LOJAS RENNER

2Q23 Preview: The weather warmed up, but profit cooled down…

Apparel Retail

Main takeaways:

· Retail revenue should decline y/y amid weakened demand, a delayed winter and challenging comps;

· We expect a slower growth pace for Realize, due to a more conservative credit policy;

· Higher markdown activity should lead to a -145bps y/y pressure on gross margin;

· Lower operating leverage should lead to a -653bps y/y contraction of the EBITDA margin;

· We expect Renner to post a -60.4% y/y drop in net profit.

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Company

LREN3 BZ Equity
Neutral

Price: R$ 18,86 (July 24, 2023)
Target Price 12M: R$ 20,50

Renner will post its 2Q23 results on Thursday (Aug 3). We expect the numbers to reflect the challenging moment the company has been facing, struggling with a weakened demand, higher markdown activity and tough comps.

From 2H23 forward we should start to see more positive signs for the industry. Against easier comps, the apparel sector should start to benefit from **(i)** a slowdown in cost inflation and **(ii)** the expectation of an increased demand. Specifically, Renner should also gradually benefit from the conclusion of the ramp-up phase of its new DC.

Still, better outcomes are yet to be worked out over the next few quarters. The signs tend to be more positive, but the return of demand should not be immediate, and margin recovery should be something gradual.

At the same time, the company will have to deal with an increasingly fierce competitive environment, as foreign e-commerce platforms grow their presence in Brazil, benefiting from more favorable tax conditions (see Cross-border risk topic).

Thus, we believe we should still see Renner under pressure in the near term, facing compressed margins due to lower operating leverage. We continue with our **NEUTRAL** recommendation with a **2023E target price of BRL 20.50**, implying a **4,5%** upside against today's closing price (24/07).

Store network revision

Given the challenging macroeconomic environment, Renner started to reassess its strategy and store portfolio, closing 20 locations in 1Q23. In this quarter we still see some moves in this direction, with 7 store closures - 6 Renner and 1 Camicado. Still, unlike 1Q23, in this quarter we see new stores being opened again - we had a total of 6 openings of Renner and 4 of Youcom.

The slow evolution of the sales area (+0.9% y/y), coupled with a tough macroeconomic scenario for consumption, should be an obstacle for revenue growth.

Retail revenue should decline, and here's the reason

We expect Renner to post a y/y revenue retraction. Three main points should contribute to this scenario:

(i) Weakened demand. Although we are beginning to see signs of a slowdown in inflation, we do not expect an immediate rebound in sales volume. The scenario of high inflation and interest rates over the last few periods still pressures consumers' disposable income and household indebtedness, leading to a lower appetite for consumption, especially for discretionary items.

(ii) Delayed winter. The anticipation of the winter collection in 1Q23 disrupted sales in the quarter, leading to higher markdown activity in 2Q23. We believe that the persistent warmer temperatures throughout 2Q23 also influenced sales as cold weather items increase their share in stores.

(iii) Challenging comps. Last year, in addition to the returning demand that was pent-up over several waves of COVID-19, we had an early winter and lower temperatures throughout 2Q22, leading to stronger sales of full-price winter items, solidifying a comparative base that's difficult to beat.

Combining these effects, against a strong comparison base, we expect **Renner's retail business' net sales to decline -8.5% y/y, to R$2.9b (-8.5% y/y; +27.6% q/q)**.

We expect Youcom to be the only label to show growth in 2Q23. We estimate a +11.5% y/y growth in its net sales. In our projections, Renner should have the worst individual performance, with an estimated -9.3% y/y drop in net revenue in 2Q23. Camicado should continue to decrease, but at a lower pace than seen in recent periods due to the effect of a weaker comparison base (-6.9% y/y).

For Realize, we believe that the conservative credit policy adopted should prevent large revenue growth. We expect a slower growth pace in Renner's financial business compared to that seen in previous quarters.

With a weakened sales volume and softer growth in Realize, we believe Renner will report **consolidated net sales of R$3.4b - a -5.4% y/y decline**.

Compressed margins

Pushing forward the winter collection should have a double impact this year. In mid-March, Renner launched its winter collection. With no appetite for sales, the company saw its 1Q23 revenue drop y/y and its inventory increase.

Facing a warmer fall, this forward momentum should have a negative carry into 2Q23, generating more inventory to dispose of and anticipating markdowns to rotate items that were not sold in 1Q23.

Given the tough comps, we estimate Renner to report **-145bps y/y pressure on retail gross margin at 54.7% (-145bps y/y; +51bps q/q)**. We estimate a **consolidated gross margin of 60.4% (-36bps y/y; -90bps q/q)**.

As in the last period, we should still see an impact on operating income from higher expenses related to structure revision and the ramp-up process of the new Cabreúva DC - this phase should be finalized later this year.

Faced with a challenging sales volume, the low operating leverage, added to the burden of gross margin retraction, should generate significant pressure on the company's EBITDA margin. We estimate an **operating margin of 12.8% (-653bps y/y; +378bps q/q)**.

Higher costs, greater expenses and softer sales…

The formula is almost perfect for a sharp drop in net profit. We expect Renner to report a -60.4% y/y bottom-line contraction. We estimate a **net profit of R$143m (-60.4% y/y; +205.3% q/q)** and a **net margin of 4.2% (-579bps y/y; +249bps q/q)**.

Cross-border risks

Import tax exemption. The new tax rules published on cross-borders taxation feature the exemption of taxes on all amounts below US$ 50 for companies who adopt the "Remessa Conforme" program.

Previously, all imported purchases were subject to a 60% tax, only shipments (up to US$ 50) between individuals were exempt. As a counterpart to the exemption, the ordinance published by the government imposes the payment of a 17% ICMS on sales.

In our assessment, the new rules should formalize the current scenario. We believe that the new cross-borders tax regulation should not avoid an asymmetric tax environment, putting Renner's items at a disadvantage compared to the aggressive prices of foreign platforms.

We believe that the maintenance of the significant gap between domestic and cross-borders prices should result in a loss of share for the main local players. This dynamic should be emphasized by the entry of new players in the country, stimulated by the officialization of the tax exemption for import shipments of up to US$ 50. For the next semester, we already expect the entry of Chinese giant Pin Duo

Duo in the Brazilian market, through its e-commerce platform Temu.

As consumers have been extremely price sensitive, local companies have been losing part of the demand for apparel items to large cross-border platforms, who operate with more aggressive prices than players like Renner can sustain. We believe that the apparel market is in a highly disruptive stage and, even though Renner is the industry leader, it will need to adapt to the new game.

Competition with cross-borders platforms should be another challenge to be faced by Renner. Even with positive signs for a recovery of better sales volume, we believe that a more robust demand will be shared with large companies such as Shein, which has been gaining more and more share in the local market.

Table 1: Genial estimates for Renner in 2Q23.

	2Q23 E	2Q22 A	% y/y | bps	1Q23 A	% q/q | bps
Gross revenue	**4.277**	**4.887**	**-12,5%**	**3.707**	**15,4%**
Net revenue	**3.429**	**3.626**	**-5,4%**	**2.775**	**23,6%**
Retail	2.906	3.176	-8,5%	2.278	27,6%
Realize	523	451	16,1%	497	5,2%
Gross profit	**2.073**	**2.205**	**-6,0%**	**1.702**	**21,8%**
% Total Gross Margin	60,4%	60,8%	-36 bps	61,3%	-90 bps
Retail	1.588	1.782	-10,9%	1.234	28,8%
% Retail Gross Margin	54,7%	56,1%	-145 bps	54,1%	51 bps
Adj. EBITDA (IFRS 16)	**440**	**702**	**-37,3%**	**251**	**75,2%**
% Total Adj. EBITDA Margin	12,8%	19,3%	-653 bps	9,0%	378 bps
Net financial result	(17)	(2)	608,1%	(14)	24,0%
IR/CSLL	(21)	(71)	-69,8%	88	-124,2%
Net profit	**143**	**361**	**-60,4%**	**47**	**205,3%**
% Total Net Margin	4,2%	10,0%	-579 bps	1,7%	249 bps
EPS	**0,14**	**0,36**		**0,05**	

Source: Genial Estimates and Company info.

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Sell	Expected return below -10% in relation to the Company's sector average	**5%**
under Review	Under review	**5%**

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