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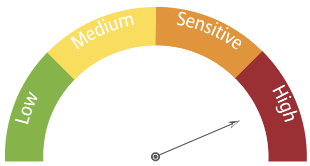
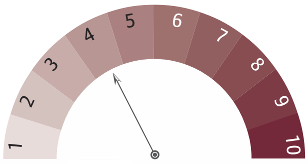
Retail in Brazil

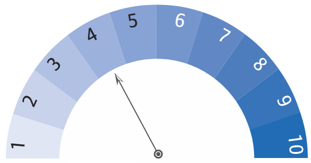
No more beginners' luck



Retail Non-Payment Risk
(Q1 2017)



Digital Pressure



Digital Potential

- **Retail sales are slipping into negative territory as Brazil goes out of recession because of the soaring unemployment rate. Given the poor consumption prospects, the situation is not set to improve in 2017.**
- **Brazilian retailers' financial standing dramatically deteriorated over the last two years. Net gearing (indebtedness) climbed to 110% in 2016, up from +70% in 2014.**
- **Apparel and food & drugs have shown resilience while electronics is most at risk starting 2017 with a staggering indebtedness of 300% and profits at a low 2.9%.**

Out of recession, not yet out of the woods

For the first time in more than a decade, real retail sales slipped into negative territory in mid-2015. The almost doubling of the unemployment rate, from less than 7% starting 2015 to nearly 12% at the end of 2016, was the main reason for consumers' reduced appetite for shopping. Consumer confidence sharply declined at the end of 2016. The political uncertainty is likely to intensify ahead of 2018 and the next Presidential election. Therefore, in spite of the exit from recession and recovering consumer spending (+0.3% in 2017, +2.3% in 2018), the outlook remains gloomy for the Retail sector.Furthermore, Brazilian consumers show a moderate appetite for e-retail. Despite 127 mobile subscriptions per 100 inhabitants in 2015 (+8% y/y), only 35% of consumers are e-shoppers, of whom only 14% use their mobile phones for purchases. Thus, omni-channeling is yet to become the strategy of choice. Consumers prefer bargain-hunting and prioritize essential products, be it via an online or physical channel. One successful way to serve customers' needs could be an online-to-offline (O2O) approach, which combines e-shopping with brick-and-mortar. This strategy could appeal to Millennials, who account for a third of the population as of 2016.

Tackle (infra)structural deficiencies first, then proceed to digital

The 2015-16 economic recession has dramatically affected Brazilian retails. All financial indicators have worsened since 2014, with net gearing (indebtedness) up to 110% (+40pp from 2014), solvency yielding -3pp down to 40% and EBIT (profits) down to 12.3% from 14% in 2014. Euler Hermes' a non-payment risk rating stands at High.

Brazilian retailers' perception of top challenges in the longer run, includes the following top priorities: (#1) the costs of online migration and presence, (#2) tapping into big data, (#3) integrating new payment methods. Brazil is yet to join the global trend toward integration and ecosystems. Most retailers outsource fleets and even resort to dispatching centers to lower fixed costs.

The country suffers from poor logistic efficiency, a weakness illustrated by the decline in productivity growth from 1.8% in 1990-2001 to 0.2% in 2002-2011. This structural limitation hinders retailers' ability to benefit from a strong business model and invest in innovative activities.

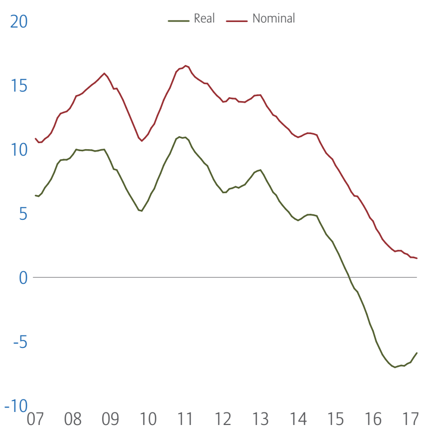
Looking forward: What does it all mean for businesses?

The strained financial situation impacts firms and customers' ability to embrace digitalization. The best strategy retailers have going forward is to finance efficient investment, skip the laptop/desktop stage and move directly to m-retail.

✓ Promising sub-sectors: Fashion and food were the top performers with indebtedness level of 64% and 32% and EBIT reaching 10% and 3% in 2016, respectively.

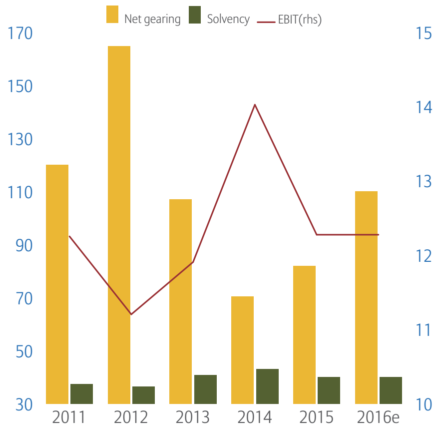
✓ Sensitive sub-sectors: The electronics sub-sector has taken a hit: net gearing peaked at 300% and profits were at a low 2.9%. ■

Chart 1 Retail sales in Brazil
in %, 12m/12m, as of March 2017



Sources: IHS, Euler Hermes calculations

Chart 2 Financial performances of Brazilian listed retailers



Sources: Bloomberg, Euler Hermes calculations