Equity Research

Pharma Retail

2Q23 Preview: New CMED and margin impacts

Pharmaceutical Retail

Next week, pharmaceutical retail companies will report their Q2 2023 results. Pague Menos is the first in the sector to release its figures, on Monday (Aug 07), followed by Raia Drogasil the next day (Aug 08) and ending with Panvel on Thursday (Aug 10).

We have separated two main topics that should affect the three companies in this 2nd quarter:

Topic I: CMED 2023 readjustment in drug prices

The second quarter is defined by Law No. 10,742/2003, which regulates the pass-through on drug prices. The announcement of the readjustment is made at the end of March and applied by pharmacies as early as April.

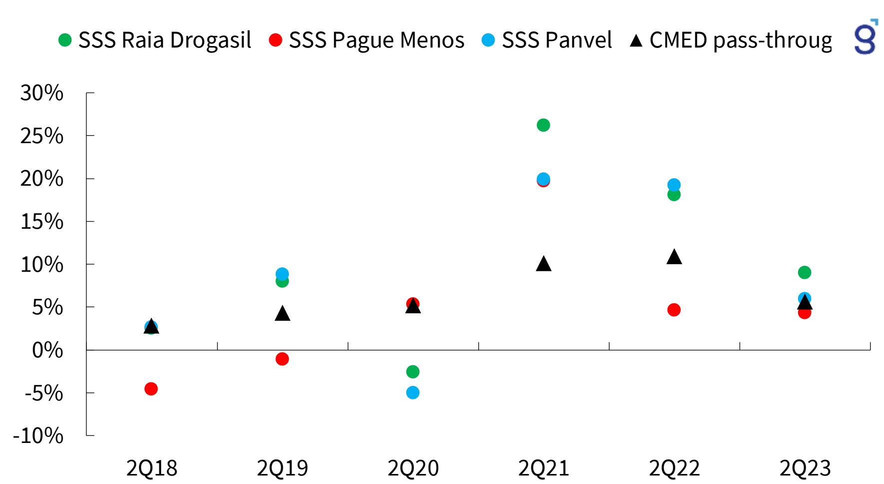
For companies in the sector, this adjustment is one of the main pillars for the expansion of revenues. It is common to observe companies in the sector increasing their stocks at the end of the 1st quarter to resell at the new price. Thus, the 2nd quarter brings a positive seasonality for pharmaceutical margins.

Although CMED's adjustment formula is composed of IPCA and X + Y + Z factors, these factors have been set to zero in the last two years.

With one of the largest adjustments in the historical series in 2022, the comps for this quarter are strong. Last year, the base adjustment was 10.89% and, for 2023, with the slowdown in inflation, the rate was 5.60%.

Below, we have compiled a comparison between the Same Store Sales of the three companies and the CMED adjustment in recent years (Graph 1).

Graph 1: Evolution of Same Store Sales and CMED Readjustment.



Analysts

Iago Souza
iago.souza@genial.com.vc

Vinicius Esteves
vinicius.esteves@genial.com.vc

Nina Mirazon
nina.mirazon@genial.com.vc

Company

RADL3 BZ Equity
Neutral

Price: R$ 28,34 (August 3, 2023)
Target Price 12M: R$ 25,00

PGMN3 BZ Equity
Neutral

Price: R$ 4,33(August 3, 2023)
Target Price 12M: R$ 5,20

PNVL3 BZ Equity
Buy

Price: R$ 13,03 (August 3, 2023)
Target Price 12M: R$ 18,60

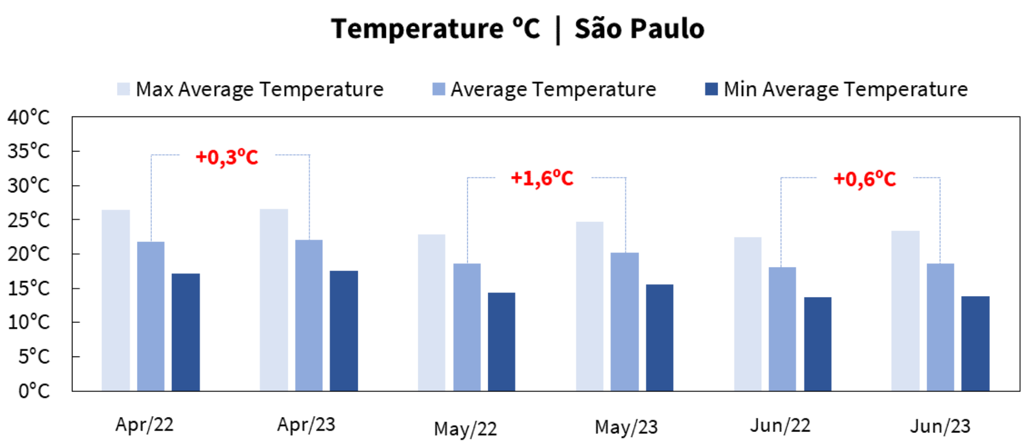
Overall, for revenues, we expect a deceleration in top-line growth, given the 5 p.p. y/y gap. Regarding profitability, our estimate of the average impact on gross margin is -77 bps. Raia Drogasil is expected to have the largest impact, at -124 bps y/y (Est. Genial).

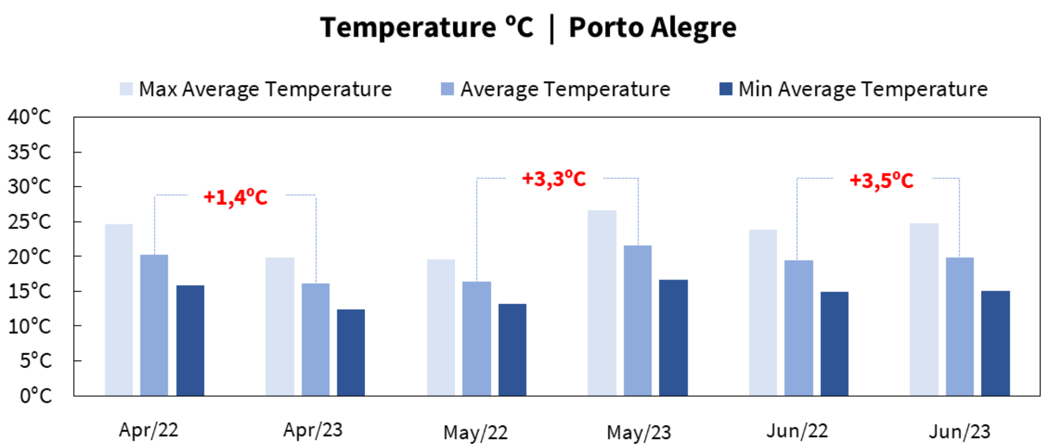
Topic II: Climate and changes in category mix

Coming from a comparative base with earlier cold temperatures in 2022 (arriving in mid-April), we should imagine a change in the product mix composition for this quarter, as we had warmer average temperatures during autumn in 2023, with temperature dropping only in June.

From the INMET (National Institute of Meteorology) fall balance, events such as strong warm air masses were responsible for the higher temperatures in the season. The Southern Region was the most affected, with Rio Grande do Sul showing positive anomalies between +1.5° and +3°C compared to the average (see Graph 2 below).

Graph 2: Annual temperature evolution for Porto Alegre and São Paulo. Prepared by Genial from INMET data.





Given this, with lower demand for anti-thermics, we expect the OTC (Over The Counter) category to lose traction in the annual comparison, showing a flat behavior. In contrast, we see strong growth in the Generics and Hygiene & Beauty categories, which should offset the average performance of OTC

Preview | Raia Drogasil (RADL3)

With tough comps (see topic 1), we expect Raia to show top line deceleration. However, even with this scenario, we estimate that the company will present the highest gross revenue growth in the sector for this comparison, we use the Pague Menos standalone view, since the acquisition of Extrafarma brings an inorganic effect to the company's revenue growth.

With a 5.6% readjustment of drug prices, a 9% Same Store Sales and an 8.5% increase in the store park - considering 55 net openings - we project **gross revenue at R$8.8b**, growing 15.3% y/y.

We understand that RADL will be the most pressured company in gross margin due to **I)** single-digit CMED adjustment; **II)** higher revenue penetration of 4Bio, which operates in the specialty drug segment and has lower margins than the retail operation; and **III)** increased share of the online promotional setting. The decline should be softened by higher growth in Hygiene & Beauty, given that the category's gross margin is around 30-35% (see topic 2).

In this scenario, we estimate a **gross profit of R$2.5b** (+10.5% y/y; +10.4% q/q) and margin at 29.1% vs. 30.3% in 2Q22, meaning a pressure of -124 bps y/y.

We don't expect SG&A to be diluted this quarter as the slower pace of revenue growth results in a less favorable base for expense dilution, in addition to increasing operational expenses from the 264 LTM openings. As a result, we estimate that expenses will represent approximately -20.6% of gross revenue. Considering the negative impact on gross margin together with this SG&A dynamic, we project an Adjusted EBITDA of R$716mn (-1.5% y/y; +27.3% q/q) and a margin of 8.1%, down -139 bps y/y.

Finally, we expect a **net profit of R$ 334m** (-10.3% y/y; +59.8% q/q) and a margin of 3.8% (-108 bps y/y; +133 bps q/q).

Table 1: 2Q23 Genial Estimates for RADL3

	Est. Genial	Consolidated	Change	Consolidated	Change
[R$ mn] IAS 17	2T23e	2T22a	% y/y	1Q23a	% q/q
Gross Revenue	**8.807**	**7.641**	**15,3%**	**8.479**	**3,9%**
Same Store Sales (%)	9,9%	18,1%	-821 bps	14,8%	-491 bps
Net Revenue	**8.256**	**7.179**	**15,0%**	**7.931**	**4,1%**
(-) Cost of Goods and Services Sold	(5.693)	(4.861)	17,1%	(5.610)	1,5%
Gross Profit	**2.563**	**2.318**	**10,5%**	**2.322**	**10,4%**
Gross Margin (%)	*29,10%*	*30,34%*	-124 bps	*27,38%*	171 bps
(-) SG&A	(1.796)	(1.547)	16,1%	(1.755)	2,4%
Adjusted EBITDA	**716**	**728**	**-1,5%**	**563**	**27,3%**
Adjusted EBITDA Margin (%)	*8,13%*	*9,52%*	-139 bps	*6,64%*	150 bps
Net Financial Result	(169)	(98)	72,5%	(160)	6,1%
Net Income	**334**	**372**	**-10,3%**	**209**	**59,8%**
Net Margin (%)	*3,79%*	*4,87%*	-108 bps	*2,46%*	133 bps

Preview | Pague Menos (PGMN3)

We expect **consolidated gross revenue at R$2.9b**, expanding 34.0% y/y. However, much of this growth should come from the acquisition of Extrafarma, boosting the store network by ~40% y/y. When looking at Pague Menos Standalone, we expect top line growth at 12.6% y/y and Same Store Sales at 4.3%.

In May/23, the company announced a revision of its store openings guidance from 60 stores to only 20. Considering the four openings in Q1 plus 16 in Q2, we do not expect new openings for the year.

With the gap provided by the new CMED and with the digital channel gaining share in revenues y/y (despite a sequential normalization), we expect pressure on the company's gross margin. Part of the impact should be offset by a good performance of the Generics and Hygiene & Beauty categories growing +20% y/y, in addition to the positive contribution from Extrafarma.

With this, we project a **gross profit of R$ 908m** (+30.4% y/y; 11.1% q/q) and a margin at 30.6%, with -70 bps pressure y/y.

The positive highlight in the quarter should be in the expenses. We expect a +79 bps sequential dilution in consolidated SG&A, driven by the restructuring of general and administrative expenses. Therefore, we estimate an EBITDA at R$134m (+4.9% y/y; +141.1% t/t) and a margin of 4.5%, contracting -125 bps y/y by the incorporation of Extrafarma's portfolio.

The financial result at -R$130m, should continue to pressure bottom line results. Finally, we expect a **net loss of -R$ 12m** vs. a net profit of R$ 60m in 2Q22, with sequential improvement (-R$ 53m in 1Q23).

Table 2: 2Q23 Genial Estimates for PGMN3

Expectations Summary | PGMN3 2Q23

[R$ mn] IAS 17	Est. Genial 2T23e	Consolidated 2T22a	Change % y/y	Consolidated 1T23a	Change % q/q
Gross Revenue	**2.962**	**2.210**	**34,0%**	**2.813**	**5,3%**
Same Store Sales (%)	4,3%	3,1%	114 bps	2,4%	185 bps
Net Revenue	**2.767**	**2.070**	**33,6%**	**2.620**	**5,6%**
(-) Cost of Goods and Services Sold	(1.855)	(1.374)	35,0%	(1.803)	2,9%
Gross Profit	**912**	**696**	**31,0%**	**817**	**11,6%**
Gross Margin (%)	*30,80%*	*31,50%*	-70 bps	*29,06%*	175 bps
(-) SG&A	(779)	(569)	36,9%	(762)	2,2%
EBITDA	**134**	**127**	**4,9%**	**55**	**141,1%**
EBITDA Margin (%)	*4,51%*	*5,76%*	-125 bps	*1,97%*	254 bps
Net Financial Result	(119,6)	(45,8)	161,0%	(127,3)	-6,0%
Net Income	**(13)**	**60**	**-121,3%**	**(53)**	**-75,9%**
Net Margin (%)	*-0,43%*	*2,70%*	-314 bps	*-1,88%*	145 bps

Source: Genial Institucional and PGMN3

Preview | Panvel (PNVL3)

With the slowdown in top line growth (see topic 1) in the annual comparison (23.4% in 2022 vs. 14.1% 2023 Est. Genial), we expect Panvel to come close to, but not reach, the R$5.0b guidance projected for 2023 (R$4.9b Est. Genial).

Panvel had 9 net openings in the quarter, increasing its store network by 6.9% y/y. Two openings scheduled for 2Q were left for 3Q, as the stores were inaugurated in July.

We estimate a consolidated **gross revenue at R$ 1.2b** (Retail R$ 1.1b; Wholesale R$ 95m; Manufacturing R$ 3m), which represents a 10.1% y/y increase and a Same Store Sales of 5.9%.

Despite the warmer weather in the Southern Region of the country (see topic 2), we believe the company has better handled category reshuffling to preserve its gross margin.

Despite the lower CMED readjustment, the projected growth of +20% in Hygiene & Beauty - which has better margins than the average mix - should offset much of the pass-through gap. It is worth remembering that the penetration of Panvel products within HB, is about 20%, helping even more in the defense of profitability, in our view.

At this pace, we project **gross profit at R$343m** (+8.7% y/y; 9.2% q/q) and a margin of 29.45%, with -38 bps pressure y/y.

With gross revenue decelerating, we do not expect the company to be able to dilute its expenses year-on-year, accounting for -24.5% of Panvel's revenues. Therefore, with gross profitability defense and a flat SG&A, we get to an Adjusted EBITDA at R$57m (+1.8% y/y; +14.3% q/q) and a margin of 4.9%, contracting only -40 bps y/y.

Finally, we project a **net profit at R$ 24m**, down -9.4% y/y and a margin of 2.1% (-45 bps y/y; +20 bps t/t).

Table 3: 2Q23 Genial Estimates for PNVL3

Expectations Summary | PNVL3 2Q23

[R$ mn] IAS 17	Est. Genial 2T23e	Consolidated 2T22a	Change % y/y	Consolidated 1T23a	Change % q/q
Gross Revenue	**1.164**	**1.057**	**10,1%**	**1.106**	**5,3%**
Same Store Sales (%)	5,9%	19,2%	-1327 bps	10,0%	-407 bps
Retail	1.066	965	10,4%	1.002	6,4%
Wholesale	95	90	6,0%	101	-6,0%
Industry/Others	3	3	6,0%	2	22,8%
Net Revenue	**1.084**	**986**	**9,9%**	**1.027**	**5,5%**
(-) Cost of Goods and Services Sold	(741)	(671)	10,4%	(714)	3,8%
Gross Profit	**343**	**315**	**8,7%**	**314**	**9,2%**
Gross Margin (%)	*29,45%*	*29,83%*	-38 bps	*28,38%*	107 bps
(-) SG&A	(286)	(259)	10,2%	(286)	0,0%
Adjusted EBITDA	**57**	**56**	**1,8%**	**50**	**14,3%**
Adjusted EBITDA Margin (%)	*4,90%*	*5,31%*	-40 bps	*4,52%*	39 bps
Net Financial Result	(6,8)	(6,0)	12,1%	(6,8)	-1,1%
Net Income	**24**	**27**	**-9,4%**	**21**	**16,4%**
Net Margin (%)	*2,09%*	*2,54%*	-45 bps	*1,89%*	20 bps

Source: Genial Institucional and PNVL3

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under Review	Under review	**5%**

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