24th October 2016

Food retailing

Jeronimo Martins

Price EUR16.25

Q3 2016 (first take): the virtuous circle linked to a cash margin approach to the business

Fair Value EUR13,5 (-17%) **NEUTRAL**

Bloomberg	JMT PL
Reuters	JMT.LS
12-month High / Low (EUR)	16.4 / 10.9
Market Cap (EURm)	10,226
Ev (BG Estimates) (EURm)	10,625
Avg. 6m daily volume (000)	849.0
3y EPS CAGR	7.3%

	1 M	3 M	6 M	31/12/15
Absolute perf.	8.1%	16.5%	10.2%	35.5%
Food Retailing	3.2%	2.9%	-2.2%	0.7%
DJ Stoxx 600	0.5%	1.1%	-1.5%	-5.9%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	13,726	14,570	15,597	16,510
% change		*6.1%*	*7.0%*	*5.9%*
EBITDA	799	868	974	1,038
EBIT	485.0	495.5	563.1	590.1
% change		*2.2%*	*13.6%*	*4.8%*
Net income	354.0	358.8	413.2	437.0
% change		*1.4%*	*15.2%*	*5.8%*

	2015	2016e	2017e	2018e
Operating margin	3.7	3.5	3.8	3.7
Net margin	2.6	2.5	2.6	2.6
ROE	NM	NM	NM	NM
ROCE	22.0	21.4	24.6	26.5
Gearing	13.6	7.0	-5.9	-17.1

(EUR)	2015	2016e	2017e	2018e
EPS	0.56	0.57	0.66	0.69
% change	-	*1.4%*	*15.2%*	*5.8%*
P/E	28.9x	28.5x	24.7x	23.4x
FCF yield (%)	4.5%	2.5%	4.2%	4.6%
Dividends (EUR)	0.27	0.00	0.33	0.35
Div yield (%)	1.6%	NM	2.0%	2.1%
EV/Sales	0.8x	0.7x	0.7x	0.6x
EV/EBITDA	13.4x	12.2x	10.7x	9.7x
EV/EBIT	22.1x	21.4x	18.4x	17.1x

1/ On the one hand, optimists will remain impressed by topline momentum at Biedronka (+8.5% LFL in Q3 vs +7.4% e), with a clear focus on the cash margin (+10bp increase in quarterly margin) and the sequential improvement at PD (+2.4% LFL vs -1.5% in Q2 and +1.1%e). 2/ On the other hand, the pessimists will stress that the wording of the guidance has changed as management indicated that start-up losses from Ara and Hebe are now expected to be marginally ahead of 2015. As far as we are concerned, we are totally impressed by the group's performances but estimate that a very demanding valuation (2017 PE of 25x vs 16.5 for the sector) tends to be somewhat prohibitive. Neutral maintained at this stage.

On Friday evening, Jeronimo Martins published its Q3 2016 trading statement (group sales worked out at EUR3,78bn vs EUR3,74bne) and results (EBITDA reached EUR239m vs EUR238m e) in line with consensus expectations. The group's performance as a whole reflected its consistent focus on sales (i.e. cash margin approach to the business). At this stage (conference call at 10:00 CET), we see no obvious reasons why analysts should increase their FY estimates.

In Poland (66% of sales and 76%e of EBITDA), on the one hand, promotions continue to dominate the market and the competitive landscape shows no signs of softening. Food inflation improved slightly to +0.9% in Q3 (vs +0.6% in H1). On the other hand, the increase in disposable income continued to contribute to the favourable consumer environment. In this context, Biedronka’s focus on topline turned out to be very successful again judging by the +8.5% LFL sales growth (vs +7.4% expected by the consensus). This strategy did not prevent Biedronka from increasing its margin by 10bp e (that is the beauty of the strategy when the marginal cost decreases as volume increases, allowing the group to restore the margin rate initially sacrificed in prices). Very strong.

As far as Retail in Portugal is concerned (32% of sales and 32% of EBITDAe), the environment also remains challenging with stong promotions and consumers remaining highly price sensitive. In this context, Pingo Doce (79% of sales of Retail in Portugal) maintained its promotional intensity while continuing to invest in reinforcing the attractiveness of its offer. This resulted in +2.4% LFL sales growth (vs +1.1%e) and an estimated 20bp decline in margin. Recheio (21% of sales) benefited from strong tourist activity across the country (given the defection of tourists in France and Maghreb in favour of destinations such as Portugal?) and delivered a strong +5.9% LFL sales growth in Q3 (vs 3.7% e).

Losses at Ara (Q3 sales of EUR61m) and Hebe (Q3 sales of EUR30m) stand at EUR44m in Q3. As a reminder, the wording of the guidance for FY losses at Ara and Hebe already changed in Q2 (“losses in Ara and Hebe, at the EBITDA level, are not expected to surpass their 2015 level” at cc vs “are expected to be below the 2015 level” excl F/X previously mentioned in Q1). At the end of the day, management indicated in Q3 that Ara will invest in infrastructure and internal organisation to accelerate its expansion. This is bringing a bit more upfront opex and therefore start-up losses from Ara and Hebe are now expected to be marginally ahead of 2015. Admittedly, given the strength of the momentum at JM, we would almost conclude that this is a non-event. Nevertheless, nosayers could probably insist on this little “warning”. We believe there is no real point…

ANALYSIS

- Everyone is looking out for themselves… **1/** On the one hand, optimists will remain impressed by topline momentum at Biedronka and the sequential improvement at PD. **2/** On the other hand, pessimists could stress a warning in the new wording of guidance.
- As far as we are concerned, we are totally impressed by the group's performances but estimate that a very demanding valuation (2017 PE of 25x vs 16,5 for the sector) tends to be somewhat prohibitive. Neutral maintained at this stage.

VALUATION

- 2017 PE of 25x vs 16.5 for the sector

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