11th March 2016

Food retailing

Carrefour

Price EUR23.68

Analyst meeting: we hoped management would be more specific

Fair Value EUR31 (+31%) **BUY**

Bloomberg	CA FP
Reuters	CARR.PA
12-month High / Low (EUR)	32.8 / 22.3
Market Cap (EUR)	17,487
Ev (BG Estimates) (EUR)	23,087
Avg. 6m daily volume (000)	3 237
3y EPS CAGR	10.4%

	1 M	3 M	6 M	31/12/15
Absolute perf.	0.2%	-11.9%	-14.4%	-11.1%
Food Retailing	4.2%	0.2%	-1.2%	0.0%
DJ Stoxx 600	5.8%	-8.2%	-7.2%	-8.8%

YEnd Dec. (EURm)	2014	2015e	2016e	2017e
Sales	74,706	77,020	78,398	81,494
% change		*3.1%*	*1.8%*	*3.9%*
EBITDA	3,768	3,938	4,174	4,448
EBIT	2,536	2,411	2,637	2,850
% change		*-4.9%*	*9.4%*	*8.1%*
Net income	1,040	1,127	1,258	1,405
% change		*8.3%*	*11.7%*	*11.7%*

	2014	2015e	2016e	2017e
Operating margin	3.2	3.2	3.4	3.5
Net margin	1.4	1.5	1.6	1.7
ROE	NM	NM	NM	NM
ROCE	9.2	9.0	9.4	9.9
Gearing	48.4	40.3	37.7	32.6

(EUR)	2014	2015e	2016e	2017e
EPS	1.47	1.59	1.77	1.98
% change	-	*7.8%*	*11.7%*	*11.7%*
P/E	16.1x	14.9x	13.4x	12.0x
FCF yield (%)	NM	1.8%	3.8%	6.0%
Dividends (EUR)	0.80	0.89	0.97	1.06
Div yield (%)	3.4%	3.8%	4.1%	4.5%
EV/Sales	0.3x	0.3x	0.3x	0.3x
EV/EBITDA	6.1x	5.9x	5.6x	5.2x
EV/EBIT	9.1x	9.6x	8.8x	8.1x

Carrefour has been punished (-6.5%) despite fairly decent 2015 results. Indeed, investors may have been somewhat dissatisfied. 1/ In terms of outlook, we hoped management would add more flavour to 2016 concerning the margin in France, especially since losses at Dia should be flat in 2016 (i.e. around EUR50-60m) vs the reduction in losses previously expected by the group. 2/ Along with a slight disappointment concerning the dividend, this certainly put pressure on the stock, not to mention the fact that 3/ management was perhaps not specific enough notably regarding e-commerce intiatives (a question mark) going forward. On the whole, we hoped there would be a bit more meat on the bone in terms of fresh impetus for the equity story. This being said, valuation remains attractive.

We have been developing the following investment case for months: **1/** underpinned especially by the LME, Carrefour has entered a growth cycle (hypermarkets are dead, long live hypermarkets!). **2/** In the rest of Europe, Carrefour has managed to trim its fixed cost base and should be able to tap into operating leverage (especially in Spain). **3/** In emerging countries, a favorable format mix in Brazil should allow Carrefour to weather the storm (potential margin widening remains significant in this area). No denying that Carrefour delivered performances in line with this investment case.

In terms of risk/momentum, we have also been saying for a while that: **1/** for as long as China makes money, it remains a "secondary issue" (so far, ~3-5% of earnings), but the day it starts losing money, it could become a question mark (operating deleverage can be very painful). Indeed, following a series of hugely negative LFLs, the retailer is in negative territory. This concern accompanies those regarding **2/** financial services in Brazil. However, management appeared to be rather confident regarding China (the CEO fears no significant increase in losses and even foresees a turning point at the end of 2016) and claimed to have good control of default risk for financial services in Brazil. These elements (China and financial services in Brazil) will nevertheless need to be closely monitored in 2016.

Over the medium medium term, management still sees room for margin improvement notably thanks to **1/** a more favourable inflation scenario, **2/** logistics and **3/** the recovery in both Italy (in positive territory in H2 we understand and which could break even in 2016) and China. However for the short term, we hoped management would add more flavour to 2016 especially in terms of the margin in France, since losses at Dia should be flat in 2016 vs 2015 (i.e. ~EUR50-60m) vs the reduction in losses previously expected by the group. As such, investors may have been a bit dissatisfied. Along with a slight disappointment concerning the dividend, this certainly put pressure on the stock, not to mention the fact that management was perhaps not specific enough regarding e-commerce intiatives notably.

From a more fundamental viewpoint, we are witnessing a change in paradigm (anorexic growth... the bigger the better!), which for a large number of mature retailers has meant that solid and recurring growth has sunk to a sinusoidal pace limited to just a few points (a disruptive factor in a fixed-cost industry). Yet with hindsight, this challenge for Georges Plassat (and his future successor) has already come up tangentially, especially when the current CEO spoke of an engine that had to be repaired so that it can accelerate in terms of growth going forward. That is what the very issue is going forward.

VALUATION

- Carrefour is currently showing a 2016 P/E of 13.5x vs 16x on average for the sector

NEXT CATALYSTS

- An IPO of Carmila (even with a limited impact on the SOTP) would feed momentum

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