26th July 2016

Food retailing

DIA

Price EUR5.71

Q2 results (in line): a much healthier top-line/bottom-line articulation

Fair Value EUR6,5 (+14%) **BUY**

Bloomberg	DIA.SM
Reuters	DIA MC
12-month High / Low (EUR)	6.5 / 4.4
Market Cap (EURm)	3,557
Ev (BG Estimates) (EURm)	4,655
Avg. 6m daily volume (000)	4 173
3y EPS CAGR	6.7%

	1 M	3 M	6 M	31/12/15
Absolute perf.	18.6%	14.8%	17.5%	5.0%
Food Retailing	5.1%	-3.7%	2.9%	-1.3%
DJ Stoxx 600	5.9%	-1.7%	1.4%	-6.8%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	8,926	9,024	9,533	10,025
% change		*1.1%*	*5.6%*	*5.2%*
EBITDA	610	627	685	724
EBIT	274.1	349.5	407.8	437.6
% change		*27.5%*	*16.7%*	*7.3%*
Net income	254.1	249.1	295.7	307.7
% change		*-2.0%*	*18.7%*	*4.1%*

	2015	2016e	2017e	2018e
Operating margin	4.4	4.4	4.8	4.9
Net margin	2.8	2.8	3.1	3.1
ROE	NM	NM	NM	NM
ROCE	22.5	20.6	22.1	22.2
Gearing	361.8	228.4	149.7	116.5

(EUR)	2015	2016e	2017e	2018e
EPS	0.42	0.41	0.49	0.51
% change	-	*-1.6%*	*18.7%*	*4.1%*
P/E	13.6x	13.8x	11.6x	11.2x
FCF yield (%)	NM	6.1%	7.8%	6.8%
Dividends (EUR)	0.19	0.20	0.21	0.22
Div yield (%)	3.3%	3.5%	3.6%	3.8%
EV/Sales	0.5x	0.5x	0.5x	0.4x
EV/EBITDA	7.7x	7.4x	6.7x	6.2x
EV/EBIT	17.1x	13.3x	11.2x	10.3x

Once again following Q1, we believe that the ~30bp estimated decline in Q2 underlying margin in Iberia (~35 bp decrease in Q1) cannot be interpreted as a margin restatement, while the relationship between the top line (+2.90%% LFL) and the bottom line (the decline in margin implies healthy investment, we believe) should look healthy to the market. Buy.

Top line (group sales flat at the group level / +12.4% at cc / +9.7% LFL): 1/ In Iberia (66% of sales), LFL sales increase 1.70% excluding the calendar effect and 2.90% including it (vs +2.0%e). This LFL rate, at last positive (!), is showing an obvious sequential improvement vs Q1 16 (-0.3% excl. calendar) and Q4 15 (-1.40%). **2/** In emerging markets (34% of sales), given the difficult macro-economic context in LatAm, Dia's performances turned out to be very resilient (+20.1% LFL vs +17.6%e). From Q1, LFL figures moved from 9% to twenty due to inflation acceleration in LatAm (especially in Argentina).

Bottom line: once again this quarter, the forex impact was hugely negative (sales down -5.5% in emerging markets on account of a 34% negative forex impact). The margin mix was therefore favourable since the relative weight of emerging markets (2.9% EBITDA margin / up +12bp vs +6bp e) which are far less profitable than Iberia (8.7% / down -11bp vs -4bp e), has decreased vs Q2 15. As a consequence, the group's EBITDA margin was slightly up +9.2bp (vs +11bp e) to 6.8% despite the margin in Iberia being down and that of emerging margin slightly up.

Outlook: 1/ cash generation was rather strong in H1 (EUR65.5m vs EUR -248.5 in 2015) and management estimates that the group is well on track to achieve its 2016/18 target which is for EUR750m FCF (i.e. EUR250 per anum). **1/** in 2016, Dia still expects high-single-digit growth in gross sales at CC; **3/** the consolidated EBITDA margin is expected to be stable in 2016.

ANALYSIS

- Remember that over the past year, the relationship between the top line (declining LFL rates) and the bottom line (growing underlying margin rate) in Iberia has appeared unhealthy in the market's eyes. This observation comes after Tesco's nightmare, which resulted in violent and unprecedented margin restatement in order to attract clients back to its stores. Hence, the market became convinced that, at some point, Dia would have no choice but to do the same.
- In that context, ahead of Q4 2015 results, the guidance provided by management for the FY implied a 190bp (-130 bp finally released) decline in the 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).
- Once again following Q1, we believe that the ~30bp estimated decline in Q2 underlying margin (~35 bp decline in Q1) in Iberia cannot be interpreted as a margin restatement, while the relationship between the top line (+2.90%% LFL) and the bottom line (the decline in margin implies healthy investment we believe) should appear healthy to the market. From Q1 16, the relationship top line/bottom line has become much more appropriate (we thus upgraded on May 13th).

IBERIA Margin estimates (Bryan Garnier)	Q1	Q2	Q3	Q4	2015	Q1 16	Q2 16
LFL sales gowth	-4,50%	-5,20%	-2,30%	-1,40%	-3,30%	-1,30%	+2,90%
Excl. calendar	na	na	na	na	-0.9%	-0.3%	+1,70%
Est. underlying margin var.	83bp	109bp	12bp	-129bp	19bp	-35bp	-30bp

VALUATION

- Dia is showing a 11.6x 2017 P/E vs 16.5x on average for the sector.

NEXT CATALYSTS

- Acceleration of LFL in Iberia

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