Goldman Sachs

Brazil: Retail

Equity Research

Initiating coverage: Building national apparel brands. Buy Marisa, Neutral Hering

More than just structural growth

Brazilian apparel retailers are poised to grow fast for several years out, on favorable macro and structural drivers. While the emerging middle class theme is well-known, we also believe direct and indirect barriers to entry will continue to protect high returns, making apparel one of the most attractive markets in Brazilian retailing.

The right business models for growth

We initiate coverage of Hering and Marisa, both of which are well-positioned to form leading national brands, with multi-format platforms that will be increasingly hard for new entrants to replicate.

Like both, tactical preference for Marisa

Both stocks have outperformed strongly, with HGTX +207%, AMAR +142% vs. IBOV YTD. We see further upside for both on a DCF basis, but Marisa (Buy) offers more room for multiple expansion, as it is at a discount to local/global peers on most metrics. Hering is Neutral, as share performance and high cotton content leave it relatively more exposed to margin pressures and profit-taking.

Marisa (Buy): One brand, diversified growth

Marisa is one of Brazil's leading apparel retailers, selling primarily to female mid-to-low income customers. Despite a steady build-out in recent years to what is now the most diversified store footprint in the sector, we expect sales area expansion of on average 15% pa in 2010-13E. We expect Marisa to increasingly pursue a multi-format approach, as it capitalizes on its brand equity with new stand-alone lingerie stores. We see 19% potential upside to our R$31.50 12-month blended DCF/multiple price target, implying 2011E EV/EBITDA of 12.1X and P/E of 23.7X.

Hering (Neutral): High potential, high returns

Hering is a vertically integrated casual wear retailer, with a broad target audience and reach, as it sells its three brands through a mix of owned, franchised and multibrand stores. It achieves best-in-class ROIC on a combination of high operating leverage and sales turnover, paired with low capital requirements. Our R$32.10 12-month price target implies 8% potential upside and a 2011E EV/EBITDA of 15.4X and a P/E of 23.7X.

MARISA LOJAS (AMAR3.SA): BUY

Key data	Current
Price (R$)	26.39
12 month price target (R$)	31.50
Market cap (R$ mn)	4,870.3
Dividend yield (%)	1.9
Net margin (%)	11.7
Debt/total capital (%)	32.6

	12/09	12/10E	12/11E	12/12E
Revenue (R$ mn)	1,434.1	1,722.9	2,154.1	2,631.4
EPS (R$)	0.77	1.09	1.33	1.68
P/E (X)	34.5	24.1	19.9	15.7
EV/EBITDA (X)	3.7	12.5	10.2	8.2

CIA HERING (HGTX3.SA): NEUTRAL

Key data	Current
Price (R$)	29.70
12 month price target (R$)	32.10
Market cap (R$ mn)	4,832.8
Dividend yield (%)	1.1
Net margin (%)	16.9
Debt/total capital (%)	11.6

	12/09	12/10E	12/11E	12/12E
Revenue (R$ mn)	720.9	998.1	1,271.3	1,556.8
EPS (R$)	0.71	1.04	1.35	1.70
P/E (X)	42.0	28.6	22.0	17.5
EV/EBITDA (X)	5.0	18.0	14.2	11.0

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Apparel retail: High returns in a sheltered growth market. Buy Marisa, Neutral Hering

More than just a structural growth story

Across the last several years, Brazilian retailers have benefited from an unprecedented combination of buoyant labor markets, lower real interest rates and a rapidly expanding middle class, driving pronounced growth in consumption. Despite our expectation for a tightening of monetary policy to curb accelerating inflation (GS Global ECS forecasts +250 bp in rate hikes and inflation of 6.5% in 2011E), the macro backdrop looks to remain favorable, with 4.8% real GDP growth expected in 2011.

Within retail, apparel should benefit from some of the fastest growth rates (2010-13E sales CAGR +20%), in our view, as rising disposable income falls on particularly fertile ground, with near constant elasticity to income and generally low per capita consumption levels for clothing. Unlike for other discretionary categories, like durables, where households typically limit purchases to one or two units, spend on apparel tends to increase at a constant rate with higher levels of income. Clothing, after all, not only fulfills basic needs, but also social status and lifestyle preferences, with growth in spend coming from both increasing number of items and average ticket. Women are the main shoppers for apparel, so their increased workforce presence should also ensure a greater spend in this category.

Beyond the well-known macro and structural growth drivers, there are several additional characteristics that we believe are not yet fully appreciated by investors, but make apparel retailing one of the most attractive sub-sectors within Brazilian retail:

- **High returns, unharmed by foreign competition:** High import tariffs, inverted seasons and a complex corporate tax system are the key factors that have kept foreign apparel chains from aggressively entering the Brazilian apparel market. We believe these barriers to entry should remain effective in the short to medium term, and maintain ROIC close to the current average 28% level, compared to 17% for the rest of Brazilian retail.
- **Opportunity to build powerful national brands in a highly fragmented, but aspirational market:** The five leading Brazilian apparel retailers have a combined share of around 23% (source: Euromonitor), but given an estimated 40% of the market is still informal, the actual share is potentially closer to 15%. Rising penetration of card payments should increasingly squeeze out informal competitors and drive consolidation. International brands are strikingly absent in Brazil's mass market, leaving an opportunity for domestic players to build national brands that cater to the aspirations of an emerging middle class.
- **The advantage of local knowledge:** The Brazilian (apparel) retail market is characterized by distinct characteristics that create a competitive advantage for companies with the necessary local expertise of working – for example – with consumer credit and regional differences in climate, culture and socioeconomic make-up.

Marisa and Hering: Leveraging opportunities with the right business models

The right macro environment and market characteristics alone do not guarantee success. Companies also need the right business models to capture the opportunities at hand. We believe Marisa and Hering, respectively the 4th and 5th largest apparel retailers in Brazil, are well-placed. Both have a strong recent track record of execution and are increasingly shaping themselves into diversified multi-format players that are strategically moving into even more fragmented sub-categories such as lingerie (Marisa) or children's wear (Hering).

This should create a first mover advantage, as both occupy not only more and more mind share, but also preferred locations in shopping malls and on high streets. As they build nationwide platform intelligence in merchandise and logistics that is increasingly hard to replicate, this erects an additional barrier to entry and potentially makes them M&A targets for foreign competitors.

Lojas Renner, the second-largest apparel retail chain, is analyzing additional formats but has so far only launched a smaller and a female-oriented version of its traditional format.

A strong year-end ahead, but also harder comps and higher cotton prices

The short-term outlook for year-end sales is positive, as consumers' disposable incomes receive a boost from Brazil's legally mandated year-end bonuses, further enhanced by minimum wage rises, a favorable exchange rate and generous credit offers, which have pushed consumer confidence to unprecedented highs. This should drive strong top-line growth, but the basis of comparison has also become more challenging, while a concentration of store openings could temporarily weigh on operating margins, particularly for stores with longer maturity times (Lojas Renner). Looking ahead to early 2011, we see the current spike in global cotton prices as the main challenge. Although we expect the Brazilian apparel retailers to predominantly pass higher costs through to consumers, there may be a risk of temporary gross margin pressure. We believe this risk is most relevant for Hering, which is vertically integrated and has more cotton in its mix.

Initiate coverage of Marisa (AMAR3.SA) as Buy

Marisa is one of Brazil's leading apparel retail chains, with 240 stores spread across Brazil, focused on mid-to-low income women. It has steadily expanded sales area across the last several years (+22% 2004-09 CAGR), to what is now the broadest geographical footprint among Brazilian apparel retailers, with some 30% of stores in high-growth regions in Brazil's North(east) and Mid-West. Despite this higher base than before we believe Marisa is on the cusp of accelerating unit build-out, pushing into new cities with its traditional and new formats like stand-alone lingerie stores, resulting in +15% sales area and +21% sales CAGR in 2010-13E. With about half of its stores still in maturation, we expect the ongoing ramp-up in sales productivity to continue to spur same-store sales growth and expense dilution that more than offsets pre-opening expenses from new stores.

Our 12-month price target of R$31.50 is based on an equal-weighted blend of a DCF and target multiple valuation and implies 19% upside. Marisa currently trades at a 23% and 10% discount to the average of Hering and Lojas Renner on 2011E EV/EBITDA and P/E, while growing EBITDA and EPS at an expected +23% and +24% in 2010-12 (vs. 24% and 21% for peers). While Marisa's lower liquidity (US$3 mn ADTV) may justify a certain discount, we see room for multiples to expand and trade closer to Brazil peers. Our price target implies on average an 11% discount to the Brazilian retailers in our coverage.

Potential catalyst: Board approval for the 2011 store opening plan in mid-December, which would highlight the company's large opportunities to expand its footprint with what is now increasingly a multi-format strategy.

The largest short-term risk is near-term margin pressure from a less-than-full pass-through of higher cotton prices, cannibalization of sales between new and existing stores and slower dilution of pre-opening expenses.

Initiate coverage of Hering (HGTX3.SA) as Neutral

Hering is a vertically-integrated apparel producer and retailer, selling through owned (15% of 2010E sales), franchised (34%) and multibrand stores (51%). It operates under a multi-format strategy, dominated by the casual-wear Hering store including Hering Kids (84% of 2010E sales) and complemented by children apparel PUC (8%) and contemporary denim brand "dzarm" (8%). Its diversified approach allows Hering to achieve a broader reach and faster build-out, and it is now leading all other branded apparel producers in terms of number of stores that serve as its channel. In addition, multibrand stores enable a presence in markets that would not justify a store yet, and help sound out opportunities for new openings.

Our 12-month price target of R$32.10 is based on a blend of DCF and target multiple and implies 8% upside. Hering trades at an average 7% premium to Renner on a 2011E EV/EBITDA and P/E, but on average 25% above Marisa, despite offering similar growth. We are positive on Hering's growth outlook and believe its business model is among the strongest in the LatAm retail space. However, following the strong YTD performance (207% vs. IBOV) and a risk of near-term margin pressure from higher cotton prices, we initiate with a Neutral and look for a better entry point.

Valuation: Marisa's valuation attractive relative to Brazilian retailers and EM peers

Brazilian apparel retailers trade on average at 12.3X EV/EBITDA and 21.3X P/E in 2011E, with expected EBITDA and EPS CAGR of +23% and +22% respectively for 2010-12. This implies a sharp premium to mature market peers in Europe and the US, but we believe this can be justified by the Brazilians' higher near- and medium-term growth outlook, on not only cyclical but also structural opportunities. Chinese peers are projected to grow at similarly rapid rates, and while differences in business models and liquidity may limit direct comparisons, we note that the Brazilians are trading at a sharp discount to Shanghai-listed peers (mostly department stores), but in line with or above the Hong Kong-listed ones.

Compared to the average of global peers, Marisa and Hering look reasonably valued, at an average 39% discount on PEG ratios (0.7X vs. 1.2X). They also trade at an average 14% discount on 2011E EV/EBITDA and P/E to Brazilian retailers in our coverage.

Exhibit 1: Marisa and Hering stand out on a global peer comparison, offering high growth at reasonable P/E multiples

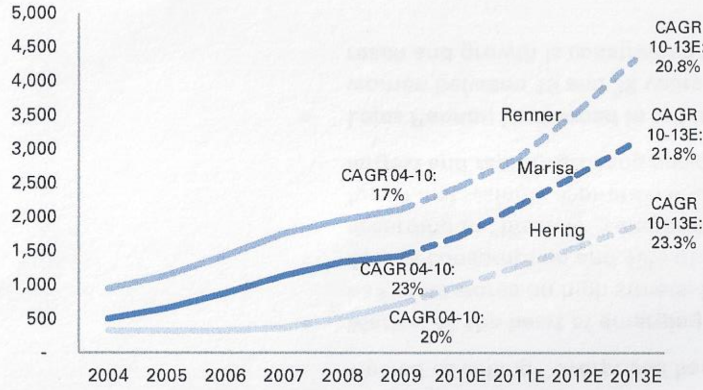
Global valuation snapshot for apparel retailing, clothing & accessories, department stores (China). Priced as of close of Nov 29, 2010.

		Mkt cap	ADTV	EV/EBITDA		EBITDA	P/E		EPS	PEG		ROIC
Company	Rating	US$ mn	US$ mn	2011E	2012E	CAGR 2010-12E	2011E	2012E	CAGR 2010-12E	2011E	2012E	2011E
Cia Hering	Neutral	2,794	13.0	14.2x	11.0x	+27.6%	22.0x	17.5x	+28.0%	0.8x	0.6x	36.5%
Lojas Renner	Neutral	4,200	34.7	12.4x	10.1x	+19.7%	22.0x	18.6x	+14.4%	1.5x	1.3x	26.4%
Marisa Lojas	Buy	2,816	3.0	10.2x	8.2x	+23.3%	19.9x	15.7x	+23.9%	0.8x	0.7x	21.7%
Average			16.9	12.3x	9.7x	+23.5%	21.3x	17.3x	+22.1%	1.0x	0.9x	28.2%
US & Europe: Average				7.6x	6.7x	+12.6%	18.7x	16.8x	+26.3%	1.1x	1.0x	25.5%
Japan: Average				6.1x	5.4x	+5.2%	17.6x	15.7x	+9.0%	2.9x	2.3x	21.6%
Emerging Asia: Hong Kong average				**13.0x**	**10.4x**	**+25.5%**	**19.8x**	**16.3x**	**+24.3%**	**0.9x**	**0.7x**	**32.4%**
Emerging Asia: Shanghai average				**15.6x**	**12.7x**	**+19.3%**	**34.6x**	**28.5x**	**+26.0%**	**1.6x**	**1.3x**	**19.9%**
Global peers average				9.6x	8.1x	+15.1%	21.3x	18.4x	+24.0%	1.3x	1.1x	25.4%
Brazilian retail average (excl. apparel)				**11.0x**	**9.5x**	**+19.9%**	**34.8x**	**26.5x**	**+27.9%**	**1.2x**	**0.9x**	**17.0%**
Premium (discount) to US & Europe				*+61%*	*+46%*	*+87%*	*+14%*	*+3%*	*-16%*	*-7%*	*-17%*	*+11%*
Premium (discount) to Japan				*+103%*	*+82%*	*+356%*	*+21%*	*+10%*	*+145%*	*-64%*	*-63%*	*+31%*
Premium (discount) to Hong Kong				*-6%*	*-6%*	*-8%*	*+7%*	*+6%*	*-9%*	*+18%*	*+17%*	*-13%*
Premium (discount) to Shanghai				*-22%*	*-23%*	*+22%*	*-38%*	*-39%*	*-15%*	*-32%*	*-33%*	*+42%*
Premium (discount) to Global peers				*+27%*	*+20%*	*+56%*	*+0%*	*-6%*	*-8%*	*-18%*	*-23%*	*+11%*
Premium (discount) to Brazilian retail average (excl. apparel)				*+12%*	*+2%*	*+18%*	*-39%*	*-35%*	*-21%*	*-15%*	*-9%*	*+66%*

* For detailed information please refer to Exhibit 24

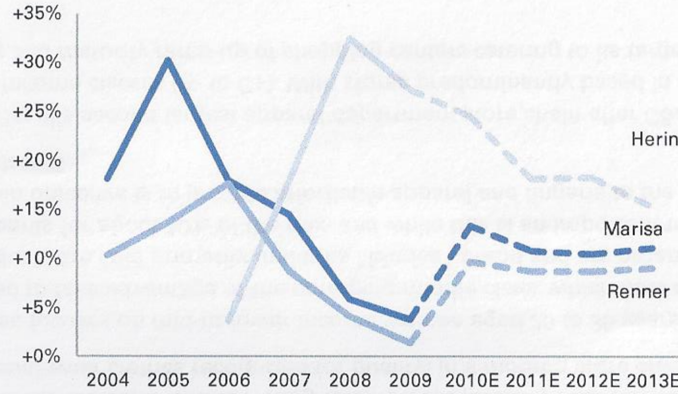
Source: Company data, Goldman Sachs Research estimates.

Exhibit 2: Sales should continue to grow at 20% + rates
Net retail sales, R$ million



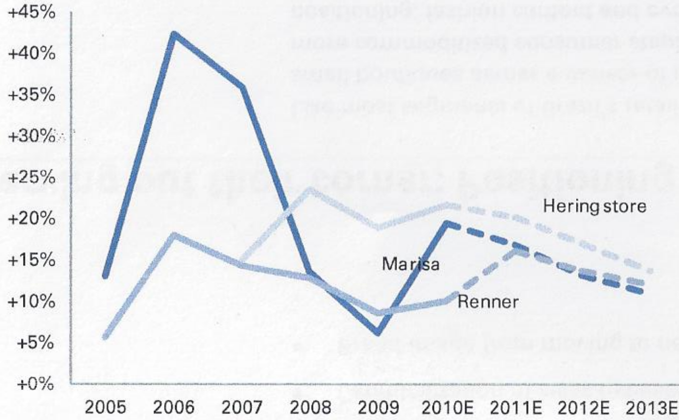
Source: Company data, Goldman Sachs Research estimates.

Exhibit 3: ...driven by double-digit same-store sales growth, and...
Same-store sales growth (% yoy)



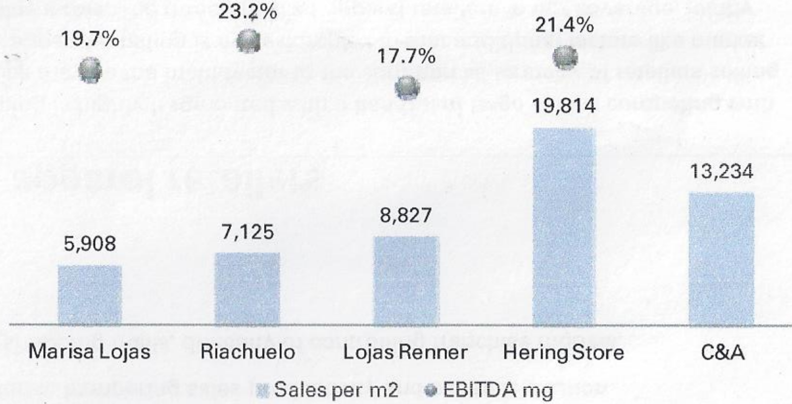
Source: Company data, Goldman Sachs Research estimates.

Exhibit 4: Continued build-out of sales area
Annual selling area growth (% yoy)



Source: Company data, Goldman Sachs Research estimates.

Exhibit 5: Brazil apparel retailers: Similar margins, different sales productivity
Sales per m² 2009 (R$ 000), EBITDA margin 2009 (%)



Source: Company data, Goldman Sachs Research estimates.

Key risks to the sector

In addition to macro risks relevant to the broader retail space (slower GDP growth, higher unemployment, a drop in consumer confidence), apparel retailing is subject to certain additional risks, including:

- Input prices (cotton) and exchange rate: A sudden and sharp rise in input prices could temporarily put gross margins under pressure if retailers are not able to pass the higher costs immediately and fully through to consumers.
- Adverse climatic conditions, discouraging consumption of seasonal items (e.g. cold weather at launch of summer collection).
- Cannibalization of sales between new and existing stores, hampering sales productivity and expense dilution.
- Brand image from moving to new areas and outside shopping malls, difficulty of controlling franchise models.

Carving out their corner: Positioning of Brazilian apparel retailers

Like most segments of Brazil's retail market, apparel retailing is highly fragmented with a handful of large chains competing with small boutiques across a variety of price points. While price may be the main factor to the commercial strategy of retailers selling more commoditized consumer staples like food or drugs, apparel retailing is more complex in that additional factors like market positioning, fashion content and even credit availability play a role. The three Brazilian apparel retailers in our coverage, jointly accounting for 11% of the market, have looked to carve out distinct positions, although there is inevitably a certain overlap in terms of target customers, locations and formats.

- **Hering: Tapping different customer groups.** Hering defines itself as a "democratic" brand, catering to a broad target audience, with a wide acceptance among all age groups and social classes, especially those older than 20 and in income classes A to C. With a general overhaul of its image, including a new architectural look to Hering stores, it successfully repositioned from being viewed as selling "overpriced basics" to offering casual-wear clothes recognized for quality, in a modern store environment.
- **Marisa: At the heart of emerging middle class**. Marisa focuses on mid-to-lower income women aged 20 to 35 years. With about half of its stores on high streets, Marisa is well-placed to take advantage of the emerging middle class, which now represents 46% of consumption and 49% of population. Its products are sold primarily under its "Marisa" brand and are organized according to "lifestyle" categories. Fast fashion accounts for about 10% of the mix, and while this is an important traffic driver for an increasingly aspirational target public, the main objective is to provide affordable apparel and lingerie to the single largest and rapidly growing socioeconomic group, class C.
- **Lojas Renner: Less broad in set-up.** Lojas Renner is Brazil's second largest apparel department store chain after C&A, targeting women between 19 and 39 years in the mid-to-high income classes (A- to C+). With stores predominantly based in malls, its reach and growth is constrained to the development and maturity ramp-up of shopping centers catering to its target audience.

As the emerging middle class matures, the challenge for each will be on how to best accompany their aspirations, without moving to far ahead nor falling behind. Examples of recent initiatives include:

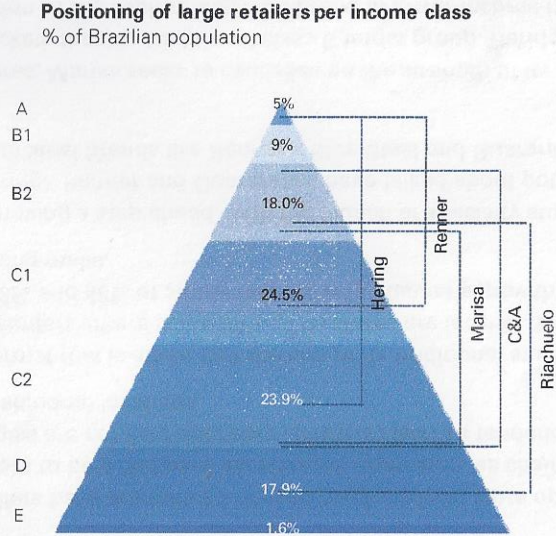
- **Store remodeling and flagship stores:** C&A at Iguatemi, Hering in Center Norte, Lojas Renner and Marisa on Paulista Avenue
- **New specialty stores** (e.g. Marisa Lingerie, Hering Kids)
- **Campaigns with top designers or celebrities** (Guararapes contracting designer Oskar Metsavaht for a limited collection)
- **Launch of online operations**
- **Co-branded credit cards** that can be used in other stores.

Exhibit 6: Different formats give Marisa and Hering a broader reach, occupying additional, fragmented sub-categories
Target customer groups and market positioning of Brazilian apparel retailers in our coverage

		Hering	Lojas Renner	Marisa
Target market	**Target customer**			
	Income class	A / B / C ("democratic brand")	A- / B / C+	C
	Gender	Both	Women	Women
	Age	All ages	18 to 39 years	20 to 35 years
	Stores in malls	17%	94%	52%
	Share of stores outside South / Southeast	17%	21%	30%
Formats	**Traditional**			
	Stores	337 Hering Store (81%) / 78 PUC stores (19%)	131 traditional format (98%) and 2 compact format (1%) by 2010E	206 Marisa extended mix (74%) by 2010E
	Average size (m2)	130	2,100 (1,200 in compact format)	1,200 - 2,000
	Assortment	Women, Men, Children & Accessories	Women, Men, Children, Footwear, Lingerie & Accessories	Women, Men, Children, Lingerie & Accessories
	Additional formats			
	Stores	4 pilots of Hering Kids and 1 of Dzarm by 4Q10E-1Q11E	1 pilot of Renner feminina (1%) by 4Q10E	58 Marisa Women (21%) and 14 Marisa Lingerie (5%) by 2010E
		Hering Kids - Children	**Renner Feminina** Avg. Size: 1,200m2 Female, Lingerie & Accessories	**Marisa Women** Avg. Size: 600 - 900m2 Female, Lingerie & Accessories
		Dzarm (own brand, contemporary youth)		**Marisa Lingerie** Avg. Size: 250 - 350m2
	Annual collections	6 (2 - 3 week cycles)	4 (+ 2 interim)	3 (+ 12 mini-collections)
	Lifestyles (#)	**1** in Hering (+ "dzarm" and "PUC" brands)	**5** under 6 different private label brands	6 all under Marisa brand
Branding	**Assortment mix**	60% fashion / 40% basics	n/a	50% fashion / 50% basics
	Recent marketing initiatives	Celebrities incl. Lucio Mauro Filho, Ingrid Guimarães, ...	No recent celebrity campaigns	Focus on 'normal', everyday personalities
		Flagship/ remodelled stores	Christmas raffle to win cars	Flagship/ remodelled stores

Controlling 45.8% of the income, class C has a greater share of income compared to classes A and B together.

Positioning of large retailers per income class
% of Brazilian population



Source: Company data, ABEP, Goldman Sachs Research estimates.

Growth unbound: Not just more of the same

Encouraged by the positive macro backdrop, Brazil's leading apparel retailers have announced revised medium-term store opening plans since late 2009. The year 2010 marked the opening shot for what looks to be a period of accelerated expansion, as chains venture into new regions and experiment with new formats. While strategies are not homogeneous, there is clearly a tendency to diversify, moving from a single to a multi-format approach and beyond traditional locations.

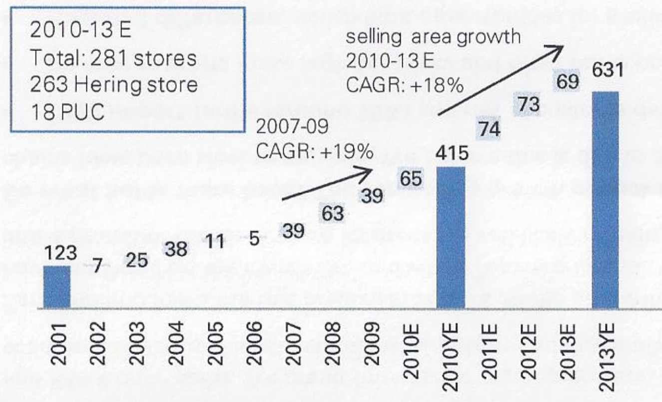
- **Moving off mall:** In 1H2010, Lojas Renner introduced a "compact" format that is about half the size of its traditional store and should make it easier for Renner to grow outside the large shopping centers where some 94% of its stores are located. While Hering and Marisa already have a strong high street presence, with 83% and 48% of stores respectively, Renner's growth has so far been limited to the development as well as maturity of new shopping malls.
- **Creating new formats:** Marisa and Hering, meanwhile, are already moving a step ahead, with the launch of specialty stores like Marisa Lingerie, Hering Kids and private label brand "dzarm" (Cia Hering). Renner and Guararapes have talked about potential innovative formats like Renner Home, or a spin-out of one of its private label brands like Renner's Blue Steel and Guararapes' Pool, but for now no concrete plans have been formulated.
- **Reaching up and down the pyramid:** With the launch of lingerie stores, Marisa seeks to capitalize on the strength of its brand in this segment and reach additional customers in higher-income brackets than its traditional class C target group. Hering is testing a Hering Kids store that includes a corner with a limited selection of the aspirational PUC brand in lower-income malls. Renner has long been eyeing possibilities to capture the growth opportunities presented by mass-market retailing. Management has made clear that a potential move "down market" would be done through M&A, to avoid tarnishing the Renner brand.

Although both Lojas Renner and Marisa have signaled interest in growing through M&A (Lojas Renner even made a bid for privately-held Lojas Leader, but withdrew in the context of economic uncertainty in late 2008), the space has seen very few transactions. Growth has come primarily from organic build-out, with acquisitions limited to points of sale. The key reason, in our view, is a lack of suitable targets, given the sector is highly fragmented and due diligence for family-run operations often lengthy and complicated.

Exhibits 7-10 illustrate the Brazilian apparel retailers' track record and plans for store openings. Marisa and Hering both stand out for a pronounced acceleration in unit additions across the 2010-13E period, by the end of which they will be 67% and 78% larger than today (as of 3Q2010). Both have successfully executed on a steady organic build-out across recent years and have a positive track record in terms of limited number of store closures. This makes the ambitious growth plans for the next several years look achievable.

Exhibit 7: Hering: Maintaining pace of recent years

New store openings, units (all formats, owned and franchised)

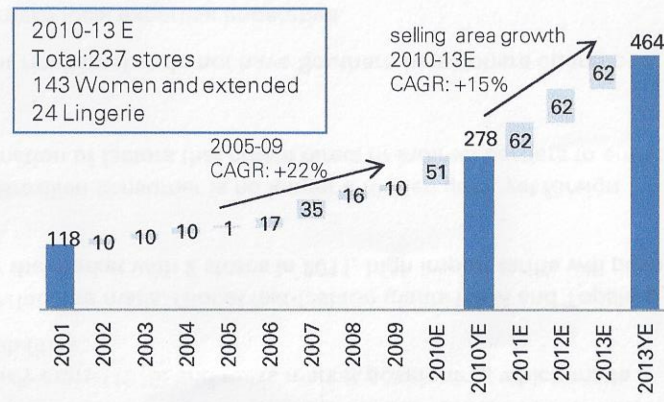


* selling area growth for Hering Store only

Source: Company data, Goldman Sachs Research estimates.

Exhibit 8: Marisa: Accelerated unit build-out and broader mix

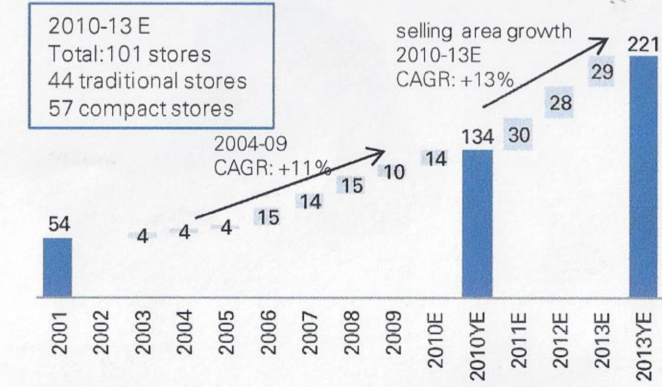
New store openings, units



Source: Company data, Goldman Sachs Research estimates.

Exhibit 9: Lojas Renner: Growing with smaller units

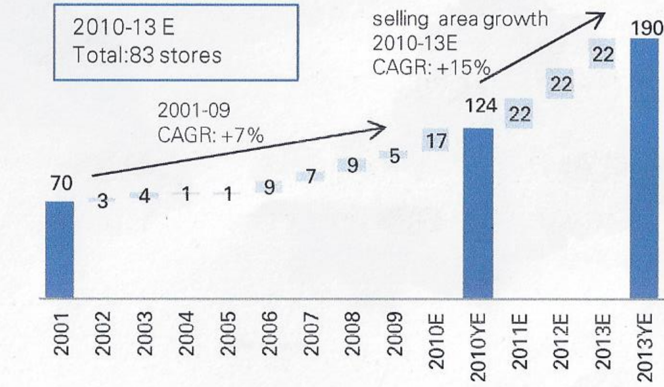
New store openings, units



Source: Company data, Goldman Sachs Research estimates.

Exhibit 10: Guararapes: Doubling pace, but only one format

New store openings, units (2010-13 reflects company guidance)

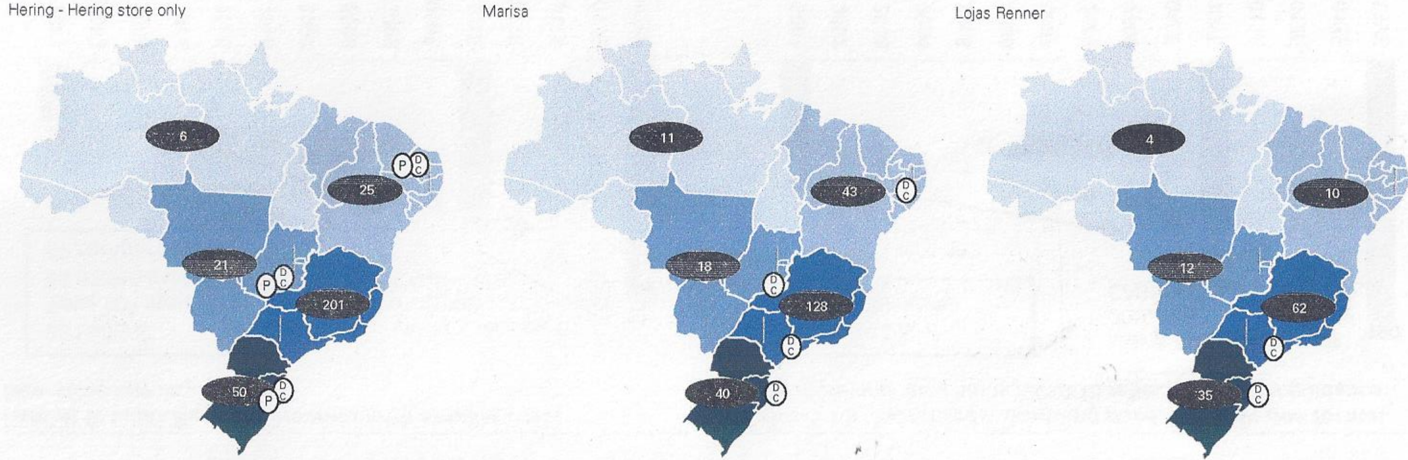


Source: Company data, Goldman Sachs Research estimates.

Its smaller average store size (1,100 m^2 vs. 2,100 m^2 for Renner) and the broader socioeconomic target group (Class C now represents 50% of Brazilian population and 46% of consumption) have allowed Marisa to reach a much broader geographic footprint with some 30% of stores outside the wealthy states in Brazil's South and Southeast vs. on average 19% for Renner and Hering

(Exhibit 11). While we believe it is strategically important to create a foothold in new growth markets, this also requires the right format. We expect Renner, with its primarily mall-based stores focused on the higher end of the middle class, to remain relatively more locked within its current footprint. The initial focus of openings in the new compact format will be on regions where it is already present, thus capitalizing on existing logistical capacity and mind share, before making a real move into new markets.

Exhibit 11: Marisa has the broadest geographical footprint, with 30% of stores outside the South and Southeast
# of stores, production units, distribution centers



Source: Company data, Goldman Sachs Research estimates.

Limited foreign competition: The Brazilian market is characterized by the near absence of foreign retail chains. The privately held Dutch apparel retailer C&A is the only foreign retailer with a sizeable presence in Brazil – in fact, it is the market's #1 with 178 stores and R$4.4 bn in sales. We credit this market-leading position to its early entry (1976) and mass market positioning, which made it economic to set up a local network of suppliers and distribution capabilities.

Zara (Inditex) has a modest presence, with 28 stores primarily in high income malls. Global fast-fashion giants H&M and Topshop have put Brazil on their wish list, and while Topshop intends to enter the market with 2 stores in 2011, high import tariffs will push it into a premium positioning, so its presence will likely remain limited.

So what holds them back? The compelling growth outlook for the Brazilian consumer is no longer a hidden gem, yet foreign chains have been slow to move in. We believe this is due to a combination of factors that create direct or indirect barriers to entry:

- **High import tariffs** (around 35%) and risk of customs delays.
- **Inverse seasons** make logistics tricky and often not economic for retailers that do not have Southern hemisphere operations.
- **Regional differences,** which limit opportunities for scaling and make local expertise imperative.
- **Complex corporate tax system**.
- **Importance of consumer credit,** which is not typically used by apparel retailers in other markets.

High margins and limited capital needs lead to high returns

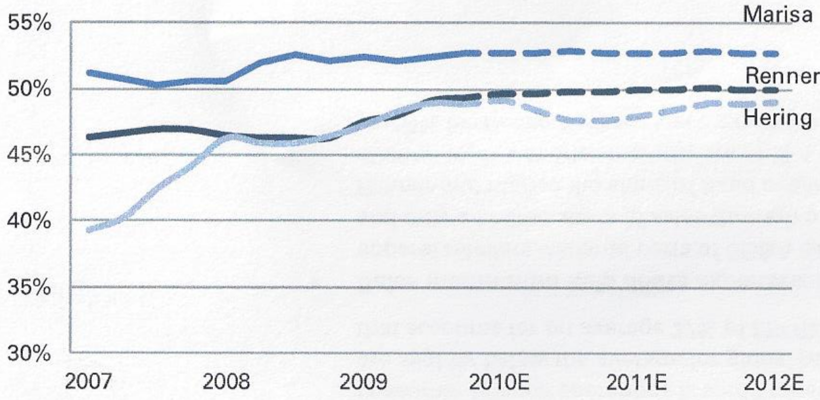
The limited presence of foreign competitors and imported product is, in our view, a key factor contributing to the high returns in Brazilian apparel retailing. As the barriers to entry are not only a result of deliberate government policies, but also of inherent characteristics of the Brazilian market, we believe that returns can remain protected from foreign competition for several years out.

However, the protected nature is not the only explanation for the apparel retailers' attractive margin and returns. Strong execution has also lifted EBITDA margins to levels that are now among the highest even on a global comparison. Supply chain improvements, pronounced top-line growth driving expense dilution and a turnaround in the profitability of consumer credit operations have been the most important strategic initiatives contributing to this change.

Marisa and Hering saw the most pronounced turnaround on margins, which almost doubled between 2007 and 2010, on the back of a successful brand repositioning (Hering), a turnaround of consumer financing (Marisa) and expense dilution (both).

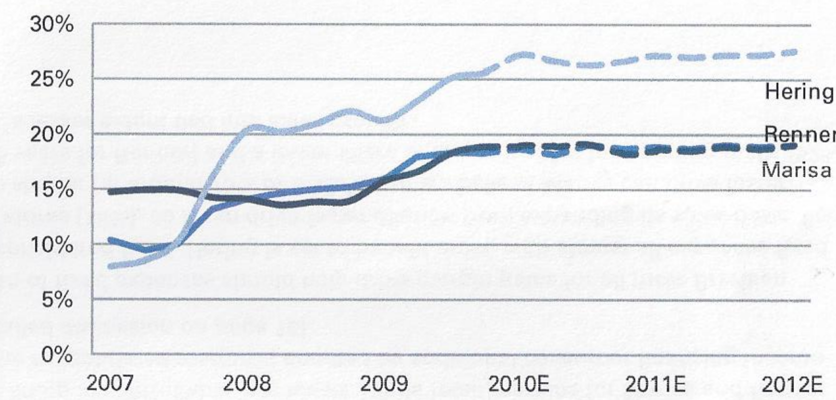
- **Gross margins now in line with global peers:** Exhibits 12 and 14 illustrate that part of this expansion was driven by gross margin gains, particularly at Hering, which benefited from a successful repositioning of its brand. Gross margins at Marisa and Renner also increased, as the companies improved procurement terms and supply chain management. Compared to global peers, the Brazilians are now broadly in line with the average, but still 21% below the benchmark set by global fast-fashion giants Inditex and H&M. While we see scope for incremental gains from better procurement, pricing and inventory management, reaching the benchmark of 60% would probably require a higher degree of global low-cost sourcing, which is difficult in light of the import barriers protecting the Brazilian apparel industry.
- **Consumer finance boosts EBITDA margins:** In addition to import tariffs, there is another structural peculiarity of the Brazilian market that boosts EBITDA margins to amongst the highest on a global scale: consumer finance. What started with simple monthly installment plans, that allowed low-to-mid income consumers to buy with in-store credit, has now grown into full financial service offers, including co-branded credit cards, insurance and emergency cash withdrawals. The key to profitable consumer finance operations is credit quality, resulting in controllable loss levels. While retail margins for Marisa and Renner are slightly below the average for global peers, the consolidated margin is boosted by additional consumer financing income that accounts for on average 27% of EBITDA (detailed discussion on page 16).
- **Sales momentum help dilute expenses:** Dilution of fixed expenses should help drive margin gains for all three Brazilian apparel retailers, as large parts of SG&A can be considered fixed. Hering is set to benefit most, with almost all expenses fixed and only a limited share of sales through owned stores (15%), so it can drive faster dilution from expanding its sales basis. For Renner and Marisa the share of fixed expenses is similar (at around 75% of SG&A), but we believe Marisa can drive faster dilution from a shorter maturity curve (3-4 vs. 3-5 years for Renner) and a lower share of stores located in shopping malls (52% vs. 94% for Renner), where lease expenses are to a lesser extent tied into sales growth.

Exhibit 12: Brand repositioning boosted Hering gross margin since 2007
Gross profit/net sales (retail), trailing 12 months



Source: Company data, Goldman Sachs Research estimates.

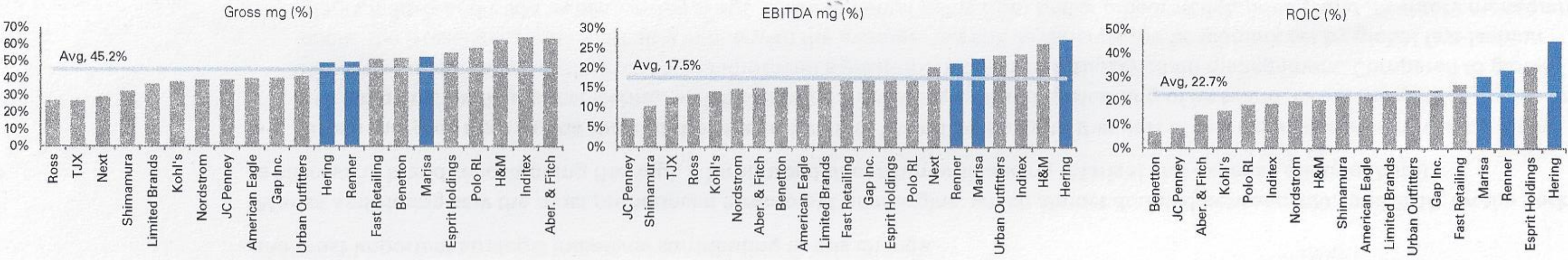
Exhibit 13: Hering and Marisa improved EBITDA margins most visibly
EBITDA/ net sales (total), trailing 12 months



* Hering 2007 EBITDA margin affected by non-recurring expense related to IPO (13.8% on an adjusted basis)

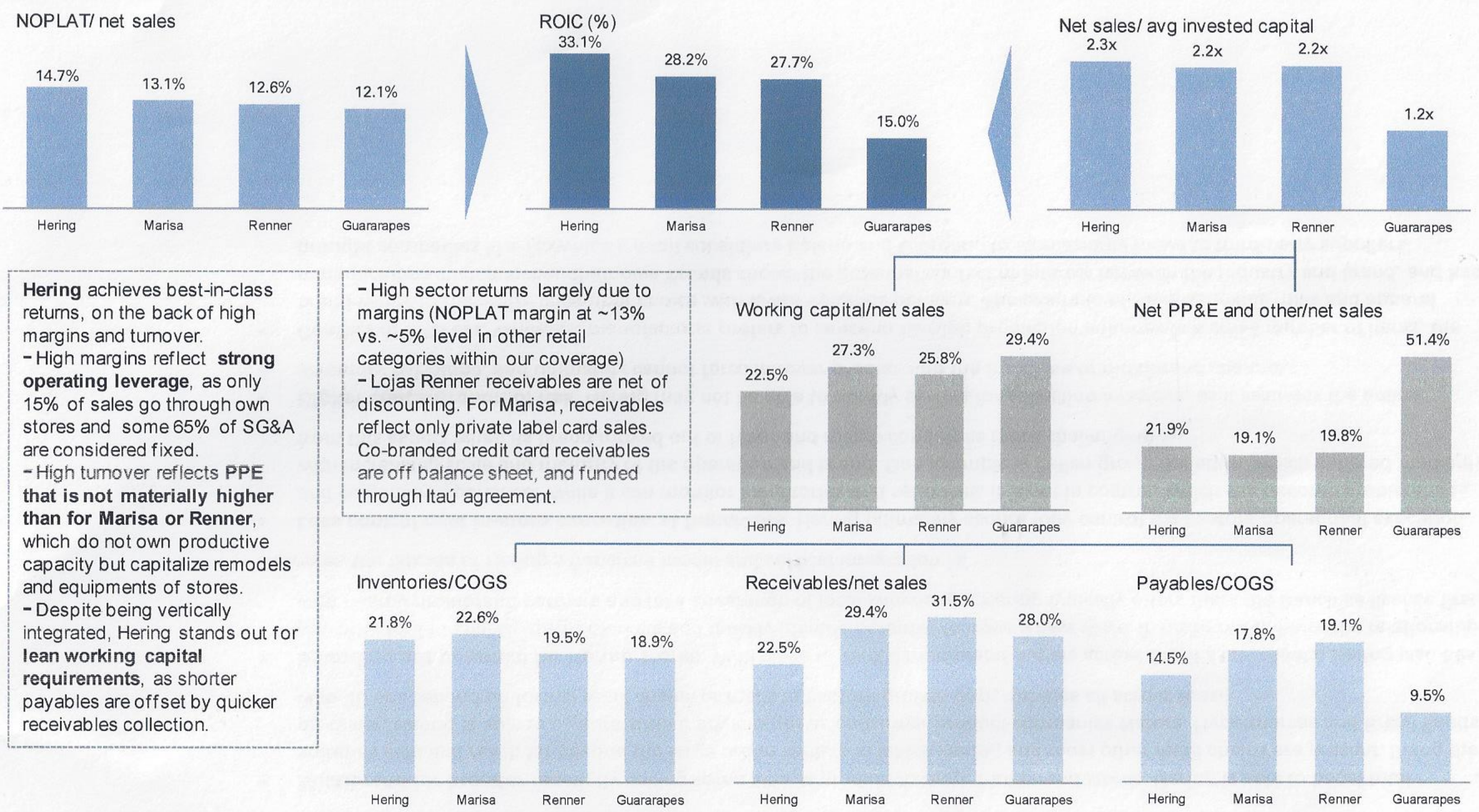
Source: Company data, Goldman Sachs Research estimates.

Exhibit 14: Brazilian apparel retailers are in mid-ground on gross margins, but above average on EBITDA margins
Global apparel: Operating metrics for selected peers (2010E)



Source: Company data, Goldman Sachs Research estimates.

Exhibit 15: Brazil apparel retailing: Hering achieves highest returns, with operating leverage and asset-light model, with Marisa and Renner close on its heels
Selected ROIC decomposition, Last twelve months (as of 3Q2010, LTM)



Source: Company data, Goldman Sachs Research estimates.

The Hering model: Pros and cons of vertical integration and franchising

Hering is the only of Brazil's leading apparel retailers whose business model combines vertical integration (in-house production of 85% of product sales) with a distribution model that mixes franchised and owned stores, in addition to sales to multibrand stores. We believe this model is a powerful way to capitalize on growth opportunities in the Brazilian apparel market and generate superior returns. However, it is not without its risks, particularly in a slower growth environment.

- **Franchising for faster unit growth**: The franchise model allows Hering to pursue a rapid unit build-out without the need to commit sizeable capex or pre-opening expenses. Franchise takers' interests are – for the most part – aligned with Hering, as they look to maximize sales productivity in their stores. In addition, they benefit from a lower corporate tax rate.
- **Multibrand for broader reach:** By selling some 50% of product through multibrand stores, Hering is able to boost total volumes sold and reach far beyond the large urban centers in which Hering and most other retail chains are present. Being the producer, Hering is able to capture similar advantages as consumer product companies Natura, Hypermarcas and Brasil Foods, who do not depend on formal retail chains or malls to capture growth opportunities all across Brazil.
- **Sounding out potential for Hering stores:** With close to 15,800 multibrand outlets across Brazil as its clients, Hering also has a powerful tool to analyze micro markets and quickly identify potential to open a new store. In order not to harm the relationship with nearby multibrand partners and take advantage of local knowledge, Hering typically offers them the franchise license first.

However, the flipside of Hering's franchise model and vertical integration is:

- **Less control over in-store execution at franchises:** Hering ultimately cannot fully control the in-store operational execution and customer experience. While it can monitor inventories and set prices, it is not in control, which can become problematic with increasing scale and maturity of the operation and brand. One example is Italian group Benetton, which suffered markedly from this aspect when its brand moved out of favor and macro conditions more challenging.
- **Higher concentration of risk**: Hering may not be able to quickly correct for collection missteps, as it assumes the entire inventory risk alone, and ultimately cannot force leftover product into the franchise or multibrand channel.
- **Conflict of interest:** While the manufacturer prefers to concentrate high production volumes in a small number of items, the brand wants to maximize consumer choice with lower volumes per item. The example of Chinese textile mills and apparel manufacturers that launched their own brands shows the potential conflict of interest between the industry and brand, and has brought companies like Texwinca's retail subsidiary Baleno and Giordano to increasingly move to third-party suppliers.

Exhibit 16: Hering model reaps higher returns, but is also not without its risks
Advantages and disadvantages of different business models in apparel retailing

Business models	Pro	Contra	Examples
Vertical integration	Direct control of product quality and cycle Higher gross margins	Higher asset base / capex needs Greater working capital (higher inventories, shorter payables)	Hering Guararapes Benetton Group
Franchise model	Faster growth with low capex requirements Franchise-taker is owner-manager Testing new markets w/out comitting capital	No direct control (presentation / mix / inventories / pricing) Cannot extract full retail margin Risk of cannibalizing merchandise where also operating through multibrand stores Not owner of real estate	Hering Esprit Holdings Geoxx Benetton Group

Source: Company data, Goldman Sachs Research estimates.

The role of credit – beefing up margins

Consumer finance plays a role for most Brazilian retailers, and mid to low-end apparel chains are no exception. Some 50% of sales at Renner and Marisa stores are made on private label cards, and income from interest rates and fees accounts for more than 20% of EBITDA. But as the emerging middle class increasingly gains access to financial services through banks, retailers need to broaden their offer to fend off competition from third-party cards.

Whereas the large majority of those Brazilians that now constitute the emerging middle class had no bank account ten or even five years ago, with the only access to credit through retailers, they are now increasingly sought after by commercial banks. This has already driven a steady decline in private label card participation, from 60% down to 50% of Renner and Marisa sales. We expect this trend to continue, but the speed of this process will depend on the retailer's target consumer and geographic footprint, as well as proactive strategic initiatives.

We see Marisa as relatively better-placed to stem this structural decline, as (1) it targets a **lower income group** that is still relatively more dependent on retailers' credit offers, (2) it has a stronger presence in **less developed regions** like North and Northeastern Brazil (23% vs. 11% Renner), where consumer finance still retains greater appeal, and (3) it may benefit from a **first mover advantage**, having launched its card 1.5 years earlier than Renner and with the expertise of a banking partner (Itaú).

Credit scoring systems are key to profitability in consumer financing, as provisions are the most important expense (42% of Marisa's financing revenues, 40% at Renner). Retailers differ in what they deem to be the best way to manage this operation: while Lojas Renner relies on a long-standing (since 1974) and high quality in-house operation, Marisa launched its card only in 2000 and – following a period of sizeable losses – opted to enter a JV-like agreement with banking partner Itaú in late 2008. Hering also offers a card and financing (operated by Losange [HSBC]), but it is not a relevant part of its strategy or results, and is used primarily for loyalty. We think this is unlikely to change, given its higher income focus and franchise model.

Exhibit 17: Consumer financing plays a role for every Brazilian apparel retailer, but most relevant at the low end
Overview of consumer financing programs among main players

	Lojas Renner	Marisa Lojas	Cia Hering	Riachuelo	C&A
Consumer financing					
# of cards - 000 (2009)	16,400	14,275	126	16,900	20,500
% of sales on credit (own)	57%	47.2%	n.a.	54.8%	
0+5x	50%	38.7%	n.a.	40.4%	
0+8x	7%	8.5%	n.a.	14.4%	
JV partner	None	Itau	None	None	Bradesco (Ibi)
Co-branded	MC, Visa	MasterCard	Visa	MC, Visa	MC, Visa
Delinquency (% of own card receivables)	3.3%	3.6%	n.a.	6.5%	
Launch of co-branded card	3Q10	1Q09	1Q08	2Q10	

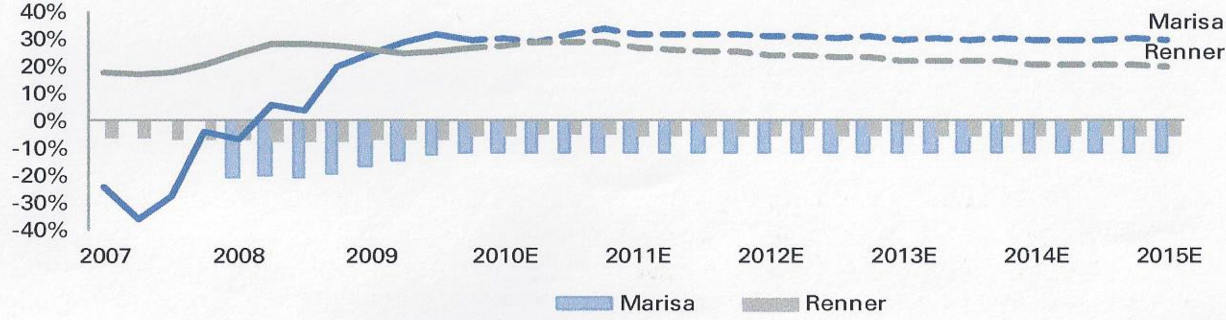
Source: Company data, Goldman Sachs Research estimates

Marisa: Following a period of overextension and subsequent losses in its private label card in 2007, Marisa successfully turned the operation around along 2008/09, by being more rigorous in credit concession and bringing collections back in house. Income from consumer financing already accounting for 24% of consolidated EBITDA in 2009, and with the migration to co-branded cards, management expects this share to reach 30%.

In late 2008, Marisa agreed to a 10-year JV-like partnership with Itaú, and launched a co-branded card. The initial breakeven target of 2 years was achieved after barely one year. The fact that co-branded card holders are pre-selected from among the existing Marisa card holders accelerated the path to profitability, while Itaú's stringent concession process has also helped to keep loss levels low. As of 3Q2010, Marisa had converted 952,400 cards and across the next three to four years, it aims to have converted about a third of the existing card base (14 mn). Although this means its private-label card basis (and income) will gradually shrink, Marisa is confident that its 50% share of the income from the Itaú cooperation will more than offset this. The main reasons are higher usage levels and lower loss rates, as the co-branded card can also be used outside Marisa stores and concession is controlled by Itaú.

Lojas Renner: With Renner card participation gradually declining from the 2003 peak of 75% of sales to closer to 50% today, management decided in mid-2009 to follow other retailers and launch a co-branded card. However, with Renner's conservative approach and no expertise from a banking partner, the project was slow to get off the drawing board. After a period of internal testing, it only recently (September 2010) started piloting some 130,000 card with pre-selected clients in three cities, and expects to convert 1 million cards within the first twelve months of operation. The breakeven target is 1-2 years.

Exhibit 18: Consumer finance accounts for 20% to 30% of Renner and Marisa's EBITDA
Income from financing business/EBITDA (consolidated) - lines, Net provisions/Financed sales, Trailing twelve months %



Source: Company data, Goldman Sachs Research estimates.

Cotton price inflation should be passed through from early 2011

Global cotton prices are up 50% yoy and 36% in the year to date, with a pronounced spike in recent months, which should result in higher input prices for upcoming collections. We estimate that cotton accounts for 60%-70% of input costs for fabric, which in turn accounts for 20%–30% of the garment's end consumer price, depending on the item. As a result, a 60% increase in cotton prices should – if fully passed through – translate into a 10% rise in prices. This is in line with other the other retailers' estimates, and broadly matches the Goldman Sachs US Retail team's expectation for factory-level inflation. We believe a certain inflation pass-through without negative volume reaction is possible, as long as nominal wages continue to enjoy pronounced growth (+8% YTD).

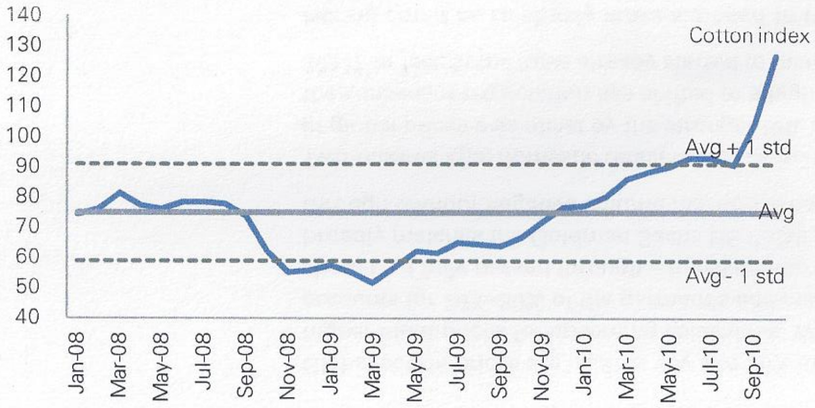
Two months ago, domestic retailers dismissed the risk of any relevant pass-through to end consumer prices, arguing that the spike in global prices was offset by the stronger BRL and that the remainder could be passed up to the fragmented supplier base. Now, the consensus expectation has shifted to a high single to double-digit increase with the next fall/ winter collection (February/March 2011). In fact, some have already started to increase prices of product currently in stores.

Hering could be relatively more exposed to this spike in cotton prices, since (1) its mix has a heavier share of basic items (40%) with high cotton content, (2) being vertically integrated means it is more difficult to push higher costs up the chain. Management plans to only pass a portion through to end prices, absorbing some of it into margins. However, it believes gross margin pressure should be limited to 1H2011, as cotton forward prices are already moderating. Rather than risking a potential negative backlash from frequent re-marking of list prices, Hering prefers to shoulder a certain short-term gross margin pressure, some of which it expects to offset with ongoing expense dilution (we estimate 260 bp on 1H2011 EBITDA margins).

Lojas Renner expects to be able to pass higher costs, not only from cotton, but also freight or labor, fully through to end consumers. It has already started to raise prices with the current spring collection, and expects a 7%-10% rise for affected items in

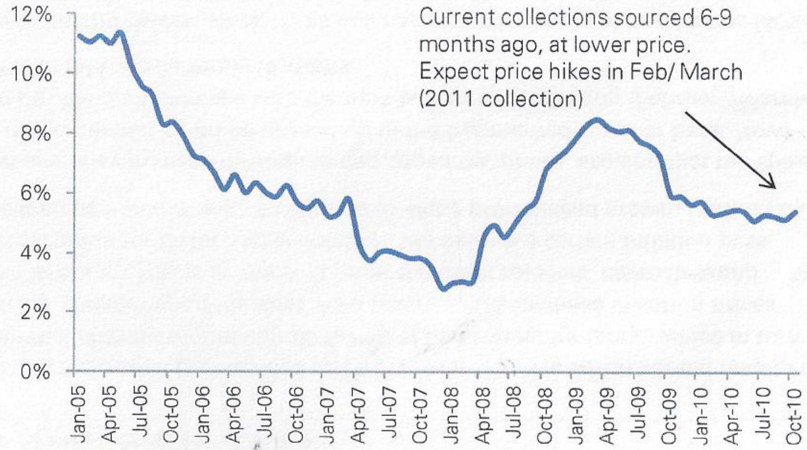
the next fall/winter collection (February/March 2011), and 5%-8% on average overall. **Marisa is similarly confident** that it can raise prices without losing sales, particularly given it is relatively less affected as some 20% of sales are in lingerie, which contains little cotton. In reality, we expect apparel retailers to look to reorient their mix and price points to minimize the visibility of price hikes. The fact that apparel is not a standardized commodity should help in this strategy.

Exhibit 19: Cotton prices have seen a sharp rise in recent months
Cotton commodity price index



Source: National Council for Cotton, Goldman Sachs Research estimates.

Exhibit 20: But should only fully hit consumers by February/March 2011
Brazilian inflation (IPCA index) for apparel and footwear (yoy change)



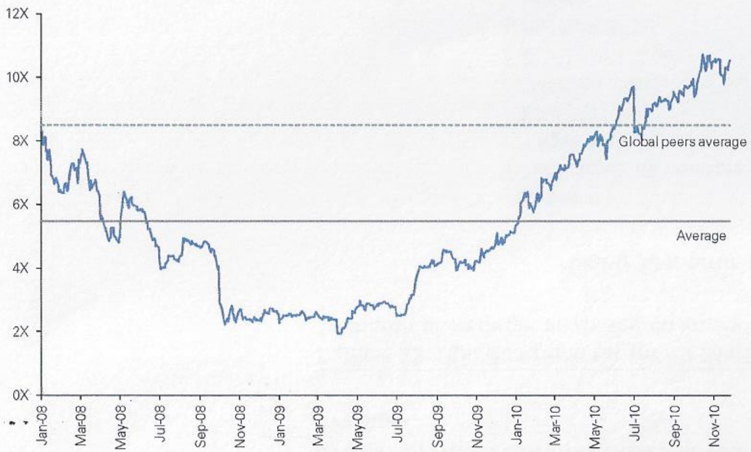
Source: Company data, Goldman Sachs Research estimates.

Valuation: Marisa most attractively valued in LatAm apparel retail

Valuation: Strong outperformance, but still some upside left

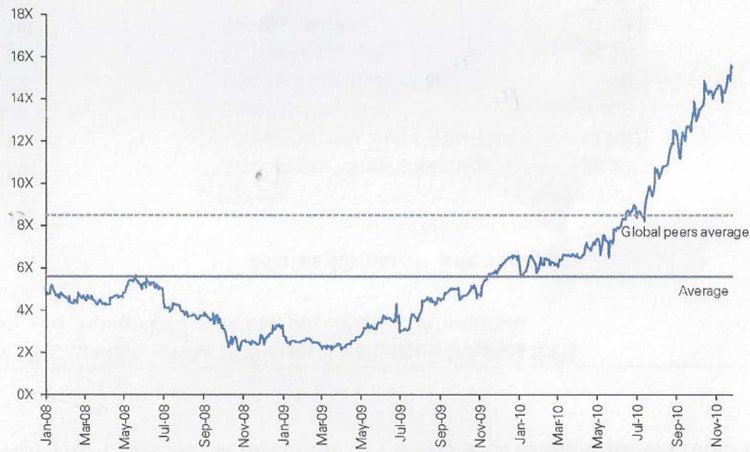
In the last six months and year to date, Hering and Marisa have enjoyed the strongest performance among our LatAm Retail & Consumer Goods coverage, outperforming the Bovespa index by 95% (6m)/ 207% (YTD) (Hering) and 36%/ 142% (Marisa) respectively. While we see further upside for both on a DCF basis, we see greater relative room for multiple expansion and estimate upgrades at Buy-rated Marisa. Our EBITDA estimates for Marisa are 3%-4% above consensus, while they are in line for Hering. We initiate on Hering with a Neutral rating, as we believe the sharp outperformance leaves the stock vulnerable to profit taking, particularly given the higher relative risk of gross margin pressures in 1H2011 from higher cotton prices.

Exhibit 21: Strong YTD outperformance have taken Marisa...
Marisa: Forward EV/EBITDA multiple



Source: Company data, Goldman Sachs Research estimates.

Exhibit 22: ...and Hering valuations to above the global average
Hering: Forward EV/EBITDA multiple



Source: Company data, Goldman Sachs Research estimates.

DCF valuations imply upside for both companies

We determine our 12-month target prices for Marisa and Hering using an equal-weighted blend between a three-stage DCF and a target multiple for forward EV/EBITDA. We use a cost of equity of 10% and a terminal growth rate of 6.0% (nominal US$ terms). Our target multiples of 12.7X forward EV/EBITDA for Hering and 11.0X for Marisa are set in reference to the 5-year historic average of Lojas Renner, which has a longer trading history. Their faster expected growth rates could justify a premium valuation for both Hering and Marisa (EBITDA CAGR of +28% and +23% vs. +20% for Renner). However, because of its shares' lower liquidity (US$3 mn ADTV), we set Marisa's target multiple in line with Renner's historical trading average (11X). For Hering, liquidity is no longer a constraint (US$13 mn ADTV), and the growth outlook is markedly above that for Renner, so we attribute a 15% premium (12.7X).

Our DCF valuations imply 39% and 34% upside for both Marisa and Hering, but we see relatively more room for multiple expansion at Marisa, which currently trades at 10.2X 2011E EV/EBITDA and 19.9X P/E, at discounts of 7% and 43% to the Brazilian retail sector average.

Exhibit 23: Blended price target for Marisa (Buy) implies 19% upside, while DCF-based valuation implies 34%
12-month price target are based on an equal-weighted blend of a 3-stage DCF and a target EV/EBITDA multiple

Hering 12-month price target

R$ basis	
12m target, R$ (multiple based)	**24.35**
Target multiple, fwd EV/EBITDA	**12.7X**
Fwd EBITDA	308
Net debt (cash), as of 3Q11E	**-63**
DCF-based target	**39.90**
Blended target	**32.10**
Upside	**+8%**
Implied 2011E EV/EBITDA	**15.4X**
Implied 2011E P/E	**23.7X**

Marisa 12-month price target

R$ basis	
12m target, R$ (multiple based)	**26.28**
Target multiple, fwd EV/EBITDA	**11.0X**
Fwd EBITDA	439
Net debt (cash), as of 3Q11E	**-19**
DCF-based target	**36.70**
Blended target	**31.50**
Upside	**+19%**
Implied 2011E EV/EBITDA	**12.1X**
Implied 2011E P/E	**23.7X**

* For DCF details please refer to Exhibits 44 and 45 on appendix section

Source: Company data, Goldman Sachs Research estimates

Exhibit 24: Brazilian apparel retailers trade at a premium to mature market peers, but valuations look reasonable compared to peers in Emerging Asia

Global valuation table for apparel retail, clothing & accessories, department stores (China). Priced as of close of November 29, 2010.

Global apparel retailers	Mkt cap US$ mn		Last Price	Rating	EV/EBITDA		EBITDA CAGR	P/E		EPS CAGR	PEG		ROIC	
					2011E	2012E	2010E-12E	2011E	2012E	2010E-12E	2011E	2012E	2011E	2012E
Brazil														
Cia Hering	2,794	R$	29.7	Neutral	14.2x	11.0x	+28%	22.0x	17.5x	+28%	0.8x	0.6x	37%	36%
Lojas Renner	4,200	R$	59.5	Neutral	12.4x	10.1x	+20%	22.0x	18.6x	+14%	1.5x	1.3x	26%	26%
Marisa Lojas	2,816	R$	26.4	Buy	10.2x	8.2x	+23%	19.9x	15.7x	+24%	0.8x	0.7x	22%	23%
Brazil: Average					**12.3x**	**9.7x**	**+24%**	**21.3x**	**17.3x**	**+22%**	**1.0x**	**0.9x**	**28%**	**29%**
Premium (discount) to US & Europe					*+61%*	*+46%*	*+87%*	*+14%*	*+3%*	*-16%*	*-7%*	*-17%*	*+11%*	*+14%*
Premium (discount) to Japan					*+103%*	*+82%*	*+356%*	*+21%*	*+10%*	*+145%*	*-64%*	*-63%*	*+31%*	*+34%*
Premium (discount) to Hong Kong					*-6%*	*-6%*	*-8%*	*+7%*	*+6%*	*-9%*	*+18%*	*+17%*	*-13%*	*-19%*
Premium (discount) to Shangai					*-22%*	*-23%*	*+22%*	*-38%*	*-39%*	*-15%*	*-32%*	*-33%*	*+42%*	*+35%*
Emerging Asia														
Hong Kong listed														
Bosideng International Holdings	4,044	HK$	4.0	Neutral	9.8x	9.1x	+33%	15.0x	14.4x	+33%	0.5x	0.4x	26%	29%
Esprit Holdings	6,229	HK$	37.6	Buy	6.9x	5.5x	+14%	11.8x	9.6x	+8%	1.4x	1.1x	35%	35%
Li & Fung	23,768	HK$	48.4	Buy	20.4x	16.2x	+27%	25.2x	19.7x	+29%	0.9x	0.7x	96%	106%
Maoye International Holdings	2,661	HK$	4.0	Buy	12.4x	9.8x	+31%	25.1x	20.0x	+26%	1.0x	0.8x	15%	17%
Intime Department Store (Group) Co.	2,964	HK$	12.1	Buy	18.8x	13.6x	+34%	24.8x	19.0x	+33%	0.7x	0.6x	10%	13%
Parkson Retail Group	4,671	HK$	12.9	Neutral	13.4x	11.2x	+21%	23.2x	19.7x	+24%	0.9x	0.8x	29%	33%
Ports Design	1,736	HK$	24.0	Sell	14.7x	11.8x	+21%	21.3x	17.6x	+18%	1.2x	1.0x	22%	24%
Xtep International Holdings	1,895	HK$	6.8	Buy	7.7x	6.1x	+24%	12.3x	10.6x	+22%	0.6x	0.5x	26%	27%
Hong Kong: average					**13.0x**	**10.4x**	**+26%**	**19.8x**	**16.3x**	**+24%**	**0.9x**	**0.7x**	**32%**	**35%**
Shanghai listed														
Beijing Wangfujing Department Store (Grou	2,736	Rmb	46.4	Buy	11.5x	8.7x	+25%	27.4x	22.0x	+30%	0.9x	0.7x	39%	39%
Dashang Group Co	2,360	Rmb	53.5	Neutral	13.7x	11.7x	+21%	38.5x	32.9x	+52%	0.7x	0.6x	13%	13%
Guangzhou Friendship Group Co	1,509	Rmb	27.9	Buy	13.1x	9.3x	+25%	24.1x	18.7x	+25%	1.0x	0.8x	24%	26%
Shanghai Bailian Group Co	2,737	Rmb	16.6	Neutral	12.2x	10.5x	+14%	32.7x	29.4x	+13%	2.4x	2.2x	12%	13%
Wuhan Department Store Group Co.	1,451	Rmb	19.1	Neutral	12.1x	11.3x	+2%	30.0x	24.2x	+17%	1.8x	1.4x	17%	20%
Hunan Friendship & Apo. Co	1,310	Rmb	25.0	Sell	16.1x	13.2x	+16%	32.5x	27.2x	+16%	2.0x	1.7x	17%	18%
Shanghai Metersbonwe Fashion & Accesso	5,847	Rmb	38.8	Neutral	30.8x	24.3x	+33%	56.6x	44.9x	+28%	2.0x	1.6x	17%	20%
Shanghai: average					**15.6x**	**12.7x**	**+19%**	**34.6x**	**28.5x**	**+26%**	**1.6x**	**1.3x**	**20%**	**21%**
US & Europe														
Abercrombie & Fitch	4,238	$	48.8	Buy	6.7x	4.8x	+28%	26.5x	17.8x	+56%	0.5x	0.3x	11%	15%
Aeropostale	2,691	$	26.9	Neutral	4.9x	4.5x	+2%	10.4x	10.4x	+6%	1.7x	1.7x	37%	30%
American Eagle Outfitters Inc.	3,443	$	16.7	Neutral	5.8x	5.2x	+5%	15.8x	15.1x	+7%	2.4x	2.3x	15%	15%
Ann Taylor Stores Corp.	1,524	$	25.8	Neutral	5.2x	4.1x	+36%	20.5x	17.1x	+134%	0.2x	0.1x	18%	17%
Gap Inc.	15,188	$	20.7	Neutral	4.8x	4.6x	-2%	11.4x	11.3x	+8%	1.5x	1.5x	26%	25%
J. Crew Group, Inc.	2,721	$	43.7	Not Rated	8.3x	7.5x	+6%	21.1x	20.3x	+6%	3.5x	3.4x	25%	22%
Limited Brands, Inc.	10,878	$	33.5	Sell	7.8x	7.4x	+14%	17.4x	17.1x	+26%	0.7x	0.7x	39%	36%
Polo Ralph Lauren Corporation	10,218	$	108.7	Neutral	10.5x	9.5x	+7%	19.9x	18.0x	+13%	1.5x	1.4x	19%	20%
Chico's FAS, Inc.	2,130	$	12.1	Sell	6.2x	5.9x	+12%	18.6x	18.6x	+21%	0.9x	0.9x	13%	12%
Ross Stores, Inc.	7,675	$	64.2	Neutral	6.6x	5.9x	+12%	14.4x	12.8x	+19%	0.8x	0.7x	38%	39%
Urban Outfitters Inc.	6,388	$	38.2	Neutral	11.6x	9.4x	+20%	23.2x	20.1x	+22%	1.1x	0.9x	21%	21%
Nordstrom, Inc.	9,223	$	42.6	Neutral	7.4x	6.4x	+17%	15.7x	14.0x	+25%	0.6x	0.6x	15%	16%
The TJX Companies, Inc.	18,021	$	45.3	Neutral	6.4x	5.6x	+9%	13.4x	11.9x	+16%	0.9x	0.8x	38%	39%
Kohl's Corp.	17,383	$	56.4	Buy	6.5x	5.4x	+10%	15.1x	13.1x	+15%	1.0x	0.9x	13%	13%
J.C. Penney Company	7,750	$	32.8	Not Rated	6.9x	6.8x	+4%	22.5x	22.6x	+15%	1.5x	1.5x	6%	6%
The Buckle, Inc.	1,802	$	38.3	Neutral	7.2x	7.6x	-3%	13.9x	15.3x	-4%	n.m.	n.m.	24%	21%
The Children's Place Retail Stores, Inc.	1,453	$	51.4	Buy	6.0x	4.7x	+7%	18.2x	14.5x	+16%	1.2x	0.9x	18%	17%
lululemon athletica inc.	3,706	$	53.6	Buy	19.1x	14.7x	+43%	42.2x	33.2x	+40%	1.1x	0.8x	29%	27%
rue21, inc.	655	$	29.9	Neutral	9.5x	7.4x	+25%	25.0x	20.6x	+22%	1.2x	0.9x	31%	32%
Benetton Group	1,042	€	4.6	Neutral	4.4x	4.0x	+5%	6.8x	6.3x	+7%	1.0x	0.9x	8%	9%
Next	5,971	£	2,015	Neutral	5.8x	5.4x	+6%	8.9x	8.2x	+13%	0.7x	0.6x	64%	59%
Kappahl Holding AB	539	Skr	50.5	Buy	6.0x	5.0x	+16%	7.8x	6.5x	+18%	0.4x	0.4x	45%	50%
Hennes & Mauritz	55,590	Skr	236.2	Neutral	11.6x	10.3x	+11%	18.5x	16.4x	+11%	1.7x	1.5x	45%	46%
Inditex	46,819	€	57.4	Buy	10.7x	9.3x	+19%	20.8x	18.3x	+22%	0.9x	0.8x	36%	37%
Charles Voegele	479	SFr	54.5	Sell	4.8x	4.9x	+4%	39.9x	40.5x	+125%	0.3x	0.3x	4%	3%
US & Europe: Average					**7.6x**	**6.7x**	**+13%**	**18.7x**	**16.8x**	**+26%**	**1.1x**	**1.0x**	**25%**	**25%**
Japan: Average					**6.1x**	**5.4x**	**+5%**	**17.6x**	**15.7x**	**+9%**	**2.9x**	**2.3x**	**22%**	**21%**

Brazilian apparel retailers valuation and growth are similar to Emerging Asia. Within our coverage we prefer Marisa which offers high growth both on EBITDA and EPS and trades at a discount to its Brazilian peers Hering and Renner

US, Europe and Japan trade at lower multiples, but also offer less scope for structural growth

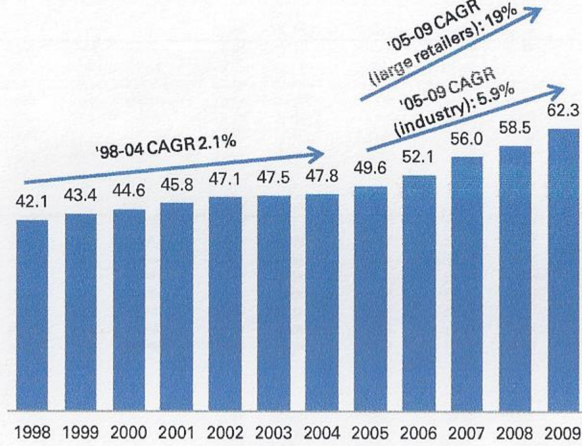
Source: Company data, Goldman Sachs Research estimates.

Brazil's apparel retail market: Poised for growth and formalization

Apparel retailing is a R$62 bn market in Brazil, and while it grew at a modest nominal +2.1% pa in 1998-2004, the pace accelerated to +5.9% in 2005-2009, on the back of strong wage growth, declining real interest rates and abundant consumer credit. During this period, the major chains (Guararapes, Renner, Marisa, Hering) expanded at a much faster pace (+19%), implying a gradual consolidation as they captured a greater share of new demand. As all four tapped the equity market for capital between 2005 and 2007, they were well-positioned to invest in new sales area and expand their store footprint. Unlike small, informal players that still account for at least 40% of the market (source: Renner), they were also able to attract consumers with generous credit offers, allowing them to pass on falling base interest rates and thus leverage sales floor productivity.

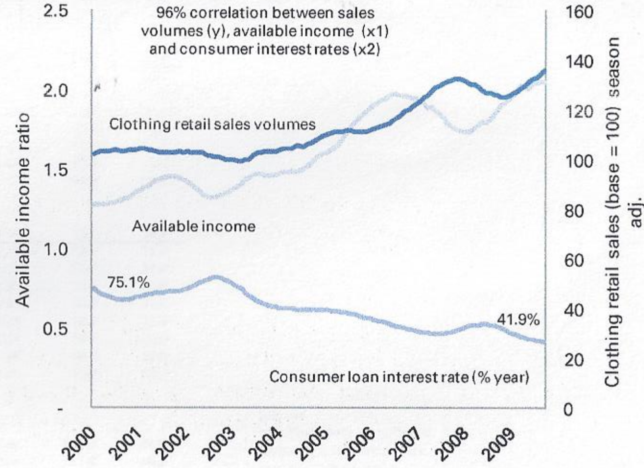
Available income (defined as the ratio of the minimum wage to *cesta básica* or basic spend) and consumer credit are key drivers of consumption growth in general, but of particular importance for discretionary products like apparel. As Exhibit 26 illustrates, the pronounced rise of available income (2001-10 CAGR +5.1%), combined with steadily declining rates on consumer loans (from 75% pa in 2000 to 42% in 2010) fuelled apparel retail sales by an average annual rate of 3.0% in the same period.

Exhibit 25: Large retail chains expand faster, gaining share
Brazil apparel ex-footwear sales (R$ bn)



Source: Euromonitor, Company data, Goldman Sachs Research.

Exhibit 26: Income and interest rates are important variables to explain growth in clothing sales
Av. Income (min. wage/basic spend basket), sales vol, int. rate (%)



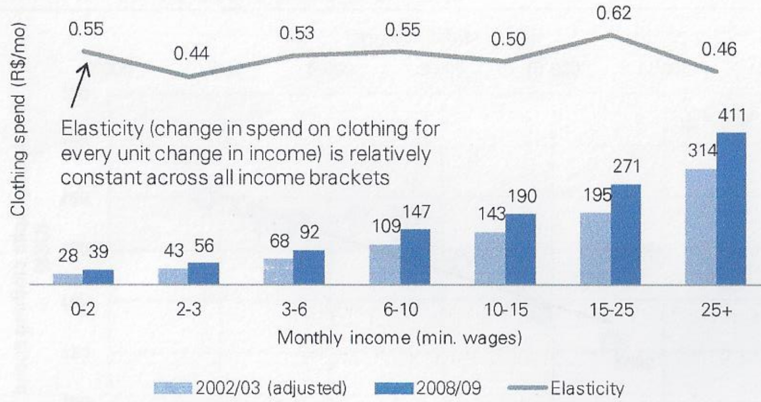
Source: IBGE, Brazilian Central Bank, DIEESE, Brazilian Ministry of Labor, Goldman Sachs Research.

We illustrate the discretionary nature of spend on clothing below, with income elasticity that is remarkably stable across different income brackets (Exhibit 27), resulting in constant returns to rising levels of income (Exhibit 28).

Elasticity (defined as the change in spend for every unit change in income) is highest among households earning between 15 and 25 minimum wages per month (US$3,500-5,800) at 0.62, implying that if income rises by 10%, spend on clothing increases by about 6%. Unlike more basic consumption needs like food, where above a certain threshold the rise in income is not accompanied by a diminishing rise in spend, the incremental spend on apparel remains relatively constant. This highlights the discretionary nature of apparel retailing, where consumers not only look to dress themselves, but to transmit additional messages like social status and lifestyle preferences.

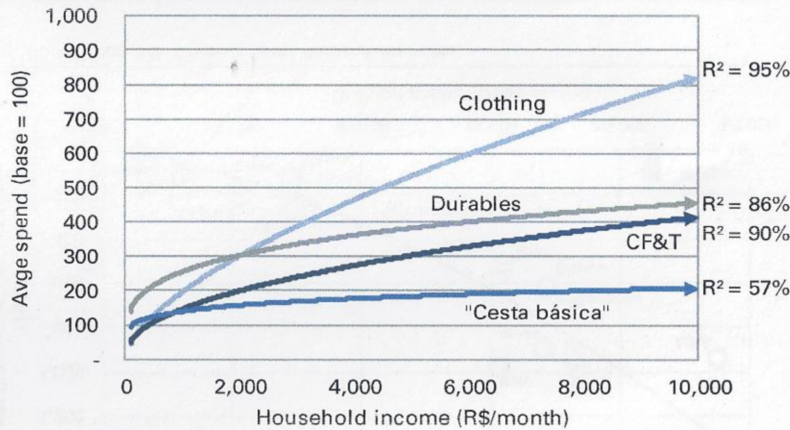
As opposed to other discretionary categories like durables, there are few limits on how many additional pieces a richer household may want to purchase. The increase in spend results not only from a higher number of items per wardrobe, but also a bigger average ticket. Different pricing points also apply for other consumption categories, but the disparity between a mass market and a designer item is arguably much more pronounced. The fact that wardrobes are typically upgraded with rising levels of income explains the high correlation between household income and average spend.

Exhibit 27: "Flattish" elasticity of clothing spend across income brackets
Average household clothing spend (R$ per month) in 2008/09 vs. 2002/03



Source: POF, Goldman Sachs Research.

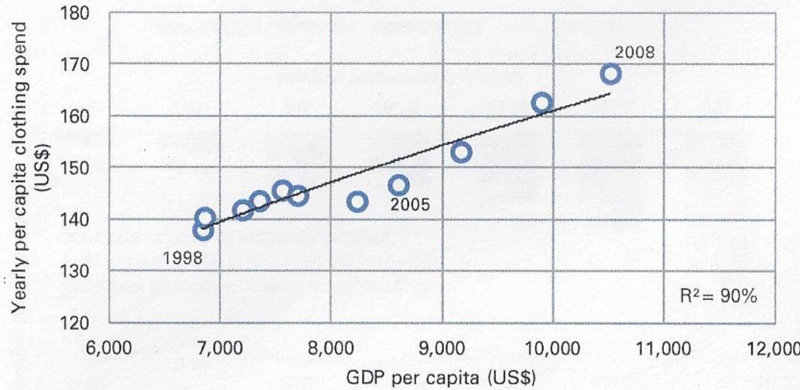
Exhibit 28: Strong correlation to income, at nearly linear relationship
Average monthly spend across income levels (base = 100)



Source: POF Micro data, Goldman Sachs Research.

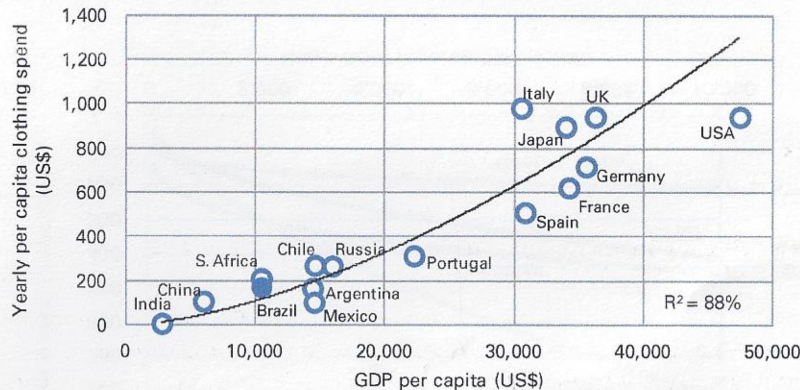
With rising levels of income, Brazilians have increased spend on clothing, so that monthly per capita consumption is now 107% above the level 10 years ago at R$307 vs. R$149 in 1999. Yet, it is still significantly below wealthier economies like the US, UK and Japan. Brazil also lags other markets in terms of penetration of formal retail space and sales floor productivity. If we assume constant growth at the current rate, Brazil should reach the level of United States and Japan per capita spend in 12 years.

Exhibit 29: With rising incomes, Brazilian have also spent more on clothes
Brazil: Annual clothing spend per capita (US$) vs. GDP per capita (US$)



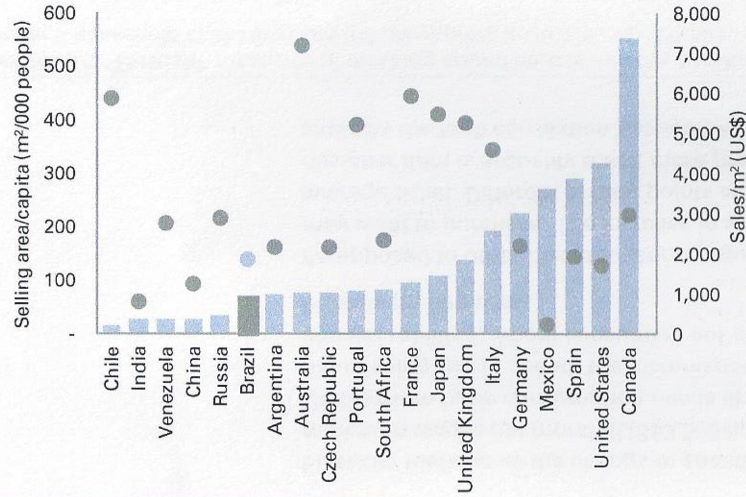
Source: Euromonitor, IMF, Goldman Sachs Research estimates.

Exhibit 30: But still much less than consumers in richer economies
Global: Annual clothing spend per capita (US$) vs. GDP per capita (US$)



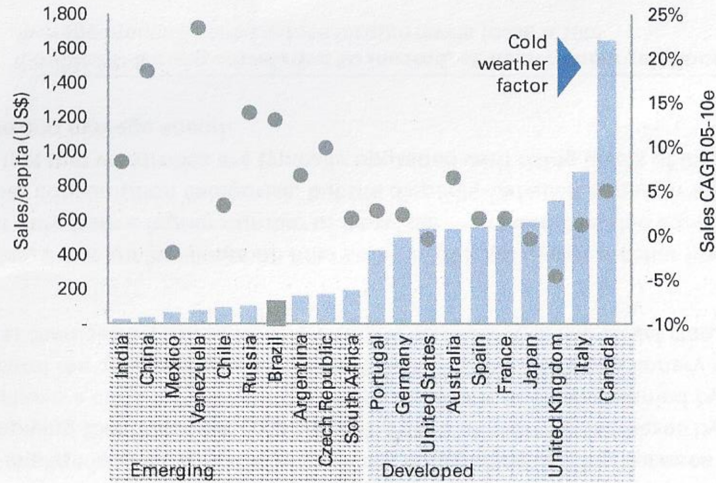
Source: Euromonitor, IMF, Goldman Sachs Research estimates.

Exhibit 31: Room to catch up in selling area and productivity...
Selling area per thousand people (bars), annual sales per m² (dots)



Source: Euromonitor, Goldman Sachs Research.

Exhibit 32: ...converging to developed markets' per capita consumption
Sales per capita (bars), sales CAGR 2005-2010E (dots)



Source: Euromonitor, Goldman Sachs Research.

Card penetration and legislation should drive gradual formalization

The Brazilian apparel retail market is highly fragmented, with at least 40% of the market dominated by informal outlets, while the five largest chains together represent only 23% of the market (see Exhibit 33).

Several sub-sectors of the Brazilian retail market are benefiting from the so-called "Substituição Tributária", a legislative change that essentially marks a clampdown on tax evasion, as it shifts the burden of sales tax collection from the retail to the supplier level. This forces the retailer to purchase goods at a price that already includes the tax, making it economically unattractive to exclude it when setting the price to the end consumer. This measure has already been implemented for fuels, food, personal care and drugs, but not yet apparel, possibly because the supplier level is so highly fragmented that it would be difficult to enforce.

However, there are some other drivers of gradual formalization in the sector:

- **Higher penetration of credit cards (usage)** makes it easier for authorities to track retail transactions and thus potential tax evasion. Card transactions represent some 23% of private consumption expenditure vs. 19% in 2007 and 15% in 2005, but we believe there is still plenty of room to grow as penetration remains low in the low-income classes. Among low-income classes D and E, only 41% of those older than 18 years hold either a debit, credit or private label store card, compared with 83% in the A and B income classes (source: Datafolha surveys).
- **Incentives for electronic invoicing (Nota Fiscal Eletrônica)** have been implemented in four Brazilian states, including São Paulo and Rio de Janeiro (45% of the country's GDP). The measure incentivizes customers to request a tax receipt when paying for goods and services, as they receive back a certain portion of the tax paid in credits.
- **SPED** is the replacement of the traditional pen and paper tax book with a digital bookkeeping system for taxes. The information that is inputted by contributors can be exchanged between city, state and federal governments as deemed necessary. The authorities expect to have better control over informal activity since they are able to quickly cross-check information for inconsistencies. The deadline for compliance was July 30, 2010.

Exhibit 33: Six largest retailers account for 23% of Brazil's "official" apparel market; closer to 15% taking into account informality
Companies' shares by sales (%)

Brazil	2004	2005	2006	2007	2008	2009
Clothing and Footwear Specialist Retailers						
C&A Brazil	8.2	7.8	9.4	10.1	10.1	7.6
Lojas Renner	3.9	3.4	4.3	4.9	5	5.5
Lojas Riachuelo (Guararapes)	4.8	4	4.4	4.4	4.5	4.7
Lojas Marisa	2	2	2.6	3.5	3.6	3.7
Hering	1.4	1	0.6	0.6	1	1.5
Zara (Inditex)	0.8	0.7	1	1	1	1
Others	78.9	81	77.8	75.6	74.8	76.2
Total	100	100	100	100	100	100

Source: Euromonitor, Company data, Goldman Sachs Research estimates.

Appendix: Brazilian apparel industry: fragmentation all along the chain

Exhibit 34 provides an overview of the apparel supply chain in Brazil. Fragmentation is evident across the different levels, but is probably greatest at the apparel supplier level. Retailers that are not vertically integrated, like Marisa and Lojas Renner, typically work with 300-400 different suppliers, the large majority of which are domestic. No single supplier usually accounts for more than 5% of purchase volumes, while the retailer also does not buy more than 20% of the supplier's production. Exclusive suppliers are rare, although the actual product will be exclusively manufactured and supplied.

With greater focus on labor conditions in the production of consumer goods, most Brazilian retailers now audit suppliers, as well as their suppliers further down the chain.

Exhibit 34: Fragmentation and informality on all levels of Brazil's apparel industry
Structure of Brazilian apparel industry

	Clothing
Estimated industry size	R$62.3 bn
Industry	Intense competition from informal players and imports (China) and low barriers to entry characterize high fragmentation. Limited vertical integration squeezes margins further and production is largely regional. Informality estimated at 40%
Large players industry share (%)	11%
Retail	Returns stemming from margins rather than turnover (high WC needs). Low market concentration vs developed economies (<10% vs. estimated 30-40%) and sector formality make way for further share gains by large retailers. Consumer financing limited to large retailers, offering competitive advantage.
% small retailers in total sales	85-90%
Consumer	Strong correlation between consumer spend and household income. Lack of consumer financing in N/NE regions presents further pent up demand.
Correlation to income	~95%
Initiatives for formalization	SPED (electronic invoice)

Source: Company data, Euromonitor, IEMI, Goldman Sachs Research estimates.

Importance of imports: Foreign suppliers vs. local suppliers

The Brazilian apparel manufacturing industry benefits from high import taxes, government financing (through development bank BNDES), tax incentives (mainly ICMS), and low labor costs (although higher than in many Asian countries). As a result, Brazilian retailers typically import no more than 15% of their annual sales, with a heavier share during the winter month (2Q). Imported apparel has a higher pricing point and very long lead times (up to one year). As a result, most retailers, particularly those catering to the mid-and-lower income classes, are forced to limit the share in collection – despite high gross margins often being higher.

Exhibit 35: Overview of Brazil's top five apparel retailers, all of which are listed, except privately-held Dutch C&A
Selected operating metrics of large apparel retailers in Brazil, latest available

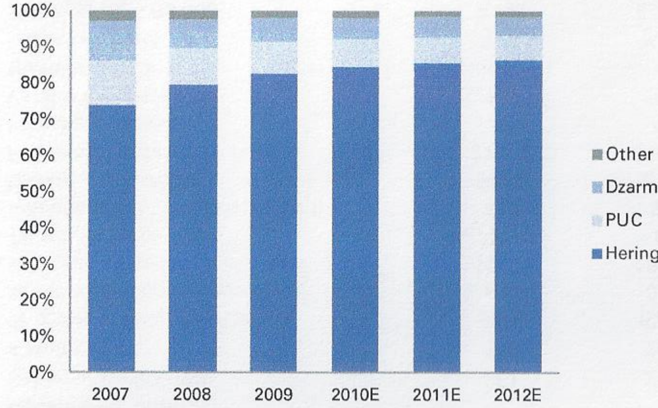
	Lojas Renner	Marisa Lojas	Cia Hering	Riachuelo	C&A (as of 2009)
Financial data					
Total net sales (retail) - R$mn	2,351	1,615	920	2,080	4,381
Gross margin	49.3%	52.7%	48.9%	48.7%	
EBITDA margin	21.1%	22.4%	25.7%	22.8%	
Working capital - % of net sales	25.8%	27.3%	22.5%	29.4%	
Cash conversion cycle (days)	**118**	**115**	**95**	**135**	
Inventory days	40	43	42	68	
Receivable days	113	106	81	101	
Payable days	36	34	28	34	
Net Debt / EBITDA	0.0x	0.0x	-0.2x	0.3x	
Operational data					
Selling area - 000 m2	261	263	39[1]	293	341
# of stores	126	240	303[1]	114	178
% stores in Shopping Centers	94%	52%	17%	65%	75%
% stores owned vs. leased	n.a.	0%	n.m.	40%	
% stores owned vs. franchised	100%	100%	12%	100%	100%
Target consumer class	A- / B / C+	C	A / B / C	B / C / D	B / C / D
Average ticket (private label card)	126	95	89	111	
Market share (2009)	5.5%	3.7%	1.5%	4.7%	7.6%
Presence - states	21 + 1	24 + 1	23 + 1	21 + 1	26 + 1
Presence - regions	All	All	All	All	All
Vertical integration	No	No	Yes	Yes	No
Number of DCs	2	4	3	2	2
Loyalty program	Yes	Yes	Yes	Yes	Yes
Sales per m2 - R$ 000	9,292	6,399	22274[2]	7,380	
Avge store size - m2	2,072	1,097	128[1]	2,573	
EBITDA per m2 - R$ 000	1,964	1,434	n.m.	1,684	
Employees	12,191	11,658	n.a.	39,834	

Note: Considers latest available data. (1) Hering Store only. (2) Sell out concept.

Source: Company data, Euromonitor, Goldman Sachs Research estimates.

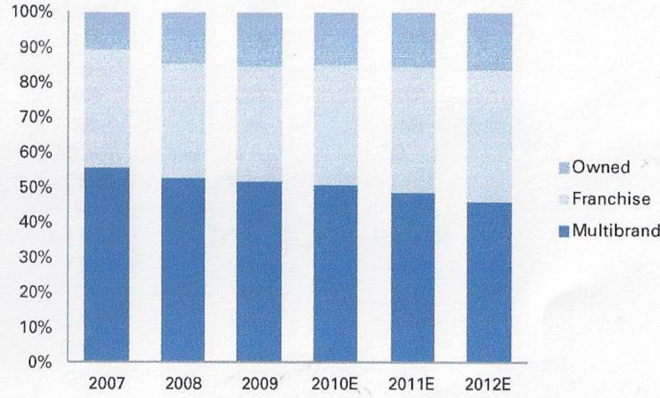
Appendix: Hering (HGTX3.SA)

Exhibit 36: Sales breakdown by brand



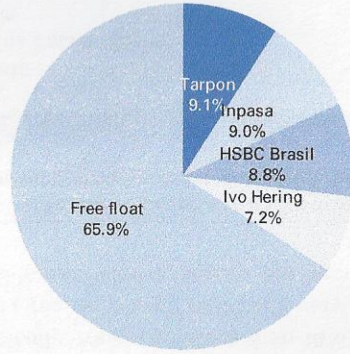
Source: Company data, Goldman Sachs Research estimates.

Exhibit 37: Sales breakdown by channel



Source: Company data, Goldman Sachs Research estimates.

Exhibit 38: Cia Hering shareholder structure
As of November 2010



Source: Economatica, Company data, Goldman Sachs Research estimates.

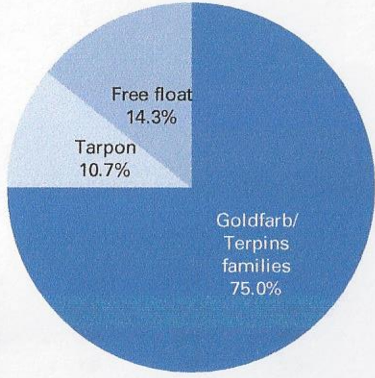
Exhibit 39: Cia Hering composition of the board
As of November 2010

Name	Position	Mandate ends
Ivo Hering	Chairman	Apr-11
Fabio Hering	Member/CEO/IRO	Apr-11
Patrick Morin Jr	Member (ind.)	Apr-11
Nei Zelmanovits	Member	Apr-11
Arthur Negri	Member (ind.)	Apr-11
Marcelo Lima	Member (ind.)	Apr-11
Marcio Pereira Jr	Member (ind.)	Apr-11

Source: Company data, Goldman Sachs Research estimates.

Appendix: Marisa Lojas (AMAR3.SA)

Exhibit 40: Marisa Lojas shareholder structure
As of June 2010



Source: Economática, Company data, Goldman Sachs Research estimates.

Exhibit 41: Marisa Lojas composition of the board
As of November 2010

Name	Position	Mandate ends
Marcio Luiz Goldfarb	Chairman/CEO	Aug-11
Decio Goldfarb	Member	Aug-11
Denise Goldfarb Terpins	Member	Aug-11
Jose C Magalhaes	Member	Aug-11
Cassio Casseb Lima	Member (ind.)	Aug-11

Source: Company data, Goldman Sachs Research estimates.

Appendix: Summary financials and DCF models

Exhibit 42: Marisa (AMAR3.SA): Summary financials
R$ million, except per share and operational data

Income statement	2009	2010E	2011E	2012E
Net revenue (retail)	**1,434**	**1,723**	**2,164**	**2,631**
Net revenue (total)	1,756	2,073	2,539	3,076
Cost of goods and services (Retail)	(682)	(814)	(1,018)	(1,243)
Gross profit (Retail)	**752**	**909**	**1,136**	**1,388**
Gross margin	*52.5%*	*52.8%*	*52.8%*	*52.7%*
Total operational expenses (exc. Depreciation)	(539)	(636)	(796)	(961)
Income from Sax and Marisa card	69	114	140	162
EBITDA	**282**	**387**	**480**	**588**
EBITDA margin (reported)	*19.7%*	*22.5%*	*22.3%*	*22.4%*
Depreciation and amortization	(84)	(100)	(110)	(132)
EBIT	**198**	**288**	**370**	**457**
Net financial result	(15)	(20)	(39)	(38)
Income bef. taxes and min. interest	**183**	**268**	**331**	**419**
Total income tax	(42)	(66)	(86)	(109)
Net income	**141**	**202**	**245**	**310**
EPS	0.77	1.09	1.33	1.68

Operational data	2009	2010E	2011E	2012E
# of stores	227	278	340	402
new stores y-on-y	*+10*	*+51*	*+62*	*+62*
Total selling area	250	299	349	396
y-on-y growth	*+6%*	*+19%*	*+17%*	*+13%*
Same-store sales (SSS) (%)	+4%	+13%	+11%	+11%

Balance sheet	2009	2010E	2011E	2012E
Cash & cash equivalents	356	425	398	484
Accounts receivable	551	667	831	949
Inventory	147	178	222	268
Other current assets	66	79	99	119
Total current assets	1,120	1,350	1,551	1,820
Net PP&E	240	294	354	393
Net intangible assets	52	80	80	80
Other long-term assets	86	144	144	144
Total assets	**1,498**	**1,867**	**2,129**	**2,437**
Accounts payable	162	196	244	294
Short-term debt	154	252	252	252
Other current liabilities	214	218	272	327
Total current liabilities	530	667	769	874
Long-term debt	96	158	158	158
Other long-term liabilities	168	192	192	192
Total long-term liabilities	264	350	350	350
Total liabilities	794	1,017	1,119	1,224
Total shareholders' equity	704	851	1,011	1,213
Total liabilities and sh. Equity	**1,498**	**1,867**	**2,129**	**2,437**

Additional financials	2009	2010E	2011E	2012E
Net debt/equity (%)	-15%	-2%	1%	-6%
Interest cover (X)	3.2	5.5	4.0	5.0
Inventory days	72.0	73.1	71.9	71.9
Receivable days	142.3	129.0	126.9	123.5
BVPS (R$)	3.82	4.61	5.48	6.57
ROA (%)	9%	12%	12%	14%
CROCI (%)	19%	28%	27%	28%
Dupont ROE (%)	20%	24%	24%	26%
Margin (%)	10%	12%	11%	12%
Turnover (X)	1.0	0.9	1.0	1.1
Leverage (X)	2.1	2.2	2.1	2.0
Free cash flow per share (R$)	0.87	(0.02)	0.32	1.05
Free cash flow yield (%)	14%	0%	1%	4%

Source: Company data, Goldman Sachs Research estimates.

Exhibit 43: Hering (HGTX3.SA): Summary financials
R$ million, except per share and operational data

Income statement	2009	2010E	2011E	2012E
Net revenue	**721**	**998**	**1,271**	**1,556**
Cost of goods and services (Retail)	(380)	(508)	(661)	(793)
Gross profit (Retail)	**341**	**490**	**610**	**762**
Gross margin	*47.3%*	*49.1%*	*48.0%*	*49.0%*
Total operational expenses (exc. Depreciation)	(187)	(224)	(272)	(328)
EBITDA	**164**	**267**	**338**	**434**
EBITDA margin (reported)	*21.4%*	*26.7%*	*26.6%*	*27.9%*
Depreciation and amortization	(19)	(29)	(35)	(51)
EBIT	**135**	**238**	**302**	**383**
Net financial result	(10)	7	17	18
Other non-operating income (exp.)	61	(0)	-	-
Income bef. taxes and min. interest	**186**	**244**	**319**	**401**
Total income tax	(71)	(75)	(99)	(124)
Net income	**115**	**169**	**220**	**277**
EPS	0.71	1.04	1.35	1.70

Operational data	2009	2010E	2011E	2012E
Hering store				
# of stores	276	337	405	474
new stores y-on-y	*+46*	*+61*	*+68*	*+69*
Total selling area	35	43	52	61
y-on-y growth	*+19%*	*+22%*	*+20%*	*+17%*
Same-store sales (SSS) (%)	+27%	+25%	+19%	+18%
PUC				
# of stores	74	78	84	88
new stores y-on-y	*+15*	*+4*	*+6*	*+4*

Balance sheet	2009	2010E	2011E	2012E
Cash & cash equivalents	102	85	80	115
Accounts receivable	215	286	368	444
Inventory	89	119	153	184
Other current assets	26	35	45	54
Total current assets	433	525	645	798
Net PP&E	175	220	303	372
Net intangible assets	15	28	28	28
Other long-term assets	30	31	31	31
Total assets	**655**	**804**	**1,007**	**1,228**
Accounts payable	54	72	92	112
Short-term debt	37	14	14	14
Other current liabilities	99	97	124	150
Total current liabilities	190	183	231	276
Long-term debt	41	46	46	46
Other long-term liabilities	108	114	114	114
Total long-term liabilities	148	160	160	160
Total liabilities	338	343	391	436
Total shareholders' equity	316	461	616	792
Total liabilities and sh. Equity	655	804	1,007	1,228

Additional financials	2009	2010E	2011E	2012E
Net debt/equity (%)	-8%	-5%	-3%	-7%
Interest cover (X)	3.5	8.6	9.1	11.2
Inventory days	79.1	74.8	74.9	77.5
Receivable days	97.5	91.7	93.9	95.3
BVPS (R$)	1.95	2.84	3.79	4.87
ROA (%)	17%	23%	24%	25%
CROCI (%)	31%	48%	34%	35%
Dupont ROE (%)	36%	37%	36%	35%
Margin (%)	16%	17%	17%	18%
Turnover (X)	1.1	1.2	1.3	1.3
Leverage (X)	2.1	1.7	1.6	1.6
Free cash flow per share (R$)	0.49	0.54	0.37	0.83
Free cash flow yield (%)	10%	2%	1%	3%

Source: Company data, Goldman Sachs Research estimates.

Exhibit 44: Marisa: DCF value of R$36.7, 39% above current price

Three-stage DCF. Priced as of close of November 29, 2010

Intrinsic current value (US$)	19.6
Risks	19.6
12-month DCF value (US$)*	21.7
12-month DCF value (R$)*	**36.7**
Upside from current share price	**+39%**
*Adds 12-month equity yield	

Market, share-price, target, and balance-sheet data	Reais
Last reported quarter	3Q10
Current stock price (R$)	26.39
Exchange rate R$:US$ eop	1.69
Number of shares (m)	184.6
Current market capitalization (R$m)	**4,870.3**
(+) Net debt (R$m)	0.4
(+) Estimated value of non-core assets (R$m)	-
Current EV (R$m)	**4,870.7**

Input data for 3-stage growth model	
1st-stage explicit forecast (see US$ model)	5 years
2nd-stage growth period	5 years
3rd-stage growth period	Perpetuity
Avg. 2nd-stage growth rate of FCF (nominal US$)	9.0%
Avg. 3rd-stage (terminal) growth rate (nominal US$)	6.0%
Weighted avg. cost of capital, including tax shield fr. debt	9.9%

Present value of enterprise free-cash flows in each stage	
(+) PV of cash flow in 5-year explicit forecast period	443.5
(+) PV of cash flows in years 5 to 10	545.3
(+) PV of terminal cash flows, beginning at year 11	2,624.3
Present value of all enterprise free-cash flows	**3,613.1**
(+) Estimated value of non-core assets	-
Estimated total enterprise value	**3,613.1**
Net debt (cash)	0.3
Equity value	**3,612.8**

Discount rate calculation	
US risk-free rate (10-yr. bond yield)	2.61%
Brazil risk premium (EMBI Braz)	1.42%
Beta	1.04
Equity risk premium (Ibbotsen series)	6.8%
Cost of equity	**11.1%**
After-tax cost of debt	7.5%
Equity as percent of LT sectoral financing structure	69%
Weighted avg. cost of capital (WACC)	**9.9%**

First stage (explicit modeling of next 5 years, years defined as next four quarters)	Year 1	Year 2	Year 3	Year 4	Year 5
Future val. enterprise FCF	75.4	82.1	121.5	151.4	179.7
Present value FCF	**68.6**	**67.9**	**91.4**	**103.7**	**111.9**

Second stage (years 5 through 10) growth:			**9.0%**		
	Year 6	Year 7	Year 8	Year 9	Year 10
Future val. enterprise FCF	195.9	213.5	232.7	253.7	276.5
Present value FCF	**110.9**	**110.0**	**109.0**	**108.1**	**107.2**

Third stage (perpetuity at GDP growth rate)	
Enterprise FCF year 11	293.1
Present value of perpetuity	2,624.3

Source: Goldman Sachs Research estimates.

Exhibit 45: Hering: DCF value of R$39.9, 34% above current price

Three-stage DCF model. Priced as of close of November 29, 2010

Intrinsic current value (US$)	21.5
Risks	21.5
12-month DCF value (US$)*	23.7
12-month DCF value (R$)*	**39.9**
Upside from current share price	**+34%**
*Adds 12-month equity yield	

Market, share-price, target, and balance-sheet data	Reais
Last reported quarter	3Q10
Current stock price (R$)	29.70
Exchange rate R$:US$ eop	1.69
Number of shares (m)	162.7
Current market capitalization (R$m)	**4,832.8**
(+) Net debt (R$m)	(51.7)
(+) Estimated value of non-core assets (R$m)	-
Current EV (R$m)	**4,781.2**

Input data for 3-stage growth model	
1st-stage explicit forecast (see US$ model)	5 years
2nd-stage growth period	5 years
3rd-stage growth period	Perpetuity
Avg. 2nd-stage growth rate of FCF (nominal US$)	9.0%
Avg. 3rd-stage (terminal) growth rate (nominal US$)	6.0%
Weighted avg. cost of capital, including tax shield fr. debt	9.9%

Present value of enterprise free-cash flows in each stage	
(+) PV of cash flow in 5-year explicit forecast period	368.0
(+) PV of cash flows in years 5 to 10	530.3
(+) PV of terminal cash flows, beginning at year 11	2,565.2
Present value of all enterprise free-cash flows	**3,463.5**
(+) Estimated value of non-core assets	-
Estimated total enterprise value	**3,463.5**
Net debt (cash)	(30.6)
Equity value	**3,494.1**

Discount rate calculation	
US risk-free rate (10-yr. bond yield)	2.61%
Brazil risk premium (EMBI Braz)	1.42%
Beta	0.92
Equity risk premium (Ibbotsen series)	6.8%
Cost of equity	**10.2%**
After-tax cost of debt	7.1%
Equity as percent of LT sectoral financing structure	90%
Weighted avg. cost of capital (WACC)	**9.9%**

First stage (explicit modeling of next 5 years, years defined as next four quarters)	Year	Year	Year	Year	Year
	1	2	3	4	5
Future val. enterprise FCF	39.9	48.5	114.1	141.4	174.5
Present value FCF	**36.3**	**40.1**	**85.9**	**96.9**	**108.8**

Second stage (years 5 through 10) growth:			**9.0%**		
	Year	Year	Year	Year	Year
	6	7	8	9	10
Future val. enterprise FCF	190.3	207.4	226.0	246.4	268.6
Present value FCF	**107.9**	**107.0**	**106.1**	**105.2**	**104.3**

Third stage (perpetuity at GDP growth rate)	
Enterprise FCF year 11	284.7
Present value of perpetuity	2,565.2

Source: Goldman Sachs Research estimates

Reg AC

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