

## Tesco

Price 164.15p

A first take on Q1 sales prompts no change to our view on the stock (sell)

Fair Value 166p (+1%)

SELL

Bloomberg	TSCO LN
Reuters	TSCO.L
12-month High / Low (p)	223.7 / 139.2
Market Cap (GBPm)	13,418
Ev (BG Estimates) (GBPm)	21,346
Avg. 6m daily volume (000)	29 356
3y EPS CAGR	103.4%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-0.1%	-16.9%	13.0%	9.8%
Food Retailing	-0.7%	-3.5%	-0.2%	-1.3%
DJ Stoxx 600	0.6%	-0.2%	-4.8%	-7.0%

YEnd Feb. (GBPm)	02/16	02/17e	02/18e	02/19e
Sales	54,433	56,245	57,696	58,948
% change		3.3%	2.6%	2.2%
EBITDA	2,278	2,225	2,437	2,581
EBIT	1,046	1,069	1,252	1,370
% change		2.2%	17.1%	9.4%
Net income	103.5	473.0	606.7	866.2
% change		NM	28.3%	42.8%

	02/16	02/17e	02/18e	02/19e
Operating margin	1.7	1.9	2.2	2.3
Net margin	0.2	0.8	1.1	1.5
ROE	NM	NM	NM	NM
ROCE	4.5	5.2	6.1	6.8
Gearing	59.3	48.5	38.5	30.6

(p)	02/16	02/17e	02/18e	02/19e
EPS	1.27	5.83	7.48	10.68
% change	-	NM	28.3%	42.8%
P/E	NS	28.1x	21.9x	15.4x
FCF yield (%)	0.1%	0.1%	0.1%	0.1%
Dividends (p)	0.00	0.88	2.24	4.27
Div yield (%)	NM	0.5%	1.4%	2.6%
EV/Sales	0.4x	0.4x	0.4x	0.3x
EV/EBITDA	9.7x	9.6x	8.5x	6.1x
EV/EBIT	21.2x	20.0x	16.5x	11.5x

UK LFL sales growth came in at 0.3% in Q1 vs +0.2% expected by the consensus (volumes and transactions up 2.2% and 1.7% respectively). International LFL sales growth worked out at 3.0% in Q1 vs +2.8% expected by the consensus (volumes and transactions up 2.7% and 1.5% respectively). On the whole, the statement was pretty much in line with expectations and at this stage, does not allow us to amend our mitigated view on the stock. Sell maintained.

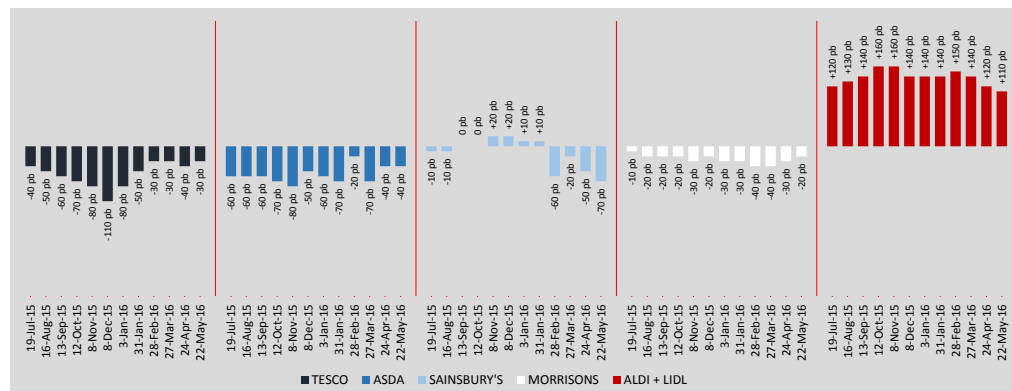
In the UK (~75% of revenues), Q1 2016/17 LFL sales growth excl. fuel and VAT (main kpi) came in at 0.3% (vs +0.9% in Q4 and -1.5% Q3 LY) vs +0.2%e. Beyond the figures, management indicates that new exclusive fresh food brands (deflationary impact of 0.7% on total UK LFL) are performing well in the UK.

In ROI (~4% of revenues), Q1 LFL sales growth excl. fuel and VAT worked out to 0.3% (vs +1.0% in Q4 and -1.2% Q3 LY) vs +0.7%e.

Overseas (~19% of revenues), sales momentum remained healthy with a 3.0% LFL rate (+3.8% in Q4 and +2.7% in Q3 LY) vs +2.8%e.

In detail concerning international activities, LFL sales growth worked out to 3.3% in Asia (~8% of revenues) vs +2.8%e and +2.8% in Europe (~11% of revenues) vs +2.9%e.

## Market share in the UK (Kantar / 12 weeks moving average)



Source: Kantar worldpanel

## ANALYSIS &amp; REMINDER OF OUR INVESTMENT CASE

- An improvement in the major balances (ND/EBITDA ratio of ~5.0x) depends on a recovery in lfl growth in the UK (+0.2% LFL currently vs ~2% needed, *ceteris paribus*, to cover natural cost inflation). There is still a long way to go in an environment that remains disrupted by discounters.
- Given the sluggishness specific to the sector, Tesco's commercial resolutions could take time to produce their effects. Growth is at a standstill (a disruptive factor in a fixed-cost industry, as Tesco's CEO Dave Lewis hinted at when he spoke of a "lethal cocktail of costs" in the UK).
- Note that the CEO stated that it would be "a significant, significant achievement" to meet analysts' estimates for operating profit of GBP1.25bn this year. So in the end, even if we do not question the ongoing commercial recovery, we are sticking to our cautious stance.

## VALUATION

- NM

## NEXT CATALYSTS

- Significant improvement in LFL sales growth in the UK & in ROI (i.e. > 2%)



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