

Initiation of Coverage

Emerging Stronger from the Turnaround;
Initiating Pague Menos at Buy

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Daniela Eiger, CFA
daniela.eiger@xpi.com.br

Marco Nardini
marco.nardini@xpi.com.br

Thiago Suedt
thiago.santos@xpi.com.br

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Emerging Stronger from the Turnaround - Buy

Pague Menos (PGMN3)

We launch coverage of Pague Menos shares (PGMN3) with a Buy rating and a YE21 target price of R\$13.0/sh, yielding 54% upside. After facing challenges from a fast and a bit unorganized expansion, Pague Menos entered in a long restructuring and adjustment process in 2016. As a result, the company put in place several initiatives to improve operations and corporate governance. We believe Pague Menos emerges as stronger and better prepared to resume its growth, while capturing several efficiency gains in the near term. We also see upside risks to the story, not embedded on our model.

Leading position in a high growth market. Pague Menos stands as the #3 largest drugstore chain in Brazil, being a consolidated market leader in the North and Northeast regions. The company focuses on Brazil's expanded middle class, with 2/3 of stores and 75% of its EBITDA originated from these classes, which has an addressable market of R\$100bn vs. R\$25bn for A/B1 classes.

East, West, Home's best. We expect the company to open 500 stores through 2021-25e, firstly concentrated in the North and Northeast regions. We believe Pague Menos' expertise in opening and managing stores in these regions, with a more robust expansion structure to support it should enable the company to deliver a top line CAGR of 12% in 2020-25e.

Initiatives in place to drive EBITDA margin (ex IFRS16) to 6.5% in 2025e. The company's turnaround process during 2016-19 has yielded important initiatives to improve the company's operations. As a result, we expect Pague Menos to reach an EBITDA (ex-IFRS16) margin of 6.5% in 2025e, capturing 245bps in margin gains by 2025e. As a result, we forecast a +24% 2020-25e EBITDA CAGR.

More to it than meets the eye. We see three key upside risks to the story that are not embedded on our model and, therefore, target price: (i) **Clinic Farma**, an initiative to provide health services at the pharmacy, which not only increases consumers' loyalty but also increases frequency and expenditure – we estimate an upside of at least R\$1.4/sh (see page 10 for more details); (ii) **private label sales**, which currently account for 6% of sales vs. RD's at 2-3% and Panvel's at ~6.5%; and (iii) **higher digital penetration**, as the initiatives put in motion during the pandemic start to yield results.

But mind the risks... We highlight three main concerns regarding the investment case: (i) **Competition**, as listed players have been expanding into popular store formats; (ii) **Execution**: solid top line growth derives from a successful expansion plan and store productivity gains; and (iii) **Tax benefits**: the company benefits from state granted tax benefits that may not be renewed at expiration.

ESG. Embracing gender diversity. We see the company well positioned in the Social and Governance pillars, being a clear winner when it comes to gender diversity, while in the Environmental front the company has room to improve its current initiatives (more on page 16).

Rating	BUY
YE21 Target Price (R\$)	13,0
<i>Current Price (R\$)</i>	8,4
<i>Upside / Downside</i>	54,0%

Trading metrics	
Market cap (R\$mn)	3.746
n. of shares (mn)	444
Free Float	19,9%
Avg. Daily Volume (mn)	0,7
Avg. Daily Value (R\$mn)	6,9
Net debt (cash) / EBITDA 2021e	0,4x

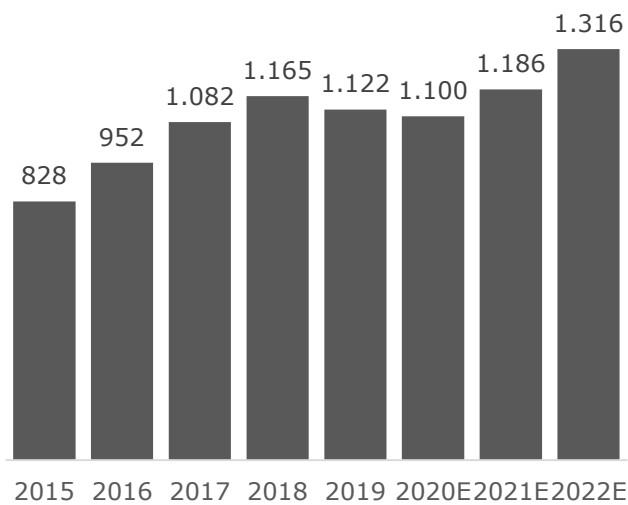
Multiples	2020e	2021e	2022e
EV/Sales	0,6	0,5	0,5
EV/EBITDA	13,5	11,6	8,5
P/E	38,1	25,9	14,4
PEG	-0,2	0,6	0,2

Key Financials	2020e	2021e	2022e
Gross Sales	7.197	7.637	8.771
EBITDA	295	350	490
Net income	98	144	260

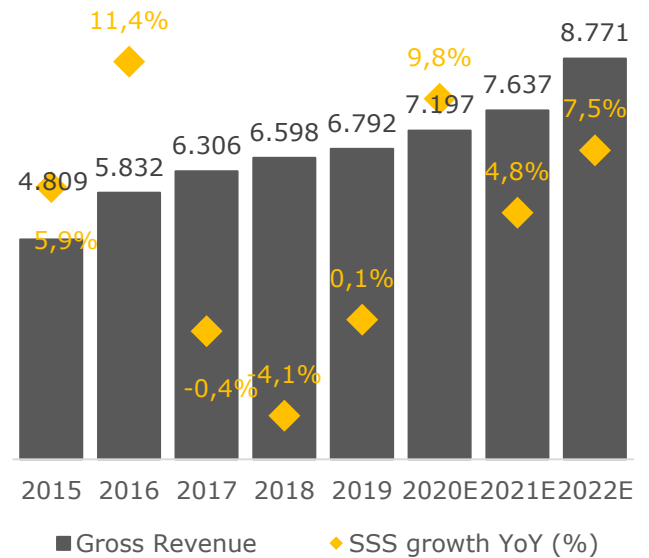
Margins (%)	2020e	2021e	2022e
Gross Profit	28,9%	29,9%	30,0%
EBITDA	4,1%	4,6%	5,6%
Net Income	1,4%	1,9%	3,0%

Pague Menos: Key Financials

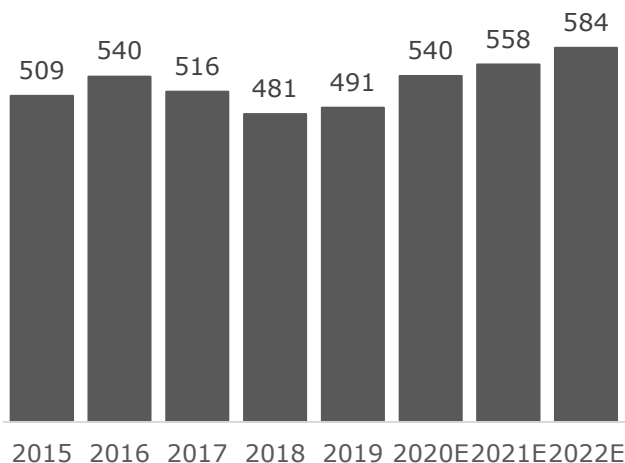
of Stores



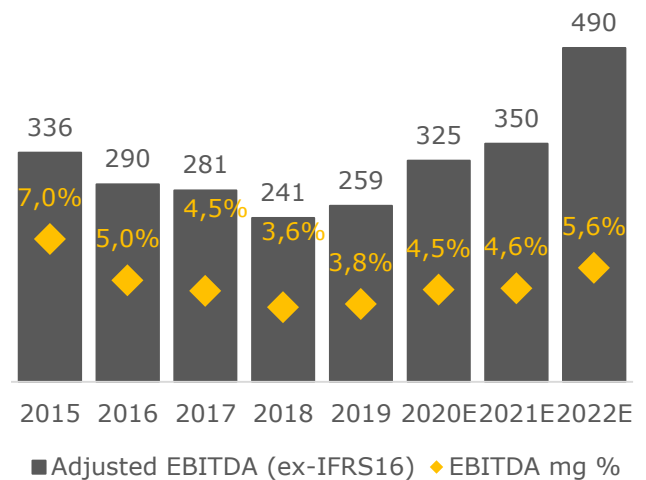
Gross Revenue (R\$m) and SSS growth



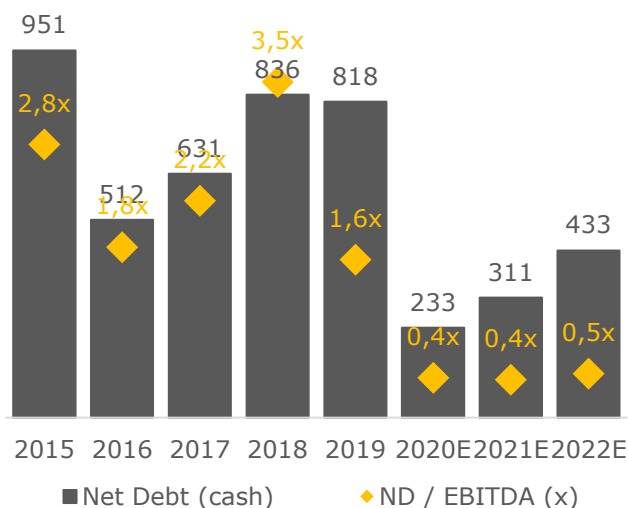
Store Productivity ('000 R\$/store/month)



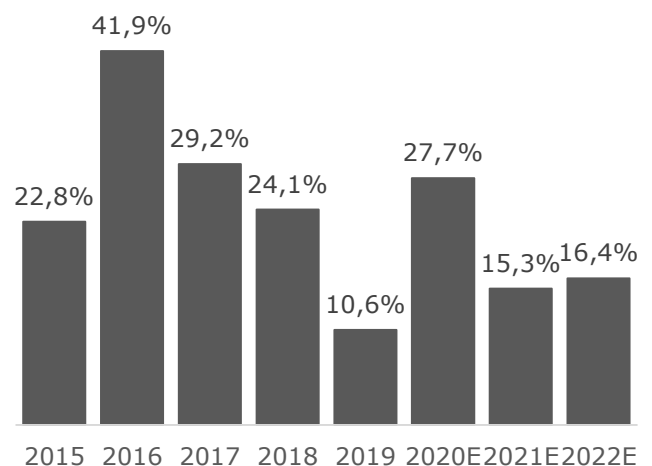
Adjusted EBITDA (R\$m)



Net Debt (cash) – R\$m



ROIC

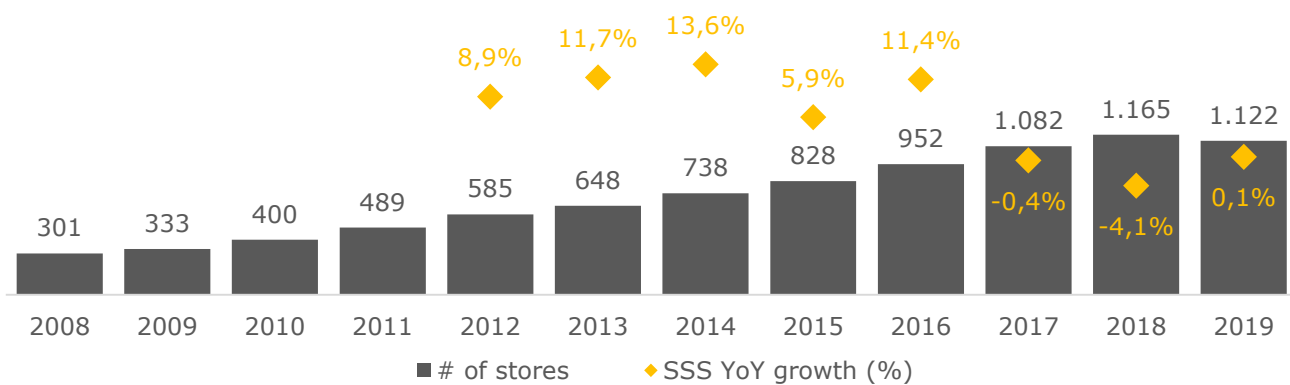


Are we there yet?

Yes sir – Turnaround is complete; now is time to reap the benefits

Between 2010 and 2016, Pague Menos grew from 400 stores to 952, more than doubling their physical presence in the period. However, the company was still a family business and, therefore, was not prepared to deal with the growth pains that came together with the strong expansion acceleration. In 2016, General Atlantic (GA) entered as a partner, investing R\$600mn for a 17% stake, and, together with the company, reassessed Pague Menos' business strategy. As a result, a restructuring of the company's strategy, management, governance, processes and systems was triggered, leading to an adjustment period between 2016-19. Since Oct/19, the company began to reap the benefits of all the initiatives implemented, though Covid-19 got in the way.

Topline Growth

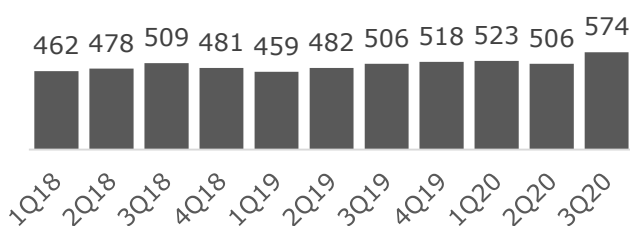


Cleaning up the house; new and remodeled Pague Menos

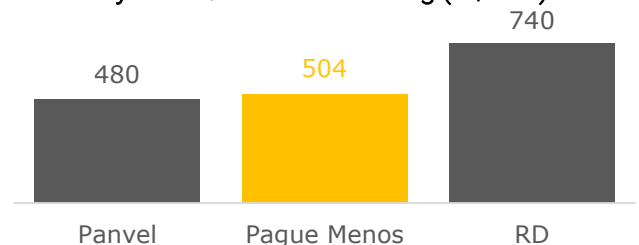
During 2016-19 the company attacked seven different fronts at the same time:

- **Stores Optimization:** (i) redesign of store concept: four different formats (see more on page 19), with the remodeled store adding ~5% in sales; and (ii) portfolio optimization: closure of 170 underperforming stores since 2017, which had sales close to 60% below portfolio's average and were mainly concentrated in the Southeast (46%) and South (17%) regions. **Estimated EBITDA savings of R\$60mn.**

Pague Menos: Monthly Sales / Store (R\$'000)

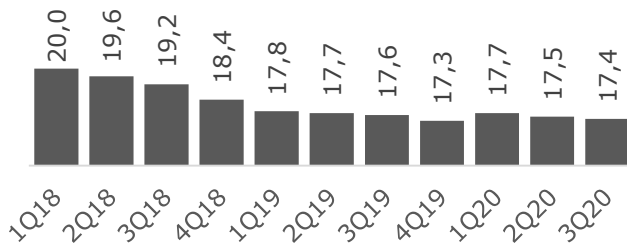


Monthly Sales / Store - 2019 avg (R\$'000)



- Operational Improvements: (i) higher store productivity, reducing HC/store by 4 employees in 2016-20, while improving NPS (net promoter score). **Estimated EBITDA savings of R\$200mn/year**; (ii) rent and service providers' contract negotiations. Estimated EBITDA savings of R\$20mn in 2019-20; (iii) outsourcing / insourcing optimization; (iv) lower transportation costs. Estimated EBITDA savings of R\$35mn in 2019.

Pague Menos: Employees / store



Employees / store vs. Peers - 2019 avg



- Governance: Board professionalization with inclusion of two GA and two independent members, in addition to the four members from the founding family (see page 21 for more details); creation of statutory committees and working groups focused on strategic themes (e.g. expansion committee or IT & Innovation working group).
- Management Professionalization: hiring of professionals from benchmark companies to improve and introduce best practices – more than 30 professionals hired for key leadership positions since 2016. Initiatives implemented are already yielding results: higher digital penetration, product activations and lower discounts, reduced inventory losses.
- Processes and Systems: investments to improve processes in key back office areas such as Finance, HR, Operations and IT.
- Pricing and Assortment: assortment custom-made to meet consumers' demand since 2019 – clear correlation between medicine coverage and SSS performance; and adjustment on pricing, with a clear discount policy established.
- Digital and New Initiatives: digital focused team; partnerships with insurers and large companies; and specialty drugs department.

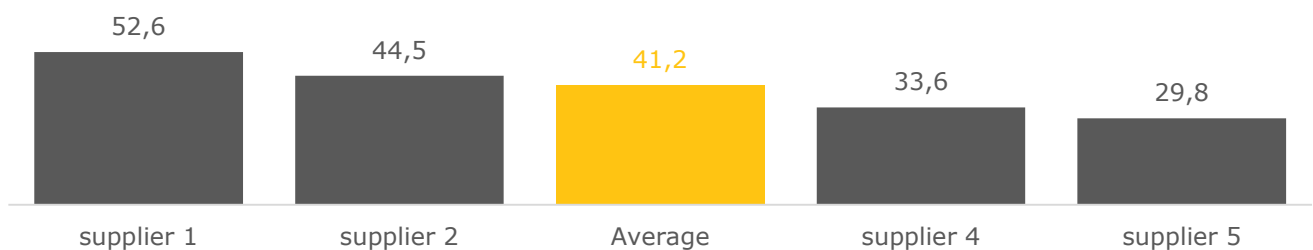
250bps upside potl. on EBITDA mg by 2025

Significant improvements already delivered, but wait.. there is more!

Pague Menos has already delivered significant improvements since 2016, and now is time to reap the benefits. In 2020, the company should already deliver a 100bps EBITDA margin expansion vs. 2018, but we see room for an additional +245bps by 2025 as the company focuses on five main value levers:

#1. Vendor Management and Private Label: the company identified big margins distortions between suppliers of the same category. As a result, they have made a detailed potential margin analysis to guide their negotiations at the sub-category level.

Toothpaste: Commercial margin, %



#2. Category Management: although product mix has already improved a lot and is now adjusted according to the store's customers and surrounding profile; there is still room to reduce coverage gaps, mainly in generics and beauty & hygiene. This should not only boost sales, but also contribute to margins as generics and HPC have better margins.

#3. Store Productivity: we estimate average sales per store will increase to R\$670k in 2025e (from R\$540k in 2020e), as the company (i) will focus expansion on the North/Northeast regions, where their stores' sales are higher than average; (ii) should continue to work on reducing its coverage gap, mainly in generics and beauty and hygiene; and (iii) will work on increase clients' loyalty and frequency. The company will also continue to focus on reducing SG&A per store, targeting having 16.4 employees/store vs. 17.4 in 3Q20.

#4. Pricing Optimization: currently Pague Menos' pricing strategy does not consider the stores' area competition and consumer's profile. As a result, it does lever on having a stronger brand awareness, or benefiting from lower competition in a certain region. Pague Menos will begin to explore ways to have a greater price assertiveness, being more competitive in regions where it has lower competitive advantages and/or consumption frequency is higher, while focusing on margin expansion where it has a higher competitive advantage and/or consumption frequency is lower.

#5. Supply Chain: there is still room to improve stockout levels by 100bps, which are currently at ~3%. In order to reduce this gap, Pague Menos will improve its planning & execution processes, work on inventory algorithms optimization, review routes and redesign optimal inventory levels. According to the company, for every 1% of stockout reduction, sales increase by 1% in non-competitive or by 2% in competitive regions.

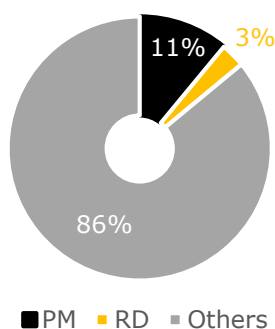
East, West, Home's Best

Back to core; expanding on lower-income

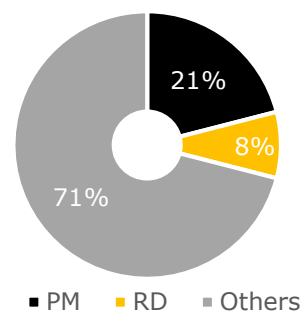
After a tough adjustment period, Pague Menos is ready to resume its growth but now in a much more robust shape and with a highly professionalized team and governance. The company plans to open 500 stores by 2025e, divided into two waves:

- (i) First wave (2021-22): focused where it has a leading position, namely North and Northeast regions. The strategy here is to gain share mainly from Associations and Independent players, so **competition risks with big players should be mitigated**.

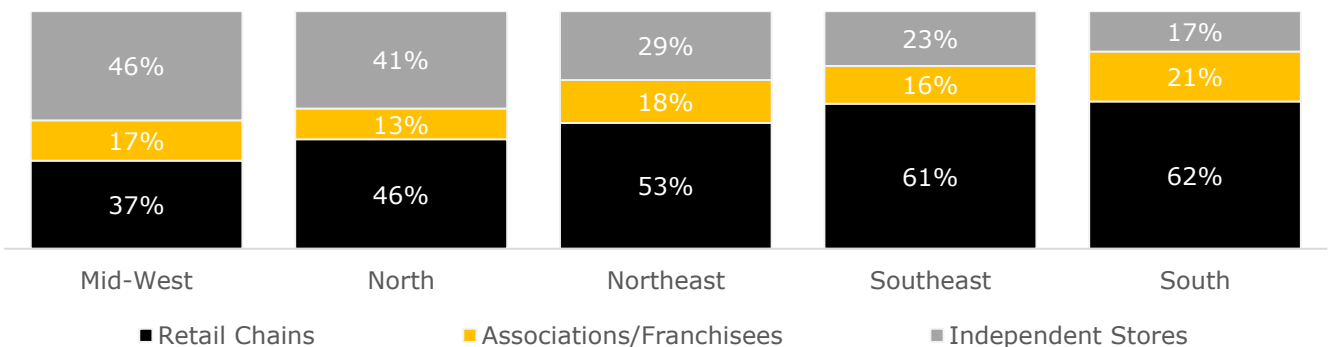
Pague Menos Market Share - North (2019)



Pague Menos Market Share - Northeast (2019)

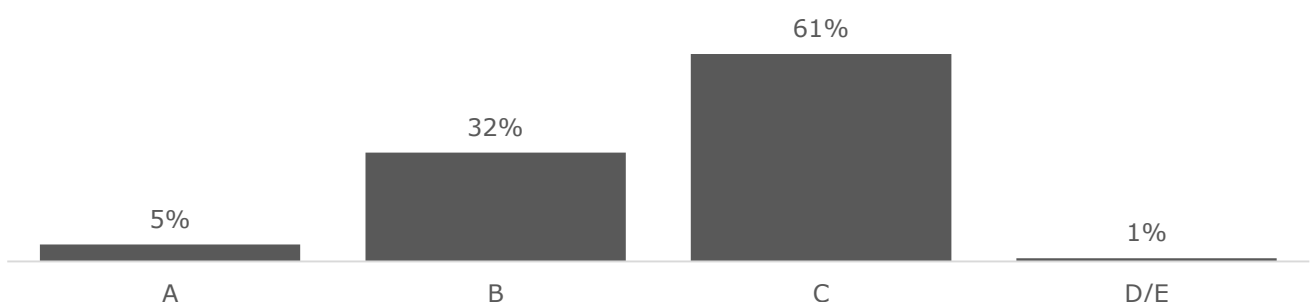


Market Share Breakdown per Region (LTM Sep2019)



- (i) Second wave (2023-24): focused on the Southeast region but aiming at the expanded middle class and locations with similar characteristics to the Northeast. So **execution risks should be mitigated** as it is basically replicating the company's current strategy.

New Store Openings in the Second Wave – Breakdown by Income Class



Lessons learned; clear criteria when selecting where to open stores

After an unorganized expansion period before 2016, Pague Menos, together with GA, learned from their mistakes and defined clear selection criteria to guide their next locations:

- (i) Market share between 10% and 25%: benefit from scale gains and brand awareness while not cannibalizing existing stores;
- (ii) Focus on expanded lower income: Pague Menos has a successful model to meet B2/C/D income classes while it is a segment with a high addressable market, estimated at R\$100bn vs. R\$25bn for A/B1 classes;
- (iii) Competition: focus on regions where there is no clear competitor dominance;
- (iv) Profitability: the company aims to get an IRR of at least 20%;
- (v) Others: percentage of 50+ year old people; distance to closes DC, saturation levels (total consumption per PDV) still low.

New Stores	Average Household Income, R\$	Share PM, % ¹	Share Top 10 ²	Share Top 2 / Pague Menos Share ³
Top 200	3,016	19.6%	24.0%	0.5x
Top 400	6,015	18.2%	26.7%	0.6x
Top 500	9,035	10.7%	50.9%	4.5x
Others	10,891	9.4%	39.1%	4.4x

¹ PM share in micro markets where PM has a store; ² Share of top 10 pharmacy chains in Brazil; ³ Share of top 2 pharmacies divided by the PM share

Remake, remodel; at least 200 to go

Together with its expansion plan, Pague Menos is also implementing a remodeling strategy given strategic market conditions or lack of infrastructure. At least 200 stores have been mapped to be remodeled by 2025, divided into two types:

- (i) Non-discretionary stores (36 mapped): longer remodeling period given poor conditions of key items, such as the store's roof, electrical network, etc.
- (i) Strategic stores (165 mapped): mature stores, located in high growth potential areas, but facing strong competition. These 165 remodeling have been divided into two waves, with the prioritization being set based on age, IRR levels and growth capacity.

According to the company, once remodeled, stores post a 5% increase on sales. **We estimate the store's remodeling yields an IRR of 15%.**

More to it than meets the eye: upside risks

Clinic Farma: Making the most out of what you have

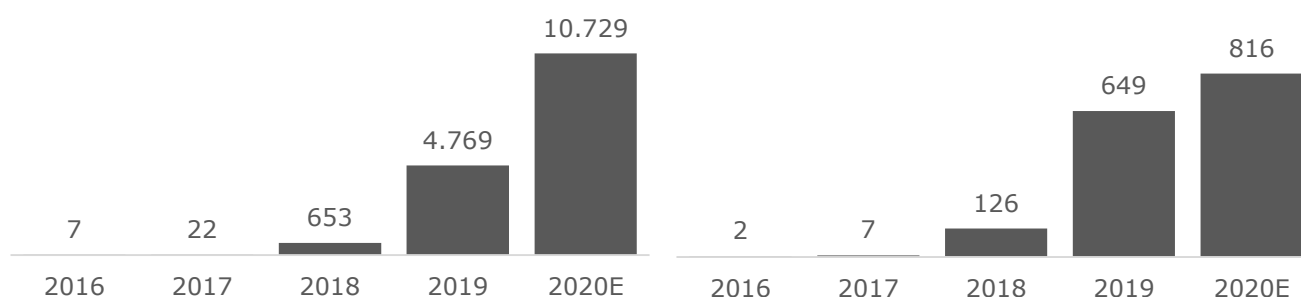
Pague Menos believes that its pharmacies should be more than “just a drugstore”, being a place where people are able to find health services, in addition to products and medicines. As a result, the company developed the Clinic Farma, a section of its store that provide health services such as BHCG tests, blood pressure measurement, diabetes control, vaccines, among others. Currently, there are 806 Clinic Farma in Pague Menos’ chain, representing ~70% of total stores. More than to implement the initiative in new stores, the company aims to increase services on their current locations, such as vaccination and telemedicine. We believe this is the upside risk with higher potential as around 70% of their targeted customers do not have a private insurance plan while Pague Menos is very competitive in terms of pricing.

Keep them coming; Increasing expenditure and frequency

This initiative not only increases consumers’ loyalty, given higher convenience and improved customer experience, but it also increases frequency and expenditure. However, penetration is still low, at only 3% of clients base vs. the company’s target to reach between 20-25% by 2025e.

Services Sales (R\$'000)

Number of provided services ('000)



A lot of upside to be captured – analysis point to upside potential of at least R\$1.4/sh

We analyze the potential upside from Clinic Farma, considering that (i) Clinic Farma clients spend on average 3x more than average clients, according to the company; and (ii) penetration reaches 20% in 2030e, which implies a ~10% penetration in 2025e vs the company’s target of 20%-25%. As a result, we estimate this initiative can offer an upside of at least R\$1.4/sh.

Potential upside from Clinic Farma (R\$/sh) – Sensitivity Analysis

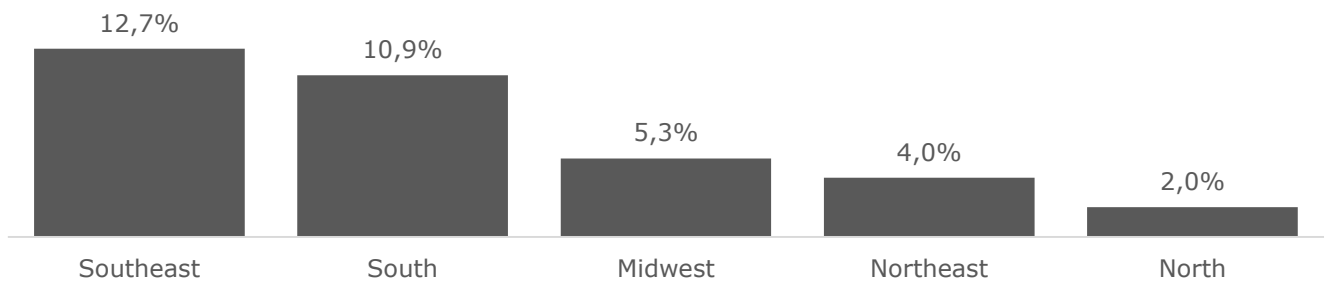
		Penetration in 2030 (% of clients base)					
		12,5%	15,0%	17,5%	20,0%	22,5%	25,0%
Clients' ticket	1,5x	0,2	0,3	0,3	0,4	0,4	0,5
	2,0x	0,4	0,5	0,6	0,7	0,8	1,0
	2,5x	0,6	0,8	0,9	1,1	1,2	1,4
	3,0x	0,8	1,0	1,2	1,4	1,6	1,8
	3,5x	1,0	1,2	1,5	1,8	2,0	2,3
	4,0x	1,2	1,5	1,8	2,1	2,4	2,7

Our base case assumes: (i) penetration increases linearly until 2030, when it stabilizes until perpetuity, (ii) we use our forecasted gross margin and assume variable expenses of 5% of sales; and (iii) Income tax rate, WACC and perpetuity growth in-line with Pague Menos.

Digital: Closing the gap; Still a lot of room to go

Pague Menos' digital initiatives are still very incipient, being ~2% of sales in 2019 and ~5% in 2020e. This is mainly explained by the company's geographic exposure, as the North and Northeast are still regions with low digitalization. However, we see a lot of room to grow in this front, as consumers have become more digital with the pandemic, while there are important gaps between the company's digital vs. market share per income class. Moreover, several initiatives have already been put in place, and have been accelerated this year, with Click&Collect and ship from store already implemented in all stores, partnerships made with last mile companies and opening of 92 mini DCs.

Penetration by Region, % of Total Sales (3Q20)



Digital Share per Region

Store Profile	E-commerce Sales Growth May/19 – May/20	Share of PM Digital Sales	Share of the Total Market
A Stores	125%	28%	8%
B stores	175%	57%	31%
C/D Stores	142%	15%	61%
Total	154%	100%	100%

Private Label: 6% of sales but there is still lots of opportunities

Currently, the company has over 1k SKUs of private label products, representing close to 6% of total sales, vs. RD at 2-3% and Panvel at ~6.5%. Almost 200 SKUs were launched in 2020, and the products pipeline should remain solid in the next years, with entrance in new categories such as healthy food, products for seniors, child diapers haircare and eco-friendly.

Valuation: YE21 target price of R\$13.0/sh

Valuation methodology: Our YE21 R\$13.0 TP is based on a 10-year DCF (FCFF) using a 10.3% cost of capital (WACC), 5.5% long-term growth rate and 7.0% long-term EBITDA (ex IFRS-16) margin. At our TP, the shares would trade on 2021-22e EV/EBITDA multiples of 17.4x and 12.4x, and P/E of 40.0x and 22.2x, respectively.

Bear and Bull Cases. At our bear case scenario (SSS growing in line with inflation as of 2022 and half of the EBITDA mg expansion delivered), our YE21 TP would be R\$9.0/sh (10% upside), while on our bull case scenario (SSS growing 300bps above inflation as of 2022 and adding upside potential from Clinic Farma), our YE21 TP would be R\$16.5/sh (101% upside).

Key Financials

Top line: 13% 2020-2025e CAGR. we estimate a +13% average top-line growth by 2025e, driven by new space growth, store maturation and store renewals. The company plans to open 500 new stores by 2025e, while at least another 200 stores should be renewed. Moreover, we forecast SSS to grow 200bps above inflation, at ~4.5% per year.

EBITDA: 24% 2020-2025e CAGR. from 2020 to 2025 we expect EBITDA margin to expand by on average 50bps per annum, mainly driven by the several efficiency initiatives discussed previously. As a result, we expect consolidated EBITDA margin (ex-IFRS16) to reach 6.5% in 2025 (from 3.8% in 2019 and 4.1% in 2020e).

Net Income: 39% 2020-2025e CAGR. we forecast positive R\$141mn net income (excluding IFRS 16) in 2021 (from R\$24mn in 2019) and estimate a +39% annual growth rate, mainly supported by top-line growth acceleration as well as margin expansion.

FCF: we expect muted FCF generation in the short term, given high capex investments. However, we highlight FCF should consistently increase throughout the years, reaching a FCF/EBITDA conversion of 10% in 2025e and ~30% in the following years. As for leverage, we estimate Pague Menos to deleverage through cash generation coupled with operational improvement, becoming net cash by 2024e.

XP estimates for Pague Menos (PGMN3)

Key Financials (R\$m)	2018a	2019a	2020e	2021e	2022e
Gross Sales	6.598	6.792	7.197	7.637	8.771
Gross Profit	2.015	2.054	2.077	2.280	2.627
EBIT	133	248	317	369	534
EBIT mg	2,0%	3,6%	4,4%	4,8%	6,1%
EBITDA (ex-IFRS 16)	241	259	325	350	490
EBITDA mg (ex-IFRS 16)	3,6%	3,8%	4,5%	4,6%	5,6%
Net Income	48	-7	98	144	260
Net Income (ex - IFRS 16)	0	24	121	141	226
Free Cash Flow (R\$m)	2018a	2019a	2020e	2021e	2022e
EBIT (ex-IFRS 16)	133	166	236	263	388
Taxes	45	23	22	(15)	(66)
D&A (ex-IFRS 16)	108	92	89	87	102
Capex	(186)	(54)	(39)	(214)	(311)
Changes in Working Capital	(1)	157	(246)	(100)	(131)
FCFF	98	384	62	21	(18)
Dividends			-	-	-
Balance Sheet (R\$m)	2018a	2019e	2020e	2021e	2022e
Total Gross Debt	954	939	955	955	955
Cash & Equivalents	118	121	722	644	522
Net (debt) / cash	836	818	233	311	433
Net (debt) / EBITDA	3,5x	1,6x	0,4x	0,4x	0,5x
Return / Yield Metrics	2018a	2019e	2020e	2021e	2022e
ROIC	24,1%	32,8%	31,2%	15,3%	16,4%
ROE	4,7%	-0,7%	5,3%	7,2%	11,4%
Dividend Yield			0,0%	0,0%	0,0%
FCF Yield			1,6%	0,6%	-0,5%
Operating Metrics	2018a	2019e	2020e	2021e	2022e
# of stores (EoP)	1.165	1.122	1.100	1.186	1.316
Net openings	83	-43	-22	86	130
Sales per Mature Store (R\$ '000 per mont	507	500	542	565	592
SSS Mature Stores	-7,1%	-2,2%	8,4%	4,2%	4,8%
SSS Consolidated	-4,1%	0,1%	9,8%	4,8%	7,5%
Valuation Metrics	2018a	2019e	2020e	2021e	2022e
EV/EBITDA	n.a.	n.a.	12,2x	11,6x	8,5x
P/E	n.a.	n.a.	38,1x	25,9x	14,4x
PEG ratio	n.a.	n.a.	n.m.	0,6x	0,2x

XP estimates vs Bloomberg Consensus

	XPi estimates			Bloomberg Consensus			XPi vs BBG		
	2020e	2021e	2022e	2020e	2021e	2022e	2020e	2021e	2022e
Net Sales	6.757	7.156	8.218	6.771	7.190	8.056	-0,2%	-0,5%	2,0%
Gross Profit	2.077	2.280	2.627	1.991	2.139	2.405	4,3%	6,6%	9,3%
Gross mg	30,7%	31,9%	32,0%	29,4%	29,8%	29,9%	130 bps	210 bps	210 bps
EBITDA	569	617	797	448	508	620	27,1%	21,5%	28,5%
EBITDA mg	8,4%	8,6%	9,7%	6,6%	7,1%	7,7%	180 bps	160 bps	200 bps
EBITDA (ex-IFRS 16)	295	350	490	n.a	n.a	n.a			
EBITDA mg (ex IFRS16)	4,4%	4,9%	6,0%	n.a	n.a	n.a			
Net Income	90	141	226	80	150	195	12,3%	-5,6%	15,9%

1. Our margins are calculated in terms of net sales in this table to be comparable to Bloomberg estimates

2. EBITDA comparison is distorted as Bloomberg does not differentiate which EBITDA estimates are excluding IFRS-16

Valuation Comps

Companies	Current Price	Mkt Cap (US\$m)	ADTV (US\$m)	P/E		EV/EBITDA		2020-22 CAGR EBITDA	2020-22 CAGR Sales
				2020e	2021e	2020e	2021e		
D1000 Varejo Farma	10,7	100	4,0	n.a.	n.a.	29,1x	9,9x	102,0%	19,5%
Pague Menos	8,4	694	n.a.	38,1x	25,9x	13,5x	11,6x	28,8%	10,4%
Dimed	21,2	591	2,4	n.a.	n.a.	21,3x	14,5x	36,3%	17,1%
RD	23,5	6.747	30,1	72,7x	50,0x	29,7x	23,6x	23,6%	19,0%
Brazilian Pharmacies Average				55,4x	38,0x	23,4x	14,9x	47,7%	16,5%
CVS Health	67,5	88.391	482,6	9,2x	9,0x	8,0x	7,8x	3,9%	4,0%
Walgreens	39,8	34.450	267,7	8,5x	8,4x	7,6x	7,7x	2,5%	3,1%
Walgreens BDR	103,3	33.223	0,0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Global Pharmacies Average				8,8x	8,7x	7,8x	7,8x	3,2%	3,5%
Profarma	5,2	120	0,9	n.a.	n.a.	6,5x	4,6x	n.a.	n.a.
Hypera	31,8	3.739	24,2	16,5x	13,5x	15,1x	10,8x	23,5%	21,1%
Odontoprev	13,4	1.320	26,8	20,6x	23,2x	12,3x	14,0x	0,2%	6,7%
Notredame Intermédica	72,1	8.163	233,6	53,9x	46,2x	25,4x	21,8x	17,6%	17,6%
Qualicorp	33,8	1.783	126,6	21,2x	17,5x	10,0x	9,2x	5,9%	5,0%
Fleury	28,1	1.658	61,0	69,0x	27,3x	16,8x	12,1x	24,7%	11,8%
Hermes Pardini	22,1	536	16,2	22,3x	16,3x	10,9x	8,8x	10,9%	7,7%
SulAmérica	41,5	3.036	133,6	12,4x	16,9x	n.a.	n.a.	n.a.	4,8%
Alliar	11,1	243	8,6	n.a.	n.a.	12,1x	7,7x	23,3%	9,6%
Hapvida	69,8	9.631	126,3	57,0x	45,9x	26,0x	22,4x	22,1%	15,9%
Brazil Healthcare Average				34,1x	25,9x	15,0x	12,4x	16,0%	11,1%
Localiza	66,1	9.308	64,8	59,9x	41,4x	13,8x	25,2x	23,2%	27,4%
Pagueseguro	43,6	14.299	11,6	52,7x	35,9x	13,9x	31,4x	34,0%	25,4%
WEG	82,1	32.000	67,6	78,8x	66,4x	13,5x	57,1x	6,4%	14,7%
Natura	49,2	12.547	61,0	n.a.	73,8x	11,1x	24,3x	22,3%	7,0%
Others Average				63,8x	54,4x	13,1x	34,5x	21,5%	18,6%
Brazil Average				32,8x	24,2x	15,4x	11,7x	22,3%	10,4%

ESG: Embracing gender diversity

By Marcella Ungaretti

We see Pague Menos well positioned in Social and Governance factors, while in the Environmental front the company has room to improve its current initiatives. When it comes to gender equality, Pague Menos is a clear winner, with highlight to (i) company's Board of Directors composition; and (ii) Ms. Patriciana Rodrigues as the chair of the Board. Regarding company's ESG metrics' disclosure, we see room for improvement, aiming to give more transparency to investors and to market at all. On the positive side, in our last call with the company, it was clear that PM recognizes such need and is already engaged to enhance this matter – we welcome such effort as we see the lack of ESG data disclosure as an important challenge for investors and analysts. Please find below key highlights from each ESG pillar.

We see Pague Menos playing an important **Social** role in the communities where it operates, which was also intensified during pandemic, with the effective use of PM' Health Hub serving society's needs.

In the **Environmental** front, we welcome company's initiative to promote the adaptation of their energy matrix to clean sources, with the use of photovoltaic energy for the operation of its stores, while we see room for Pague Menos to expand its current initiatives aiming to reduce more broadly its carbon footprint through tracking and consequently reducing their GHG emissions, not only on its store, but also related to company's logistics and DCs.

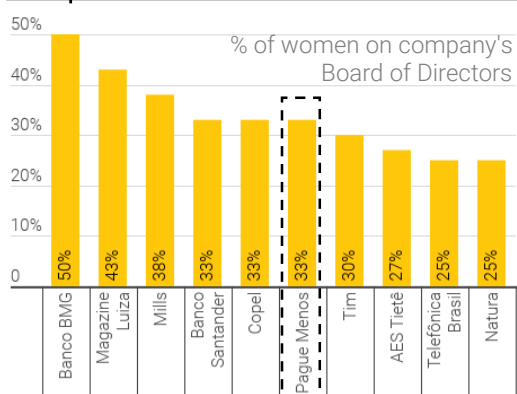
Regarding **Governance**, Pague Menos is a controlled and family-owned company, with company's shares (MGMN3) listed on Novo Mercado, the highest standard of corporate governance in B3. Pague Menos board of Directors still lacks an independent majority (only 2 out of the 9 members), however we welcome Board professionalization with inclusion of two GA and two independent members. Finally, when it comes to Board diversity the company is a clear winner: more than 30% of its members are female directors (3 out of the 9 members), with Ms. Patriciana Rodrigues being the chair of Board.

According to Teva Indices, among 221 Bz listed companies*, only 14 has women occupying this position and only 10 have 3 or more women on the board. On this matter, we note researchers have found that companies with three or more female directors tend to outperform, on average, companies where this threshold is not achieved. As such, Pague Menos' board is ahead of its peers and seems well equipped to guide the company's future.

Pague Menos' Board of Directors

Name	Title	Gender
Patriciana Maria de Queirós Rodrigues	Chairman	♀
Josué Ubiranilson Alves	Deputy Chairman	♂
Francisco Leite Holanda Junior	Member	♂
Rosilândia Maria Alves de Queirós Lima	Member	♀
Paulo José Marques Soares	Independent member	♂
Manuela Vaz Artigas	Independent member	♀
Martin Emiliano Escobari Lifchitz	Member	♂
Pedro Pullen Parente	Member	♂
Carlos Henrique Alves de Queirós	Member	♂

Companies with 3+ women on the Board



Companies with women as Chairman of the Board

Company	% of female on Board of Directors	Company	% of female on Board of Directors
Magazine Luiza	43%	Cia Estadual de Geração e Transmissão de Energia Elétrica	20%
Eletrobrás	40%	Cia Melhoramentos de São Paulo	20%
Mills	38%	M. Dias Branco	17%
Pague Menos	33%	Graziotin	17%
Santos Brasil	29%	Cia Estadual de Distribuição de Energia Elétrica	17%
Cia Participações Aliança da Bahia	25%	CCR	15%
Cia Estadual de Geração e Transmissão de Energia Elétrica	20%	B2W	14%
		Banco Amazônia	14%

Source: XP Investimentos, Teva Indices, Company Data

* Teva Indices eligibility criteria: (i) Free Float: Companies that have less than 1.0% of their outstanding shares are not considered. (ii) Market Cap: Companies below < R\$300mn are not considered.

Key Risks: Competition, Execution, Tax benefits

We highlight three main concerns regarding Pague Menos' investment thesis:

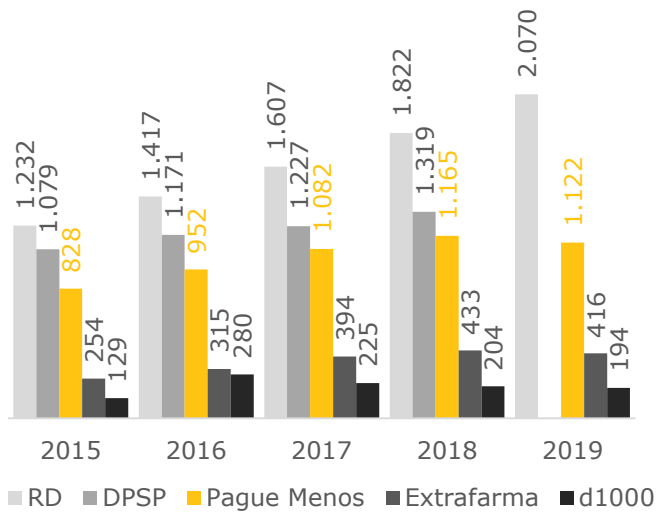
#1. Competition: this was a key topic of the sector during 2017-18, as competition was fierce, with players expanding out of their core regions. However, competition has moderated since then as expansion returns were below expectations, while leverage increased. This could become an issue once again as players are once again capitalized and focused on expansion. Nonetheless, we believe competition risks associated with Pague Menos' expansion in the short term should be mitigated by the company's strategy to focus where it already has a leading position or competitive advantages.

#2. Execution: the bulk of Pague Menos' upside relies on delivering solid top line growth, mainly driven by expansion and store productivity, coupled with margin expansion on the initiatives previously discussed. Therefore, execution is key to support our investment thesis.

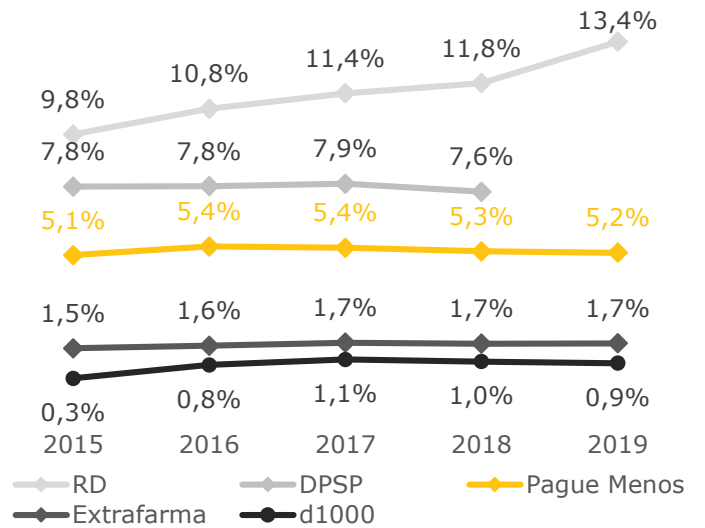
#3. Tax benefits: the company has access to tax benefits associated with the VAT – ICMS exemptions in Ceara, Goias, Pernambuco, Bahia and Minas Gerais states. These benefits are granted in a state-based way in exchange of the company meeting certain investments and job generation criteria and are subject to renewals at expiration. This is very common, mainly in the North and Northeast regions, to foster activity and motivate companies to settle operations in the state. Important to note that this benefit is not given exclusively to Pague Menos, but to all companies that meet the required conditions and have operations in these states. The benefits' expiration vary among different states, but they are guaranteed until Dec/2022 if states follow the required conditions set by the Federal Government. At expiration, each will decide if the tax benefit will be renewed or not. In 2019, these benefits positively impacted results by R\$180.5mn in 2019 (or 2.5% of gross sales) and R\$51.7mn in 1H20 (or 1.5% of gross sales). **In our model, we do not include the tax benefit gain in perpetuity, which leads to a higher tax rate at perpetuity.**

Pague Menos vs. Peers

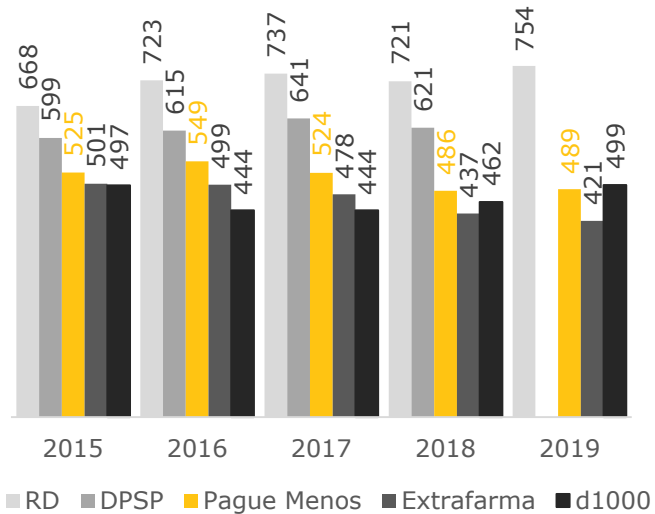
of Stores



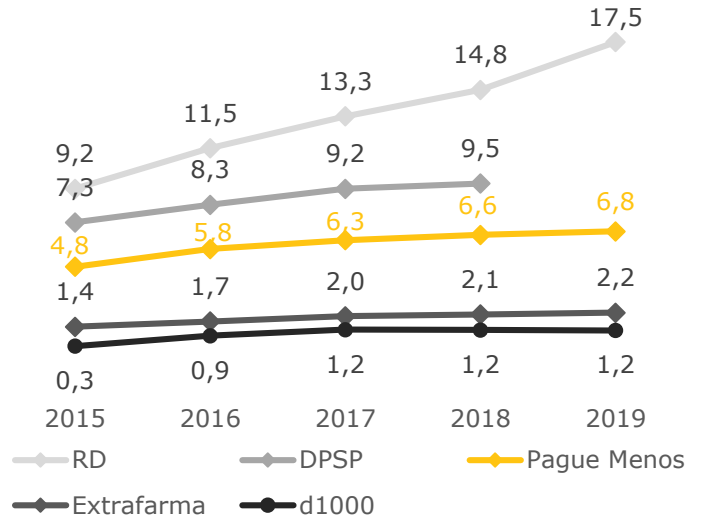
Market Share (%)



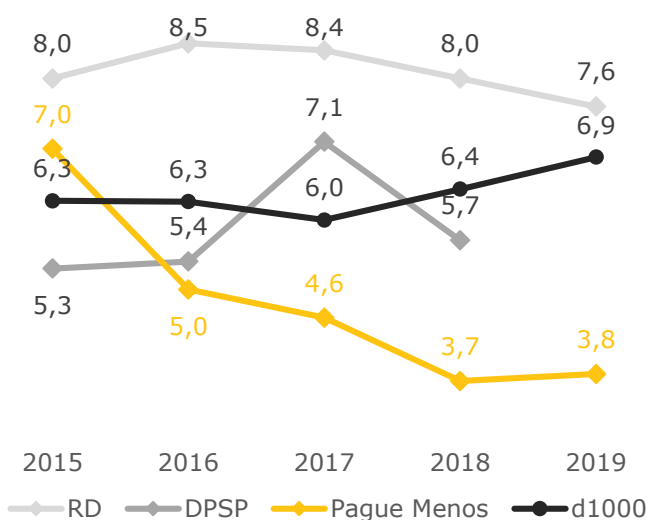
Store Productivity ('000 R\$/store/month)



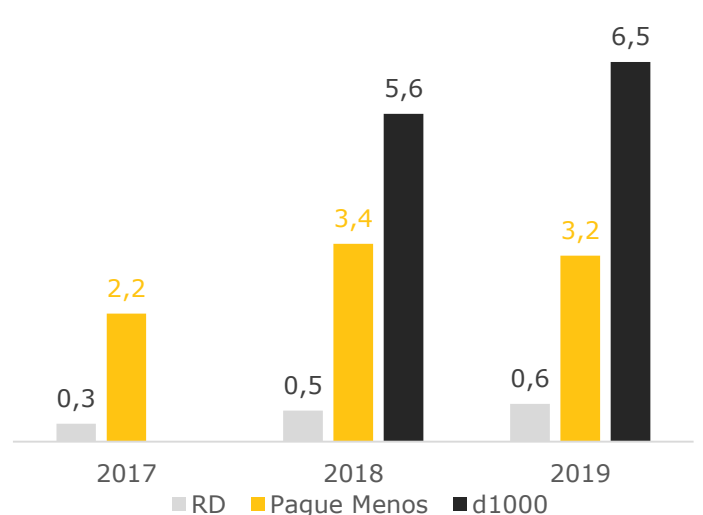
Gross Sales (R\$m)



Adjusted EBITDA Margin (%)



Net debt / EBITDA (x)

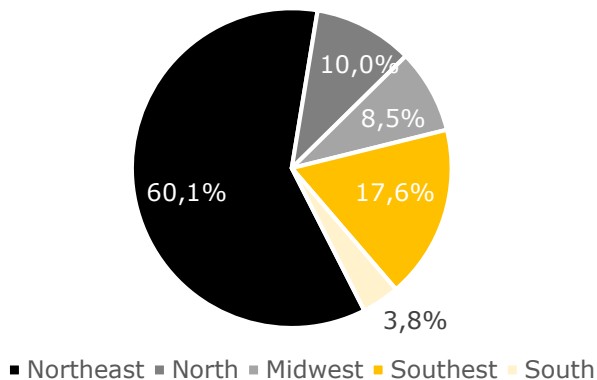


Quick Company Overview

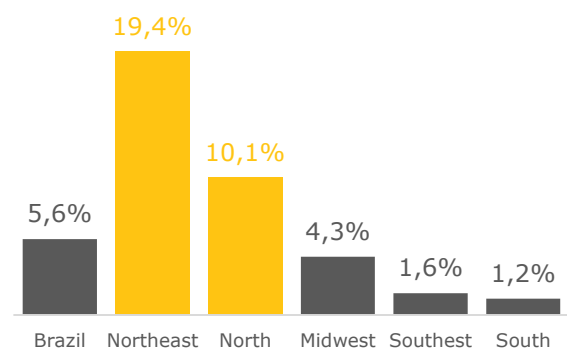
Born in the Northeast, but raised to Brazil

Pague Menos is the #3 largest drugstore chain in Brazil, with 5.6% market share, ~R\$7bn in annual gross sales and 1,105 stores across all Brazilian states – the only drugstore with a 100% national presence. The company was born in Fortaleza (Ceará) and, therefore, has most of its stores concentrated in the region (60% of stores) and is the consolidated market leader in the region, with ~19% market share vs. RD's at ~9%. Pague Menos is also market leader in the North region (10% of stores), with a 10% market share, vs. RD's at 3-4%.

Pague Menos: Stores Footprint (% of stores)
(as of 3Q20)



Pague Menos: Market Share per Region
(as of 3Q20)



Focus on lower income, but store formats to meet all needs

Until 2019, Pague Menos operated in “one size fits all” store model. However, since then, four different store formats were created to better serve client needs: Malls, Top, Pop and Pop Combate. Regarding target consumers, currently ~2/3 of PM's stores are in expanded middle class (Classes B2/C/D) regions, which accounts for ~3/4 of PM operating results.

Pague Menos: Store Formats



Relevant Improvements Compared to Previous Format

- New store model is transparent, creating an inviting atmosphere
- Better illumination in dermocosmetics area
- 47 stores (4% of total)

- Increased presence of the blue color in the forefront increases client identification
- Strategic product display in certain areas of the store
- 392 stores (35% of total)

- Clear view on all sectors inside the store from the entrance
- Metallic furniture applied in dermocosmetics session to highlight high value added products
- 491 stores (44% of total)

- Increased number of aisles and enhanced product display
- Attributes of visual communication are strategically highlighted
- 194 stores (17% of total)

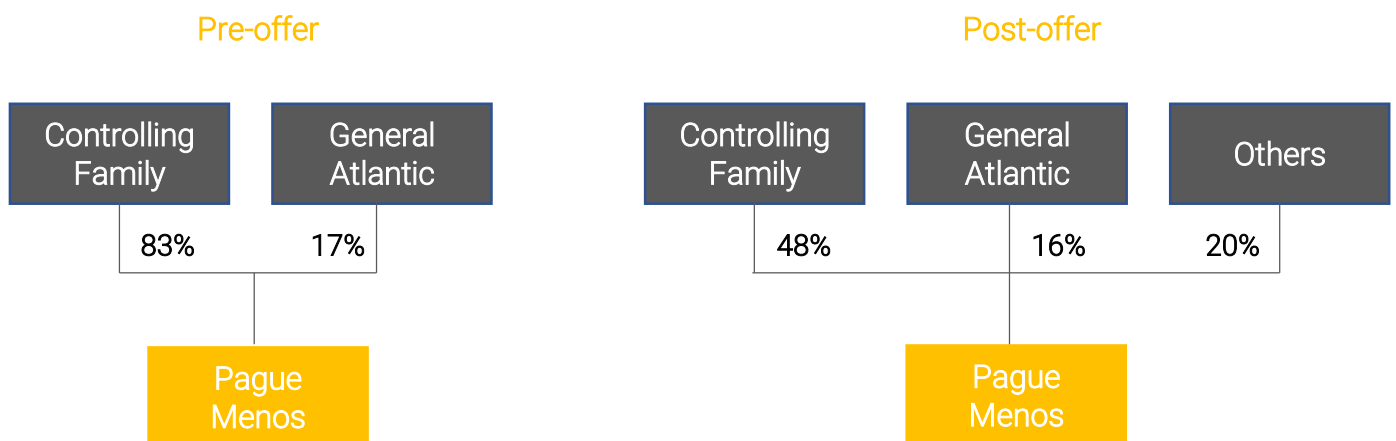
Pague Menos IPO

On September 2nd, Pague Menos has priced its IPO, raising ~R\$860mn through the issuance of ~100mn shares at a R\$8.5 offer price. PGMN3 shares are listed in the Novo Mercado (the segment with the highest level of corporate governance).

























Use of proceeds. The proceeds raised in the primary offering will be primarily used to accelerate company's store expansion plan (60% of total). The remaining should be destined to deleveraging (22%); Tech/Clinic Farma initiatives (10%); and Store Refurbishments (8%).

Shareholders' Structure. Prior to the offering, the founding family had an 83% stake at Pague Menos, while General Atlantic (GA) had a 17% stake. Interesting to note that GA injected R\$600mn in 2016 to acquired 17% of the company, leading to an implied equity value of R\$3.5bn vs. current market at R\$3.8bn. We believe this reinforces GA's view that there is still a lot of value to be captured in the company and, therefore, that they are extremely well aligned with shareholders.

























Following the IPO, the founding family's stake was reduced to 64% and GA's to 16%.



Appendix: Management

 <p>Mário Queirós</p> <ul style="list-style-type: none"> CEO Since 1989 	 <p>Marcos Colares</p> <ul style="list-style-type: none"> CCO Since 2019   
 <p>Luiz Novais</p> <ul style="list-style-type: none"> CFO Since 2016    	 <p>Jorge Jubilato</p> <ul style="list-style-type: none"> CHRO Since 2018    
 <p>José Rafael Vasquez</p> <ul style="list-style-type: none"> COO Since 2018    	 <p>Joaquim Garcia</p> <ul style="list-style-type: none"> CTO Since 2020  

Appendix: Board of Directors

 <p>Patriciana Rodrigues</p> <ul style="list-style-type: none"> Chairman 	
 <p>Rosilândia Queirós Lima</p> <ul style="list-style-type: none"> Founding Family 	 <p>Pedro Parente</p> <ul style="list-style-type: none"> GA Member since 2019   
 <p>Carlos Alves de Queirós</p> <ul style="list-style-type: none"> Founding Family 	 <p>Martin Escobari</p> <ul style="list-style-type: none"> GA Member since 2016   
 <p>Josué Ubiranilson</p> <ul style="list-style-type: none"> Founding Family 	 <p>Manuela Artigas</p> <ul style="list-style-type: none"> Independent Member since 2018  
 <p>Francisco Junior</p> <ul style="list-style-type: none"> Member 	 <p>Paulo Soares</p> <ul style="list-style-type: none"> Independent Member since 2017  

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