot in productivity ability, in activation of new SKUs and reducing stockouts, we are investing a lot in stocks.

What we expect, our normal level is not 110 days of PME, it is shorter than that, but we are doing this very diligently, working very diligently. And as we implement new SKUs, these are long tail SKUs that have lower churn, so they pull the PME up, the cycle days up, but we are always looking at the stock turns.

As we heard in the presentation, we have been improving the availability, expanding our assortment and decreasing our stockouts without any compromise of the product cycle.

So we are reducing stock losses as well. But the normal level is not 110, it is shorter than that. We know that now in 4Q, the pharma industry particularly goes on vacation, so we need to have stock, and they will come back in February. So 4Q, we usually have a longer cycle. We probably will not see a reduction in the PME in 4Q, but this is something that we are monitoring closely.

And now Novais can ask about the average sales.

Luiz Novais:

About the average sales per store, with the new store openings, the average sales are somewhat corroded, so the total average sales is 602. But if we look at the only one point, the same-store sales that we have, the level was 117,000, even slightly higher than in 2Q21.

So we are very optimistic, and we are working on the same levers that we were talking about today, but we still have a lot of room to improve, as you said. So assortment, we have room to expand our assortment in stores, also private label and relevant launches. We are having relevant launches recently that will help us with assortment and gross margin.

The digital sales are still growing, the ticket is also growing for digital sales. We are getting more and more clients to our digital channels, though, since the products are dispensed by our stores, this also helps in the average sales per store.

So this makes us very optimistic that we will keep seeing an increment in the average sales per store for same-store above the inflation rate. This is what we can share with you at this point. We still have many levers that we can work on, and we are very optimistic about the growth of our same-store sales.

Ruben Couto:

Thank you for answering.

Joseph Giordano, JPMorgan:

Good morning, everyone. Thank you for answering my question. My question is about your expansion front. We saw positive results in the quarter, and we saw the low pressure of your preoperational expenses as you accelerate your expansion plans. So I would like to understand what you are doing differently to control these expenses, and what we should expect looking forward, because your expansion volume will probably accelerate in the future.

And a second question, I do not know how much information you can give, but how you are seeing the approval of the acquisition of Extrafarma with CADE, with the competition authority of Brazil? What is the timing of this transaction?

Mário Queiros:

Good morning, Joseph. Thank you for your questions. I am going to start with the second question. About Extrafarma, we did not even include it in the presentation because there is nothing new about the transaction, neither positively nor negatively. Our lawyers are helping us right now, and we are at a time of silence, I would say. It is almost like a quiet period because now we are waiting for CADE’s work.

We have been working with them and talking with them since May, giving them all the information they needed, and now we have to wait. Now the competition authority, CADE, is talking to other entities in the market, with the competition and associations. They are doing their part of the work now. So for now, we have no positive or negative news to share, and we are still expecting to have some decision by in the 1Q22.

Regarding the expansion, about the operational expenses, what I can tell you is that our team, our expansion team, they come from a 3G school from Burger King, where they got excellent negotiations. So with our main expenses, for example rentals, we can start paying our rentals only after the story is inaugurated. So in most cases, we get a very good granting period, which was not the case in the past. In the past, we only had three or four months and then we have to start paying, even if the story was not inaugurated yet. So this was a very good negotiation that changed our preoperational expenses.

Novais?

Luiz Novais:

Thank you, Joseph, for your question. And since we are inaugurating stores here in the regions where we have a very good brand awareness in the North and Northeast, as you heard on the slide, in the first months of life of our stores, we already reach very good sales levels compared to mature stores.

So with this rapid ramp up of sales in the first months, on average, we can reach a breakeven point close to the fifth or sixth month. And from then on, we can even start seeing a positive EBITDA for news stories.

So this has been really helping us. And the optimization of the new store openings, these are regions where we have a very good brand awareness and a very good profitability level. As I said, we have nearly zero cannibalization. So that is why these new stores are performing so well in terms of results.

And this should continue. We have very good perspectives for the new stores that we are going to inaugurate in the coming quarters.

Joseph Giordano:

Thank you very much, Novais. And I have one last question. Your numbers are really good. So do you think that we can expect an acceleration now that the pandemic is slowing down?

Luiz Novais:

We are very realistic about the expansion. The guidance for the next year, 120 stores, we think it is an important number, an impressive number that will help us increase our market share and have a very good assertiveness level in terms of expansion.

We will have an outlier point in 3Q. We will have more inaugurations in 4Q because we are breaking the inertia of the pandemic and adjusting our store opening machine here. But this 120 is a good number for next year. It is a very impressive number that will help us improve our share with good quality.

Joseph Giordano:

Thank you.

Pedro Pinto, Credit Suisse:

Good morning. Thank you for answering my question. My question is also about Extrafarma. We saw the results of the Ultra Group, and the numbers of Extrafarma are marginally deteriorating.

The negative same-store sales, the EBITDA, the sales per store. What are you doing to receive the assets at a good quality level and without so much deterioration of the quality indicators?

Mário Queiros:

Pedro, good morning. Thank you for your question. About Extrafarma, we believe that the results are in line with what we expect. We know that Extrafarma is a company that has been solving some internal problems, and we are not seeing very positive surprises or very negative surprises.

We cannot fool ourselves. We know that a company that is going through an M&A process will not be making large investments for improvements in large projects. So this is what we expect. What we expect to see with Extrafarma is that they will move horizontally, they will keep the wheels turning until this deal is closed with CADE. This is within expected.

Luiz Novais:

Pedro, I would like to add that this reinforces how eager we are to start working with them, because we really see a lot of potential in terms of improving results and sales, and improving the EBITDA of the Company. We see a lot of nice things that we can do with this company. But as you well know, we have some limitations that we have to respect CADE's this work. And as soon as that work is completed, we will start to implement the actions that we already mapped.

The team is working on the planning right now. We cannot really interfere in the management of the Company at this point. So we are only planning, there is a large team that is planning logistics integration, and we hope this process can be completed as soon as possible so that we can start implementing the action and start capturing value in a very short period of time.

Pedro Pinto:

Thank you.

Operator:

We are now closing the question and answer session. Now I hand the conference over to Mr. Mário Queiros for his final remarks.

Mário Queiros:

I would like to thank you all for attending. Thank you for your interest. Once again, I apologize for the technical problems that we had today. I would like to take this opportunity to reinforce our commitment to bringing health care and access to health care to millions of Brazilians through our stores, our digital channels and our health hubs.

The numbers of 3Q are proof that we are on the right track. We are resuming our expansion and regaining market share. Our digital channels are growing very fast, and the population is recognizing and using our clinics and our services and our entire health ecosystem as their primary option to take care of their health.

And since innovation has always been in the DNA of Pague Menos, today, in times of disruption, we are being recognized as one of the most innovative companies in the country.

Thank you for attending. We will see you next time.

Operator:

This conference call is now closed. Thank you for participating. Have a great day. You may disconnect now.