

Wholesale Trade Distributor in Brazil: resilience heroes

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Executive summary

- Although at slower pace, both wages and credit expansion are supporting the sector favorable performance
- Northeast Region in spot light due to their economic performance above National average
- The food inflation continues to encourage consumer migration from supermarkets to cash and carry stores
- Complex tax rules among states, logistical bottlenecks, and limited bargaining power, making harder distributor's life

Sector performance in Brazil:

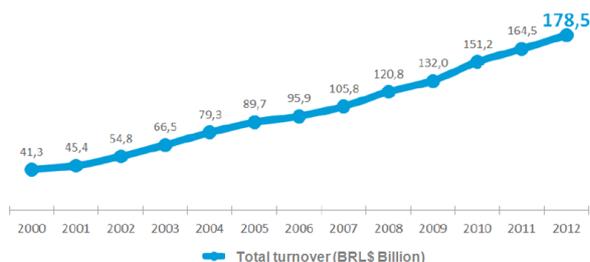
Wholesale Trade Distributors reached BRL\$ 178.5 billion turnover in 2012, a nominal growth of 8.5% year over year and 2.5% in real term YoY - deflated by the National Consumer Price Index (IPCA) of the Brazilian Institute of Geography and Statistics (IBGE) - according to the Brazilian Association of Wholesalers and Distributors (ABAD) released with Nielsen in their '2013 ranking.

The performance of the Wholesale Trade and Distributor sector proved to be favorable in comparison with performance below expectations of Brazilian GDP in 2012, which has just been revised from 0.9% to +1%. Important to mention that the Brazilian Industrial Production posted a 2.7% decrease in 2012 and reaching the worst performance recorded since the crisis peak in 2009.

However, the performance of the Wholesale Trade and Distributor sector was lower than Supermarket sector, which closed the year 2012 with real growth of 5.30% in T/O, according to the Brazilian Supermarkets Association (ABRAS).

The credit volume to consumers expanded at slower pace +16.2% in 2012, (+19% in 2011 and +20.6% in 2010), according to Brazilian

Chart 1: Wholesale Trade Distrutor sales performance



Source: Ranking ABAD Nielsen 2013 and Estrutura do Varejo Brasileiro Nielsen

Central Bank, that combined with high inflation scenario and weaker consumption disposal resulted in a challenging environment for 2013.

'2013: adjustment year, preparing for a better shape in '2014

Although IPCA inflation showed a slight improvement in 2012, it still ended very high +5.84% YoY, leaving the exact and uncomfortable value of 6.5% recorded in 2011, identical to the ceiling of the inflation target. Undoubtedly, the villain of inflation was the food and beverages group, which rose 9.86% in 2012; up from 7.18% recorded in 2011, and became the Government's main target due to its 23.93% representativeness in the families' budget, according to IBGE.

During 2013, the government took some measures such as the creation of Public Food Stocks Council of Ministers - in late February - to consolidate an "integrated policy" to strive against inflation via F&B inventory management, defining the conditions for the acquisition and release of public stocks. The board, composed of ministers Mendes Ribeiro (Agriculture), Gleisi Hoffmann (Chief of Staff), Nelson Barbosa (Deputy of Finance) and Pepe Vargas (Agricultural Development), which have estimated F&B inflation for '2013 in the same level of '2012 between 9% and 10%.

In early March 2013, President Dilma Rousseff announced tax exemption to basic food basket, related to the following federal taxes: Social Integration Program (PIS) and Contribution for Social Security Financing (COFINS), bringing a new look to an instrument normally used to stimulate the economy that was used also to contain inflation. The tax exemption on basic food basket would relieve the IPCA by 0.4 percentage points. The average price reduction was estimated by the government at 6.5%, and tax resigns of BRL\$ 3.6 billion to federal revenue.

The government planned to achieve a more comprehensive package of federal and state taxes exemption, but the lack of consensus among states for the unification of Tax on Circulation of Goods and Services (ICMS), limited the role of the federal government.

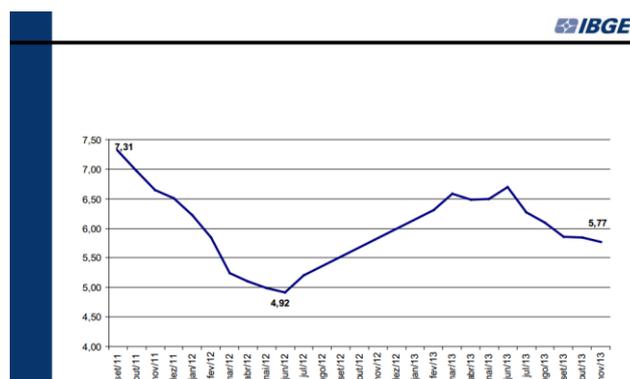
In April 2013, the government has exempted the Common External Tax (TEC) from wheat imports outside Mercosul, to hold rising prices of wheat flour, and french bread that represented a tax waiver of BRL\$ 77.5 million, according to calculations by the National Supply Company (Conab).

The latest inflation data - as of November, 2013 -, indicate that the food and beverages group reached 8.63% in 12 months accumulated. The indicator remains high, despite government efforts, however, the outlook for early 2014 are favorable, due to the high base of comparison, see chart 3.

Cash and Carry & Distribution: distinct and complementary performances

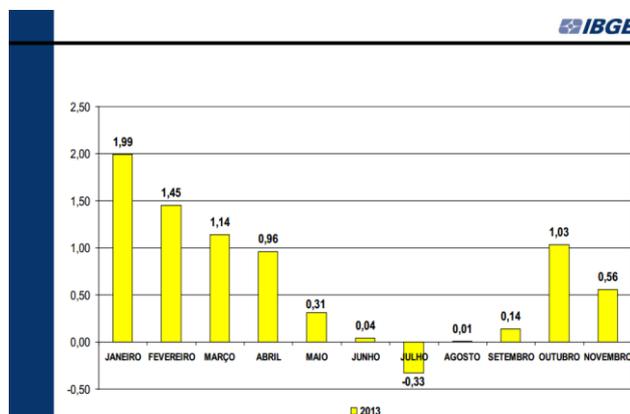
While the Wholesaler Distributor segment grew 8.5% in '2012 over '2011 - in nominal terms -, the Cash and Carry segment was estimated amongst 15% and 17% on the same basis, according to Brazilian Association of

Chart 2: IPCA inflation (12 months accumulated)



Source: IBGE

Chart 3: Monthly variation on F&B group during 2013



Source: IBGE

Table 1: Monthly var. and 12 months accumulated in 2012 and 2013

Month	Variation(%)			
	Monthly		Accumulated	
	2012	2013	2012	2013
January	0,86	1,99	0,86	1,99
February	0,19	1,45	1,05	3,47
March	0,25	1,14	1,30	4,65
April	0,51	0,96	1,82	5,65
May	0,73	0,31	2,56	5,98
June	0,68	0,04	3,26	6,02
July	0,91	-0,33	4,19	5,67
August	0,88	0,01	5,11	5,68
September	1,26	0,14	6,43	5,83
October	1,36	1,03	7,88	6,92
November	0,79	0,56	8,74	7,52
December	1,03	-	9,86	-

Source: IBGE

Wholesalers and Distributors (ABAD). While the Wholesale Trade and Distribution business is being squeezed by both Suppliers Industry and Retailers, the Cash and Carry business takes advantage by offering prices up to 20% cheaper than the Supermarkets, at a time that the consumer is trying to escape inflation to maintaining the standard of consumption level achieved.

The service level offered into a Cash and Carry store to consumers is worse than Supermarkets, but offset by price and assortment to boost demand and, similar to what already happens in the big supermarket chains, the products replacement on shelves in Cash and Carry stores as well visibility and positioning of the products end up in charge of the Suppliers which absorbed the costs of stockers, team leaders and managers, in the fierce competition to increase product and brand visibility. However, Suppliers Industries seek to pass these additional costs to distributors.

Active customers, visibility at sale point and supply without break entered into Industries vocabulary

Technical terms from distributors became part of daily Industry's routine who shared with buyers their sales goals, and also the pressure for results.

According to Nielsen, 95% of small supermarkets and 40% in average supermarkets are supplied by wholesale trade distributors.

Altogether there are 83,572 food retail stores in Brazil, according to the Brazilian Association of Supermarkets (ABRAS), as of 2012.

Given the broad universe of shops and extensive territory, distributors became strategic partners to positioning brands and products with relevance to act in the consumer market that represents BRL\$ 344.1 billion last year, and that the distribution segment accounted for 51.9% of deliveries of basic household consumption items, reported ABAD.

Complex tax rules among states and Logistical bottlenecks are impacting negatively the working capital needs for wholesale trade distributors

Brazil is characterized to be a country of continental dimensions and complex interstate relationship, where their 26 states and the Federal District practice a declared tax war in dispute for Tax on Goods and Services (ICMS) - on both origin of the product and also in the delivery destiny - under close supervision from Finance Secretaries of each state, respectively. The complexity extends to products, and the accumulation of tax credits is around 90 days, to return on the companies' cash flow.

Despite the Government efforts to relieve the logistical bottleneck via concessions, the current reality is the structural limitation on road transportation model that bump in the low quality of the country's roads in average.

The result is a longer shift, which requires longer-term inventory which is far away from the ideal for wholesaler and distributor sector.

Table 2: TOP 5 Wholesale Trade Distributors in Brazil

WHOLESALE TRADE DISTRIBUTORS			
Classification	Company	FU	'2012 Turnover (BRL\$)
1	PROFARMA	RJ	3.907.750.000
2	MARTINS	MG	3.812.008.768
3	TAMBASA	MG	1.560.545.957
4	MEGAFORT DISTRIBUIDORA	MG	1.153.900.392
5	GAZIN	PR	1.058.400.000

Source: ABAD Nielsen 2013 Ranking

Table 3: TOP 5 Cash and Carry in Brazil

CASH AND CARRY			
Classification	Company	FU	'2012 Turnover (BRL\$)
1	MAKRO	SP	6.773.494.043
2	ASSAÍ	SP	5.078.717.879
3	TENDA ATACADO	SP	1.643.730.000
4	ATACADISTA ROLDAO	SP	1.240.999.484
5	SPANI ATACADISTA	SP	874.950.094

Source: ABAD Nielsen 2013 Ranking

Table 4: Infraestructure investments in Brazil

Large infrastructure programs were announced over the last two years. The value of investments involved in these programs is near to USD \$ 470 billion in the coming years, not including the large urban infrastructure investments required for the World Cup 2014 and Olympics 2016

Government concessions planned	BRL\$ Billion
Logistic	242,0
Roads 	42,0
Railway 	91,1
Harbors 	54,6
High Speed Trains 	35,6
Airports 	18,7*
Electric Energy	148,1
Oil & Gas	80,0
Total	470,1

*Investments on regional airports included

Source: Ministry of Finance

What to expect for 2014?

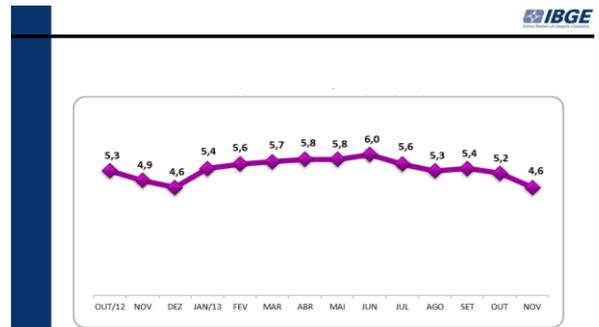
The Wholesaler Trade and Distributor sector is dependent on employment level and private income, and Brazil enjoys the lowest unemployment rate of the series started in 2002, which reached 4.6% in November 2013, according to IBGE data, which also released expansion the average real income by 3% in the same basis.

Still on private income, an increase on minimum wage by 6.78% is set to January, 2014, according to a decree signed by President Dilma Rousseff in December 23, 2013, aimed at restoring inflation and offer a real gain of 1.18% to workers, bringing BRL\$ 28.4 billion more into the economy, according to the Department of Statistics and Socioeconomic Studies (DIEESE).

The Wholesale Trade and Distributor sector has shown resilience to withstand the pressures from Industries, Retail and Government, with visible improvement in their professionalism levels.

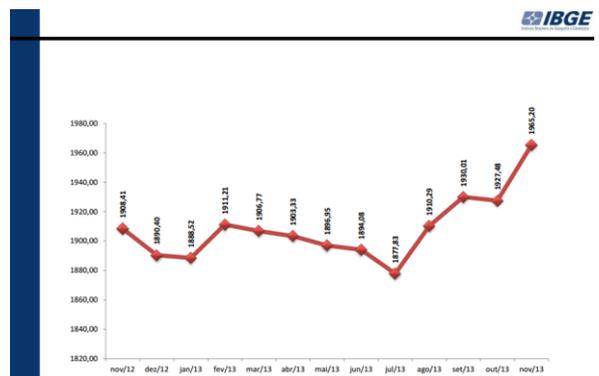
Cash management and liquidity remain key factors. Expected challenges are even greater for inventory maintenance and/ or days sales outstanding further elongated to avoid disruption of supply over a promising year 2014, and intense, with fewer working days due to the World Cup and elections in Brazil.

Chart 4: unemployment rate



Fonte: IBGE

Chart 5: real average private income



Fonte: IBGE

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