12th May 2016

Food retailing

# Metro AG

Price EUR28.27

## Quid of the ex-post credit situation in separatly listed entities?

**Fair Value EUR26 (-8%)** **SELL vs. NEUTRAL**

| | |
|---|---|
| Bloomberg | MEO GY |
| Reuters | MEOG.DE |
| 12-month High / Low (EUR) | 32.2 / 21.9 |
| Market Cap (EUR) | 9,161 |
| Ev (BG Estimates) (EUR) | 12,039 |
| Avg. 6m daily volume (000) | 1,290 |
| 3y EPS CAGR | 12.3% |

| | 1 M | 3 M | 6 M | 31/12/15 |
|---|---|---|---|---|
| Absolute perf. | -0.3% | 22.6% | 0.4% | -4.4% |
| Food Retailing | -5.9% | 4.6% | -9.2% | -2.7% |
| DJ Stoxx 600 | 0.6% | 10.3% | -11.6% | -8.5% |

| YEnd Sept. (EURm) | 09/15 | 09/16e | 09/17e | 09/18e |
|---|---|---|---|---|
| Sales | 59,220 | 58,320 | 59,835 | 61,396 |
| *% change* | | *-1.5%* | *2.6%* | *2.6%* |
| EBITDA | 2,457 | 2,460 | 2,544 | 2,631 |
| EBIT | 711.0 | 1,497 | 1,557 | 1,618 |
| *% change* | | *110.6%* | *4.0%* | *3.9%* |
| Net income | 502.3 | 597.5 | 652.5 | 711.0 |
| *% change* | | *18.9%* | *9.2%* | *9.0%* |

| | 09/15 | 09/16e | 09/17e | 09/18e |
|---|---|---|---|---|
| Operating margin | 2.6 | 2.6 | 2.6 | 2.6 |
| Net margin | 0.8 | 1.0 | 1.1 | 1.2 |
| ROE | NM | NM | NM | NM |
| ROCE | 10.5 | 10.2 | 9.8 | 9.6 |
| Gearing | 48.9 | 44.4 | 45.9 | 46.4 |

| (EUR) | 09/15 | 09/16e | 09/17e | 09/18e |
|---|---|---|---|---|
| EPS | 1.54 | 1.83 | 2.00 | 2.18 |
| *% change* | - | *18.9%* | *9.2%* | *9.0%* |
| P/E | 18.4x | 15.5x | 14.2x | 13.0x |
| FCF yield (%) | NM | NM | NM | NM |
| Dividends (EUR) | 1.00 | 0.98 | 1.02 | 1.05 |
| Div yield (%) | 3.5% | 3.5% | 3.6% | 3.7% |
| EV/Sales | 0.2x | 0.2x | 0.2x | 0.2x |
| EV/EBITDA | 4.9x | 4.9x | 4.8x | 4.8x |
| EV/EBIT | 17.0x | 8.0x | 7.9x | 7.8x |


**To the question of whether we can rule out a rights issue in order to address the capital structure problem ahead of the spin-off, management refused to answer. Some answers or non-answers can tell us a lot and, in this case, create an uncomfortable zone of uncertainty. On top of that, following the recent strong share performance, we now have 7% downside risk on our FV (EUR26). Downgrade to Sell vs. Neutral.**

The Metro share has been underpinned since the beginning of April by the buzz surrounding the announcement of a spin-off by mid-2017. Hence, we upgraded our recommendation at this moment while stressing that: 1/ the spin-off makes sense from a strategic point of view; 2/ separate listings would help gain operational flexibility, 3/ a pure player is far more valuable than a patchwork of different BUs. But we also layed a clear emphasis on fundamental issues that remain harsh facts in our view:

**1/** The favorable tax lever (shifting of costs out of Germany, in a bid to boost the domestic operating result at Metro C&C and thus activate the loss carry forward) should not eclipse soft commercial trends. In 2015, Metro beat the consensus thanks to property development revenues (~EUR150m) that are incorporated in EBITDA. In the end, it is not so much Metro's commercial potential that seems to be acclaimed but rather the tax engineering potential.

**2/** So far, in view of EBIT margin at around 10% (!), Russia accounts for ~25%e of EBIT whereas its share of sales stands at less than 10%. In a restricted consumer spending environment, and with the market stigmatising and harshly punishing margin rate policies in “oligopolistic areas”, a margin rate of this level leaves us somewhat perplexed. Moreover, we are concerned by the situation of Media Saturn outside Russia given that it is in the front row concerning the ramp-up of e-commerce.

On top of this, raising concerns regarding the post spin-off credit situation of both separately listed entities seem to be clearer. Our first-take estimates point to an adjusted Net/EBITDAR of ~3.5x and ~3.0x respectively on MMS (which, we believe, has very little debt) and the Food Business (most of the group’s NFD). The precedent of Casino (which has proved that beyond the ratio, a diversified profile is key to maintain a rating) leads us to believe that the situation at MMS (undiversifed cyclical profile and in the front row concerning the ramp-up of e-commerce) is stretched.

On the whole, the LFL (+0.6% in Q2) performances (certainly below the normative natural cost inflation) remain soft and prevent us from talking about a commercial recovery. And at this stage, we continue to think that hype surrounding the spin-off (details on which would have been very much appreciated especially regarding the ex-post credit situation of both seperatly listed entities) has underpinned the share price rather than a commercial recovery whose strength remains unproven.

### ANALYSIS & CONLUSION

- Management refused to answer the question of whether we can rule out a rights issue in order to address the capital structure problem. This creates an uncomfortable zone of uncertainty for investors ahead of the spin-off.
- As such, in view of the positive buzz surrounding the spin-off, we believe that the market will start to look at the capital structure more in depth. The cat could truly be let out of the bag sooner rather than later.
- In the end, we have more questions than answers. This situation of uncertainty prompts us to focus on growth fundamentals (SECTOR REPORT – Anorexic growth... the bigger the better!) which are soft (LFL below normative natural cost inflation)! Hence we downgrade our rating to Sell.

### VALUATION

- 2017 P/E of 14x vs 16x on average for the secor excl. Tesco

### NEXT CATALYSTS

- Q3 15/16 (2nd August). Spin-off by mid-2017

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