

## **Pague Menos Conference Call Transcript – 4Q22**

### **Operator:**

Good morning, ladies and gentlemen. Welcome to Pague Menos and Extrafarma's earnings conference call to discuss the results of 4Q22. This conference call is being recorded and the replay will be available at the Company's website. [ri.paguemenos.com.br](https://ri.paguemenos.com.br). The slide presentation will also be available for download.

We would like to inform that all participants will be in a listen only mode during the Company's remarks, right after which we will open for questions when further instructions will be provided.

We also inform that this conference call is being recorded and simultaneously translated into English. The translation is available by clicking on the Interpretation button on the bottom bar for those listening to the conference in English, you can mute the original audio by clicking on Mute Original Audio. We would also like to inform you that the presentation is available for download at [ri.paguemenos.com.br](https://ri.paguemenos.com.br) in the Results Central session.

Before proceeding, I would like to reinforce that any forward looking statements made during this conference call are based on premises and beliefs of the Company and the information currently available to the Company. These forward looking statements may involve risks and uncertainties. They refer to future events and therefore depend on circumstances that may or may not occur.

Investors, analysts and journalists should understand that macroeconomic environment, events related to the macroeconomic environment, to the industry and other factors may lead to results that differ materially from those expressed in such forward looking statements.

Today we have with us Mr. Mario Queiros, CEO, Mr. Luis Novais, CFO and RI Director and Mr. José Rafael Vasquez, COO.

Now I would like to turn the conference over to Mr. Mario Queiros to start his presentation. Mr. Queiros, you may proceed.

### **Mario Queiros:**

Hello, everyone. Good morning. Welcome to another earnings conference call of Pague Menos and Extrafarma. We are going to talk about the numbers of the full year 2022 and 4Q22.

Let's start with 4Q. It was a very robust quarter when it comes to our EBITDA, net income and a robust integration process with Extrafarma. Looking at the year 2022, we had consistent growth of our sale. When we look at the CAGR for the past three years, our growth rate was about 10%, our EBITDA was up on average 16% in the past three years, and the net income grew by 41,3% in the past three years.

So Pague Menos and Extrafarma are showing consistent numbers over the years, and I will now turn it over to Mr. Novais and he is going to slice and dice these numbers for you.

And we will also listen to Rafael Vazquez, he is going to talk about the integration with Extrafarma and how we are capturing the synergies from this acquisition. And then I will come back and talk about the strategic pillars of the Company.

Mr. Novais, the floor is yours.

**Luis Novais:**

Thank you, Mario. Good morning, everyone. So let's start on page number four. Here we have the highlights of 4Q, as you heard from Mario. We are seeing a strong margin expansion and this was really marked in 4Q last year and also the capture of the synergies from Extrafarma. So the highlights of 4Q were: same store sales of Pague Menos 6,8%, ex Covid test 7,6% of same store sales and for Extrafarma 12%.

Also, in December, the last month of 4Q was a weaker month because of the comparison basis that we had in December 2021, where there was strong influence of influenza and the Covid wave and also the World Cup. And we are going to hear more about that later.

And the second indicator here, and perhaps the best news of 4Q was the expansion of our EBITDA margin. It increased by 150 basis points year over year and a 50 basis points for the consolidated. Our omnichannel sales showed consistent growth, they were up by 11,4% of the total sales of Pague Menos and 3,4% for Extrafarma.

The fifth very positive indicator that we had in 4Q was the Extrafarma integration. We have completed the most complex part of the integration, which was the integration of distribution centers and systems. And you are going to hear more about that from Vazquez.

And finally, the capture of synergies. So we already have 34 million on an annual basis or 15% of the total synergies that we were planning to capture with this integration.

Now on chart number five, here we have the highlights for the full year, 2022. As you heard from Mario, we are in our third consecutive year of sustainable growth in our sales and profitability. 2020, 20221 and 2022 were three consecutive years of consistent growth.

In gross revenue, we had an increase of 10,5% for the year and 9,5% in our CAGR in the past three years, our EBITDA, 16,4% year over year and 15,9% for the CAGR in the past three years. Adjusted net profit, 8,7% year over year and 41% for the two year CAGR. So we grew more than 200 million in the past three years.

The fourth indicator here is network expansion. In 2022, we had record breaking numbers with more than 500 new stores. This combined with new openings and the integration of Extrafarma, which allowed us to recover the share that we had in 2019 and 2020.

Digital acceleration was a very positive surprise. We reached close to R\$1 billion in sales, very constant growth, more than 52% year over year and more than 19 million customers in our customer base after intense work of our CRM team to capture and retain our customers.

On page number six, we have additional information about Pague Menos same store sales. We closed the year at 7,6%, same store sales, excluding Covid tests, a very important growth rate during 4Q22.

As you can see on the first chart on the right, we had close to double digit growth and in December the growth was slightly weaker at 3% and this was due to the comparison basis of December 21, which was very strong and also due to the World Cup that we had last year, which also had an influence on this December sales. We finished 4Q at 7,6% growth for same store sales.

Then, the bottom chart on the right shows the distinct behavior that we had during the year 2022. So in the south and southeast, our stores grew close to 15% and in the northeast and

north this rate was lower, close to 6%. The south and southeast still in 4Q was still quite impacted by a more severe winter, the cold weather, which lasted until the end of last year. So this contributed to more robust growth in the south and southeast .

During 2022, we had some problems with supply in one of our CDs. So this led to some reduction in our sales, but this was addressed during the year, and Vasquez is going to talk about the impact of the DCs in our integration. So at the end of the year, the same store sales were 7,3 and very robust growth for the year.

On chart number seven, for Extrafarma we had an exceptional evolution which started at the end of 2021. The Company grew greatly and continues to grow. In 4Q, we had a growth rate of 12%, slightly lower than in 3Q due to the comparison basis in the World Cup and also due to the migration of our DCs, which had a temporary impact.

We have very positive prospects for Extrafarma for 2023, particularly after 2Q, when we will complete the supply process for Extrafarma stores. We still have a lot of opportunities in assortment, incrementing our private label sales, partnerships, digital partnerships and partnerships with health plans. So we still have a lot of opportunities to improve and decrease the difference in the average store sale between Pague Menos and Extrafarma.

Market share was also very positive in 2022 with the incorporation of Extrafarma, we had a 1% increase in our market share in Brazil, we reached 6%. In the northeast, we had a nearly 2% increase reaching 19,1 in the northeast and we also showed a lot of growth in the north. We grew 6,6p.p. and we reached 50% share in the north region.

As I said in the beginning, we also recovered the share that we had in 2019 and 2020 because we did not open any new stores in 2019 and 2020. And I will be recovering the share of Extrafarma.

Now, looking at Pague Menos standalone, in 4Q we grew less than the market because the contribution of new Pague Menos stores is still smaller than the contribution of new stores in the market as a whole. But the good news here is that on December 22 we were able to equalize the growth of the new openings.

So we grew our market share standalone for Pague Menos in 2022, and on January 23 we already saw an increment for the market share for Pague Menos standalone. So we have very good prospects for this indicator.

On page nine, we see the evolution of our product categories. For Pague Menos, in the two first charts, we have a very favorable evolution of our gross margin, a 21% increase for generics, 22% for hygiene and beauty, and OTC. So three categories that are delivering very good results and we had very positive evolution in these product categories for our gross margin.

And the third column here shows for Extrafarma that we have a very important opportunity in RX. So Extrafarma has 35% of the total sales and in Pague Menos we have close to 40%. So here we have an important opportunity to increase the supply and assortment of Extrafarma as we already mentioned in today's discussion.

The third chart here for private label, excellent news here. Our private label team has been working intensively and has reached record breaking share of our private label, 7,1% of the Company's total sales, nearly one point increase year over year.

And we still have a lot of opportunities in Extrafarma because most of the stores are in markets where Pague Menos has a relevant share. So here we have an expectation and a very positive

trend towards incrementing our private label to Extrafarma, which will contribute to Extrafarma gross margin.

And as a consequence here on chart number ten, we see our gross profit margin. There was a 20 bips growth year over year reaching 30,2% gross margin in the year. The effect of the mix, we had the effect of the pre price increase, which was also important in 2022.

We have continuous improvement in our stock losses. All our indicators were positive in 2022, which compensated for the negative pressure that shook the strategic growth, important growth of our digital channels that we saw in 2022, of course, put some pressure on our margin of about 70 bips, but all the positive effects here were more than enough to compensate for this pressure from our digital channels.

In 4Q, now, when we look at the consolidated numbers on the right, Extrafarma also had a gross margin close to 30%, which is a very good level, much better than previous quarters. And we can already see in Extrafarma a relevant volume of capture of synergies in our gross margin. We believe that Extrafarma will stabilize at a higher gross margin than that of Pague Menos, because it is more concentrated in regions where we have a more favorable mix for margin closer to 31%.

On chart number 11, in our selling expenses we also have good news. Vasquez and the operations team have been working hard to improve the productivity of our stores, so we were able to reduce by 30 bips the share of our selling expenses in the Company as a whole.

And we see a constant trajectory, a constant decreasing trend from 2021 until the end of 2022, reducing the number of employees, the average number of employees per store. So this is a relevant productivity increase which allowed us to improve the EBITDA margin of the Company.

And also during 2022, we were also supported by a specialty consulting firm. We updated 12 rubrics of our expense groups. And we were able to run some bids during 2022 and we are now capturing the benefits of these bids that were run during 2022, which allowed us to better control the Company's expenses.

As a consequence, on page 12, we see the contribution margin, a combination of a positive gross margin and control of our expenses and reduction of our selling expenses. Our contribution margin grew by 40 bips year over year, despite the one off pressure of the Company's expansion that was resumed in 2021. But today we have about 200 stores with less than three years old, which have a lower contribution margin than that of mature stores.

So even with this one off pressure, one time pressure of the expansion cycle which was resumed, we were able to gain contribution margin and this is excellent news. And this is due to important growth of our mature stores. And also the 200 new openings have a very good maturation curve, very steep, and they are already contributing to the positive results of the Company.

On page 15 and other piece of good news we have our expenses controlled. During the year, we were able to maintain 2,8% of our G&A expenses over the total gross revenue of the Company. We reduced about 50 million in 4Q compared with 3Q. So this is of course, an outlier. We were able to control really well our expenses.

We had some projects during the year that finished closer to the end of 3Q, so we did not have costs with consulting firms and services for these projects. And some of these projects are now being resumed in the 1Q23. So we are expecting to maintain this level of 2,8% of G&A

expenses during 2023 as well. With this very good control of expenses that we have been doing.

And in 1Q we have the collective bargaining contract and the salary adjustments in January. So like every other year, the 1Qs of the year we will have a larger share of G&A expenses in the Company's P&L.

On the right side, this growth year, 2,8% to 3,1% of G&A expenses over the gross revenue of the Company due to Extrafarma, which still has a lower revenue per store compared with Pague Menos, so there are a lot of opportunities to capture synergies here. So here we should see numbers closer to 2,8% for G&A expenses in the next two years, which is the time we have to complete the integration of Extrafarma.

On Chart 14 as a consequence, our adjusted EBITDA grew by 50 basis points, which is a very important mark for us in 4Q. We went from 8,3 to 8,8 for Pague Menos. Nominal growth of 38% for Pague Menos and 48% consolidated. So as we heard from Mario, very positive constant evolution in the past three years.

So we still consider ourselves a catch up store and we still have a lot of value to be captured. So positive trends ahead. We are one of the few companies in our industry that is showing constant growth in its EBITDA margin in the past few years.

And we also have very good prospects for Extrafarma which is already approximating its breakeven point for its EBITDA. So we believe that in the next few months, with all the evolution of our synergies, we will achieve breakeven for Extrafarma and we will start seeing positive contributions

On chart 15 our net income. We reached 192 million for Pague Menos standalone, the accounting result was much higher, close to R\$263 million. The growth rate is close to 9%, very relevant. And this combines operational improvements in our EBITDA, as we just heard.

Positive effect of the deliberation of our own capital interests over our own capital, which compensated for the negative pressure of our financial results, which is something that we are seeing in Brazil due to the very high interest rates. And of course, this has an impact on our financial results.

So we were able to maintain the net margin at about 2,2% and in the consolidated numbers on the right, we see the impact of the negative results of Extrafarma in the five months since we acquired the Company, since August, and we see a gradual reduction of these negative results with a very positive trend. And we believe that in the mid-term we should also achieve a breakeven point for our results in Extrafarma.

And on the last slide of my part of the presentation, cash cycle and debt. Here, we started doing an additional disclosure of the drawn risk information. We have information about that in the explanatory notes of the Company. We will maintain drawn risk as operational, which affects the working capital of the Company.

And we see that during 2022 we had a relevant investment in stock. So we finished the year at 126 days of stock. The cash cycle is at 61 days, very similar to the previous quarters because we financed the incremental stocks by anticipating receivables. So we decrease the receivables term in seven days and we have an increase in the average payment term, a four day increase. So this is our cash cycle.

We are expecting to maintain levels close to these levels in 1Q, but starting 2Q23, we will enter a reduction normalization cycle for a cash cycle. So right now we are still replenishing

our stocks to supply to our stores and in our opinion, the main point to capture synergies are our stocks. So we will start the cycle to reduce our working capital and reduce our indebtedness starting 2Q23.

We finish 2022 at 2,6x the net debt over EBITDA ratio. We did some important work during 2021 with an important extension of the average duration of our net debt. The average duration is now 2,7 years. More than 80% of our debt will mature only in 2024. So we are very well structured to go through these times of high interest rates in Brazil.

So now I would like to turn it over to Vasquez and he is going to talk about the Extrafarma integration. Vasquez, the floor is yours.

**Rafael Vasquez:**

Thank you, Novais. Good morning, everyone. It is an honor to be here, and it is an honor to be the sponsor of the integration project.

On chart number 18, this is my third M&A process in my career, and we have some very solid information to share with you about Extrafarma. And more than just going over each of the bullet points on this slide, I would like to talk about some references that I think make a lot of sense and that I want to share with you today.

We are today already a Company that can be called Pague Menos Extrafarma with one single business and financial ERP, one single DC management system and unified platform for management of our stores. So Pague Menos and Extrafarma can be seen as one single Company and particularly starting at the end of the integration of our DCs and stores, which was completed on February 7.

Now we can see the results in our store productivity, partnership and supply. So this is fundamental for this integration to progress and it is progressing successfully, as you can see.

So some important points: we reduced the stockout levels in Extrafarma due to the integration of our de DCs, but we still have a learning curve. And I am going to talk more about this later. But as I said, we have migrated system. So one single Company, one single management of the two brands. We were able to anticipate this process because we were expecting this in March and April, but we finished everything on February 17.

A good news for both brands. Since 2020 and 2021, we have been rolling out the new POS system, a more modern, more user friendly system that leads to higher productivity in Pague Menos. And this one was already rolled out for Extrafarma. So today, right after today's earnings conference call I am flying to Belem and what I hear in our store is both Pague Menos and also Extrafarma, is that the POS is more user friendly and better serves our customer.

In organizational structure, in the back office, we have been working on the redesign of our organizational corporate structure. And also for the front office, today I have an Operation's Manager which is responsible for both brands. Also centralization of contracts with single suppliers, both sales and resale contracts and engagement to align a corporate culture.

This was the point that since the beginning we had a lot of temperature surveys since the middle of last year to understand how the M&A was taking place from the cultural perspective. And we had very positive results and we see that we were able to also integrate our cultures.

In operational convergence. Going back to suppliers, we talk about leveling of our payment terms, which goes along the line of what Novais said. We are all paying attention to the cash subject here in our Company considering the difficult times that we are going through right

now with high interest rates. So we are leveling our payment terms and we completed the efforts of leveling of our payment terms with suppliers. Also, the leveling of our budget price is 70% completed. We believe that in the next 60 days we will reach close to 100%.

And another important point is the optimization of our store footprint for Extrafarma. We closed some of our Extrafarma stores, which we considered harder to reverse, and we started converting some stores. We have converted seven Extrafarma stores to the Pague Menos brand in the states of Pernambuco, Bahia and São Paulo. And initial results have been very positive particularly in the first ones that we converted in the states of Pernambuco and Bahia.

On chart 19 we give some more information about the DC process. In other calls, we had the chance to talk about this. This was one of the reasons for concern, the conversion of our DCs. Of course that stores raised concern because of the customers, but DCs are serving our stores. But luckily we did not have any major incidents and I am going to talk more about this on the next chart.

Of course, we had some lessons learned doing the process. We changed our WMS, we changed our supply algorithm and the team had to learn how to work under this new optics. But we did not have any interruptions. We did not have any major problems throughout the process of converting our DCs.

And one important point which we heard from Novais is that Pague Menos DC 1 here in Fortaleza, the most important DC of the Company. And right now, when we have more DCs and more distribution points, both to Pague Menos and to Extrafarma, we already see a good level of relief in the DC 1 of Pague Menos so we went from 580 stores being served by this DC to 460 currently. And at the end of the wave in February or March, we will finish the current wave and we will have only 400 stores being served by DC 1.

So this optimization, in addition to everything that we already talked about, it leads to a shorter lead time, a shorter supply curve, lower logistic costs and tax benefits. So this also leads to optimization of the main DC that we have, DC 1, and we are already seeing the results of that with better supply conditions in Extrafarma and Pague Menos stores, which used to be a concern, particularly in the second half of 2022.

On the next slide. Here we see some of these lessons learned that I mentioned. So in every M&A we will learn lessons, of course, and we have to think about how to fix these problems for the future. So these are the most important learnings from the M&A process. So for Pague Menos, what happened was that the teams both in our stores and in our DCs, how did they learn how to work with the new systems, new algorithms, the new WMSs?

So from December to mid-February there was an impact on our sales, and I am going to give you more information about that when I talk about the synergies. We had very good sales. We saw a recovery of our sales in November, December, but then starting in December with this learning curve with the change of our systems and also the effects of the World Cup.

In early December, we had an impact on our sales, but in the end of February, we started to see a ramp up gaining traction. And now in March we are probably going through the best moment of our sales per square meter in our stores for Extrafarma.

I saw a question here about our margin and opportunities in Extrafarma. So I talked about the unified management of the two brands. And one example that I want to give you is that in our private label from the common trunk that we have of products for both brands, we are at about 60% to 65% of the items being supplied to Extrafarma as well. So this is a very important sales leverage for us and margin leverage for us. So we still have about 30-40% to implement in Extrafarma.

And another point is our pricing, today in the Pague Menos system, we have much more granularity and clusterization than we used to have in Extrafarma, for example, in Extrafarma we had the same price in the metropolitan area of Belem. So I had the same price in peripheral stores and central stores and this is now being addressed in the past few months.

So we had the adaptation and the interruption of our supply when we changed our lead time and we changed our WMS and there was also the market ruptured which aggravated the problem. But this was from mid-December to mid-February and now we are seeing a ramp up and we are gaining traction again.

And in my last slide, this is what Novais was talking about. We are very positive about the capture of synergies, which was another question that I saw on the chat window. So organizational, restructuring, G&A expenses, assortment, which is another point. We have already added more than 1,5 thousand SKUs to be supplied to Extrafarma stores. But we still have a lot of work to do in private label and we have synergies of about 14 million on an annualized basis.

We had the learning curve that I was talking about, particularly between mid-December and mid-February and the total synergies captured on an annualized basis that we see today is about 15% of what was projected at the time of the M&A and in running rates this means we are already at a comfortable position.

Of course, this is something that will continue to progress over the months and every month we see the evolution. But this is my third M&A, as I said, and I think this is one of the most successful ones. And we have everything we need to deliver great value from the synergies that we constructed with the Extrafarma deal.

Now, I would like to turn it back over to our CEO, Mario Queiros.

### **Mario Queiros:**

Thank you, Vasquez. Next slide, please. So here, this slide shows our strategic pillars going through store expansion, both organic and inorganic. One example was the acquisition of Extrafarma, and I am going to give you more details on the next few slides.

Our omnichannel strategy, so the performance of our digital channels driving the growth of the Company as a whole. Customer loyalty, the relaunch of our loyalty program, I am going to talk more about this shortly. Our Health Hub, which is very well known by all of you and the health services offered at our stores are growing. And our complementary businesses or partnerships with startups which are allowing for some innovation leaps that the Company is taking.

So the next slide talks about our store expansion. So in addition to the 392 stores that were added to the Company with the acquisition of Extrafarma, here excluding the remediation required by CADE, our competition authority, we were planning for 120 stores, we opened 118 new stores in 2022, and the two remaining ones were opened in January 2023. So 200 new stores in the past two years.

And the impact of these stores, as you heard from Novais, the market was growing at higher rates compared to our new store and now in the second half of 2022 we started to grow more than the market. So we are growing by 9%, 10% of our basis and the market is declining and dropping to six and now 4%.

And here on the bottom right, we see the contribution of the sales of these new stores to the total sales of the Company. The red line shows the level of the market and we see how the



contribution of the market starts to decline and Pague Menos has a positive inflection point starting in 4Q and continuing in 1Q this year, so we are leveling this contribution in December.

We already gained market share, when we look at Pague Menos standalone and in February, we also gained market share because the new stores that we opened in the past two years are now contributing more to the total sales of the Company. So this is what makes us comfortable and confident that we are on the right track regarding the recovery of our market share, in addition to the inorganic growth that came from Extrafarma acquisition.

The next chart shows the omnichannel strategy. We have very strong numbers that you heard from Novais. We reached nearly 1 billion in sales from our digital channels in 2022 reaching 11,4% share in the 4Q22 and in the 1Q23, we still see a very strong trend, increasing trend, and we are now one of the sponsors of Big Brother Brazil and this has been driving our sales, particularly on our digital channels.

On the bottom left of this chart, we see the participation of digital by region. We know that both in the southeast and south, they have a much higher maturity in terms of adherence to digital channels. So that is why we have this striking difference when compared with the core regions, the north and northeast.

But this makes us confident and reassured that we still have a lot of potential to grow in our digital channel because when the north and northeast reach higher levels, the levels of the south and southeast we will be even more relevant in the sales that we have in our digital channels.

And here we have the sales per digital channel. You see that e-commerce is driving more than 50% of our sales, both on our website and our app. We also have telephone sales accounting for 25% of our digital sales. And this channel is very important, particularly in the north and northeast, where people still use the telephone a lot.

We have our Superapps, Rappi and iFood, accounting for 10% of our sales, and we also have the Infinite Aisle, which was one of our greatest moves. So if customers do not find a product in a certain store because it is not part of the mix of that store, because it is out of stock, they can receive the product at home or they can go and pick the product at a different store having paid in the first store. So it is a true omnichannel strategy.

The next chart talks about customer loyalty and here, this is the result of the work that we have been doing for a few years now. We are recovering our customers and we grew nearly 10% when we compare year over year.

And on December 22 we reached more than 17 million active customers, as you heard from Novais. We have another 2 million because there are 4 million active customers in Extrafarma but there is an overlap between Extrafarma and Pague Menos, so the total was 17,2 million active customers for Pague Menos.

And on the right we talk about our quick ratio. The quick ratio is the leaking bucket, as we call it. It is the ratio between the new customers that we are adding to the bucket, the customer that we are reactivating, divided by the inactive customers and we want this ratio to be higher than one. This means that we are adding new customers to our base and we see constant growth resulting from all the work that we did in the past few quarters.

So on the bottom we see for the total Company. And on the bottom we see the same store sales. So here we are looking at Pague Menos alone, so in same store sales, we are also growing and adding new customers. And this is very relevant. This is a number that we are always measuring.

The next chart talks about our loyalty program. With the acquisition of Extrafarma, we unified and we launched our loyalty program. So our loyalty program now is Sempre Bem, so the golden Sempre Bem customer, the customer that has more than 1,2 thousand in purchases in over six months.

And now we launched our paid category. We are the first Company to offer a paid customer loyalty option and by paying 19,90 per month, they have all the benefits of our golden customers and telemedicine on our app or at home. So Pague Menos is here once again innovating in its customer loyalty program.

The next chart shows our ESG journey. Last year we presented our ESG journey to the market. We reached all our goals in 2022. Here, the highlight goes to renewable energy. We have 100% of our stores being supplied with renewable energy, with solar panels. And our target is that every new store in up to two years, it has to be supplied by renewable energy because, of course, there is all that bureaucracy of connecting the system. So we have a two year period that we allow for stores to use renewable energies.

And we also have training being offered to our employees, scholarships, undergraduate and postgraduate courses.

And this is the end of our presentation. We can now open for questions.

**Dannielia Eiger, XP:**

Thank you for answering my question. Congratulations on your results. I have two questions. The first one is a broader question about profitability. And I want to ask a follow up question because Novais talked about a gross margin of 31%. So I want to know what we can expect in terms of the dynamics of your gross margin,

Looking both at standalone and Extrafarma and also your EBITDA. I do not know if you are still expecting some efficiency gains that we will see during this year still resulting from these initiatives that you implemented in 2022.

And also very striking the improvement that you had in Extrafarma gross margin. And I think Novais talked about the EBITDA breakeven for Extrafarma, but I think I missed the timing. So I want to understand how we should be thinking about this evolution of your EBITDA line for Extrafarma during 2023.

And my second question. It is really striking to see how you are being able to exceed both in terms of the amount and the speed, and exceed the synergies expected to be captured with the integration of the two brands. So I want to know when or if at some point you will revise your guidance, maybe increase your guidance or what are the milestones that you are waiting on before you revisit your guidance.

**Mario Queiros:**

Thank you, Daniela for your questions. I am going to ask Novais to answer and Vasquez can also contribute and talk about synergies.

**Luiz Novais:**

Good morning, Daniela. Thank you for your question. As for the gross margin, our commercial team had some very important initiatives to capture the benefits of the pre price increase and all the improvements in our product categories: generics, private label, hygiene and beauty.

So we were able to grow our margin despite the negative pressure from the digital channels sales.

The 31% that I mentioned is where we believe Extrafarma should stabilize its margin after we complete the capture of all the synergies because most of the Extrafarma stores are in regions that are more favorable for product categories to have a higher margin. So it should stabilize at a gross margin, slightly higher than the current 30% of Extrafarma and Pague Menos.

And this positive evolution of Extrafarma's margin in 4Q was also due to the migration of the DCs, particularly in Pernambuco and Bahia where we have relevant tax benefits. And because of these migrations, Vasquez and the team completed the migration of the DCs in Pernambuco and Bahia first, so in 4Q we were already reaping the benefits from that.

And also all the work the commercial team is implemented in terms of commercial synergy and pricing synergies and other elements. So we are going through a very important moment in the capture of these synergies

And about the gross margin for 2023, we indeed have a negative pressure because the price readjustment will be much lower than it was in 2022. But since we have important growth levers in generics and private label, as you already heard, and also in other lines of our P&L, for example, SG&A. So this negative pressure will be mitigated and will be compensated and we will continue to evolve the incremental Company's EBITDA.

So we consider ourselves a catch up store, as I said, and we are now in our third year of increasing profitability. But in our opinion, we still have a lot of room to grow our profitability, particularly now with the capture of synergies from Extrafarma and the dilution of the expenses of all the projects that we are implementing.

And she also asked about the Extrafarma EBITDA, about the breakeven. In 3Q last year, we had an average negative EBITDA of 8 million per month. In 4Q, it dropped to 3 million negative average per month and in January and February we are still at a negative level but we should soon be achieving our breakeven for the Extrafarma EBITDA with this positive evolution that we have been capturing with our synergies. So this is what you can expect, Danniela.

I do not know if I answered all of your questions.

**Danniela Eiger:**

Yes, Vasquez. And about the synergies?

**Rafael Vasquez:**

Yes, I think the synergies that we contracted in our deal are the synergies that we are expecting to deliver. So I do not see any relevant changes in terms of the amount.

Now, revisiting the timeline, I think it is too early to talk about revisiting our timeline. If we were to anticipate something, it would be in 3 this year.

I think we underestimated the human resources element and how long they would take to get used to the new processes. But now, since we have been gaining speed and since the second half of February, we are back on track. But I would not really revisit the timing before 3Q this year. Because in 3Q, that is when our initiatives will be very well implemented and segmented. But I am very positive with what we are seeing with this process.

**Gabriela Moraes, Itaú BBA:**

Congratulations on your result. Thank you for answering my question. We have two points. The first one is about your stockout levels. We saw a sequential worsening of this index, of this indicator. We know that the supply chain condition is still very challenging for the market as a whole. And there are still some headwinds from the integration that are facing challenges. How do you see the evolution of this indicator? Your stockout levels in 2023.

My second question is about Extrafarma. You had a very relevant evolution in your synergies in this quarter. And we see this showing consistently in our results. Now, looking forward, I think we still have several initiatives that you can implement over time. So what is the top priority in your integration process? And looking forward, what is the main challenge that you see in this process? Thank you.

**Mario Queiros:**

Thank you, Gabriela. I will start with the stockout levels. When we think macro, just to give you an idea, I went to the U.S. recently, so I was in New York, Florida, Seattle, and stockout if you visit Walgreens, Target, Walmart, they are still suffering from high stockout levels. After two and a half years, they are still suffering with high stockouts, it is a global problem. And we also have examples in Brazil.

The main product in the market, Ozempic, is a quoted product. So just to give you an example, we ordered 100 and we get 15. There is a global stockout of the substance itself. And also when you look at the regular categories: insulin, antibiotics, children's products, they are still suffering with high levels of stockout.

Things are going back to normal gradually. And we also had the change in our main DC in Fortaleza. We had an operational problem in the middle of 2022 that we had to address, and this was combined with the integration of Extrafarma. But this has now passed us. We have addressed the problem, we now have nine distribution centers. Belem is now being supplied by the Benevides DC. On Extrafarma, Maranhão is being supplied by Extrafarma's Maranhão DC.

Here in Ceará we had our DC and now we have Extrafarma Aquiraz DC and things are already balanced. So this is something that we have been able to address successfully and the situation is normal now.

Now, as for the integration of the challenges for integration, Vasquez and Novais can add if they want. But I think the greatest challenge is sales. We are focusing on our sales, on growing the average sales per store in Extrafarma stores.

This is their top priority and our main challenge right now because as you saw, we are ahead when it comes to capturing the synergies, because we did some excellent work and we were even conservative in the timeline that we established for the replacement of our systems, integration of our DCs and our supply. And everything is going according to plan, but we still have to grow our sales.

So as you heard from Vasquez, the learning curve and the drop that we had, every time that we turned a new Extrafarma store, we had to learn the systems. It was the learning curve for the systems. There was a change in the DC. So there is an adaptation.

And operationally speaking, when you turn off one system and you turn on the new one, there is a gap of 8 to 10 days. So this reduction in our sales that we are seeing in late February and

early March, it will be our top priority to continue capturing our synergies at a very good pace. Anyone want to add anything?

**Rafael Vasquez:**

No. I would just like to reinforce what we talked about when we talked about Extrafarma, that the main pillar of this integration, and I think this was Gabriela's question, the main pillar was supply. So we went from double digit levels of stockout to now single digit levels. And we are managing this proactively in all our DCs and we are now completing our last DC, in Guarulhos, in March.

And looking forward, what we want is a fluid process. We want to avoid having ups and downs in our supply chain.

And the second part, when we think about how we manage the two business models, one thing that I always say internally and Novais was talking about this. In the Pague Menos brand we have been delivering consistent results since 2Q19. So we created a culture of delivery in the organization despite headwinds or tailwinds. Tailwinds, it is a culture of growth. Now in Pague Menos, we had exceptional work being done for customers, but the team still has to focus more on results, productivity and business management.

I do not see this as a risk, I see this as an opportunity because, as I said, we unified the management of the two brands in our operations division. So with this more fluid management of our supply chain, after we address these things, we will improve our pricing strategy, this something that we already started to do, particularly for some OTC categories.

And part of the margin that we were able to capture we are investing now to generate more sales, decrease our expenses, and this is the continuous motto of retail, right, to be able to achieve better results. So the challenge is to implement this culture and to make it linger. There's a positive example in Pague Menos, which is the constant result that we have been showing since 2019. Thank you.

**Eric Huang, Santander:**

Good morning. Thank you for answering our questions, and congratulations on your results. We have two questions. My first question, when we look at Pague Menos it talks about the reduction in the average number of employees and we want to understand whether this is a consequence of the larger mix of discount stores that you opened in the past years or if you have true optimization of your existing stores, or if you still have opportunities to be captured here.

And my second question, when you talk about your expansion, regarding your CAPEX, what we have been hearing from retail companies about the variation of their CAPEX. We want to know from you: what will be the CAPEX per store and how this is evolving?

**Rafael Vasquez:**

Thank you, Eric, for your question. Eric, regarding productivity for Pague Menos, I would say that we are in a very good shape for Pague Menos. Of course, we are still looking at opportunities. We have our workforce management tools. We also compare, we do benchmark for sales, for working hours, for popular pharmacy, which can slow down service at our stores.

But do we have focal opportunities in Pague Menos? Yes, we have a few managers where we still have an opportunity and it is more than the head count per se, we want to improve our

sales per employee. And today, at Pague Menos we are close to R\$40,000 per employee. In Extrafarma our productivity is lower than that.

And if you ask me, can we do something today, in Extrafarma in terms of productivity? Yes, we do have room for that. But probably this is not the way to go, because when we go back to POS, we still have a lot of sales to unlock at Extrafarma, either through assortment initiatives, supply initiatives, or even the working hours of our stores.

So just like we attempted in the past with Pague Menos and we were very successful. We are adjusting the working hours of some of the Extrafarma stores and we are even implementing the 24 hour model in some of our stores in São Paulo. Last week I visited some stores in São Paulo and we went to test the 24 hour model. So we are going to make some of our stores in São Paulo 24 hours.

Extrafarma before Pague Menos was working with a very contracted model. Contracting is expensive, contracting is an investment, and now we want to unlock value and unlock sales. So when we look at sales today at Extrafarma, sales per store, there seems to be a lot of opportunity but this decision will still take two or three months to know for sure whether we have reached our full sale capacity and if we still have a challenge in terms of the sales per employee, then we can look at productivity.

But what I can tell you right now, this is something that we are monitoring month by month to look for opportunities and reductions. As you heard from Novais, we did something we have been doing in Pague Menos for the past three years, and we will continue to do it at Pague Menos and Extrafarma every month, because this is what we do in retail.

And I would also like to ask Novais to talk about our CAPEX and the capital cost.

**Luiz Novais:**

Well, as for our CAPEX, Eric, we saw important growth in the average investments per store during 2022 when compared with 2021. And happily, in the past few months, we are seeing stabilization in the average investment per store at about 1,5, 1,6 million. And until 1,5 years ago it was closer to 1,2 million. So investments were higher during 2022.

What helped us maintain this level of 1,5, 1.6 million per store was the new discount store model, which allowed us to lower our investment costs in these stores, and this puts us in a better position. So we are very happy with the evolution of these new stores, which account for most of the new openings that we had.

Now, as for your question about the cost of capital and cash control, this is one of the top priorities for us. Right now, we are under pressure because of the average stock term. So we have a slightly higher investment in stocks, but we are planning to reduce our investments in stocks starting to 2Q leading to higher generation of cash after we finish the supply cycle of Extrafarma stores. And the price increase? Yes.

**Mauricio Cepeda, Credit Suisse:**

Hello, Mario, Novais and Vasquez. Thank you for answering my question. I have a few questions. My first question goes along the lines of my colleague's question about the stockout and some active ingredients that are now out of stock in the market. And you talked about your intention to decrease your stock.

So how are you going to level this with your working capital? Because I understand that stocks are high in the services category, which is not traditional for the industry.

And also, I would like to ask you about your leverage. What do you see looking forward in terms of deleverage of the Company?

And I also want to ask about the drawn risk that you mentioned in your presentation. So knowing that a great part of the supply comes from the pharma industry, what type of supplier today has been asking for anticipation of receivables? Because your payment terms sound very reasonable, but do you plan to somehow continue to use this financing model looking forward? And how does this fit into your capital needs?

**Mario Queiros:**

Thank you for your question, Mauricio. I am going to talk about stockout and stock reduction. And then Novais is going to talk about leverage and drawn risk.

This is a natural process because we were obliged to buy earlier and then sell. We could not stop buying at the Fortaleza DC to start buying in Maranhão. So this is the price you pay when you have such an integration.

So during 2Q this year, we will start to see a normalization and a drop in the PME because since the end of 3Q22, we have been supplying Extrafarma stores and now with its four DCs we can expand because the DCs wanted to receive Extrafarma stores. So this is something that we expected with the integration. We are projecting this normalization and reduction of our stock levels during 2Q23.

Of course, that we are focused, our business is focused on having products available at our stores. Customer service is important, price is important, but if you do not have the product, then it is useless, right? So every time we talk about reducing our stocks, we have to do this diligently. We have to do this wisely based on science and algorithms whenever we make changes to our stock levels.

And as I said, this is something that was already expected. As the demands from the stores that are being implemented for each DC settled down, this is something that is expected now.

Now, Novais is going to talk about leverage and drawn risk.

**Luiz Novais:**

About our leverage, considering the context that Mario just explained, we have a relevant volume of stocks to mobilize starting in 2Q. We have 126 days of stock, if we go back to level of 110 or 113 days, we have more than R\$300 million in stock that we need to sell. And the working capital is a very important number for us.

And also we have other leverages that we need to deleverage. We have a relevant volume of tax credits that we need to monetize and we are working on that. All the operational improvements that the Company has been delivering, the incremental EBITDA, of course, this improves the operational cash generation of the Company. We also have a volume of synergies that we have been able to capture at a faster pace than we had expected.

So we have other leverage that will allow us to decrease our leverage. The guidance that we gave for leverage is to reach 1,7x the net debt over EBITDA ratio by the end of 2024. So we will start deleveraging starting in 2Q this year. And we reached this high level because in Extrafarma we had a level of 1,7x. Because of Extrafarma, because before Extrafarma we had a level of 1,7x.

And about drawn risk, drawn risk is a tool that we have also in our portal for suppliers. They can subscribe or not, at their discretion. So we reached a volume of 240 million by the end of last year and after the Americanas case, we saw that this was an initiative of the banks. They are more restrictive now for this type of credit concession for some suppliers.

But we have different types of suppliers. We have multinational, huge companies, we have smaller local suppliers, and all suppliers can subscribe to the step of the tool to manage their cash flow. We are still offering this option, but we see a decrease in the adherence to this type of credit.

**Operator:**

This question and answer session is now closed. Now, I would like to turn the conference over to Mr. Queiros for his final remarks.

**Mario Queiros:**

First of all, I would like to thank all of you for attending and for your interest in our Company. I want to once again say that the integration with Extrafarma is going according to what was planned and we are capturing synergies at a faster pace than expected.

The digital channels are still driving the Company's growth, growing more than 50% with sales that approach R\$1 billion. And we still see a lot of opportunities to continue expanding in our digital channels.

And finally, we know that the market now is going through a difficult time, that the cost of capital is very high and we will be very diligent to protect our cash, particularly when going through these difficult times that we are going through right now in Brazil. Thank you very much.

**Operator:**

Pague Menos and Extrafarma's Conference call is now closed. Thank you all for attending. Have a great day.

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