

PETZ
1Q23 EARNINGS RESULTS VIDECONFERENCE EDITED
TRANSCRIPT
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Sergio Zimerman (CEO):

Good morning, everyone. It's a pleasure to share with you our presentation of the First Quarter of 2023. Before we actually start the presentation, I just wanted to say a few words about our understanding of the macro scenario. On the demand side, we see a stabilization of the movement that we had seen in 2022. So demand is stabilizing with clear signals of recovery happening in some categories of discretionary products.

As you will see later on, one of the highlights of this recovery movement is happening in dog collars, where we have a significant share of our private label. The results of the first quarter show how successful the implementation of what we announced in the last call has been, which was a search for a balance in profitability, growth and innovation.

I'm going to try to explain this through a metaphor. Let's imagine we are on a ship and conditions in the sea are quite adverse. It's raining, the sea is with a turmoil and when we talk about balance, understand this concept of acceleration or deceleration as a relative concept that takes into account the acceleration of market share gain or the decrease in the speed in which we gain market share. But at no point we consider not gaining market share. It's important to clarify that because of some conversations we have been having, this is what balance means to us.

For 21 years or more than 80 quarters in a row, we have been gaining market share and we do not want to interrupt this sequence anytime soon. So for us, gaining market share is essential. However, gaining market share can be gaining a little bit of market share or more market share and that's when the external scenario comes in. And in our understanding, we believe that the acceleration in the gain of market share should not be so intense, so we can focus on our profitability.

But we are always going to work for this balance. A gain in profitability is also conditioned to increasing our market share. And this is the key message for us when we think about the future and when we think about the speed of expansion for this company.

Another important thing that I would like to share with all of you today is some big topics that are affecting the economy as a whole. And perhaps we should detail how these big topics impact Petz specifically, so this tax discussion on tax benefits, et cetera, et cetera. What is the impact that has on Petz?

Zero, pretty much no impact, simply because of the fact that we don't receive any tax benefit that is of significant importance. So this tax benefit discussion is not at all related to our company. It's something that we have already discussed in the past, the discussion with withdrawal risk ("risco sacado"). We don't work with that. Another discussion that is quite strong is the discussion on interest rate. That is quite high and here we have a much more indirect participation and why do I say that?

Well, the situation today is zero net debt, a little bit above, a little bit below, but it's almost like we have no net debt. So this scenario of high interest rates today has a very limited impact in our debt scenario. We don't sell in credit, so this interest rate scenario does not necessarily

impact our sales. Of course, high interest rates have an impact in the economy as a whole and in the purchasing power of consumers as a whole. So -- and for indirect reasons, it affects not only Petz, but the segment as a whole.

Another specificity that is important to mention, so we can contextualize is something that I have been saying since the moment of the IPO. It has to do with how resilient the pet segment is. And resilient doesn't mean immunity, but it means that we are an industry that is a little bit more protected from this adverse scenario. So the industry has still a healthy growth forecast for this year for the industry as a whole. And Petz, by this industry, is going to continue to gain market share, like I said in the beginning. So the combination of these two elements is what I called a double resilience factor that Petz has.

And still going over the macro scenario, we have the DIFAL (default?) element, which pretty much didn't affect us. So, when we are talking about results and I apologize because I'm deviating the conversation, but it's important to cover these big topics related both to the results and to the economy. So it's clear for all investors to understand what are the elements that have an effect on us and what are the big elements that do not affect us.

And some of these have pretty much no impact on our company. I also need to mention one important thing about the deceleration of the inflation rate. In the past months, we have seen the lowest level of internal accumulated inflation. So we are talking specifically about the pet inflation. So we see a deceleration in the inflation rate in a continuous space, and naturally, this is what is going to help us recover the discretionary categories of products.

Just to give you more context on the history of the company, Petz is turning 21 years this year, so we have divided this history into three main moments. The first one, in August in 2002, when the company was founded, the company had all the characteristics of a company that is starting from scratch, opening its first store and that had all the natural characteristics of a business that is just starting. The communication was much more informal, processes didn't have a lot of structure, much more feeling than science, much more general skills than specialist skills, and we carried on like that until 2013, so we have 27 stores, BRL200 million in revenue and receive investments from the Warburg Pincus Fund, which led us to the second part of our story that went from 2014 to 2022, which is the moment when we became more professional as a company. We brought quite intense levels of governance to prepare for our IPO.

We believe, we did an IPO in a very mature level when it comes to professionalism and governance levels in the company. And in this more mature stage, we also did our M&As. And we consider that this second cycle ended in 2022.

In 2023, we are starting a third cycle, which is now understanding that our company today is no longer that company from 2013 when we received our first investment fund, that's when we had our first network, our first chain of bricks and mortar stores. Today we have a huge share of digital sales, companies that were acquired and are being integrated and with this perspective of creating an ecosystem that is going to make sense for consumers, and with this view, that growth comes together, hand in hand with balance. So now we have this clear focus on profitability and cash generation at the same time, and this is the third cycle that we are starting in 2023.

Here we could say that despite the fact that we see sometimes mixed signals, we are very optimistic about 2023 because, like I just said, we see some indication of changes. And probably, this is going to be much more evident in the second half of the year when these signals are going

to be intense. But just the fact that we are already realizing signals that precede a stronger recovery, that's already a pretty good reason to be optimistic.

We started to detect these signals in the end of the fourth quarter. They are being confirmed now in the first quarter, and we hope to see this trajectory continuing. Like all of you know, retail doesn't move on big leaps, there is no button that you can push and what was bad turns good and what was good turns bad. Retail works based on trends, so we are very much paying attention to all these trends and we try to work ahead, so we can correct the trends when they are not moving in the direction that we want them to, and at the same time, so we can notice with a privileged amount of anticipated time, the positive trends on the business. And here, I can say that we are detecting signals that are not so representative in terms of figures, but that probably by staying in the same trajectory will bring a year of 2023 and 2024 for significant recovery.

It's important to remember that 2020-2021 were years that were very much favored by the pandemic. 2022, which was the year of the storm, and now 2023, we start to see the signals that now we have a balance, it's not that abnormal level of demand that we had that we had during the pandemic, but it's not the same conditions we had in 2022. It's a much more balanced business scenario that we see in 2023.

Like I said in the beginning, this level of discipline is evident in our results. We've managed innovation and growth in order to preserve our profitability with a slight gain there. And it's also important to mention that in order to reach all those goals, we are investing heavily in having a cohesive management. Many topics are related to different departments and areas. So now in 2023, our focus is to have different departments focusing on the same thing with similar commercial efforts so our actions are more effective. And this is where data science has been collaborating immensely

So, we are bringing different skills, different areas together with the support of data science. And I can say that even though we spend a lot with technology, we are just starting to reap the results of those investments. So, we have invested a lot in preparing ourselves for this moment, so we would have the possibility to track consumer behavior and understand how they behave and how they choose. And now we start to see the benefits of being able to have that visibility.

Now, focusing on today's meeting, we are going to cover these three topics, the level of profitability for Petz standalone, capturing synergies in the process of integration of the acquired companies, and the generation of cash and more effective capital structure.

So, when we talk about raising the levels of profitability for Petz standalone, a few moments ago, I mentioned this combination of different areas and departments that we work strongly together, so we can make very precise adjustments on what needs to be changed. So we test, we measure, we do control groups, we know exactly what we are going to lose in terms of sales when we apply a certain change. We are able to track this loss of sales, for example, when we change something on the pickup from store, when we remove the discount from the pickup from store, if you look at the isolated piece of data from that, you see, pickup from store is going down. It's natural, if you remove the discount, it's going to go down.

But the data science that I mentioned before is so important because it allows us to track where these customers went to. So part of those customers migrate to the ship from store modality, other part of those customers, they go shopping in our bricks and mortar stores. So they just go to the store and buy their products there, and part of these customers we lose. And that's when

we use all our science behind the contribution margin. We use science to understand the additional costs that we would have from these changes. And what are the advantages for removing that discount in the first place? And how much contribution margin you have lost from the customers that went away and how much the customers that actually go to the stores will generate in terms of margins.

So we look at them, go deep into the details and we can clearly understand if value is being generated or not and we are generating value. But science doesn't stop there because you can have that visibility based on the average or the mean data. But that's not enough. We look at the average but we look at the dispersion that we see.

So we see this level of dispersion per city, per state and that's when we do the second movement. So this tracking is so precise that it was enough for us to understand that, for example, in the city of Sao Paulo, we should remove the service fee from the pickup from store only in the city of Sao Paulo. This is how deep we go into the understanding of data. We saw that in the city of Sao Paulo's value was not being added, but it was something specific for this modality in this location.

So we're talking about the acceleration of capturing the synergies. We have Zee.Now with a very advanced moment. Inside the second quarter, we are going to conclude 100% of Zee.Now being inside the Petz environment. So Zee.Now will become a brand for B2C sales, but fully being operated inside the Petz environment, also from the fiscal perspective inside the Petz environment with all the gains in synergy that that is going to generate.

So, we are pretty advanced, and again, we expect to see the conclusion of this process in the second quarter. And this is specifically important when we remember that the Zee.Now profitability now will become -- or it shows a good trend to have exactly the same margin we have for the pet digital business. When we think about products, we launched the Slim Line, which is that Chinese piece of equipment that we brought to Brazil and that started operation in the mid of the first quarter. It is already manufacturing the Zee.Dog Pad, so we no longer import them from China. This is a reality that started in the end of the first quarter, in the beginning of the second quarter.

And definitely that is going to generate synergies, especially in the second quarter, I mean more intensively in the second half of the year. It's going to be a very important gain for us. Zee.Dog Kitchen continues to be assessed, but we still see an increase in sales, which is essential for us, but especially the level of satisfaction that customers are demonstrating. Because for us, this is the most important thing for us, happy customers with Zee.Dog Kitchen and increase in sales.

Of course, everything is still being analyzed internally. We're still analyzing how profitable this business is as a whole. We know how to do the math, and we will determine how feasible this business will be in terms of scale and the type of product, and this is why business is still being assessed.

An important forecast for the slim pad in the United States, remembering that in the U.S. market 5% of the sales of pads are from the regular pads which was offered in Brazil and Slim representing 95% of the American market. And now we have launched the Slim brand for the U.S. market. We are still on the early steps, but we are highly anticipating the results from the second quarter to see if we can actually penetrate this product category inside the U.S. market.

Talking about products still, with collars, we have Zee.Dog positioned as the best brand. We have launched a better category with the Petz brand, and now we have the Spike brand in the good level. So we have three pricing structures. Better is the 100 reference, and the best is 60% above the better reference and Spike is 40% below. And this is so significant and so important that this category, which is, collars is one of the discretionary categories that already showed clear signs of recovery. It's already growing in-line with the overall growth of the company, which is excellent news because for a few quarters, we hadn't seen growth or growth levels that we're way below the average growth.

And this is a category that is completely ruled by our own brands. We have 67% of share of our private labels when it comes to dog collars in general, which makes this category very profitable. There are some other items to be discussed here, especially the Zee.Dog franchise model. We are still assessing the system. Again, we are very cautious. We don't like to come up with a power point to sell something, if we still need to assess growth possibilities, but we have eight franchisees already. We are assessing their performance.

We are redoing the math with all of them. And if everything is validated in the end, we will accelerate this franchise project.

And this is an optionality that hadn't been mapped initially, but that will become quite interesting as an additional avenue for expansion. This assessment is going to take place in the second quarter, so most likely in the third quarter, we will have an idea already if we can accelerate this franchisee project for Zee.Dog or not.

Now, on the third big block of topics we're going to discuss today, it's important to remember the difference that exists when it comes to cash generation today. Aline, will give you more details on this, but we move from a negative cash generation of minus BRL60 million from the first quarter of 2022 to BRL30 million of positive cash generation in the first quarter. Talking about operational, so what happens? Much more discipline in imports, much more discipline in the generation of inventory and in the replenishment of stores and the full cycle.

So, we are going to continue in this search for better efficiency in logistics as a whole. It's also important to highlight that we raised BRL200 million. We still have a very comfortable cash situation. We are slightly cash positive - net cash positive. And the most important thing, luckily the fact that we don't have no type of hurry to raise these funds allowed us to raise funds at lower rates than at the time of the Americana's case. So certainly, this is one of those rare cases in which the fact that we were not in a state of urgency for finding these resources, even with the situations not being so favorable in the market, we were able to allow at lower rates that we had announced before.

Working capital wise, it's important to mention our improvement in the inventory levels and also our tax efficiency with the new DC in Hidrolandia-GO helping us recover the tax credits we had in Sao Paulo. Now, I would like to hand the floor to Aline Penna and I will come back to the Q&A session. Thank you very much.

Aline Penna (CFO):

Good morning, everyone. I'll talk about the financial highlights for the Petz Group in the first quarter of 2023. Just one comment. We are going to talk more about the Petz Group, why is that. Well, since our integration is quite advanced now, it's going to become more difficult to separate the EBITDA performance of the acquired companies and those numbers for Petz.

Even though we have talked about BRL5 million negative EBITDA for the acquired companies, Petix with Zee.Dog, it's important to mention that we already have a positive part that is allocated for Petz. So that's why from now on, we are going to focus much more on the group as a whole. One thing that Sergio mentioned that I would like to reinforce is that we have advanced a lot in the Zee.Now integration process. We have a direct report from Zee.Now to the Petz digital team, commercial strategies are being defined together and with that we are eliminating company identities.

So that's why it's going to become difficult to separate commercial conditions that it's from one company -- there are from company or the other. Having said that, the great highlights for this quarter are we grew 22.3% in gross revenue in the quarter. When we look at the digital revenue, I'll give you more details. Digital grew 36.7% and the comparison basis was really tough, and we were able to keep that pace of BRL100 million per month. So a revenue of BRL300 million in the quarter.

Our SSS for Petz standalone was 8.1% and I would like to highlight that our April number was also very good, a little bit above the 8.1 number, which makes us quite confident. And finally, is the same store, the normalized SSS metric. Like we said in the second quarter of last year, we see second or third stores being opened in cities that are still maturing. So that's why we have this normalized SSS.

So if we remove 10 stores that were strong stores that had a second store opening nearby, even though they are not near the influence area, we are talking about a SSS of 13%, a significantly higher number. And the idea is for this number to continue to improve as the new stores that were opened in the past 12 months become part of this same-store calculation.

In terms of EBITDA, our EBITDA grew 24.9%. I'll talk more about the gross margin in detail later on. A positive number for us. We were able for the first time in four quarters to close the period with a growth in margin, both for Petz standalone, as well as for the consolidated Petz results. So we are also excited with these results.

And finally, our operational cash generation, the great highlight for this quarter. We had a negative position of around BRL64 million on the first quarter of '22, and we've generated BRL34.5 million. I'll give you more details on how we were able to reach these results. So here, when we look about the number of days, we are talking about an improvement on the cash cycle of seven days, which was quite significant, and something that we see as being sustainable in the coming quarters.

Talking about our stores. In the first chart, it's important to highlight that in the first quarter of 2022, we opened 10 stores. In 2023, only three. This is already reflecting that deceleration of opening of that guidance from 30 to 40 stores. And of course, that has a consequence on the pre-operational expenses.

So, it's natural to expect this to happen. On the chart next to it, to the right, we see a record revenue outside the state of Sao Paulo. So for the first time, we reversed. So 51% of the sales come from states other than Sao Paulo, and 49% is still inside the state of Sao Paulo. The first chart, it's important to highlight that in the first part of '23, we didn't open any stores in Sao Paulo but in other states we were able to find a good balance between them still with a combination of spreading our presence and making our presence more dense.

We are keeping the same ratio even for the stores we are opening this year. And finally, in the last graph, we have 20% of stores that are still on their first year of operation. So stores that still have that margin below 10%, I'll show you, I'll talk about the new stores in a moment, but we still have a lot of stores pulling our profitability down and 52% of the stores that haven't reached the third year. So we still have a lot of stores to mature which are going to generate a growth in margin as these stores mature.

And one more highlight is with the growth in area. So even though our stores were smaller, even though we have reduced the -- actually we're increasing the density level of stores. So aisles are becoming narrower, shelves are becoming higher. So the store is becoming more efficiency without losing sales capacity. Still with all of that, our growth in area was of 17% in the first quarter.

This graph talks about the group, our Petz Group. So the Group grew above 20% as we had anticipated to you. The idea was to keep this pace, like Sergio mentioned. We have been doing a number of changes in strategies and pricing, especially on digital. The idea is never to lose market share and to continue to grow above market levels. So this is what we expect for the coming quarters. I've already talked about the SSS and that's an important piece of data for this, which is, for the second quarter in a row, we see a growth in volume and coupons. So this is great news because of the cooling down of the inflation rate.

And this BRL90 million, or the gross revenue of the acquired companies is Zee.Dog and Petix. Petix, BRL38 million in revenue, Zee.Dog, BRL52 million in the first quarter. Remembering that for Zee.Dog, we have a very strong seasonality with a focus on the second half of the year, especially in the fourth quarter. So this quarter is not so representative in terms of revenue for Zee.Dog usually.

Talking about the digital penetration, Sergio talked about the timeline and the different movements. But the key message here is that since the third quarter of 2022, we are able to stabilize the digital share. So this measurement that we're taking had this focus. So it's something that is completely under our control. If you look at the April data, it's slightly below BRL36 million, which shows that we have been able to adjust that, protecting profitability and reducing the gap that exists between the digital margin and the bricks and mortar margin.

I saw that there was a question about that. This gap in 2019 was almost nine points of margin, and today is half of that. So here, we continue with the strategy of closing this gap. It's never going to be fully eliminated, unless I change the structure of my digital business. Because again, digital has a subscription program, almost 70% of our clients are subscribers and have a 10% discount. We have a higher penetration of food in the digital channel. So completely closing the gap would be a challenge, but we continue with that focus of closing or making the gap smaller.

Another highlight is that we were able to grow 17% in the number of active clients. So even with all the initiatives focusing on profitability, our number of omnichannel customers grew. And our omnichannel customers, they used to spend 50% more, now they spend 60% more in comparison to when they buy only in our physical store.

And finally, 380,000 subscribers, we have a huge number of subscribers, almost 30% of our total revenue coming from this total group of customers. But when I look only for digital, I'm talking about 62% of our customers that our subscribers. And remember that the average discount here is 10% for them.

Talking about gross margin now, obviously, when we look year-over-year in the consolidated result, we have this pressure of 90 base points. It's important to explain that last year, we didn't have Petix. We only consolidated Petix in the second half of last year. And Petix is an industry, so naturally, it works with lower gross margins. The Petix margin is close to 15%. So I bring almost BRL40 million reels of revenue with a 50% margin comparison to the Petz margin, which is 40. So it's pretty much because of that we saw this pressure. And if I look at Petz standalone, so we were able to keep a flat margin, which is great news considering that the digital share continue to increase year-over-year, and also considering that I continue to see a lot of food products in the mix.

So how were we able to balance that? Because of the improvements made in our digital channel, basically. And also, because the competitors followed partially our initiatives. So the market helped for the results to be achieved. It's important to remember that in the fourth quarter of last year, we talked about the ramp-up of our DC in Hidrolandia that the margin would be checked together with the sales of products to end consumers. So sometimes, this is carried over, now reaching normal levels in the coming quarters. So this ramp-up also contributed for the gross margin.

Here, we talk about SG&A. On SG&A, it's important to mention that we have been quite efficient when it comes to our expenses. We have been obsessed with our expenses. We have a number of committees on that. So, even though we have three DCs sees now and stores that are much further away from our headquarters than before. So stores that are further away that have an impact on freight, even though reinforcing some departments like human resources or services or everything that we have been doing, we are still able to be quite positive when it comes to our expenses.

Another important topic to share with you is that we have been able to reduce the preoperational aspect. So the light blue that you see in the graph, in the first quarter of 2022, we had 0.8% of pre-operational expenses, now 0.3%. That reflects not only the fact that we are opening fewer stores, but it also reflects the fact that we are being more efficient in our openings. We are putting less money in the store opening process.

Another important thing is we're talking about the adjusted EBITDA, we're talking about BRL65 million and we're starting to give more disclosure even in terms of the release. So you can compare of what would be our EBITDA in IFRS. Some companies only talk about this in IFRS, so our EBITDA would be around BRL53 million higher

So when we look at the adjusted EBITDA, we have this impression that it increased 10 base points, the margin year-over-year. But when we look at the IFRS perspective, like most retailers report this number, our margin would have increased 30 base points and our EBITDA would be BRL53 million greater. So just for comparison sake, we were talking about a margin of 13% and not a margin of 7.1%.

Another thing that Sergio mentioned, and I would like to reinforce is that this EBITDA of BRL65 million does not have any type of effect coming from tax benefits. In our Goias DC, our new DC, we have a 2.5% reduction of ICMS tax. But in terms of EBITDA percentage, it's irrelevant. We are talking about a number that represents less than 1% of our EBITDA. So all this discussion of tax reform is not going to affect our P&L. And even if it did, the decision of going to Goias was purely based on location. So we could supply stores located outside Sao Paulo and to start to get this credit.

We have BRL100 million in our balance that we are going to monetize this year. But the decision was not driven by some type of tax benefit. I think that's what I had for you. Oh, by the way, in this final table for three quarters in a row, we have been showing these numbers. So you can see the consistency, the returns that we have for periods of time. So stores that were open until 2018 or in 2019, we are keeping this level close to 19% for stores that are (inaudible)

And truly, stores are following that line. First years, they're negative, and then they get close to 10%, 15%, until they reach 19%. So a very strong consistency with the results that we have been sharing with you in the past quarters, just so you can continue to track this. And the number for 2022 is interesting because I opened a lot of stores in December. So if we were to adjust this, without considering stores that I opened at the end of December, this 9.7 number would be greater, it would be 11.1, which shows that these new stores are going quite well in terms of profitability.

Another important thing is we've talked about the EBITDA of BRL5 million or negative BRL5 million for the acquired companies. I would like to say two things. First, Zee.Dog Kitchen is still in the ramp up. It's still maturing, so I can say that around BRL1.8 million is still coming from the Zee.Dog Kitchen effect. And another thing I wanted to mention is that both Zee.Dog Kitchen and Zee.Now are the business units that are growing the most in the mix. But since they are being developed, their margin is lower, so that pulls our EBITDA down a little bit. And since Zee doesn't have a very robust expensive structure, any issue in sales, both globally and in Brazil will cause this operational issue.

The first graph, like I've said is one of the biggest highlights for this quarter. We were able to improve seven days our cash cycle. We made BRL65 million using operational cash in the first quarter, that's going to be BRL35 million of cash generation. And like I said, Sergio said, the improvement in stock, better terms with suppliers, better receivables, a little bit of everything. But the two main things is better stock management and less fiscal credit being accumulated because of the Goias DC.

On the second chart, on investments, we're talking about a CapEx that is around BRL61 million for the first quarter. And it's important to have a benchmark here, when it comes to the investment that was made last year. Last year, when we look at investments in general, and I'm talking about CapEx plus the investments we've made in the acquired Companies and payments for the acquisitions, we had around BRL450 million. And that's not going to happen this year. Even though we continue to invest in Digital, we're still going to open 30 or 40 stores. We are talking about an investment level that is going to drop at least 30%.

So even in Digital, you know that for stores, we have a number of approval steps. We approve everything up to the board. We have also reinforced the fact that we look at the return of any projects, regardless if it's a Digital project, IT project, or a bricks and mortar project. So the message is we are going to see an investment level that's lower than last year, because last year, we had a new DC, the different types of manufacturing equipment. So this use of cash is going to be reduced this year. And certainly, we are not going to be around BRL450 million, we are talking something around BRL300 million for this year.

And on Digital, it's also important to say that not only we are being more careful in the approval of projects, we are also carrying over a lot of initiatives that we did in the end of 2021, 2022, and a little bit of this year that were investments that we needed to make so we would catch up. So we've invested a lot in cybersecurity, in the data protection Brazilian law, in the super app on cloud. So a lot of things are still not here, but you will be able to see that quite soon.

And now talking about leverage, the message is that we've raised a debt with the Santander Bank, with BRL200 million, and it has an extremely competitive cost, the CDI 0.97 a year, five years of term. So we were very fortunate in this movement. We have orders that are ongoing, but we start the year with a very good balance.

And like I mentioned before, we have around BRL100 million of tax credits in our balance, so this ICMS credit that we were accumulating because we were selling out by Sao Paulo and we are currently monetizing that. And we are going to do that by selling credits to our suppliers eventually. So we are going to keep you informed on the process as well. And I don't have this graph here, but it's important to mention the net profit. We had a drop of 9% in our net profit, and I'd like to mention two things that impacted our net profit.

The first one is depreciation. Depreciation has been growing above 40%, and why has that happened? In the past two years, we opened many stores, so there's a depreciation that happens, not only the digital investment. So investments in IT and everything that I've mentioned before, we're talking about 20% of the whole.

So here we have a lot of carryover from the stores that we've opened because of our expansion. That now will affect depreciation. And when we compare this year-over-year, last year we started with almost BRL800 million in cash because of the follow-on that we did in November 2021. So we had a financial revenue. Now we have a slightly greater leverage position, so we've changed this profile a little bit.

I think this is what we had for you and we can start the Q&A session.

Daniela Eiger (XP Investimentos):

Good morning. Two questions on my side. The first one has to do with the margin dynamic from now on. You mentioned different initiatives that were supposed to bring gains of margin both for Petz Standalone, like optimizing the service upfront, stabilizing the digital base, increasing private label share, as well as in the acquired companies, like verticalization of Zee Petz, Zee. Now expansion, et cetera. Could you help us conciliate that with the evolution speed of the margin in the coming quarters?

Sergio Zimmerman (CEO):

Good morning, Daniela. Thank you for your question. I was watching Aline speak, just so we have no questions. When you mentioned the tax benefits, you said that it's not relevant and it represents less than 1% of our EBITDA. Just so we have zero question about this, it's not 1p.p. of our EBITDA, it's 1% of the EBITDA. So we still have 99% of the EBITDA if we have any tax benefit issue. But it's 1% and 1 p.p. makes a big difference. Just so if you have this question, I'm just trying to solve that.

Daniela, your question is very interesting, because it allows me to talk more about the evolution of our gross margin. When you hear about the initiatives, it's reasonable to think, well, if you're doing all this, the consolidated margin is going to grow. But it's not exactly like that because the margin is composed by different factors, factors that are favoring the margin and other factors that pressure it. So sometimes, you need to make a bunch of initiatives like the ones we are making now to just hold the things that are pressuring the margins.

For example, one of the pressures that we get in the competitive landscape is the competition for products in general, and we are paying attention to that. But it happens. This is not a general

thing, but it happens in certain product line and in that product line and then you see a certain seller trying to gain share in a certain line. We try to offset that. We see that a certain region requires us to be more competitive in terms of price and we do that.

So throughout this journey, we go over a number of initiatives and many times we react to these pressures on the margin. If we don't make initiatives to improve the margin, on the other hand, we would see the margin deteriorating. And that's when the New Year started, we said, okay, we're going to make up all these initiatives just to make the margin stable. We want to make sure that we are going to keep it at least at the '22 level. And despite the results, we like to be very transparent and very fair. So how do we see 2023? Exactly the same way like we said in the previous call. In the previous call, we were working to ensure the margin for Petz Standalone with a slightly gain for Petz as a whole. This continues to be the case and these results doesn't change our view on this year until today

Daniela Eiger (XP Invetimentos):

And now my second question. On the expansion side, can you update us on the review of your store model? Are we expecting to see any changes in the value proposition for stores in this expansion cycle? Can you help us to understand how to interpret the normalized SSS? I think I've already answered that one. The trend is for the consolidated same-store sales to become close to the normalized same-store sales as new stores mature or can we think about this as a possible sign that the footprint of stores is going to be reviewed?

Sergio Zimmerman (CEO):

When it comes to expansion, like everything we do in the company, we use a lot of science. And when I say science, I say that we are assessing the productivity of every square meter. Every square meter has a CAPEX and an OPEX, so we are paying attention to the productivity levels of every square meter. We are assessing the productivities of the shelves, we are assessing cities that could accommodate more products but not necessarily more services because as soon as we added products, we would bring services automatically. That is no longer the case.

We started to notice because the level of idleness that we have in the service front we shouldn't expand services in the same speed. We expand our product operation. We have disconnected them especially in the markets where we already have a service offer. So again, it's a very living model and we shouldn't say that there is a new expansion model. What we have is a consolidated model but depending on the location, you at least speed up one element or the other.

What would be a common thing regarding the experience stores and smaller stores that still offer service and the new stores that we are opening now has to do with the return rate. And this is a point that brings everything together for us and how do we balance that? Just like we do with CAPEX and the OPEX of the store in the future, even if eventually the store might have less revenue and when I say less revenue, that is offset by the digital coverage that we have.

So we bring all the data together to define which format is going to be opened on which location. So this is the level of assertiveness that we are working towards and something that is going to be refined quarter-over-quarter. And this is what's going to ensure the longevity of this company, because again, the upcoming 200 stores, the next 200 stores, they shouldn't be the same as the initial 200 ones, because the market has changed. The competitor landscape has changed. Whether because we have changed or because they have changed and especially

because of an expressive digital share that we have now. And because of that, we are constantly refining this model too, so it adds more value.

So roughly speaking, I could say that we are always going to spread our experience stores, stores that have services, veterinary services, grooming, the adoption program with the full assortment and we are going to have a logistics mesh to cover digital sales, because it's much more of a transactional thing than an experience, right? And those formats coexisting together is what allows us to have such high return rates. If we were only focused on convenience, it would be a mistake because customers they want the experience. But if we only had experience stores, it would be a different type of mistake because we would have a lot of idleness, a lot of CAPEX and a lot of OPEX in these stores as well. And that of course would put a lot of pressure in the model. So we are doing pilots on everything to be constantly analyzing how that affects our profitability.

Going back to the SSS element of the question, when we make these adjustments, we remove the 10 stores that were impacted by second stores that were open in their influence area. And we provoke this normalization. We redirect digital sales. So in this case, the difference from 8 to 13 is by removing the 10 stores because we made that change in digital. So in theory, yes, numbers are going to converge and become the same number in the future.

Victor Rogatis (Itaú BBA):

Good morning, everyone. Thank you for allowing me to ask questions. The first one, could you comment a little bit if it makes sense to wait for the full integration process for the acquired companies to be concluded by the end of this year? How many synergies would be captured after that?

Sergio Zimmerman (CEO):

Good morning Victor! Thank you for your question. I cannot say that we are going to conclude 100% of the process, but I can definitely say that the majority of this process is going to be concluded by the end of the year. We have a very intense rhythm of integration happening now. And like I said in previous calls, there was a timing when this could have happened and the reasons for that not happening have already been clarified before. It is a delay, not a problem, but it's a delay that does not eliminate our understanding of the synergies and the competitive differentiator that the process is going to give us.

Talking about the size of the synergy, this is still being assessed. We are still analyzing all the models and this is very important when you close the deal. Now the deal has been closed, so our focus is on the integration process. So we can find the best operational models for companies that were integrated and identifying the synergies, of course. One of the clearest synergies and by the way, part of it has been done and part of it is about to be concluded has to do with Zee.Now. Because Zee.Now is coming to a structure that is similar. It comes with a structure that is similar to Pet.

So we are going to have fewer hubs in markets where we don't see the need to have a dedicated Zee.Now hub. Because again, we are developing the operational side and the process side. So the Petz store can ship a Petz product, as well as do a Zee.Now delivery with all the differentiators that a Zee.Now delivery brings. So we have a lot of synergies on the table that are going to happen quite soon. Aline, would you like to add anything?

Aline Penna (CFO):

I think the other important thing from Victor's question, I actually answered during my presentation. He talks a lot about this reduction of the gap from physical to digital. And I just wanted to reinforce that this gap was 9%. We're pretty much halfway through that. It has been reduced pretty much in half.

But again, structurally speaking, unless we do an extreme change in our subscription model, the fact that we have a lot of subscribers in digital and the fact that digital has a big share of this audience would prevent us from closing this gap completely. But I think this is the message. We are going to continue to focus on decreasing this gap in the coming years.

Victor Fuziharo (Santander):

It's very interesting to see the timeline with the different movements that took place in the first quarter in their digital operation. Could you comment on the feedback that you got from consumers when it comes to the changes that were applied? More than that, how do you see the positioning from competitors on their online channels?

Sergio Zimmerman (CEO):

All right. Victor, good morning! Thank you for your questions. Feedback from consumers, we ship 20,000 orders a day and when you have a service fee or when you remove a discount from the pickup from store modality without giving anything as a counterpart, it would be extremely unlikely for someone to give us positive feedback on that. We have never dreamed of getting a positive feedback from those changes.

What we were interesting in measuring was how relevant the negative feedback would be. Because the feedback is a qualitative way to understand the change. But like I said, we have the data science portion of this, so we can understand how relevant that perception is from people who are complaining to us or to customer service or go to the ombudsman or it's natural for that process to happen. It's almost like trying to cook an omelet without breaking eggs, you can't. It was never part of the plan for us to apply those changes and not see people complaining about them.

But what we were interesting in finding out was if this level of dissatisfaction would be absorbed or not by the changes that the model brings. Because it's so significant. It's a 5% discount of pickup from store. It's a service fee that gives us more than a BRL1 million a month. So we need to know. We need to make this calculation. And it cannot be like a tight result because if you're changing, like it's not going to be any difference. It's worthless. And this is what we have today. So yes, we are monitoring the qualitative side, but also the quantitative side of these changes.

And just like I've said before, when we saw a more specific situation, because on the average everything is fine. But when you look that, for example, the charge of service fee for the pickup from store in the city of Sao Paulo, we were reaching a zone where no longer value was being generated. We reverted that change and we can take all the changes back. Because again, we track this on a weekly basis. Just to give you an idea, it's pretty much a live follow-up of this, because consumers can have that a behavior today and change tomorrow. So we pay a lot of attention on how our consumers behave.

And just to make investors comfortable, it's important to remember that despite the fact that we all use this data size, we also have a double check stack. We have three markets in Brazil,

where we did absolutely nothing. We didn't add a service fee, we didn't remove the discount from the pickup from store. The cities of Natal, the city of Brasilia, and the other one is the state of Santa Catarina. So Santa Catarina, Brasilia and the state of Rio Grande do Norte.

In these three geographies, we didn't do anything. So we would leave these three regions with no alterations and we would make the changes in other places and with that, we can truly determine the impact in revenue in the control groups. And what about the contribution margin when it comes to the control group? So this is the positive thing of having or using data science, because if we were to depend only on the qualitative side of things, only on the negative feedback, we would never keep these changes.

The second part of your question has to do with online competitors. This online competition, it takes different characteristics. Sometimes the player that is trying to penetrate the market more changes, but we are being very selective here. We are doing different things depending on the player or the product. I think, it's part of the deal to see this movement happening, but we are paying a lot of attention to everything that is taking place in that arena. I'll give you an example. Recently we saw something more specific is taking place with Hills on Amazon. Amazon was not part of what we were tracking, but now Amazon, we are not going to allow Amazon to gain share on the Hills product because of a specific policy that they have for Hills.

Customers can rest assured that the price that they find on Amazon for Hills is going to be the same price they are going to find at Petz. So this is the type of skill we want to have. We are not going to sit and watch any type of platform gain market share just based on price. Excluding the illegal sellers that exist, those who don't pay taxes, but that's a different story, pretty much there's no effect on pet food, it's mostly related to drugs that we see in these big marketplaces.

But the real serious sellers, they can gain market share, but they will gain market share because of other things, not just based on price. And I have been saying this since the IPO, we will never just sit back and watch our customers going away to another form of competitor because of price. We are not going to see that happen under any circumstances.

Victor Fuziharo (Santander):

We have less visibility of the acquired companies. So could you comment, how do you see consumers' behaviors after the price increase that was done in the fourth quarter in the Petix operation? And what is the growth expectation that you have for 2023?

It is clear that the performance suffered because of the macro context, however, I want to know if you see a shift in this negative trench for the top-line in the short-term? And do you believe that the consolidated operation for the acquired companies could reach a break-even in 2023?

Sergio Zimmerman (CEO):

All right. When it comes to the acquired companies, the fact that you have less visibility, it's not that you have less visibility. I have a theory, information is good to be shared when it's helpful. When you share information that doesn't help or quite the opposite can lead to a misunderstanding, it's better not to share it because we don't use that type of information internally. So we see this movement much more as a consequence of the advancement of the integration. Things are becoming so integrated that internally it's becoming quite complicated to determine who is allocated for Zee.Dog, who from Zee.Dog is already working with Petz projects. Things are becoming so integrated because of this movement.

That now, eventually, we come to the point when it doesn't make sense to make this divided report because the operation already has all these nuances of integration. And since we are going to have this accounting integration taking place this year as well, naturally this information was going to disappear. So what we see in this semester is the beginning of this process. We are no longer going to see this information separate. It's the same factor that allows us not to separate digital from physical because it's an omnichannel, so everything is mixed. So we highlight some of the differences, but we cannot go beyond that, because internally we don't do the same thing. So it's the same approach for the acquired companies.

You asked about the consumer's reaction when it comes to the price increase. The price increase in the fourth quarter was a structural price increase. It was not something done by Petix, but other companies did the same thing. What we see and I believe we are doing a very important work with Luiz and Rogerio from Petix in that sense, we are looking at the whole of the industry. We are developing a very important work to make adjustments with both our bricks-and-mortar stores and digital stores, differences in products and prices on the products that we manufacture that was a level of inconsistency that happened in 2022.

But because of new commercial policies, we are trying to correct that and we are going to do that. Because of course, we are not saying that Petz should sell at a lower price than others. We don't need to do that because we have a nice mix and we want to make room so other colleagues offer the product as well. But we are not going to sit back and watch competitors selling products that we manufacture at a lower price than ourselves. And that was happening and this is what we are correcting.

So in that sense, eventually you see one retailer here or the other say, I'm not going to work with this product. So if I cannot sell it below Petz, I'm not interested in it, it is fine. We are very comfortable with that. We don't have that concern. We don't see the industry as an isolated element. Oh, we need to gain market share at all costs. No, the ecosystem as a whole needs to gain market share. And in that sense, I can assure you that the Petix's market share inside Petz or the Petix's growth inside Petz is incredible, spectacular.

We are growing, Petix is growing at pretty much 50% a year, which had a very high comparison base, and they were already our main supplier. And we are growing a lot with their product. So we are consolidating this idea that this is a group. So I think things are going quite well with Petix. When it comes to Zee.Dog, we see the category as a whole having gains. And it's important to highlight one thing, the Petz line, the Spike products, especially the Petz products, this is a product line that was fully developed using the Zee.Dog expertise.

The other day, I was talking to Felipe, and Felipe was saying, well, the Petz product line was something that we created and we consider it to be just as good as Zee.Dog in terms of design and etcetera. So that is what's interesting, because now, see how different -- how difficult it is to separate things from when we're reporting results? Because, again, the intellectual work that was done was for the Petz brand or for the Spike brand. So we see this important signs of recovery.

Collars are growing as a whole in line with the growth level of the company, but especially the market share of our private labels reaching almost 70%. And for hygiene pads, things are not much different. So we see these great leaps and we are very happy and we hope to evolve even more until the end of the year.

Aline Penna (CFO):

And in his question, he mentioned that if we can have the break-even for the acquired companies in the year.

Sergio Zimerman (CEO):

Oh yes, perfect. Well, let's try to isolate Petix, definitely. Petix, we understand that, yes. We see this as a positive result. Zee.Dog, we have different verticals. So Zee.Dog Kitchen it's where we have more significant pressure in terms of negative results. But again, we are doing a lot of math. We are conducting a lot of studies. So we can validate the Zee.Dog Kitchen initiative and make it possible. Because it's an initiative that costs, so there's a cost to it. And we are working hard so we can improve our production costs, what kind of gains we can have from scale, options that we have for manufacturing the product. We are understanding all that because we cannot see this vertical affecting our results without a clear future perspective. We are working for that.

And like I've said, since the beginning, consider Zee.Dog Kitchen as an optionality. The most difficult part of the equation is positive, because which is the satisfaction of customers, but that's not enough. Because consumers can be happy, but the whole chain needs to be profitable. If consumers are happy that we cannot make the whole process profitable, something is wrong and then we need to correct price and see if consumers would still be happy at that new price level and that's what we do for Kitchen.

But when we look at the other verticals, we still have Zee.Dog inside the Petz Group, but now in the second quarter, we are going to have a much stronger B2B integration. Especially looking at all the B2B synergies that we have between the Zee.Dog B2B and the Petix B2B. That is an important gain in synergy, something that is going to take place in the second half of the year. Zee.Dog is very volume sensitive, like Aline told you, since there it's very sensitive to the contribution margin. If sales come back a little bit lower, that has a direct impact on volume and the opposite is also true. So yes, we have expectations, excluding Zee.Dog Kitchen, but for the other lines, we have a very high expectation of reaching a breakeven.

Alexandre Namioka (Morgan Stanley):

The margin for Petz and the loan extended 50 base points year-over-year and you have that guidance, the informal guidance that we have for having a flat margin for the end of the year. Are you going to continue with that for the year or do you see any room for growth? If you reinforce maintenance, what are the points that can lead to a contraction in margin for the end of the year?

Sergio Zimerman (CEO):

Alexandre, thank you for your question. I think it's about being cautious. We were discussing this early, but I don't think it's positive to change this, because there are important pressure factors. For example, there is one when it comes to taxes. There is a new rule that is going to become effective in May that has to do with the fiscal things credits when it comes to the ICMS tax date. Potentially, we are doing some internal studies. If we don't do any type of offsetting of that movement, that is going to have an impact.

So this is a pressure factor. We also have pressure from the competition, which like I said, we are constantly assessing and we are tracking it and we are not going to allow for any marketplace or any competitor to gain market share just based on price. We don't want to be pretentious

and say, oh, nobody is going to gain market share, they can gain market share just like they have been gaining. Competitors can gain market share as much as they want, but gain market share by doing different things, by working differently with good service, good operations, with good locations, so all those elements are part of the game.

What is not part of the game is the price, because price I would love to sell cheaper, but that's not how it works. It doesn't work like that. So just like it doesn't work for us, it's not going to work for others. Anyone that tries to adopt this strategy is going to be immediately upset. So for the reasons that I mentioned, I think it's much healthier for us not to change anything on what we said about the year.

Aline Penna (CFO):

He has two more questions. One of them is that we believe the 4-wall EBITDA margin on 19% for the mature stores, is the run rate in the long-term? And as we open new stores in cities where we already are present, what happens with the productivity of stores per square meter or sales per square meter for these stores?

Sergio Zimmerman (CEO):

Well, first, that 19% is what we have been tracking. We have an important amount of data that confirms this 19% number but it's a living thing. Just like in 2020 when we were talking about the talking about the IPO, this number was 21%. 21% turned to 19%. So we have a number of factors that pressure against or favor us, so the best data that we have continue to be 19. Do we believe it's going to stay at 19%? In some sense, yes, because all the movements that we are doing tend to stabilize these things, so more bigger digital share that pressures margin, other initiatives that help the margin. So in thesis, we expect between 18.5%, 19.5%. Perhaps that would be a good range from what we expect in the future.

Regarding productivity, we need to be careful on the reference here, because sometimes when you open a first store in a new city, productivity goes way up because that store is capturing more than the primary, secondary, and tertiary areas that usually that store would capture if it was not the only one. So if you open a first store like we did in the city of Natal, the whole city of Natal is going to go shopping there. As we open the second store or the third store, naturally there's an adjustment.

So productivity goes down. Yes, it does, but it's not that it goes down because the productivity was normal and now is low, it goes down because artificially it was quite high and then it goes back to the expected levels. So it's important to differentiate what means the decreasing productivity and the reasons for that because, if the productivity levels is artificially high because of the competitive advantage that you have for being the single store there, we shouldn't interpret that as bad news and why not?

Well, if we had an agreement with the market or we're going to have a store in Natal and no one is going to open another store there, perfect. Our store is going to have wonderful productivity at all times. But if we don't do that work, if we don't normalize what's happening in these cities, we are going to just give the opportunity for the competitors to do so. So we need to do that and of course that affects our own productivity

Felipe Rached (Goldman Sachs):

I wanted to talk a little bit about how your investment on your service initiatives. You mentioned in the release about the closing of a few vets and grooming units in search of a greater profitability. Could you quantify how that impacted the margins? And still on services, if you could share the health plan development?

Aline Penna (CFO):

For health plan, there's a second question by Gustavo Cruz and he asks if you're going to have a partnership with an insurance company or if you're going to do that by yourself?

Sergio Zimmerman (CEO):

Well, Felipe, good morning and thank you for your question. When it comes to closing of some of the service unit, we start to see effect, especially in the second half of the year. In the first quarter, this effect is compromised by everything that you need to pay when you do this closing. But in the second half, we are going to start to capture this more clearly, the fact that we removed these units from operation temporarily.

And about the health insurance plan, we are in a quite advanced stage in the modeling process. Once again, we are cautious in using data science. We are excited for running the pilot project that's going to happen very soon. We are excited because we have a good feeling that we are going to launch a health insurance plan that is going to be really well received by consumers. And one cannot forget that all of us as investors, we are carrying an important cost from the health insurance plan structure, which is the fact that we have hospitals, surgery rooms, that's an infrastructure that is ready to receive this health plan product.

So it's almost like we have part of the expenses without having the revenue associated to them. So in that sense, we are very excited with that. We are doing and redoing the calculations because, again, when we think about an ecosystem, it's not just thinking about building value, we also need to remember that something that is not well done can destroy value for the ecosystem. We don't want customers to be upset about the health plan to stop buying dog food that could be the worst mistake.

But when you look at the health plan offers that exist today, they are always operated by third-parties. Nobody is working a vertical model. I think that is going to be a very important advantage for us. Right now, we don't see any need, and answering Gustavo's question now, we don't see any need to bring an operator or another insurance company together, we see this as something that's going to be internally operated, of course hiring the professionals that have expertise on that.

He also asked improving profitability started to happen in the first quarter, but we even mentioned on the non-recurrent lines the effect of termination of contracts that happened. And when we look at the upper margin for the operation after this adjustment, yes, it is better. But since we are talking about an operation that is quite small, it was not representative or significant as to justify our flat margin.

Felipe Reboredo (Citi):

We wanted to understand what is the perspective that you have for non-food products for this year? Do you expect a growth in the second quarter as well? Could you talk about the appetite of consumers for these items?

Sergio Zimmerman (CEO):

Felipe, it's important to reinforce the message that without a doubt this is something that we had over a few quarters, talking about the deceleration and the fact that these products were not growing and this great expansion of pet food on top of non-food products. On the discretionary products, so what we clearly saw on the fourth quarter starting to consolidate, something that continue to consolidate in the first quarter was an interruption of this movement that was happening and with signs of change.

And like I said before, these are signs, it's not a button that you push and that's over. We see that happening in one product line like I mentioned, which is the collar, which is a very discretionary product category that already shows signs of recovery. We also see recovery happening in other products and we expect to see this movement be intensified, because again the cause of that is very much related to the inflation rate. And the recovery has a lot to do with the decrease of the inflation rate.

So if we were to put both curves side-by-side, we would see that increases in inflation rate, drop in the sale of discretionary products, inflation goes down, we increase sales on these non-food products. So right now, we see inflation going down and we see some signs of recovery for discretionary products and we expect or this to be the trend for the whole of 2023.

Aline Penna (CFO):

And it's important to mention that in the first quarter, if you look at the category of accessories, the growth was below the growth of the company, but not for collars. It's already growing at 20%, which shows how important it is to have private labels for these products. Perhaps this is why we are able to differentiate ourselves in that specific category.

And the final question is by Nicolas from JP Morgan. A part of the question was already answered. But not his second question.

Nicolas Larrain (JP Morgan):

Have you been noticing any difficulties in finding good locations, especially outside Sao Paulo?

Sergio Zimmerman (CEO):

Good morning, Nicolas. Thank you for your question.

Well, finding the right store location is interesting, because we are going against the macroeconomic tides. The worse the market is as a whole the better it is for our expansion. Obviously, companies are closing down, other industries are suffering. We have more, a greater real estate offer. So I wouldn't say that right now finding the right real estate is an important thing. This is usually an issue that we face when everything is going well because if everything is going well, it's going well for everyone and if everyone is doing well, it's very difficult to find the right property.

But it's not the case that we have for now. This is why many times we do an expansion in this counter cycles of the economy, because this is when we can find a good real estate like we did in different occasions. When for example, when car dealers were closing, we opened operations in the same properties and other examples. So this is not a bottleneck that we have and this is a characteristic of our expansion, especially in more remote areas. We are always finding or

searching for the best property and the best real estate-- even if it's more expensive in terms of rent costs, it's not a problem.

We are not afraid of having a higher cost of occupation, we are afraid of having the wrong location, it's bad business if you have the wrong location. It's very simple to explain that, the only variable that we have when you have a good or a bad location is cost of energy, cost of personnel, the same cost of goods as the same. So having the good location makes a whole difference.

Aline Penna (CFO):

So we have answered all the questions. I think we are ready for final remarks.

Sergio Zimmerman (CEO):

Thank you, Aline. I wanted to say thank you for everyone who has sent questions and have attended this first call of 2023, talking about the results of our first quarter. And I'd like to wish you all an excellent weekend. And for those of you who are in New York, in the Itau Conference, Aline, Matheus and myself are going to be there and it will be a pleasure to talk to you in person. All the best and have a great weekend.

Aline Penna (CFO):

Thank you! Have a good weekend.