27th April 2016

Food retailing

Delhaize

Price EUR91.31

Q1 2016 (first take): strong commercial momentum / clarification needed on FCF

Fair Value EUR104,5 vs. EUR105 (+14%) **BUY**

Bloomberg	DELB BB
Reuters	DELBt.BR
12-month High / Low (EUR)	97.2 / 70.9
Market Cap (EURm)	9,519
Ev (BG Estimates) (EURm)	10,300
Avg. 6m daily volume (000)	299.7
3y EPS CAGR	10.8%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-2.1%	-1.0%	12.0%	1.7%
Food Retailing	1.2%	5.6%	-3.9%	2.4%
DJ Stoxx 600	3.6%	2.4%	-7.6%	-5.1%

YEnd Dec. (EURm)	2014	2015e	2016e	2017e
Sales	21,361	24,395	25,249	25,828
% change		*14.2%*	*3.5%*	*2.3%*
EBITDA	1,355	1,538	1,626	1,688
EBIT	424.1	696.0	922.1	952.5
% change		*64.1%*	*32.5%*	*3.3%*
Net income	445.5	474.7	571.4	616.1
% change		*6.6%*	*20.4%*	*7.8%*

	2014	2015e	2016e	2017e
Operating margin	3.6	3.6	3.7	3.7
Net margin	2.1	1.9	2.3	2.4
ROE	NM	NM	NM	NM
ROCE	7.5	7.9	8.3	8.5
Gearing	18.3	12.7	7.8	2.5

(EUR)	2014	2015e	2016e	2017e
EPS	4.37	4.58	5.51	5.94
% change	-	*4.8%*	*20.4%*	*7.8%*
P/E	20.9x	19.9x	16.6x	15.4x
FCF yield (%)	5.7%	5.3%	5.3%	5.9%
Dividends (EUR)	1.17	1.31	1.59	1.72
Div yield (%)	1.3%	1.4%	1.7%	1.9%
EV/Sales	0.5x	0.4x	0.4x	0.4x
EV/EBITDA	7.8x	6.7x	6.2x	5.7x
EV/EBIT	24.8x	14.8x	10.9x	10.2x

Delhaize's Q1 2016 revenue growth woked out at 4.3% on constant currencies to EUR6153m (vs EUR6084m expected by the consensus). LFL sales growth reached +2.6% in the US (vs +2.1% e), +2.9% in Belgium (vs +2.7% e) and +10.8% in SEE (vs +3.6% e). On the whole, Delhaize turned in a very robust performance in Q1 with a 62bp improvement in underlying operating margin to 3.6%. Only FCF (the detail of which needs to be clarified) may disappoint somewhat but, at this stage of the year, cannot wipe out the strong commercial momentum within an industry that is suffering a lack of growth. Buy maintained ahead of the conference call at 09:00 am CET (+44 203 427 1908).

In the US (66% of the group's sales in Q1 and ~72% of the EBIT), against the backdrop of deflation (-1.1% due to price cuts in meat and dairy), Delhaize's performances remained resilient with LFL sales growth working out at 2.6% (vs +2.1% expected by the consensus) excluding a negative calendar impact of -0.5%. Both Food Lion and Hannaford continued to report positive LFL and real sales growth. The underlying operating margin increased 15bp to 3.9%. Gross margin widened slightly, thanks to a lower shrink in fresh categories (we suspect that further progress could be made in this area), partly offset by ongoing price investments at Hannaford.

Belgium (20% of the group's sales and ~15% of the EBIT), which has long been a sensitive issue in the equity story, maintained strong commercial momentum even if topline performances in company operated stores remained below management expectations. On the whole, LFL sales growth worked out at 2.9% LFL excl. a positive calendar impact of +1% (vs +2.7%e by the consensus and +5.1% Q4 15), on top of a return to positive retail inflation (+2.2% internal inflation after +1.8% in Q4 15) since Q3 15 now. This translated into a 50bp market share gain to 24.3%. Underlying operating margin was up +134bp to 2.7%. This was the result of stong improvement in SG&A as a % of sales, due to the Transformation Plan savings and lower advertising expenses.

In South Eastern Europe (15% of the group's sales and ~16% of the EBIT), LFL sales rose 10.8% (vs +3.6%e) and Delhaize thus tapped into operating leverage (+168bp). LFL sales growth and real growth were positive across the segment and were particulary strong in Greece and Romania (while inflation was flat for the region overall).

ANALYSIS

- In terms of the topline, within an industry that is suffering a decline in growth potential, Delhaize continues to post strong valuable commercial performances. This translated into healthy operating leverage. As such, Delhaize generated a robust performance in Q1 with a 62bp improvement in underlying operating margin to 3.6%. Although the group benefited from a slightly stronger gross margin mainly in the US, profitability was especially boosted by lower SG&A as a percentage of revenues in both Belgium and Southeastern Europe.
- Delhaize reported negative FCF in the first quarter (i.e. -EUR268m vs -EUR93m in 2015), which may disappoint somewhat. This was mainly due to increased capex (i.e. EUR120m in Q1 2016 vs EUR85m in 2015) and WCR movements (minus EUR484m in Q1 2016 vs minus EUR265m in 2015). However, management remains confident to generate "a healthy free cash flow for the full year".
- What is of a greater importance and consequence than the quarterly figures themselves is the pending merger. Major execution risks (which cannot be ruled out during such a merger) may arise later notably when the company will have to integrate the US operations. By then, we believe both Ahold and Delhaize are a kind of "insurance" within a skittish market with no clear direction.

VALUATION

- Delhaize is showing a 15x 2017 P/E vs 16x excl. Tesco on average for the panel

NEXT CATALYSTS

- Merger with Ahold

Analyst :
Antoine Parison
33(0) 1 70 36 57 03
aparison@bryangarnier.com

Sector Team :
Nikolaas Faes
Loïc Morvan
Cédric Rossi
Virginie Roumage

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London
Beaufort House
15 St. Botolph Street
London EC3A 7BB
Tel: +44 (0) 207 332 2500
Fax: +44 (0) 207 332 2559
Authorised and regulated by the
Financial Conduct Authority (FCA)

Paris
26 Avenue des Champs Elysées
75008 Paris
Tel: +33 (0) 1 56 68 75 00
Fax: +33 (0) 1 56 68 75 01
Regulated by the
Financial Conduct Authority (FCA) and the
Autorité de Contrôle prudential et de
resolution (ACPR)

New York
750 Lexington Avenue
New York, NY 10022
Tel: +1 (0) 212 337 7000
Fax: +1 (0) 212 337 7002
FINRA and SIPC member

Munich
Widenmayerstrasse 29
80538 Munich
Germany
+49 89 2422 62 11

New Delhi
The Imperial Hotel Janpath
New Delhi 110 001
Tel +91 11 4132 6062
+91 98 1111 5119
Fax +91 11 2621 9062

Geneva
rue de Grenus 7
CP 2113
Genève 1, CH 1211
Tel +4122 731 3263
Fax+4122731 3243
Regulated by the FINMA