2nd August 2016

Food retailing

Metro AG

Price EUR28.64

Q3 sales and results (first take): still in an uncomfortable zone of uncertainty

Fair Value EUR26 (-9%) **SELL**

Bloomberg	MEO GY
Reuters	MEOG.DE
12-month High / Low (EUR)	31.6 / 21.9
Market Cap (EURm)	9,282
Ev (BG Estimates) (EURm)	12,161
Avg. 6m daily volume (000)	1 090
3y EPS CAGR	12.3%

	1 M	3 M	6 M	31/12/15
Absolute perf.	7.6%	0.2%	12.4%	-3.1%
Food Retailing	4.8%	-5.3%	-2.0%	-3.6%
DJ Stoxx 600	7.2%	-2.7%	1.4%	-7.2%

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	18.6x	15.7x	14.3x	13.2x
FCF yield (%)	NM	NM	NM	NM
Dividends (EUR)	1.00	0.98	1.02	1.05
Div yield (%)	3.5%	3.4%	3.6%	3.7%
EV/Sales	0.2x	0.2x	0.2x	0.2x
EV/EBITDA	5.0x	4.9x	4.9x	4.8x
EV/EBIT	17.2x	8.1x	8.0x	7.9x

Metro has released Q3 sales and results below expectations at the sales/EBIT levels and in line at the NR level. Adjusted EBIT worked out to EUR154m vs EUR190m expected by the consensus, while underlying EPS reached EUR0.24 (vs EUR0.23). The favourable tax lever (shifting of costs out of Germany, in a bid to boost domestic operating result at C&C and thus activate the loss of carry forwards) should not mask soft commercial trends. So far, and ahead of the conference call, management has refused to answer the question of whether we can rule out a rights issue in order to address the post spin-off capital structure problem. Stay tuned… Sell maintained.

ANALYSIS

- Q3 2015/16 sales grew +0.6% LFL (down 2.7% on the whole, on account of a 3.1% negative forex effect) to EUR13.589bn (vs EUR13.770bne). As a whole, the business seems to have been better in Germany than in other regions. In detail, LFL sales rose +0.1% in C&C (52% of sales), +1.2% at MMS (34% of sales) and decline -3.5% at Real (13% of sales). Very sparse details provided by geographies, but it seems that LFL developed positively in Russia C&C (better in Q3 than in 9M), rather in line with management previous statement according to which the country may gradually bottom out during Q4. But the fact remains that the C&C BU as a whole is up +0.1% LFL only... Hence, should the situation improve in Russia, it would mean that the rest is not moving in the right direction (?).
- EBIT before special items (BSI) worked out below expectations at EUR151m (vs EUR190m e) i.e. a 39bp decline in margin. In detail, EBIT BSI came out at EUR241m at Metro C&C vs EUR246m e (i.e. a 13bp decline in margin), minus EUR77m at Media Saturn vs -EUR49m e (i.e. 34bp decline in margin), EUR7m at Real vs EUR6m e (i.e. +7bp improvement in margin). The margin at MMS was penalised by 1/ an unfavourable product and margin mix, 2/ implementation costs related to Media Markt customer club and 3/ higher IT costs. Other activities worked out at minus EUR19m (vs -EUR12m e).
- On the whole, Q3 2015/16 EPS BSI worked out at EUR0.24 (vs EUR0.23 e), on account of a 42.5% tax rate BSI in 9M (vs 56.6% in LY). For FY15/16, Metro continues to expect a slight increase in overall sales, in a persistently challenging environment. In LFL terms, management foresees a slight increase (vs +1.5% in the previous year). It expects EBIT before special items to rise slightly above the EUR1,511m (vs EUR 1,497m in our own estimates) achieved in financial year 2014/15, including income from real estate sales. This guidance may appear challenging.
- The favourable tax lever (shifting of costs out of Germany, in a bid to boost the domestic operating result at C&C and thus activate the loss carry forward) should not eclipse soft commercial trends (+0.6% in Q3 after +0.6% in Q2; certainly below the normative natural cost inflation).
- Hype surrounding the spin-off (details on which would be very much appreciated especially regarding the ex-post credit situation of both separately listed entities) has underpinned the share price rather than a commercial recovery whose strength remains unproven.
- 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 (undiversified cyclical profile and in the front row concerning the ramp-up in e-commerce) is stretched (Net/EBITDAR of ~3.5x).
- So far, management has refused to answer the question of whether we can rule out a rights issue in order to address the capital structure problem. 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.

VALUATION

- Metro is currently showing a 14x 2017 P/E vs 16,5x on average for the sector.

NEXT CATALYSTS

- Details regarding the ex-post credit situation of both separately listed entities.

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(Tables next page)

Q3 15/16 Results:

Sales (EURm):	Q3 14/15	Q3 15/16e	Q3 15/16p
METRO Cash & Carry	7 449	7 201	7 113
Media-Saturn	4 620	4 708	4 689
Real	1 885	1 848	1 771
Others	14	14	17
METRO GROUP	13 968	13 771	13 590
EBIT before special items			
METRO Cash & Carry	262	246	241
Media-Saturn	-60	-49	-77
Real	5	6	6
Others	1	-12	-19
Consolidation	1	0	0
METRO GROUP	209	191	151
Margin BSI (%)			
METRO Cash & Carry	3,5%	3,4%	3,4%
Media-Saturn	-1,3%	-1,0%	-1,6%
Real	0,3%	0,3%	0,3%
METRO GROUP	1,5%	1,4%	1,1%

Source: BG ests

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