26th October 2016

Food retailing

DIA

Price EUR5.11

We wish management could maintain the good momentum initiated in Q2

Fair Value EUR6 vs. EUR6.5 (+17%) **NEUTRAL vs. BUY**

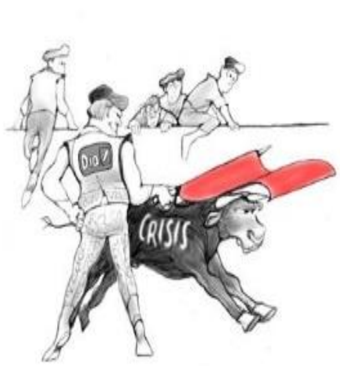
Bloomberg	DIA.SM
Reuters	DIA MC
12-month High / Low (EUR)	6.2 / 4.4
Market Cap (EURm)	3,181
Ev (BG Estimates) (EURm)	4,185
Avg. 6m daily volume (000)	3 159
3y EPS CAGR	3.9%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-9.7%	-10.6%	2.7%	-6.1%
Food Retailing	0.8%	0.8%	-3.0%	-0.5%
DJ Stoxx 600	-0.7%	0.6%	-1.0%	-6.2%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	8,926	9,001	9,472	9,937
% change		*0.8%*	*5.2%*	*4.9%*
EBITDA	610	615	646	682
EBIT	274.1	312.6	366.5	403.5
% change		*14.0%*	*17.3%*	*10.1%*
Net income	254.1	246.5	273.0	283.8
% change		*-3.0%*	*10.7%*	*4.0%*

	2015	2016e	2017e	2018e
Operating margin	4.4	4.4	4.5	4.6
Net margin	2.8	2.7	2.9	2.9
ROE	NM	NM	NM	NM
ROCE	22.5	22.5	22.6	22.6
Gearing	361.8	224.3	153.4	122.7

(EUR)	2015	2016e	2017e	2018e
EPS	0.42	0.41	0.45	0.47
% change	-	*-2.7%*	*10.8%*	*4.0%*
P/E	12.2x	12.5x	11.3x	10.8x
FCF yield (%)	NM	10.7%	8.3%	7.1%
Dividends (EUR)	0.19	0.20	0.21	0.22
Div yield (%)	3.7%	3.9%	4.1%	4.3%
EV/Sales	0.5x	0.5x	0.4x	0.4x
EV/EBITDA	7.1x	6.8x	6.4x	6.0x
EV/EBIT	15.7x	13.4x	11.2x	10.1x



Dia is a value play (2017 P/E of 11.3x vs 17x on average for the sector). But we believe that the content of the financial information and the visibility on FCF (especially with regard to LFL acceleration in Spain) may prevent investors from expecting any reward from the optionality embedded in the value case. Unfortunately, despite the current upside (+17%), we suspect that the stock could be dead-money until FY. Hence, to avoid any opportunity cost, we downgrade our rating to Neutral (vs Buy). We prefer Carrefour (Buy, top-pick, FV @EUR30).

We have adjusted down our 2016/18 EPS by 5.1% on average (a move we did not anticipate at first sight yesterday). As mentioned in the outlook, **1/** EBITDA margin should be stable in 2016 while **2/** adjusted EBITDA is expected to grow from 4 to 5% ex-currency (which has disappointed the market). Hence, we now expect FY adjusted EBITDA to reach EUR615m (vs EUR627m). Moreover, we model more aggressive price investments in Iberia (as management indicated, during the call, that the priority was the topline growth and that it would be ready to invest further to ensure positive LFL). In a first time, these potential investments could offset the positive impact from format mix (franchise) and the margin uptake from recent acquisitions. On the whole, we now expect 2017 group EBITDA to reach EUR646 vs EUR685. As a consequence, we have updated our FV to EUR6 (vs EUR6.5), which implies 17% upside potential. Nevertheless, despite this upside, we suspect that the stock could be dead-money until FY. To avoid any opportunity cost, we downgrade our rating to Neutral (vs Buy).

ANALYSIS

- Remember that over the past year, the relationship between the top line (declining LFL rates) and the bottom line (growing underlying margin) in Iberia has appeared unhealthy. 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. But from Q1 2016, the relationship between the topline and the bottom-line became healthier (its is worth noting that it was still the case in Q3) while the communication by the group turned out to be more precise and engaging (at this moment, we had decided to upgrade our recommendation to Buy; May 13th). Hopefully, the market is now convinced that Dia is not Tesco (hence the relief of the stock since Q2). This question mark behind us, today's focus is regarding FCF.
- Yet, when the Q3 numbers were published yesterday, we suspected that there was going to be a debate on the FCF (Q3 (first take): in line / potential debate on the evolution of the wording of the FCF guidance). As a reminder, in the first half of 2016, management pointed out that the cash-flow generated from operations was on track to meet the ambitious cash-flow generation targets the company has set for the 2016-18 period (namely EUR750m of Cash from Operation / i.e. adjusted EBITDA - capex - non recurring cash items). This wording disappeared in the press release (instantaneously, this creates a doubt…) while management indicated that the 2016 Net Financial Debt (NFD) should reach EUR950/1,000m (vs EUR1,311m in 2015).
- We would have appreciated signs of confidence on the ongoing business (we understand that LFL performances by format are very disparate in Iberia and could imply further unexpected capex to bring new impetus to Dia Market notably) and hence certitudes with regards the FCF guidance (PS: we understand EUR750m of Cash from Operation guidance for 2016/18 is still in place), in order to maintain the positive momentum initiated in Q2. But it has not been thus. Today, we believe that the content of the financial information and the visibility on FCF (at this stage, we do not forecast a strong decrease in the NFD / i.e. NFD of EUR932m in 2017 and EUR892m in 2018) can prevent investors from expecting any reward from the optionality embedded in the value case.

VALUATION

- 2017 P/E of 11.3 (consensus at 11.8x) vs 17x on average for peers

NEXT CATALYSTS

- Acceleration of LFL in Iberia (the main factor behind FCF)

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