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ESCOLA DE ADMINISTRAÇÃO DE EMPRESAS DE SÃO PAULO

Brazil Next

November 5th, 2019

RD - RAIA DROGASIL S.A.

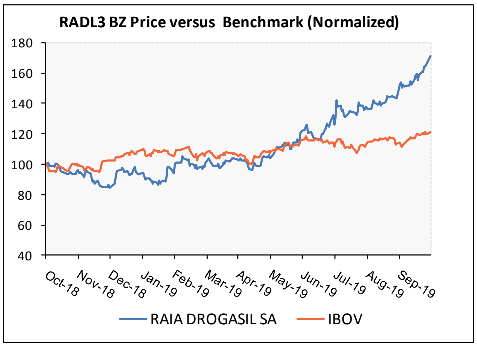
BUY

RADL3.SA, RADL3 BZ

Price (Nov 4th, 2019): R$113.8

Target Price (2019e): R$ 122.7
Target Price (2020e): R$ 134.4
Implied Upside (14-month period): 18.1%

52-Week Range: R$ 55.26 - R$ 114.60
Market Cap (Oct 31, 2019): R$37,598 MM
52-W Avg. Daily Volume: R$ 1.25MM
EPS (LTM): R$ 0.55
Dividend Yield (LTM): 0.8%
Strategy: Growth



Source: Bloomberg

Valuation	FY 18 A	FY 19 (e)	FY 20 (e)
EV/Sales	1.22x	2.44x	2.33x
EV/EBITDA	11.0x	22.2x	21.9x
P/E	37.6x	81.2x	75.9x
P/BV	5.4x	10.4x	10.2x
Dividend Yield	0.6%	0.7%	0.4%
ROE	14.9%	14.3%	15.0%

Financial Summary (R$ MM)	FY 18 A	FY 19 (e)	FY 20 (e)
Gross Revenues	15,519	18,202	20,568
Revenues Growth	*na*	*17.3%*	*13.0%*
Gross Margin	30.0%	30.0%	29.9%
EBITDA	1,711	2,007	2,195
EBITDA Margin	*11.6%*	*11.6%*	*11.2%*
Net Income	502	499	585
Net Margin	*3.4%*	*2.9%*	*3.0%*

Operating Indicators	FY 18 A	FY 19 (e)	FY 20 (e)
# of Stores	1,825	2,032	2,224
Mature Stores	64%	63%	58%
Year 3	11%	10%	10%
Year 2	11%	11%	13%
Year 1	13%	15%	19%

Source: RD / Brazil Next

Executive Summary

RD is the largest drugstore chain in Brazil. Following the merger of its two iconic, well-established main brands (Droga Raia and Drogasil) in 2011, the company has pursued an aggressive expansion strategy through both organic growth and acquisitions in mature and new markets.

RD benefits from the operating expertise in stores format and people training programs, as well as from synergies from its main brands. In 3Q19, the company reached 13.3% of market share in Brazil, with total 1,995 stores in 22 states. This figure already accounted for 42 stores acquired from CVS Health in July 2019 together with Onofre, a local specialized brand, which is currently being integrated to the platform. In October 2019, the company reached 2,000 stores and entered its 23th state (Manaus).

Investment Thesis

The company is well-known for its solid execution track record and high levels of operating cash flow generation and profitability. It has recently published an aggressive guidance of opening 240 new stores in 2020 (following a guidance of 240 new stores for 2019). In our view, short-term upside is based on:

- Same Store Sales (SSS) gains through stores base maturation, with positive near-term perspective also in mature stores due to higher economic confidence and easing in the competitive environment;
- Top-line positive *momentum*, which is likely to support solid market growth through volumes;
- Environment reflecting RD´s strategy to pressure peers (specially in generic drugs) and current positive scenario to accelerate growth and market share gains in a still very fragmented market;
- Strengthening of digital initiatives and Omnichannel strategy.

In the long term, we also see RD as the best-positioned company to benefit from the sector consolidation and from solid growth perspectives, mainly related to population aging, increase in income per capita and raise in healthcare awareness.

Key Risks

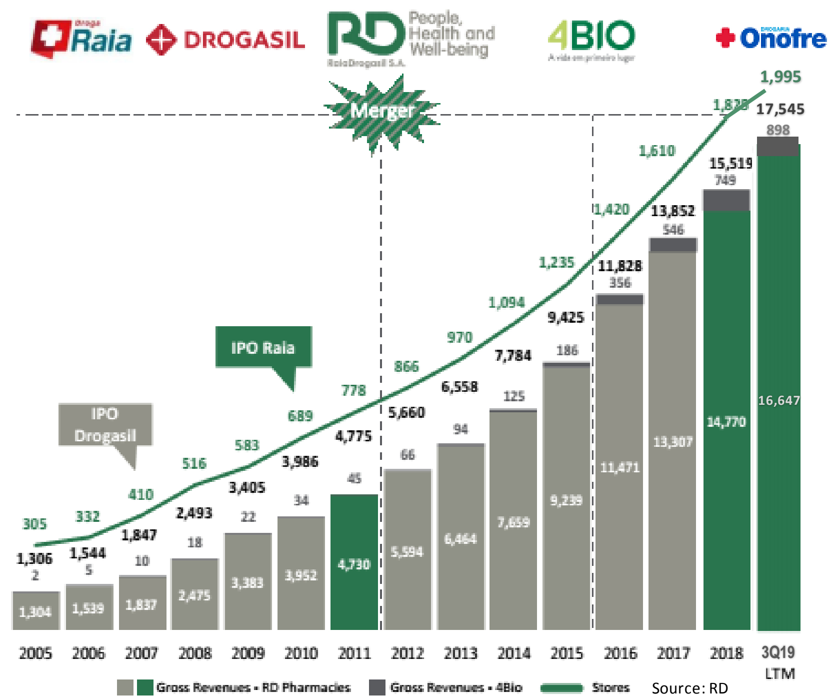
- Slower than anticipated maturation of newer stores could affect SSS, top-line and margin projections;
- The competitive environment could jeopardize expansion plans, and thus expected top-line growth and margins;
- Raise in PBMs (Drug Benefit Programs) could represent both a risk to the competitive environment and to margins;
- The government could intervene in drug prices aiming to control inflation, with negative impact on margins; and
- Prescription-Free Drugs (“MIP”) could have their sales authorized in supermarkets, potentially harming top-line projections.

Company Overview

Corporate Profile

RD is the largest drugstore chain in Brazil. Following the merger of its two iconic, well-established main brands (Droga Raia and Drogasil) in 2011, the company has pursued an aggressive expansion strategy through both organic growth and acquisitions in mature and new markets.

Combined Gross Revenues and Stores Count



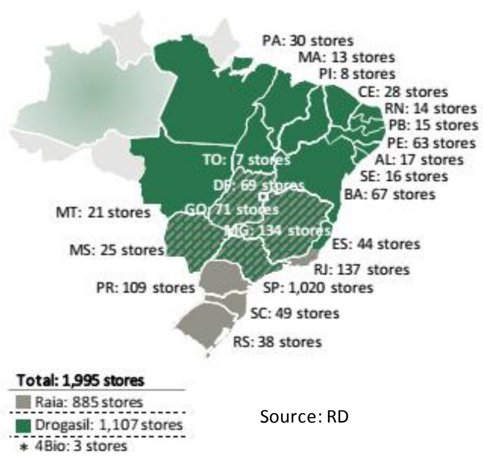
Source: RD

*Pro-Forma.

In 3Q19, the company reached 13.3% of market share in Brazil, with total 1,995 stores in 22 states. This figure already accounted for 42 stores acquired in July 2019 together with Onofre, a local specialized brand, which is still being integrated to the platform. As a subsequent event, in October 2019, the company reached 2,000 stores and entered its 23th state (Manaus).

RD is currently present in more than 350 municipalities and has around 34 million active customers.

Geographic Presence



Source: RD

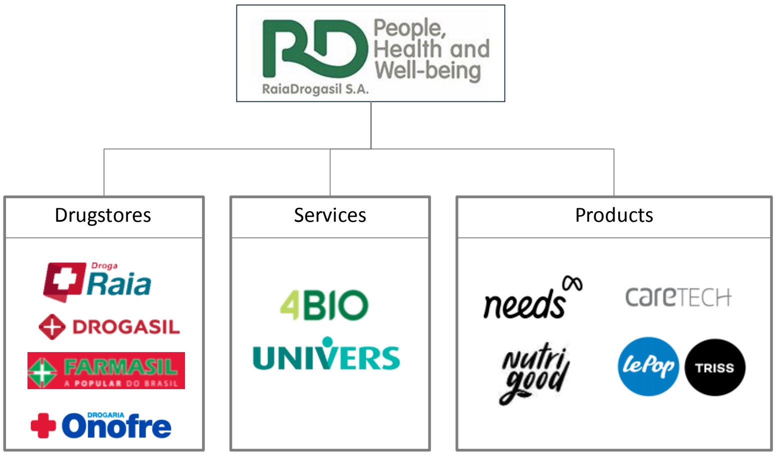
Market Share – 3Q19

RD Brand and Sub-Brands

In 2016, five years after the merger of the iconic and nationwide well-known brands Raia and Drograsil, the company announced a new corporate brand, **RD**. Although the main drugstore brands still operate separately, the joint corporate name reflected the integration of the business into a single unit, including not only drugstores (**Droga Raia**, **Drogasil**, **Farmasil**, and recently **Onofre**), but also services (such as **4-Bio**, a company focused on specialty drugs, and **Univers**, a management company for discount programs on drugs acquisition) and Product lines (such as **Needs**, **B-Well**, **Triss** and **Pluii**).

In 9M19, services sales represented less than 1% of the total sales of the company, which is mainly focused on retail business. Services represent an extension of the healthcare business in terms of loyalty and value-added to customers, strengthening and supporting the retail structure.

Product lines focus mainly in healthiness and sustainability concepts. With a lower-price positioning and appeal to consumers, they also add potential margin gains to the retail segment.



Drugstore brands are complementary and focus on different market segments, as follows:

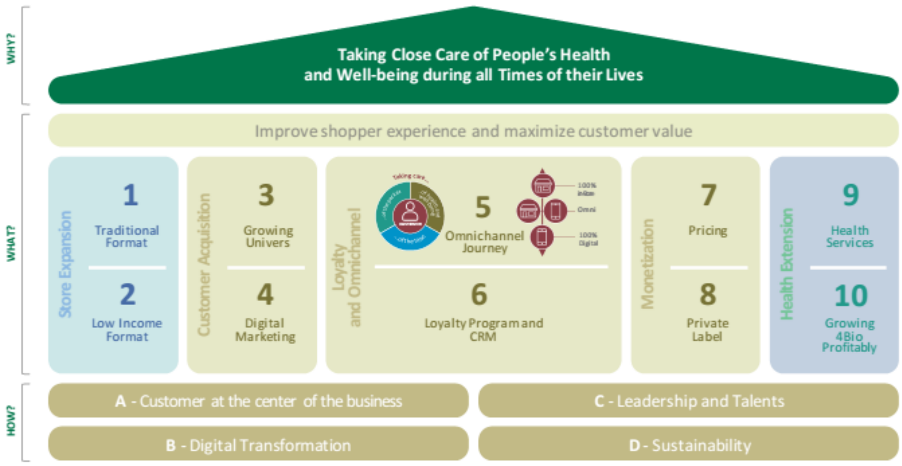
(i) **Droga Raia** – corresponds to an upscale wellness format focusing on women and families;
(ii) **Drogasil** – is a traditional drugstore brand, with focus on seniors and pharma;
(iii) **Farmasil** – corresponds to a low-cost format, aimed at lower income neighborhoods;
(iv) **Onofre** – pure-play, price-driven strategy (whereas Raia, Drogasil and Farmasil are considered to be more convenience-driven), with 45% of revenues coming from digital services – which is expected to be integrated to RD digital services and to the Omnichannel platform.

Raia Store | Drogasil Store | Farmasil Store | Onofre Store

Source: RD

Business Model

While consolidating its brands and business segments, RD has determined its purpose as "taking care of people´s health and well-being during all times of their lives". In order to accomplish this goal, the company works through several channels, among which the main reference is still the physical retail business, with different stores format and pricing positioning. Health extension services and private label products are also on the portfolio, as previously mentioned, but are not isolatedly representative in terms of revenues. Together with the physical stores, the company has been developing a digital program with potential growth perspective, in order to both retain and raise customers' base.



Source: RD

Operating Platform and Expansion Plan

The company´s current strategic expansion plan consists in combining different stores format to specific geographical regions, with support from the logistics perspective and from digital access and omnichannel, as further described.

1) Stores Format

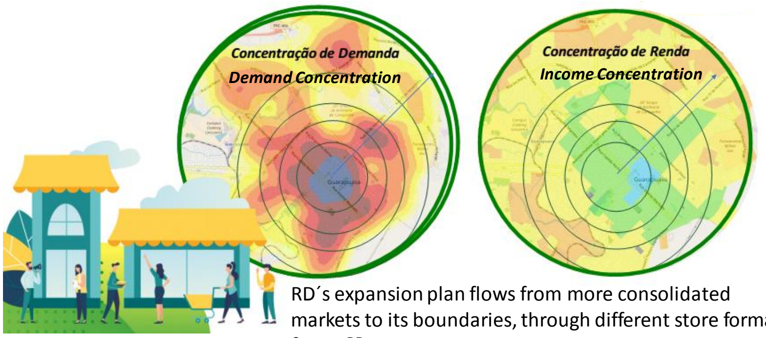
To better cater each competitive local environment, RD has recently implemented a concept of clusters for new store formats. In this regard, current stores format would be:

a) *Noble / Top* – includes premium quality products and sophisticated store design. Currently represents around 37% of the stores base;
b) *Hybrid Format* – includes a mix of premium quality and more basic products, within a less sophisticated store design. It corresponds roughly to 42% of stores;
c) *Popular* – includes a higher share of basic Health and Personal Care ("HPC", including own brands) and generic categories;
d) *Super Popular* – with 120-140 sqm, corresponds to a new format that aims to enter peripheral markets, with higher share of low-income products and generics (around 50%), aggressive promotions, low tickets and high volume of tickets. Stores design is more colorful and installation requires lower capex. The stores stay open fewer hours a day (in comparison to the previous alternatives), so that lower expenses offset potentially lower revenues, to reach similar operating results as higher-income focused stores.

Source: RD

2) Geographic diversification

In order to address its audacious expansion plan, the company has developed a geographic strategy through which it enters consolidated regions first, where income is higher and demand is concentrated, and then expand to boundary regions through adapted store formats (as previously mentioned).



RD´s expansion plan flows from more consolidated markets to its boundaries, through different store formats.
Source: RD

3) Logistics

In order to consolidate its current platform and address future needs regarding its expansion plan, RD relies on a decentralized net of eight operating warehouses and other three warehouses still to be launched (in the states of Rio de Janeiro, Ceará and São Paulo), totalizing 165,000sqm of logistics space.

Additionally, some of the largest stores in strategic geographical locations can be used as transit points to supply other smaller stores in each region.

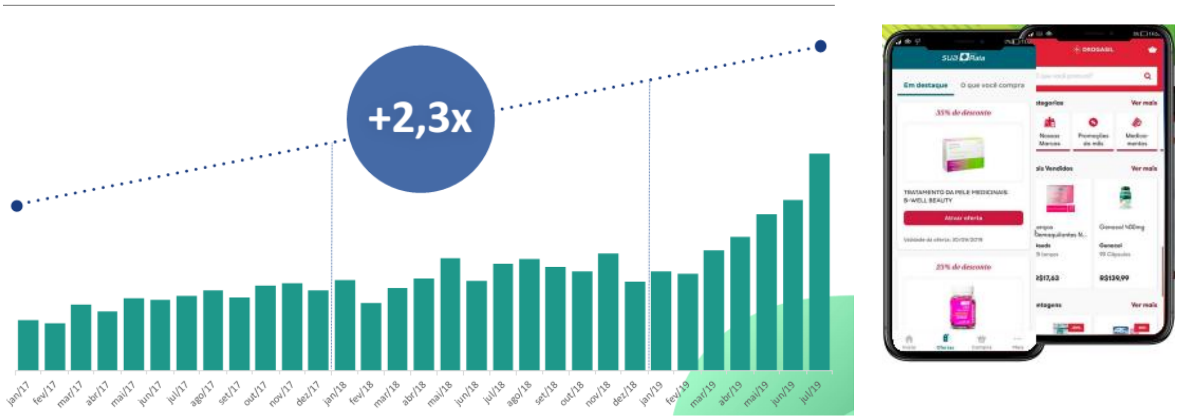
1	São Paulo (SP) Area: 18,000 m²
2	Embu (SP) Area: 22,700 m²
3	Ribeirão Preto (SP) Area: 18,500 m²
4	Aparecida (GO) Area: 15,000 m²
5	Contagem (MG) Area: 8,500 m²
6	S. J. dos Pinhais (PR) Area: 12,900 m²
7	Jaboatão (PE) Area: 10,300 m²
8	Salvador (BA) Area: 8,500 m²
9	Duque de Caxias (RJ) – to be opened in 2H19 Area: 12,100 m²
10	Fortaleza (CE) – to be opened in 2H19 Area: 10,500 m²
11	Guarulhos (SP) – to be opened in 2H19 Area: 28,000 m²

Source: RD

4) Omnichannel Strategy and Digital Initiatives

RD online demand has more than doubled from 2017 to mid-2019. The company has served more than 1 million clients through digital services in the last 12 months, with total average of 12 million accesses per month, 74% of which through mobile format. The online channel converts around 30% of visits – which could still improve.

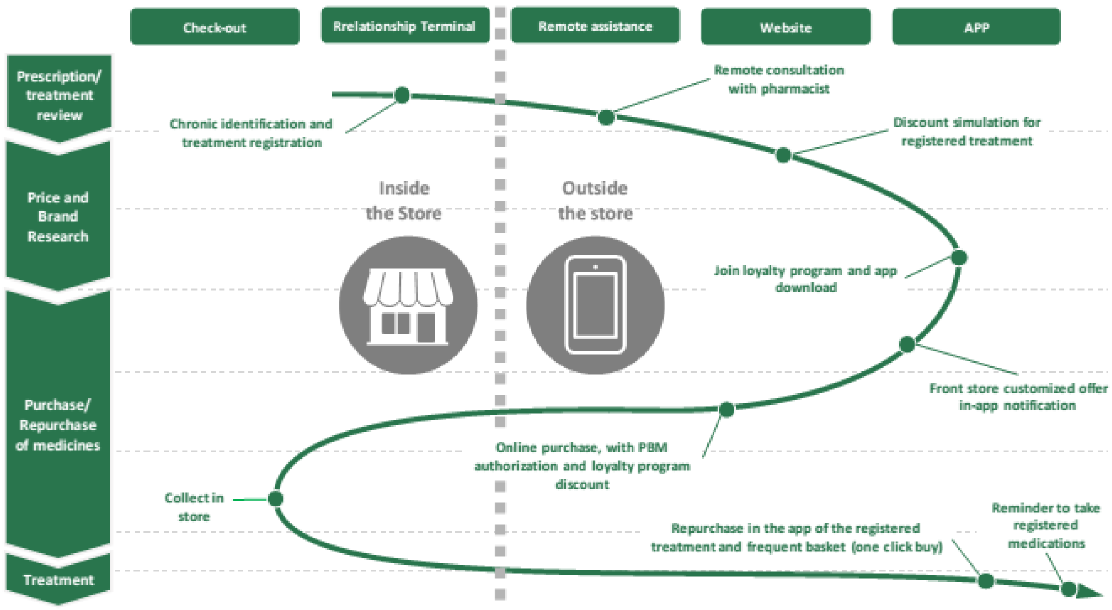
Digital Services: more than 12 million access / month



Source: RD

In order to better serve its customers and keep pace with the digital transformation scenario, the company is integrating its e-commerce platform with mobile apps and digital services to the physical structure of stores and logistics. The digital platform is expected to grow by double-digit in the next few years, and the omnichannel strategy aims to prepare the company to gather new customers from this segment, as well as to retain customers through innovative and integrated services.

In this regard, the integration of Onofre chain will be relevant, as around 45% of the brand´s sales already correspond to digital channels.

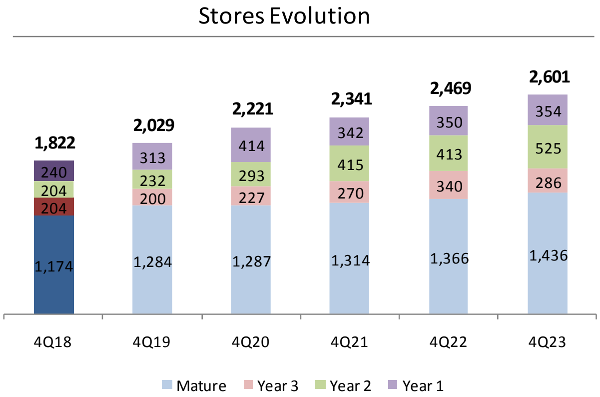


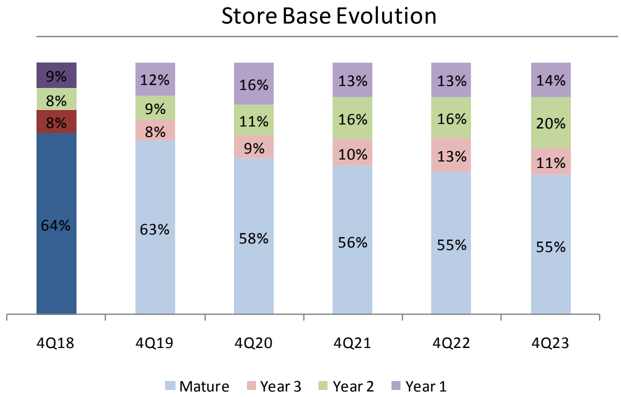
Source: RD

Investment Thesis

Store Base Maturation and Expected SSS Growth

Due to RD´s accelerated expansion plan for the upcoming years, the stores base profile is expected to be younger. For 2019, approximately 63% of stores will have reached their maturity, whereas this figure goes down to 58% in 2020 and 56% in 2021 – considering the guidance of 240 new stores in 2020 (gross) and a conservative annual expansion of 5.5% of the stores base as of 2021.

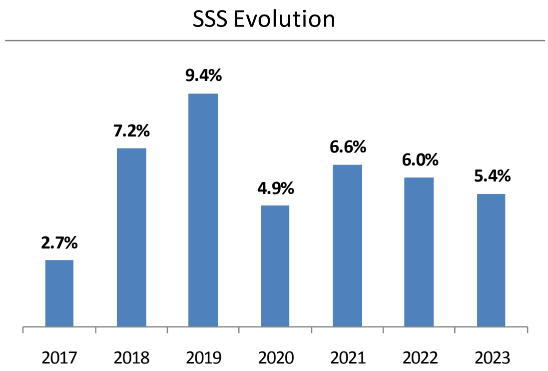


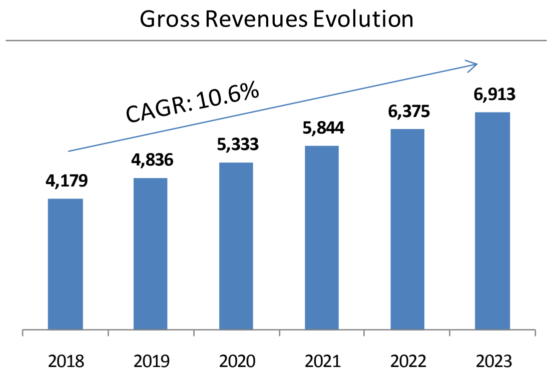


Source: Brazil Next projections

This means that a significant portion of Same Store Sales (SSS) gains will come from stores base maturation and ramp-up curve.

Additionally, near-term perspective is also positive for mature operations, with resilient growth supported by higher economic confidence and easing in the competitive environment – which are bound to contribute to the consolidated top-line six-year CAGR of 10.6%.

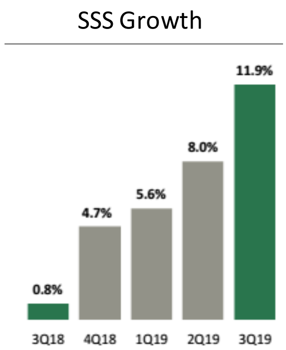


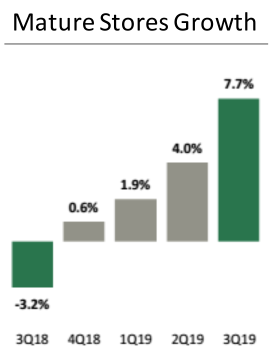


Source: Brazil Next projections

Top Line Positive *Momentum*

As mentioned, we have an optimistic view of RD´s potential sales growth for 2020, driven by the continuous recovery of the macro-economic scenario in Brazil and better competitive environment. SSS from mature stores has already surprised the market in the last few quarters, and we expect growth on mature stores to keep pace with the positive *momentum* in the next few quarters, expanding with rates above CPI (more likely in high single digit terms) and improving profitability.





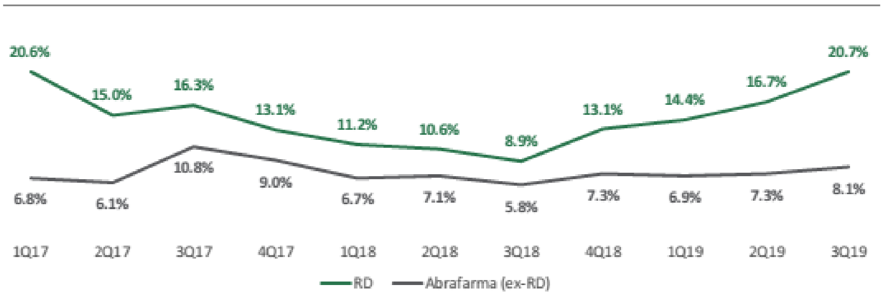
Source: RD

Strategy to pressure peers and current positive scenario to accelerate growth

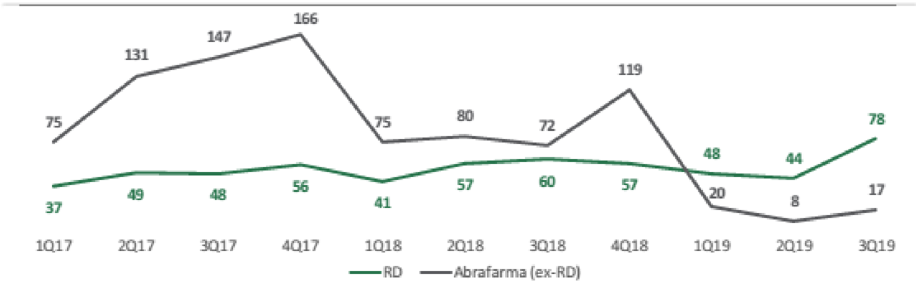
We expect RD to continue to gain market share in upcoming quarters. Despite the stepped-up competition, the company has been investing in cost leadership strategy through low prices and discounts – especially in the generics segment – in order to strengthen its competitive positioning and pressure peers and accelerate growth in the fragmented market.

The price strategy has been paying off. Revenues growth and net stores addition have actually decoupled from the industry[1] - which, together with the positive *momentum*, is a key driver for the substantiation of the company´s aggressive expansion plan.

Retail Gross Revenues – Nominal Growth (Y/Y, %)



Net Store Addition (Q/Q)



Source: RD

Long Term Growth Perspective

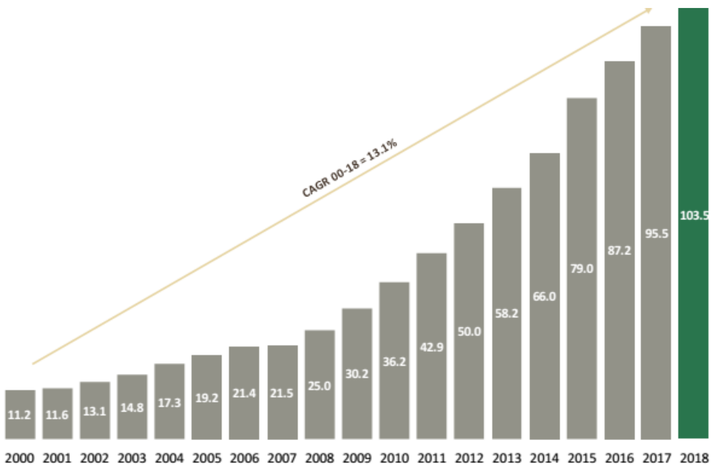
The pharmaceutical market grew significantly over the last 19 years (13.1% CAGR), backed on: (i) raise of per capita income in Brazil and outgrowth of the so-called middle-income class (families with monthly wage from R$2,000 to R$8,640, according to FGV Social); (ii) governmental programs against patents (such as the generics implementation), which granted access to the lower-income population to light-treatment drugs; (iii) improvement of communication media and raise of health awareness; and (iv) aging of the population.

In this regard, the senior population in the country is expected to escalate from 19 million to 34 million over the next 15 years, which should keep the sustainable top-line growth for the pharmaceutical segment. As the major player in Brazil, with presence in 23 states and with substantial operating know-how, we believe RD is the best-positioned company to benefit from the expected segment growth.

[1] Abrafarma corresponds to the Brazilian Association of Pharmacy and Drugstore Networks, which consolidates the industry main figures.

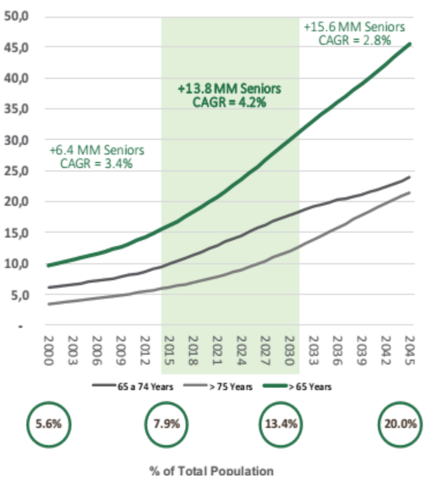
Pharmaceutical Market Growth

R$ Billion



Brazilian Population Above 65 Years Old

Million People



Source: RD / World Bank

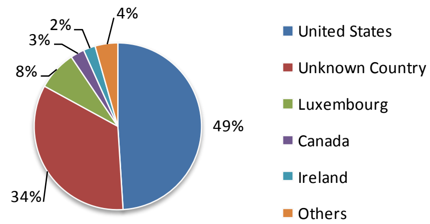
RD Financial Analysis and Valuation

Share Structure and Price Performance

Regarding its share structure, the company is listed at *Novo Mercado*, the segment with the highest level of corporate governance guidelines in the Brazilian stock exchange. Free float corresponds to 69.6% of outstanding shares, with main investors from the US (49%).

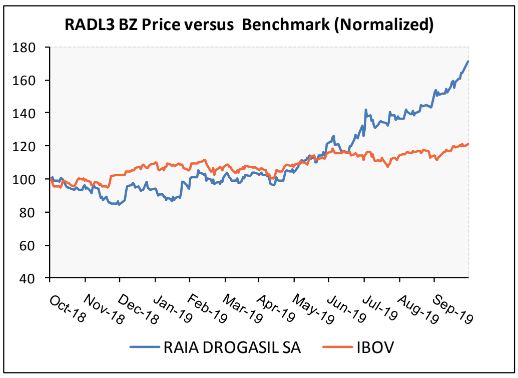
Ownership Statistics	
Shares Outstanding (M)	330.4
Float	69.6%
Days to Cover Shorts	9.33
Ownership (Institutional)	59.84%
Ownership (Retail & Other)	31.96%
Ownership (Insider)	8.20%

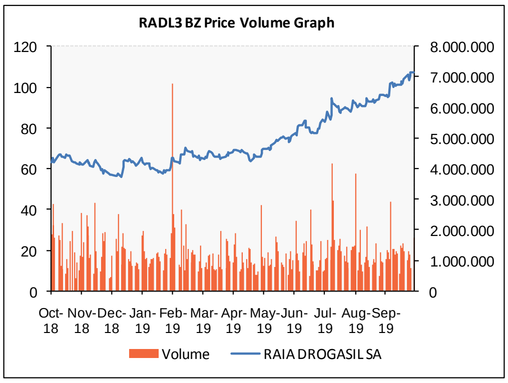
Geographic Ownership



Source: Bloomberg

In terms of performance, RD has surpassed the benchmark (IBOV) in the last 5 months, mainly backed by good top-line *momentum*, and by the approval of Onofre acquisition (from CVS). Based on our analysis, we understand that, although much of the expansion strategy of the company comes from organic growth, strong cash generation in the next few years can represent an opportunity for M&A transactions, which points towards a significant upside in a highly fragmented market.





Source: Bloomberg

Financial Analysis Main Assumptions

For our valuation of RD, we have projected a five-year explicit period – until 2023, - as displayed in the summary of financials.

Gross Revenues

As a base-case scenario for our target-price calculation, we have used a conservative modeling projection, which disregarded:

- *SSS growth above inflation*. No real growth per square meter was considered for either stage of maturity: both mature and ramping-up stores top-line growth considered only the projected CPI (IPCA)[2]. Top line growth in our model is coming only from store base expansion and maturation curve;

- *Potential growth coming from services and product lines.* As the services business is still not representative in terms of top line (less than 1% of total revenues) and both services and product lines work more as a lever to the retail business, we have not considered any upsides from these segments;

- *Potential synergies coming from the recently acquired Onofre´s operations*. Synergies could reach around R$150 million, considering the integration of the platform with current operations, including negotiation with labs and sales force. This amount was not considered in our base-case scenario. All 42 stores from Onofre, added as of 3Q19, were considered as "Year 1" maturation stage stores, as the brand will undergo a turnaround process in order to reach RD´s comparable profitability;

- *Potential future M&A transactions*. Only organic growth was considered, although M&A transactions could accelerate revenues growth; and

- *Potential market share gain coming from the Omnichannel operations*. Although the platform is expected to grow by double digit in the next few quarters and we believe in the digital improvements as a key driver for RD´s future growth, the company still does not provide any breakdown of digital figures – so that current projections did not consider any revenues or profitability upsides from this channel

Operating Leverage and SG&A Dilution

As a base-case scenario for our target-price calculation, we have also used a conservative modeling projection, which disregarded potential gross margins improvements and SG&A dilution from gains of scale, keeping a flat degree of operating leverage for 2019 (compared to 2018) and even raising it afterwards (as follows).

Operating Leverage	FY 18 A	FY 19 (e)	FY 20 (e)	FY 21 (e)	FY 22 (e)	FY 23 (e)
Gross Profit	4,446	5,200	5,866	6,433	7,036	7,644
SG&A	2,734	3,193	3,671	4,067	4,436	4,840
Degree of Operating Leverage	2.60x	2.59x	2.67x	2.72x	2.71x	2.73x

Source: Brazil Next projections

Given RD´s strong expansion plan, as an upside, we could expect EBITDA margin expansion to come from operating leverage, both from gross margin gains from scale and better negotiation with suppliers, and from diluting SG&A.

Valuation

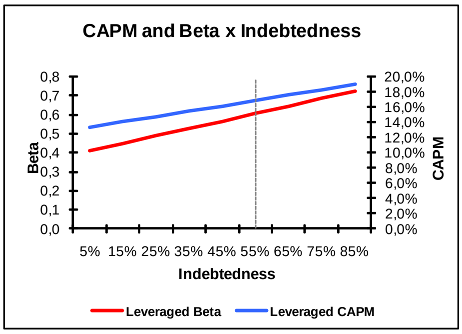
RD was valued through a discounted cash flow model (FCFF). The beta was estimated using the last twelve months (0.61). As for the capital structure, we have already considered in our projections the effect of IFRS16 – under which we believe a 55% structure (debt to capital) is adequate to the retail

[2] The projections considered the Brazilian Central Bank´s *Sistema Expectativas* ("Expectation System"), available at: <https://www3.bcb.gov.br/expectativas/publico/consulta/serieestatisticas>, access on Oct. 25 2019.

business. The WACC obtained given this scenario was 9.83%, which we consider to be an adequate risk level for current Brazilian scenario and for RD.

Beta (LTM)	0.61
Unleveraged Beta	0.3909

Indebtedness	Leveraged Beta	Leveraged CAPM	WACC
05% D / 95% E	0.4104	13.32%	12.89%
15% D / 85% E	0.4495	14.03%	12.63%
25% D / 75% E	0.4886	14.74%	12.22%
35% D / 65% E	0.5277	15.44%	11.68%
45% D / 55% E	0.5668	16.15%	10.99%
55% D / 45% E	**0.6059**	**16.86%**	**10.16%**
65% D / 35% E	0.6450	17.57%	9.19%
75% D / 25% E	0.6841	18.28%	8.08%
85% D / 15% E	0.7232	18.99%	6.83%



Source: Brazil Next projections

In the base-case scenario, we have reached a target-price of R$122.7/share in 2019 and R$134.4/share in 2020. We believe that at the current share price of R$113.8 (as of November 4th, 2019), the stock could offer significant near-term upside in 2019-2020 (in the 14-month period, up to 18.1%), with low downside risk.

Upside Scenarios Analysis

As our model construction was conservative in terms of assumptions, we have simulated scenarios where the main quantifiable upside events occur.

In this regard, as mentioned, both mature and ramping-up stores sales growth considered only the projected CPI (IPCA), with no real gross revenues increase per square meter. Theoretically, increase in mature stores sales/sqm would come from changes in store design or in product mix (which was disregarded), whereas in ramping-up stores would come from maturation. However, following the positive *momentum* observed in the last few quarters in mature stores SSS (much above the inflation rate), we could consider a 7% SSS for mature stores (in line with 3Q19) in the next three quarters – which leads to a target-price of R$125.0/share in 2019 and R$137.0/share in 2020.

Additionally, potential synergies from Onofre´s platform consolidation – which were not considered in our projections – could add around 30bps of EBITDA margin as of 2020, with relevant gains in ROE (300bps from the previous scenario), also raising target prices to R$133.3/share and R$145.9/share in 2019 and 2020, respectively.

Scale gains and SG&A dilution were neither considered in our conservative base-case model, although they could add other 30bps of EBITDA margin as of 2020, with target prices moving up to R$141.5/share and R$155.0/share in 2019 and 2020, respectively – an implicit upside potential of 36.2% for the next 14 months.

Downside perspectives will be explicitly explored in the Key Risks section of this document.

Base-Case Scenario

Financial Summary (R$ MM)	FY 18 A	FY 19 (e)	FY 20 (e)
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EBITDA Margin	*11.6%*	*11.6%*	*11.2%*
Valuation	**FY 18 A**	**FY 19 (e)**	**FY 20 (e)**
Target Price	na	122.7	134.4
P/E	37.6x	81.2x	75.9x
ROE	14.9%	14.3%	15.0%

7% of SSS for Mature Stores in the next 3 quarters

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Gross Margin	*30.0%*	*30.0%*	*29.9%*
EBITDA	1,711	2,016	2,235
EBITDA Margin	*11.6%*	*11.6%*	*11.2%*
Valuation	**FY 18 A**	**FY 19 (e)**	**FY 20 (e)**
Target Price	na	125.0	137.0
P/E	37.6x	81.8x	75.3x
ROE	14.9%	14.5%	15.4%

Synergies from Onofre´s Platform (R$150MM)

Financial Summary (R$ MM)	FY 18 A	FY 19 (e)	FY 20 (e)
Gross Revenues	15,519	18,232	20,892
Gross Margin	*30.0%*	*30.0%*	*29.9%*
EBITDA	1,711	2,016	2,385
EBITDA Margin	*11.6%*	*11.6%*	*12.0%*
Valuation	**FY 18 A**	**FY 19 (e)**	**FY 20 (e)**
Target Price	na	133.3	145.9
P/E	37.6x	87.2x	66.9x
ROE	14.9%	14.5%	18.4%

Gains of Scale and SG&A Dilution

Financial Summary (R$ MM)	FY 18 A	FY 19 (e)	FY 20 (e)
Gross Revenues	15,519	18,232	20,892
Gross Margin	*30.0%*	*30.0%*	*29.8%*
EBITDA	1,711	2,016	2,449
EBITDA Margin	*11.6%*	*11.6%*	*12.3%*
Valuation	**FY 18 A**	**FY 19 (e)**	**FY 20 (e)**
Target Price	na	141.5	155.0
P/E	37.6x	92.6x	66.3x
ROE	14.9%	14.5%	19.7%

Source: Brazil Next Projections

RD: Summary of Financials – Base-Case Scenario

In R$ millions, Fiscal Year End in Dec.

Income Statement	FY 18 A	FY 19 (e)	FY 20 (e)	FY 21 (e)	FY 22 (e)	FY 23 (e)
Gross Revenues	**15,519**	**18,202**	**20,568**	**22,599**	**24,716**	**26,852**
Taxes / Discounts	(718)	(842)	(951)	(1,045)	(1,143)	(1,242)
Net Revenues	**14,801**	**17,360**	**19,617**	**21,554**	**23,573**	**25,610**
Revenues Growth	-	*17.3%*	*13.0%*	*9.9%*	*9.4%*	*8.6%*
COGS	(10,356)	(12,160)	(13,752)	(15,120)	(16,537)	(17,966)
Gross Profit	**4,446**	**5,200**	**5,866**	**6,433**	**7,036**	**7,644**
Gross Margin	30.0%	30.0%	29.9%	29.8%	29.8%	29.8%
SG&A	(2,734)	(3,193)	(3,671)	(4,067)	(4,436)	(4,840)
Depreciation	(899)	(1,096)	(1,238)	(1,360)	(1,488)	(1,616)
Other Operating Rev./Exp.	-	-	-	-	-	-
EBIT	**812**	**911**	**957**	**1,006**	**1,112**	**1,188**
EBIT Growth	-	*12.2%*	*5.0%*	*5.1%*	*10.6%*	*6.8%*
EBIT Margin	*5.5%*	*5.2%*	*4.9%*	*4.7%*	*4.7%*	*4.6%*
Financial Income/Exp.	(184)	(287)	(225)	(283)	(318)	(335)
EBT	**628**	**624**	**731**	**723**	**794**	**852**
Income Tax	(126)	(125)	(147)	(145)	(159)	(171)
Net Income	**502**	**499**	**585**	**578**	**635**	**682**
Net Income Growth	-	*-0.5%*	*17.2%*	*-1.2%*	*9.9%*	*7.3%*
Net Income Margin	*3.4%*	*2.9%*	*3.0%*	*2.7%*	*2.7%*	*2.7%*
EBITDA	**1,711**	**2,007**	**2,195**	**2,366**	**2,600**	**2,804**
EBITDA Growth	-	*17.3%*	*9.4%*	*7.8%*	*9.9%*	*7.8%*
EBITDA Margin	*11.6%*	*11.6%*	*11.2%*	*11.0%*	*11.0%*	*10.9%*

Cash Flow Statement	FY 18 A	FY 19 (e)	FY 20 (e)	FY 21 (e)	FY 22 (e)	FY 23 (e)
Net Income	**502**	**499**	**585**	**578**	**635**	**682**
Depreciation	899	1,096	1,238	1,360	1,488	1,616
Changes in Working Capital	(561)	(235)	(256)	(138)	(137)	(107)
Cash Flow From Operations	**841**	**1,360**	**1,567**	**1,801**	**1,986**	**2,191**
Cash Flow From Investments	**(703)**	**(848)**	**(889)**	**(603)**	**(555)**	**(763)**
Changes in Debt, net	598	147	(30)	(182)	(139)	(44)
Dividends	(174)	(125)	(146)	(144)	(159)	(170)
Cash Flow from Financing	**424**	**22**	**(177)**	**(326)**	**(298)**	**(215)**
Net Change in Cash	**562**	**534**	**502**	**871**	**1,134**	**1,213**
Cash at Beginning of Period	274	242	775	1,277	2,148	3,282
Cash at the End of Period	242	775	1,277	2,148	3,282	4,495

Balance Sheet	FY 18 A	FY 19 (e)	FY 20 (e)	FY 21 (e)	FY 22 (e)	FY 23 (e)
Cash	242	775	1,277	2,148	3,282	4,495
Accounts Receivable	937	1,156	1,306	1,435	1,569	1,705
Inventories	3,087	3,253	3,679	4,045	4,424	4,806
Other Current Assets	263	317	381	458	551	663
Total Current Assets	**4,530**	**5,501**	**6,643**	**8,087**	**9,827**	**11,669**
Net PP&A (considering IFRS16)	4,960	4,911	4,757	4,117	3,306	2,576
Net Intangibles	1,202	1,247	1,247	1,247	1,247	1,247
Other Long Term Assets	72	72	72	72	72	72
Total Assets	**10,764**	**11,731**	**12,719**	**13,522**	**14,452**	**15,565**
Short Term Debt	273	91	182	139	44	-
Leasing (IFRS 16)	514	558	587	605	623	642
Accounts Payable	2,141	2,233	2,481	2,746	3,008	3,273
Other Current Liabilities	470	581	717	886	1,094	1,352
Total Current Liabilities	**3,399**	**3,463**	**3,967**	**4,376**	**4,770**	**5,267**
Long-Term Debt	570	899	778	639	594	594
Leasing (IFRS 16)	2,997	3,153	3,319	3,418	3,522	3,627
Other Liabilities	310	310	310	310	310	310
Total Liabilities	**7,276**	**7,824**	**8,373**	**8,743**	**9,196**	**9,798**
Shareholder´s Equity (Net)	**3,488**	**3,907**	**4,346**	**4,779**	**5,256**	**5,767**
Liabilities + Equity	**10,764**	**11,731**	**12,719**	**13,522**	**14,452**	**15,565**
Net Debt (Disregarding IFRS 16)	602	215	(317)	(1,371)	(2,643)	(3,901)
Net Debt / Ebitda	0.35x	0.11x	-0.14x	-0.58x	-1.02x	-1.39x
Debt / Equity	24.2%	25.3%	22.1%	16.3%	12.2%	10.3%
Debt / Total Capital	19.5%	20.2%	18.1%	14.0%	10.8%	9.3%
Net Debt (with IFRS 16)	4,113	1,082	580	(456)	(1,710)	(2,949)
Net Debt / Ebitda	2.40x	0.54x	0.26x	-0.19x	-0.66x	-1.05x
Debt / Total Capital	55.5%	54.6%	52.8%	50.1%	47.7%	45.8%

Valuation	FY 18 A	FY 19 (e)	FY 20 (e)	FY 21 (e)
EV/Sales	1.22x	2.44x	2.33x	2.28x
EV/EBITDA	11.0x	22.2x	21.9x	21.8x
P/E	37.6x	81.2x	75.9x	84.7x
P/BV	5.4x	10.4x	10.2x	10.2x
Dividend Yield	0.6%	0.7%	0.4%	0.3%
ROE	14.9%	14.3%	15.0%	13.3%

Source: RD / Brazil Next Estimates

Key Risks

Slower than anticipated maturation of newly opened stores could affect SSS, top-line and margin projections

As the expansion plan of RD mainly relies on organic growth, slower maturation of new opened stores could significantly drag down RD´s growth perspective in terms of revenues, margins improvement and ROI. RD will inevitably face this risk. The largest the portfolio gets, the more difficult it will become for the company to search for ideal locations regarding accessibility, growth potential and competitiveness.

In this sense, RD has recently developed strategies to penetrate new markets, such as amplifying its spectrum of store formats, changing product mix and adding sales promotions. However, the fast pace of expansion, combined with new formats and mix operation and potential local competition from players that might be more used to operating in such markets may also lead to slower than anticipated maturation of newly opened stores – which could affect our projected SSS and top-line growth, as well as the company´s profitability.

The competitive environment could jeopardize expansion plans, and thus expected top-line growth and margins

RD operates in the high-growth drugs and pharmaceutical segment, within a fragmented market, driven by the increasingly aging population and rising medical spending average in Brazil. Nevertheless, the fragmented market still attracts significant store opening activities by both established competitors and new entrants.

Although RD has been very successful in its expansion plan and in its strategy of pressuring peers to gain market share, the concern with increasing competition from either large pharmaceutical companies and smaller local players could challenge RD's expansion strategy, as well as jeopardize top line growth.

Under the fierce competition, RD may need more capital from the market in order to expand, which could raise the financial leverage and its cost of capital. Additionally, the continued strategy of gaining market share through price pressure could affect profitability. Eventual stronger competition could lead to a war price in the segment, thus harming the company´s margins.

Raise in PBMs (Drug Benefit Programs) could represent a risk to either the competitive environment and to margins

PBMs are programs from the pharmaceutical industry that provide consumers with discounts for frequently-used drugs. Through these programs, over 3,000 drugs offer discount to consumers, including both branded and generic medicines. In 2018, more than 110 million units (boxes) of medicine were sold under PBMs; for 2019, the Brazilian Association of PBM Operators (PBMA) estimates that drug units sold under BPM will grow 15%, driven by the increasing popularization of the concept and confidence in this market – so that projected sales can reach 125 million units in 2019.

Until recently, PBMs were practically restricted to drugstores from large corporate networks, as pharmaceutical industries which made it difficult to register independent, smaller or local pharmacies.

Nowadays, several new initiatives – such as digital cooperation – are turning the programs available to a broader range of independent players.

The easier access to discounts in daily-use medicines could pressure the competitive environment and partially hinder the ability of larger networks, such as RD, to attract customers to its drugstores. Additionally, in order to compete with the local players and penetrate new markets, RD could have to low prices, thus affecting margins.

The government could intervene in drug prices aiming to control inflation, with negative impact on margins

Many items of public interest (i.e. utilities, health insurance, freight and concession tolls) have their pricing policies regulated by the Brazilian Federal government. In this regard, pricing for regulated segments does not follow market trends of supply and demand, as administrated prices are used as a government monetary tool to regulate inflation.

Although such model is believed to turn the aggregate economic system more efficient, it is also criticized as it may lead to negative effects on the operation of specific industries and consumer markets.

The rules for price adjustment of medicines were created in 2003. The Brazilian Chamber for Medicine Regulation Markets (CMED) yearly establishes the criteria for drugs price adjustment based on different factors, including CPI (IPCA), variations of exchange rate and electricity, among others, which set a ceiling for medicine price increase per year – which may prevent the company from completely passing on prices, thus leading to negative impacts on margins. As a mitigating aspect, however, in a low inflation scenario perspective, it is easier for retailers to pass on prices.

In this regard, according to the Brazilian Central Bank survey (Focus), current trend for the CPI (IPCA) is 3.29% for 2019 and 3.6% for 2020, thus within the limits proposed by the Central Bank Committee, but below the targets of 4.25% and 4.00%, respectively. Such economic scenario, allied to the fact that the federal government follows right-winged political views, turns the possibility of further intervention on drugs prices unlike in the short-to-medium term.

Projection Date	2019	2020	2021	2022	2023
10/25/2019	3.29%	3.60%	3.75%	3.50%	3.50%

Source: Brazilian Central Bank

Year	Resolution	Date of Resolution	Target	Deviation	Limits
2019	Resolution 4,582	6/29/2017	4.25	1.5	2.75-5.75
2020	Resolution 4,582	6/29/2017	4.00	1.5	2.5-5.5
2021	Resolution 4,671	6/26/2018	3.75	1.5	2.25-5.25
2022	Resolution 4,724	6/27/2019	3.50	1.5	2.00-5.00

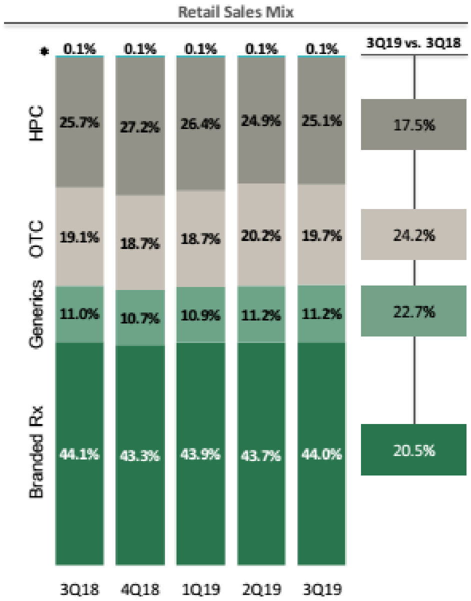
Source: Brazilian Central Bank

Prescription Free Drugs ("MIP")[3] could have their sales authorized in supermarkets

In 2018, the Law project 9482/2018, which aimed to authorize the sale of MIP in supermarkets, was processed by the Lower Chamber, but filed after the government´s Social Security and Family Commission exposed certain risks that such a measure could cause to public health – such as the raise in self-medication.

In 2019, a new Law project (1774/2019) aiming to sell MIP in supermarkets is being analyzed by the Social Security and Family Commission and, if approved, might undergo through the Lower Chamber process. The project aims to facilitate the access to drugs used in low severity diseases treatment.

In the last five quarters, generics represented around 11% of the retail sales mix, whereas OTC represented from 19% to 20% - which means that, in a worst-case scenario, around 30% of total retail sales could be potentially affected.



Source: RD

Disclaimer

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PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.

[3] Translation Note: *Medicamentos Isentos de Prescrição*. These drugs generally correspond to products designed to treat headaches, stomach acidity, fever, cough, sore throat and inflammation, diaper rash, constipation, nasal congestion, cold and flu symptoms, among other common disorders.