



Dom Maklerski

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Monday, April 18, 2016 | update

## Food Retailers

Poland, Portugal

### Strong Macro Priced In

The grocery retailers in our coverage have posted price gains over 30% since mid-2015, driven by improving fundamentals which include a decelerating pace of price deflation and increasing household income. A steady rise in salaries and job creation, coupled with the new government-sponsored '500+' child benefits program, will combine to drive consumer spending in Poland in 2016, with positive effects on retail sales. With that said, at the current level most of these factors seem to be largely discounted into the share price of Jeronimo Martins (prompting a rating downgrade from buy to hold). In case of Eurocash, the current high valuation stems from expectations attached to intensified M&A activity after two acquisitions announced in the last few months which, from our point of view (as reflected in a rating downgrade from reduce to sell rating), do not justify the steep market price given their size.

### Food prices in Poland

Food prices in Poland have remained stable since September 2015, supporting the sales effectiveness of chain grocery retailers. Note that when it comes to the inflation data for Q4 2015 and Q1 2016, the reported price falls were driven by negative base effects (with average prices in Q1 2015 falling 3.7% y/y) which are expected to weigh on food price inflation throughout the first half of 2016.

### Increasing household income

Bloomberg analyst surveys indicate potential for growth in Polish private consumption at annual rates of 3.9% in 2016 and 3.7% in 2017. The acceleration is fueled by rising salaries (with the average monthly pay up 3.3% in 2015), supported by a raise of 5.7% to PLN 1.850 in the minimum wage, coupled with the government's "500+" child benefits program launched in April 2016. Further, the consumer confidence index tracking sentiment among households today is at its highest level in four years. With the average income generated by Polish households on a steady rise, retailers can look forward to increasing sales at their stores.

### Salary pressure

Polish retailers are experiencing increasing pay pressure from their employees. In February 2016, we saw pay raises by the Biedronka supermarket operator, owned by Jeronimo Martins, and by the German discount chain Lidl. In our opinion, the rising payroll costs will not greatly affect the profitability of chain retailers because they will be offset by SG&A dilution in line with growing sales (higher consumer demand, positive price trends).

### Supermarket tax

The Polish government wants to tax big retailers with an additional levy on monthly sales. Legislation is still in progress, and according to the latest information the most likely formula for the new tax will be a flat rate of 0.9% charged on net monthly sales in excess of PLN 17m. The new tax regime is designed to also apply to franchise systems where there are capital ties between franchisors and franchisees (which means only a minimal additional burden in case of Eurocash). When it comes to the impact on the retail sector, we expect big players will take advantage of their bargaining power to pass at least part of the additional tax onto end consumers. As for smaller stores, they should be able to avoid the new tax thanks to the high tax-free revenue threshold.

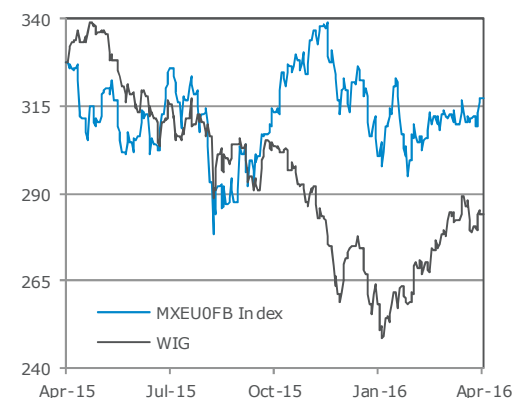
Company	P/E			EV/EBITDA		
	2015	2016E	2017E	2015	2016E	2017E
Eurocash	36.4	30.4	26.3	18.5	16.8	14.6
JMT	27.7	24.1	20.4	12.1	10.9	9.4

MSCI Europe Food, Bev. & Tob.	316.94
WIG	48,095
2016E P/E	19.8x
2016E EV/EBITDA	14.3x

### Sector Outlook

Poland-based FMCG retailers in 2016 will benefit from decreasing pressure from food price deflation combined with increasing personal spending. At the same time, the Polish market remains fiercely competitive, with the biggest players striving to keep low the average basket value. On top of that, local retailers are facing an additional tax on sales and a possible ban on Sunday trading.

### MSCI Europe Food, Beverage and Tobacco Index vs. WIG



Company	Target Price		Rating	
	new	old	new	old
Eurocash	42.70	47.50	sell	reduce
JMT	14.90	15.10	hold	buy

Company	Current Price	Target Price	Upside/Downside
Eurocash	55.77	42.70	-23.5%
JMT	14.72	14.90	+1.2%

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## Eurocash: sell (downgraded)

EUR PW; EUR.WA | Retail &amp; Wholesale, Poland

### Organic Growth Sags In 2016

By improving working capital management, Eurocash was able to reduce its net debt/EBITDA ratio to 0.4x at the end of 2015 from 2.1x in 2014. Moreover, fueled by intensified M&A plans, the Company has experienced a 30% surge in the market value of its shares since mid-2015. The acquisitions announced in the last few months include 100% stakes each in the alcohol distributor PDA and the supermarket operator EKO Holding which, combined, generated a total revenue of PLN 1.3 billion in 2015. At this level, the acquisitions are not substantial enough to justify Eurocash's expensive valuation at 28.1x 2016E P/E and 14.5x EV/EBITDA, especially looking at the weak 2016 organic growth outlook, the low profits generated by the Cash & Carry business in Q4 2015, and the disappointingly small number of new Delikatesy Centrum supermarket openings in 2015 (the two latter factors prompted reductions in our revenue forecasts). Against this backdrop, despite stellar market fundamentals, we are downgrading EUR from reduce to sell with the price target cut to PLN 42.70 per share.

### Financial results in Q4 2015

Eurocash generated year-over-year growth of 4.4% in organic sales in Q4 2015. By segment, Eurocash Distribution posted a 6.2% increase in revenue in the period, but on the other hand the Cash&Carry segment reported 0.59% contraction despite a 11.3% increase in warehouse locations and a 9.8% increase in the number of the franchise retail stores ABC. Moreover, there was a marked slowdown in the rate of store openings within the "Delikatesy Centrum" supermarket chain to 73 locations in 2015 from 128 in 2014.

### Potential to improve profit margins

Eurocash reduced the SG&A-to-sales ratio by 0.67ppt in 2015, thus reducing the negative impact of weak gross margin on the EBITDA margin. Going forward, through further integration of deliveries via a shared logistics platform, the Company is expected to further reduce SG&A, driving the 2016 EBITDA margin up by 0.1ppt to 2.44%.

### Acquisition delays

Eurocash finalized the acquisition of a 50% stake in the Delikatesy Centrum franchisee Firma Rogala in January 2016, after almost 1.5 years from its original announcement in September 2014. In February 2016, the Company was informed by the anti-monopoly office that its application to take over a 100% stake in the alcohol distributor PDA would take four months longer to examine for potential excessive market concentration. In the future, Eurocash's M&A plans may face further obstacles due to its high market share in certain segments of the retail market.

(PLN m)	2014	2015	2016E	2017E	2018E
Revenue	16,963.8	20,318.2	21,369.1	23,612.4	24,425.4
EBITDA	412.5	475.6	522.4	584.1	598.2
EBITDA margin	2.43%	2.34%	2.44%	2.47%	2.45%
EBIT	287.2	325.1	371.5	421.2	436.3
Net profit	180.5	212.4	254.9	295.1	322.6
DPS	0.79	0.80	1.00	0.92	1.06
P/E	42.8	36.4	30.4	26.3	24.0
P/CE	25.3	21.3	19.1	16.9	16.0
P/BV	7.8	7.0	6.3	5.6	4.9
EV/EBITDA	20.9	18.5	16.8	14.6	13.9
DYield	1.4%	1.4%	1.8%	1.6%	1.9%

Current Price	PLN 55.77
Target Price	PLN 42.70
MCap	PLN 7,748m
Free Float	PLN 3,583m
ADTV (3M)	PLN 52.91m

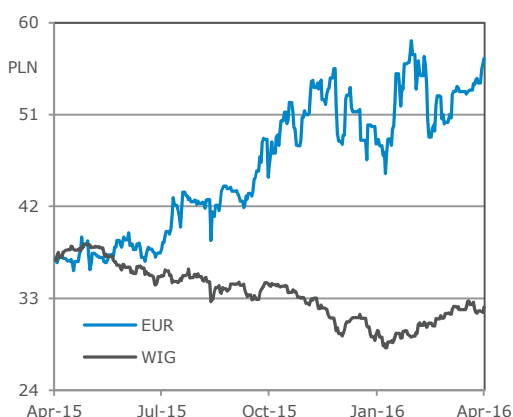
### Ownership

Luis Amaral	43.71%
Cartica Management	5.04%
Coronation Assets Management (Pty) Limited	5.00%
Others	46.25%

### Business Profile

Eurocash is the biggest FMCG distributor in Poland in sales revenues and locations. Its customers include wholesale companies, retail stores, service stations, and restaurants.

### EUR vs. WIG



Company	Target Price		Rating	
	new	old	new	old
Eurocash	42.70	47.50	sell	reduce

Company	Current Price	Target Price	Downside
Eurocash	55.77	42.70	-23.5%

Forecast revision since last update	2016E	2017E	2018E
Revenue	-1.86%	-0.38%	-2.45%
EBITDA	+0.13%	-4.04%	-7.82%
Net profit	-6.62%	-1367%	-16.40%

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# Jeronimo Martins: hold (downgraded)

**JMT PL; JMT.LS | Retail, Portugal**

## Strong Fundamentals Already Priced In

Jeronimo Martins stands to be one of the main beneficiaries of the growing disposable income of Polish households. In addition, its sales in the year ahead will be supported by contained local price deflation combined with constant product mix redesign to better address consumer preferences. JMT's long-term outlook is also bullish, with the Colombian supermarket chain Ara entering an expansion phase, and the Polish drugstore chain Hebe expected to improve profits. According to our calculations, Hebe will reach EBITDA break-even in 2018, followed by Ara in 2019. We have revised our sales forecast for JMT's Polish supermarket chain Biedronka to account for the appreciation in the EURPLN exchange rate. Biedronka is expected to grow the EBITDA margin by 0.21ppt to 6.04% in 2016 thanks to an improved sales mix and lower SG&A, resulting in a year-on-year rebound of 9.26% in the annual EBITDA, estimated at EUR 875.1m. With all that being said, at the current price level the strong earnings outlook is already priced into JMT shares after a year-to-date price increase of 23%. Accordingly, we are downgrading the Company from buy to hold with the price target at EUR 14.90 per share.

## JMT delivers excellent 2015 results

The focus put on improving the sales effectiveness of Biedronka supermarkets paid off in 2015 when same-store sales registered 3.2% growth amid a persistent price deflation. This year, as deflationary pressures in food retail ease, and the Polish economy continues to grow, Biedronka is expected to experience growth in sales per square meter at annual rates of 4.6% in zlotys and 0.9% in euros. At the same time, through reductions in operating expenses accompanying the improving sales effectiveness and widening gross margins, in 2015 the Polish unit was able to expand its EBITDA margin by 0.06ppt to 5.83%, and in 2016 it is expected to grow operating margins even further.

## Accelerating expansion in Colombia

In March 2016 Jeronimo Martins announced that after four years of preparation its Colombian supermarket chain Ara was ready to accelerate its national expansion. The Company is aiming to have 1,003 Ara locations by the end of 2020, and we predict that the Colombian business will reach EBITDA break even in 2019, becoming one of the main earnings drivers for Jeronimo Martins in the medium term.

## EURPLN appreciation weighs on 2016 profits

The zloty's depreciation versus the euro is negatively impacting the profits of Biedronka which in 2015 generated 80% of Jeronimo Martin's consolidated EBITDA. Assuming an average EURPLN exchange rate of 4.34 in 2016 and 4.15 in subsequent years, we have lowered our sales forecast for this year by 0.96%, as well as reducing our net profit estimate to reflect higher financing costs and an expected rise in the effective tax rate from 24% to 25%.

(EUR m)	2014	2015	2016E	2017E	2018E
Revenue	12,680.0	13,728.0	14,484.3	16,107.3	17,237.5
EBITDA	732.0	801.0	875.1	973.7	1,069.3
EBITDA margin	5.8%	5.8%	6.0%	6.0%	6.2%
EBIT	448.5	486.0	548.1	635.2	724.3
Net profit	302.4	333.0	384.4	454.8	522.8
DPS	0.3	0.6	0.3	0.3	0.4
P/E	30.6	27.8	24.1	20.4	17.7
P/CE	15.8	14.3	13.0	11.7	10.7
P/BV	6.6	6.9	5.9	5.1	4.4
EV/EBITDA	13.4	12.1	10.9	9.4	8.2
DYield	2.25%	4.22%	1.80%	2.07%	2.45%

Current Price	EUR 14.72
Target Price	EUR 14.90
MCap	EUR 9,263m
Free Float	EUR 3,594m
ADTV (3M)	EUR 34.46m

## Ownership

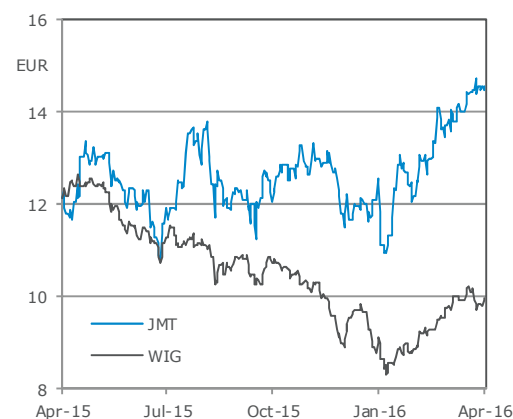
Sociedade Francisco Manuel dos Santos, SGPS, S.A.	57.73%
Aberdeen Asset Managers Limited	5.00%
Heerema Holding Company Inc.	5.00%

Others	32.27%
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## Business Profile

Jeronimo Martins is a Portugal-based distributor of food and other consumer products with operations in Poland (where it is the leader in the grocery market through the discount supermarket chain Biedronka), Portugal (where it operates the Pingo Doce supermarket chain and the cash&carry chain Recheio), and Colombia (where it recently launched a new supermarket chain under the name Ara).

## JMT vs. WIG



Company	Target Price		Rating	
	new	old	new	old
JMT	14.9	15.1	hold	buy

Company	Current Price	Target Price	Upside
JMT	14.72	14.9	+1.22%

Forecast revision since last update	2016E	2017E	2018E
Revenue	-0.96%	1.79%	2.39%
EBITDA	-0.69%	1.99%	4.31%
Net profit	-4.25%	-1.12%	1.37%

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## List of abbreviations and ratios contained in the report:

**EV** – net debt + market value  
**EBIT** – Earnings Before Interest and Taxes  
**EBITDA** – EBIT + Depreciation and Amortisation  
**P/CE** – price to earnings with amortisation  
**MC/S** – market capitalisation to sales  
**EBIT/EV** – operating profit to economic value  
**P/E** – (Price/Earnings) – price divided by annual net profit per share  
**ROE** – (Return on Equity) – annual net profit divided by average equity  
**P/BV** – (Price/Book Value) – price divided by book value per share  
**Net debt** – credits + debt papers + interest bearing loans – cash and cash equivalents  
**EBITDA margin** – EBITDA/Sales

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**HOLD** – we expect that the rate of return from an investment will range from -5% to +5%  
**REDUCE** – we expect that the rate of return from an investment will range from -5% to -15%  
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**Relative** – based on a comparison of valuation multipliers of companies from a given sector; simple in construction, reflects the current state of the market; weak points include substantial variability (fluctuations together with market indices) as well as difficulty in the selection of the group of comparable companies.

## Previous ratings issued for Eurocash

Rating	Sell	Reduce
Rating date	2015-11-04	2016-02-02
Price on rating day	49.75	53.74
WIG on rating day	50367.53	44294.89

## Previous ratings issued for Jeronimo Martins

Rating	Buy
Rating date	2016-02-02
Price on rating day	13.08
WIG on rating day	44294.89

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