genial Equity Research

LOJAS RENNER

2Q23 Review: Weak numbers, as expected

Apparel Retail

The company failed in the choice of assortment, pricing and timing of the fall/winter collection shift in the 1st quarter. These mistakes, together with the still restrictive macroeconomic scenario for discretionary retail, ended up sacrificing part of Renner's margin of this 2nd quarter.

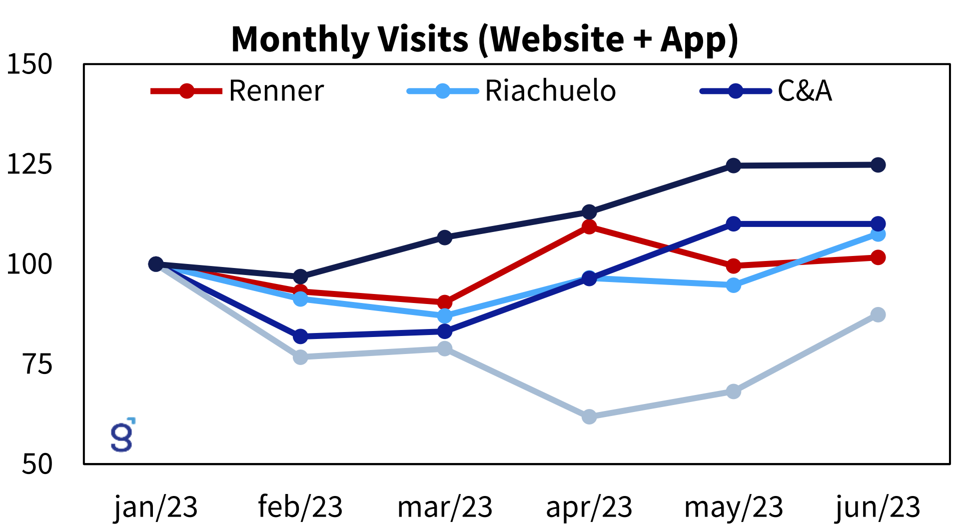
The result was the picture we saw this quarter. It was not a pretty picture! Despite a higher free cash flow (which can be explained given the lower level of investments in subsidiaries, lower capex in the period and optimization of accounts receivable), the company shows an even more anemic operating result than that presented in the 1st quarter - safeguarding seasonal impacts.

Despite considering that from 2S23 on, the comps will become more interesting, we maintain our **NEUTRAL** view on LREN3 (target 2023E of R$ 20.50).

Analyzing the monthly traffic of low-price clothing apps and websites (Chart 1), we see Shein gaining traction in the apparel sector. Although it is not possible to predict the conversion of these accesses into purchases, we continue to see price sensitive consumers.

We expect more tangible results from Renner's assortment adjustment over the coming months, which will focus more on the low-price product exposure. In a release, the company briefed that the strategy started to bring results in June (to see). If successful, this strategy could once again leverage the company

Graph 1: Monthly app traffic, taken from Similarweb and prepared by Genial. Does not consider iOS.



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Company

LREN3 BZ Equity
Neutral

Price: R$ 18,55 (August 3, 2023)
Target Price 12M: R$ 20,50

We have highlighted five topics that we believe are relevant to the reported result:

(I) Revenue retraction

Amid a macroeconomic scenario that pressures customers' purchasing power, Renner continues to deal with weakened demand. Faced with a lower appetite for consumption by customers, the dynamics of the quarter were no different from what we expected - with reduced tickets and fewer items in the basket. Adding the weak sales volume to strong consolidated comps in 2Q22, Renner posted a -6.0% y/y slowdown in retail revenues.

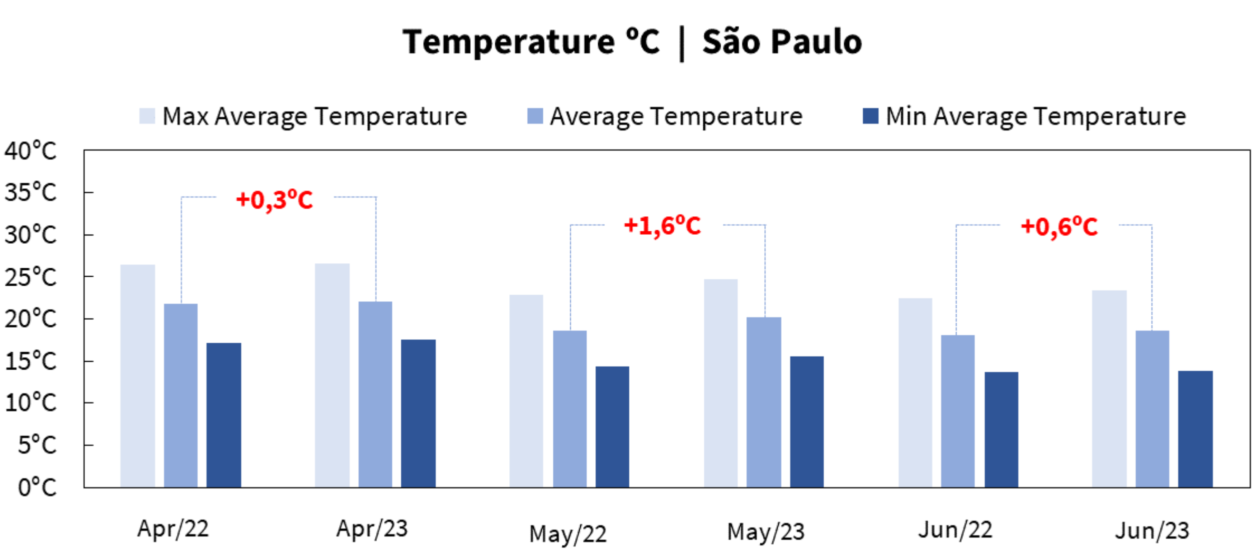
(II) High level of markdowns

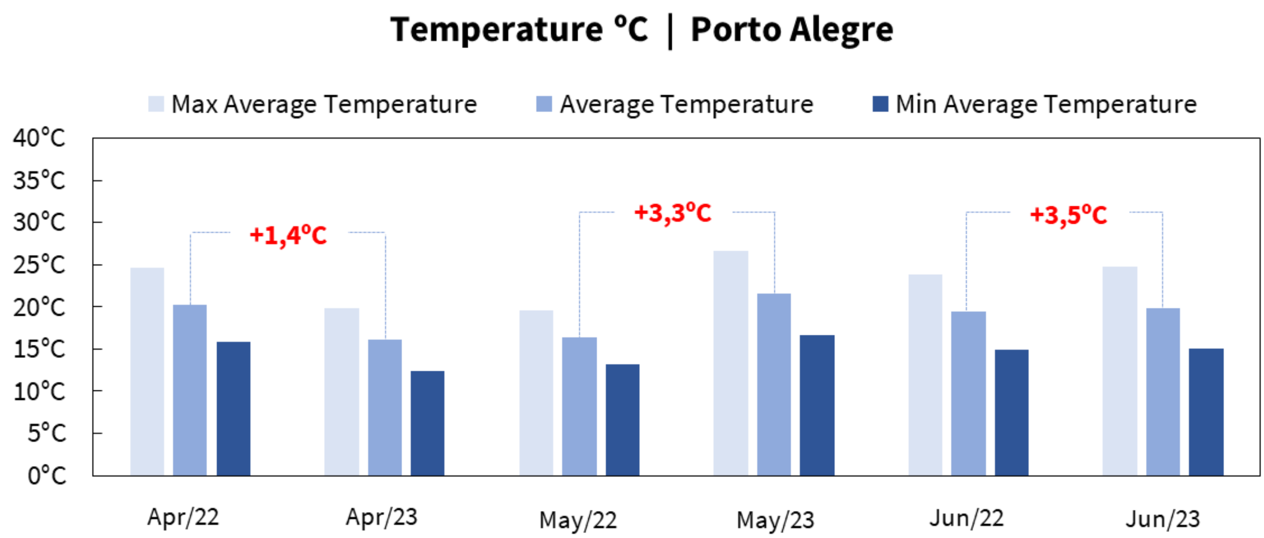
When we compare the result with 2Q22 numbers, we see a strong deceleration. Last year's base is marked by an increase in volume - characterized by the pandemic's repressed demand and an early winter - causing one of the lowest markdown levels in Renner's history.

This year, the fact that the company anticipated its fall/winter collection in the first quarter in a wrong way, brought a heavy and out-of-season inventory to the second quarter. The weather, with higher average temperatures in its main markets (see charts 2A and 2B), penalized Renner's strategy.

The result? Lower sales volumes and higher levels of markdowns, bringing significant pressure on profitability. The company reported a gross profit of R$2.1b (-4.9% y/y; +1.2% vs. Est. Genial) and a retail margin of 53.9%, falling -220 bps y/y and -75 bps vs. our estimate.

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





(III) Low operating leverage

Due to higher levels of operating expenses, mainly in the lines of expenses with the new Omni DC and administrative restructuring, and the y/y decline in revenues, the proportion of SG&A within revenues increased +330 bps, from 33.3% in 2Q22 to 36.6% in this 2nd quarter.

This, together with higher markdowns and the decline in gross margin, caused EBITDA to shrink -31.4% y/y, to R$482m, with a margin of 13.7% (-560 bps yoy).

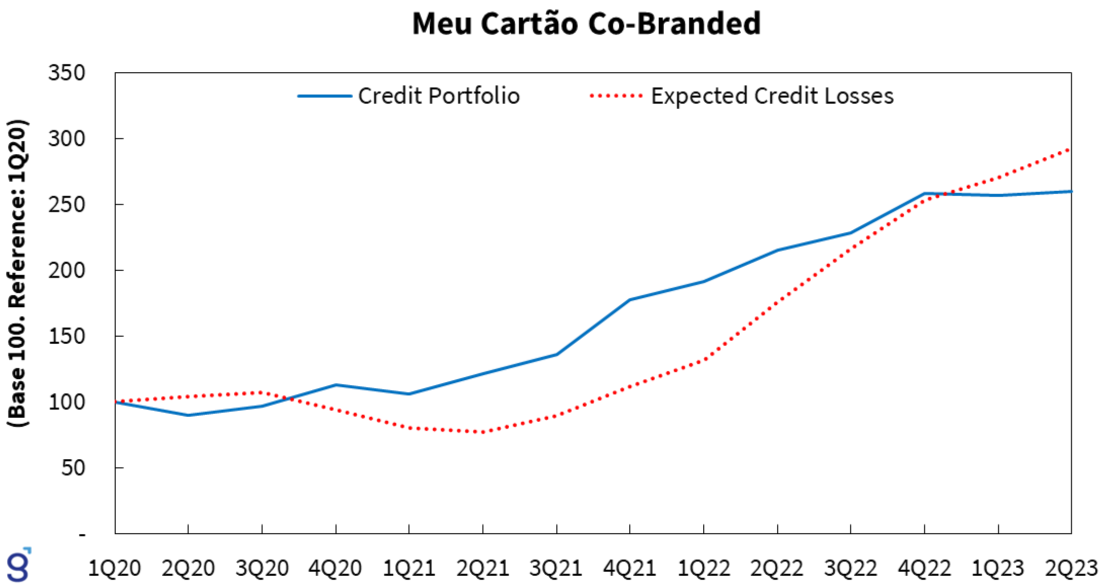
(IV) Realize: from bad to worse

If we judge that the retail result was operationally weak, the situation gets even worse when we look at Realize. Faced with a macro environment that is still challenging for discretionary consumption, Renner has been slowing down the pace of credit granting.

Undoubtedly, this is the right strategy to be made in this scenario. However, even with the slowdown in the credit portfolio, the old credit granting vintages have been taking their toll on the retailer, which needs to launch a higher provisioning of the overdue portfolio. Co-Branded's NPL>90 increased by 1.40 p.p. in the quarterly outlook, reaching 20.3% of the portfolio.

The worst of both worlds. When we add the lower portfolio growth with the higher estimated credit loss (Chart 3), Renner's financial solutions vertical became a major detractor of operating margin for the group, posting a negative result of R$53.7m (previously positive R$11.9m in 2Q22).

Graph 3: Meu Cartão loan portfolio growth and estimated losses. Prepared by Genial based on company data.



(V) A higher tax rate than our estimate

Supported by a higher acknowledgement of tax incentives as investment grants (import operation in SC and presumed ICMS credit in SC and RJ), the bottom line was above our projection.

With an IRPJ/CSLL of R$ 34m (vs. negative R$ 21m Genial Est.), Renner consolidated a net profit 60% higher than estimated, at R$ 230m (-36.4% y/y) and a net margin of 6.6% (-340bps y/y).

Lojas Renner	**2T23 C**	**2T23 E**	% C/E | bps	**2T22 C**	% a/a| bps
Net Revenue	**3.504**	**3.429**	**2,2%**	**3.626**	**-3,4%**
Retail	2.985	2.906	2,7%	3.176	-6,0%
Realize	519	523	-0,8%	451	15,2%
Gross Profit	**2.098**	**2.073**	**1,2%**	**2.205**	**-4,9%**
% Total gross margin	59,9%	60,4%	-58 bps	60,8%	-94 bps
Retail	1.609	1.588	1,3%	1.782	-9,7%
% Retail gross margin	53,9%	54,7%	-75 bps	56,1%	-220 bps
Adj. EBITDA (IFRS16)	**482**	**440**	**9,6%**	**702**	**-31,4%**
% Adj. EBITDA margin	13,7%	12,8%	92 bps	19,3%	-560 bps
Net financial result	(29)	(17)	64,4%	(2)	1064,2%
IRPJ/CSLL	34	(21)	-258,5%	(71)	-147,9%
Net Income	**230**	**143**	**60,3%**	**361**	**-36,4%**
% Net margin	6,6%	4,2%	238 bps	10,0%	-341 bps

Source: Genial Estimates and Lojas Renner.

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Buy	Expected return above +10% in relation to the Company's sector average	**46%**
Neutral	Expected return between +10% and -10% relative to the Company's industry average	**44%**
Sell	Expected return below -10% in relation to the Company's sector average	**5%**
under Review	Under review	**5%**

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