DIA

Price EUR5.08

A far less elusive speech and a more offensive statement!

Fair Value EUR6,5 (+28%) **BUY vs. NEUTRAL**

Bloomberg	DIA.SM
Reuters	DIA MC
12-month High / Low (EUR)	7.6 / 4.4
Market Cap (EURm)	3,162
Ev (BG Estimates) (EURm)	4,295
Avg. 6m daily volume (000)	4 206
3y EPS CAGR	6.4%

	1 M	3 M	6 M	31/12/15
Absolute perf.	5.5%	9.2%	-12.4%	-6.7%
Food Retailing	-6.2%	3.2%	-7.7%	-2.6%
DJ Stoxx 600	-0.5%	6.6%	-10.6%	-8.9%

YEnd Dec. (EURm)	2014	2015e	2016e	2017e
Sales	8,011	8,926	9,024	9,533
% change		*11.4%*	*1.1%*	*5.6%*
EBITDA	585	610	627	685
EBIT	323.9	274.1	349.5	407.8
% change		*-15.4%*	*27.5%*	*16.7%*
Net income	262.4	254.1	249.1	295.7
% change		*-3.1%*	*-2.0%*	*18.7%*

	2014	2015e	2016e	2017e
Operating margin	5.0	4.4	4.4	4.8
Net margin	3.3	2.8	2.8	3.1
ROE	NM	NM	NM	NM
ROCE	32.2	22.5	20.6	22.1
Gearing	141.3	361.8	228.4	149.7

(EUR)	2014	2015e	2016e	2017e
EPS	0.41	0.42	0.41	0.49
% change	-	*3.1%*	*-1.6%*	*18.7%*
P/E	12.5x	12.1x	12.3x	10.3x
FCF yield (%)	1.6%	NM	6.9%	8.7%
Dividends (EUR)	0.18	0.19	0.20	0.21
Div yield (%)	3.5%	3.7%	3.9%	4.1%
EV/Sales	0.5x	0.5x	0.5x	0.4x
EV/EBITDA	6.3x	7.0x	6.8x	6.1x
EV/EBIT	11.4x	15.7x	12.2x	10.2x

1/ In the past, management has been rather elusive concerning a return to positive lfl growth in Spain and Portugal. Today, the CEO has provided the market with clear guidance set in stone, for positive lfl growth excl. calendar effects in Iberia in Q2. 2/ Over the past year, the relationship between the topline (persistently declining LFL rates) and the bottom line (growing underlying margin rate) in Iberia has appeared to be unhealthy in the market's eyes. This relationship seems much more appropriate in Q1 16. In the end, a set of concordant items of evidence which, along with an attractive valuation (10x 2017 P/E), prompt us to upgrade our recommendation to Buy vs Neutral.

Over the past year, the relationship between the topline (persistently declining LFL rates) and the bottom line (growing margin rate) in Iberia has appeared to be unhealthy in the eyes of the market. Hence, investors started to convince themselves that Dia, against all common sense, was intentionally pursuing a margin rate (vs cash margin) commercial strategy. This observation comes after Tesco's nightmare which resulted in an extremely violent and unprecedented margin restatement process in order to attract clients back to its stores.

Having learned from this painful experience, the market became convinced that at some point Dia would have no choice but to do the same. We have never believed that this margin restatement was the right issue to focus on (see – Anorexic growth... the bigger the better!). Because: **1/** initially, the fragmented Spanish market does not have the characteristics of an oligopoly in which players could be tempted to nurture their rates; **2/** Dia, the franchiser, has a specific margin equation (the change in the mix in favor of franchises guarantees an annual improvement of 15-20bp e!: see - Olé!); **3/** Tesco's restatement stemmed from an inappropriate positioning which is not Dia's case.

However, the fact is that others believed this and have convinced the market in 2015. As a reminder, ahead of Q4 2015 results, the guidance provided by management for the FY implied a 190bp (-130 bp finally released) decline of underlying margin (i.e. excl. El Arbol and Eroski) in Q4 in Iberia. At that time, while we considered this anticipated narrowing as a temporary factor prompted in particular by the dilution of upfront synergies on the acquisitions, we also considered that it was going to be interpreted as the pre-cursor to a margin restatement. This fear prompted us to look for cover (28th October).

Nowadays, we have to admit that we were very positively surprised by the publication of Dia yesterday. It is not so much Iberian LFL figures that were in line with estimates but rather the tone of management during the conference call which turned out to be very positive (the CEO provided the market with clear guidance for positive LFL excl. positive calendar in Q2 In Iberia). Moreover, we believe that the 35bp estimated decline in underlying margin in Iberia cannot be interpreted as a margin restatement (contrary perhaps to Q4 2015) while the relationship between the topline (-0.3% LFL) and the bottom line (-35 bp / a decline implying healthy investment in the value proposition we believe; purchasing gains and efficiency gains should be reinvested) should appear to be more appropriate.

Margin estimates (Bryan Garnier)	Q1	Q2	Q3	Q4	2015	Q1 16
LFL sales gowth	-4,5%	-5,2%	-2,3%	-1,4%	-3,3%	-1,3%
Excl. calendar	na	na	na	na	-0.9%	-0.3%
Margin in Iberia (excl. EL Arbold & Eroski)	8,7%	10,2%	10,3%	11,3%	10,1%	8,3%
Underlying margin appreciation	83bp	109bp	12bp	-129bp	19bp	-35bp

In addition, our feeling is that Dia is now aiming to change its model, in order to accompany the market's moves upscale. Hence, the targeted acquisitions of El Arbol and Eroski, which should especially help make up for shortfalls in the fresh products segment.

VALUATION

- The 6% downward revision to our 2016/18estimates is mainly a reflection of forex
- 2017 P/E of 10x vs 16x on average for the sector excl. Tesco

NEXT CATALYSTS

- Positive LFL in Iberia from Q2 2016

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BUY ratings 57,1% NEUTRAL ratings 33,6% SELL ratings 9,3%

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