

Metro AG

Price EUR27.90

We believe a capital increase was narrowly avoided**Fair Value EUR26 (-7%)****SELL**

Bloomberg	MEO GY
Reuters	MEOG.DE
12-month High / Low (EUR)	31.6 / 21.9
Market Cap (EUR)	9,043
Ev (BG Estimates) (EUR)	11,921
Avg. 6m daily volume (000)	968.4
3y EPS CAGR	12.3%

Metro indicates that under the framework of the upcoming spin-off a capital increase was not intended. Both groups are also expected to maintain their Investment Grade ratings. To strengthen the capital base of the consumer electronics company, a 10% shareholding in the Wholesale and Food business is envisaged. In the same way, almost all of the group's existing financial liabilities are to be assumed by the latter. We believe that this "good" news should not wipe out what remains a stretched credit situation, which could restrict growth potential going forward. Sell maintained at this stage (conference call at 08:45 CET).

	1 M	3 M	6 M	31/12/15
Absolute perf.	4.2%	-4.2%	14.6%	-5.6%
Food Retailing	4.4%	-0.6%	-4.1%	-0.2%
DJ Stoxx 600	2.7%	2.7%	2.6%	-4.2%

With the analysis phase now complete, management is to officially start preparations for the group's demerger. In a press release, the retailer indicated yesterday that under the framework of this spin-off, a capital increase was not intended. It is also expected that that both groups (i.e. Wholesale and Food business on the one hand and Consumer Electronics – MMS – on the other) will maintain their Investment Grade ratings. To strengthen the capital base of the Consumer Electronics company, a 10% shareholding in the Wholesale and Food business is envisaged. In the same way, almost all existing financial liabilities of the group are to be assumed by the latter.

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%

ANALYSIS

- This announcement rather came as a surprise to us, insofar as we stated on 12th May 2016 (Sell vs Neutral) that a rights issue could not be ruled out. At the time, our first-take estimates pointed to adjusted net debt/EBITDAR multiples of ~3.5x and ~3.0x respectively for MMS (which, we believe, has very little debt) and the Food Business (most of the group's NFD).
- Until today, management had refused to answer the question of whether we can rule out a rights issue in order to address the capital structure problem ahead of the spin-off. We believe that this latency period (five months!), during which management finally managed to find a solution, reflects what remains a precarious credit situation.
- Whether the optimists admit it or not, the precedent of Casino (which has proved that beyond the ratio, a diversified profile is key to maintaining a rating) led us to believe that the situation at MMS (undiversified cyclical profile and in the front row concerning the ramp-up of e-commerce) remains very stretched, especially in view of weak commercial trends.
- The group's advantageous tax lever (shifting costs out of Germany in a bid to boost domestic operating result at Metro C&C and thus activate tax loss carry forwards) should not eclipse soft commercial trends. LFL performances (+0.3% in Q3 - below normative natural cost inflation) remain soft and prevent us from talking about a commercial recovery.

	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

VALUATION

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

(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	18.1x	15.3x	14.0x	12.8x
FCF yield (%)	NM	NM	NM	NM
Dividends (EUR)	1.00	0.98	1.02	1.05
Div yield (%)	3.6%	3.5%	3.7%	3.8%
EV/Sales	0.2x	0.2x	0.2x	0.2x
EV/EBITDA	4.9x	4.8x	4.8x	4.7x
EV/EBIT	16.8x	8.0x	7.8x	7.7x

NEXT CATALYSTS

- Upcoming conference call.

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