

Analysing Food Retail Companies

The standard method of analysis of retail companies has moved on after the crisis.

Before the crisis, analysts paid little attention to rental liabilities of retail chains. During and after the crisis an incredible amount of money was lost in retail. Serious analysts have completely changed the way they work as a consequence, in particular how valuations of food retails are conducted.

Previously, most valuations were done by calculating the enterprise value (EV) of a particular retailer. If the retailer was listed on the stock market, EV could be calculated by adding the net interest bearing debt (NIBD) to the market capitalization. If the company was not listed, the enterprise value could be arrived at by first calculating the average EV/EBITDA multiplier of listed retailers and then applying this number to the EBITDA of the retailer under examination to yield the EV.

Food retail is a capital intensive industry. Most of the capital associated with it is tied up in real estate and fixtures and fittings. Many food retailers own a great deal of their own property. Other retailers lease a substantial part of their property. Food retail is by nature a highly operationally geared industry. Therefore, it is impossible to compare these two types of retailers with the EV/EBITDA measure as it does not properly reflect rental liabilities.

In a benign market situation when sales, margin or both are growing food retail oozes cash. However, if there is stress - say a price war - it will haemorrhage cash. If the retailer does not own a substantial part of its property portfolio, the cost of the leases can start to dominate the negative cash flow and lead to the downfall.

This is not a new issue and the best banks that lent money to the retail investors in pre-crises retail included banking covenants in their loan agreements that acted as early warning signs. They adjusted the net interest bearing debt upwards by adding capitalized leases. Let us call this value $DEBT_{adj}(x)$. This value was then divided by EBITDAR which is EBITDA plus the annual leases. The $DEBT_{adj}(X)/EBITDAR$ would normally be set at 5 or less (even as low as 3.5) as a company with higher debt than this would find it hard to survive unless there was a good growth that significantly outgrew the need for capital investment.

When analysts calculate the equity value of food retailers¹ today they will usually use two methods which all things being equal produce similar results.

Both methods are based on calculating $EV_{adj}(x)$ which is the enterprise value including capitalized leases.

The first method is the multiplier method as mentioned. In slow growing Western Europe (see Appendix 1) they will normally multiply EBITDAR by value approximate to the median $EV_{adj}/EBITDAR$ multiple from a set of comparable food retailer to arrive at an estimate of the $EV_{adj}(X)$:

¹ Similar methodologies are also employed in the valuation of airline companies.

$$EV_{adj}(x) = (EV_{adj}/EBITDAR) \times EBITDAR$$

Currently, this median multiple is around 7 in the US and Western Europe, which is relatively high from a historical perspective.² This may be partially due to normal-than-higher expected EBITDA growth for these companies. The average multiple has historically been around 6x.

The second method is a cash flow based method. The rent is added to the free cash flow (FCF) before the new present value is calculated:

$$EV_{adj}(x) = NPV(FCF + RENT)$$

All things being equal these methods should give similar results. Those that want to be extra careful can also look at the EV to sales multiple (which is approximately 0.5 in the US and Western Europe).

$$EV_{adj}(x) = 0.5 \times \text{Sales} + \text{capitalized leases}$$

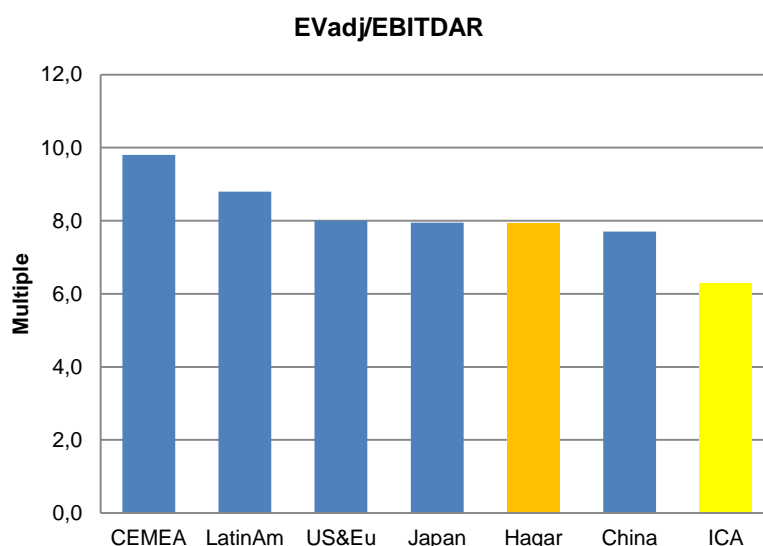
After this, they will then subtract the capitalized leases to arrive at the enterprise value:

$$EV(x) = EV_{adj}(x) - \text{capitalized leases}$$

Finally, the equity value or market value if listed is found by subtracting the net interest bearing debt (NIBD (x)) from the enterprise value:

$$\text{Equity value}(x) = EV(x) - NIBD(x)$$

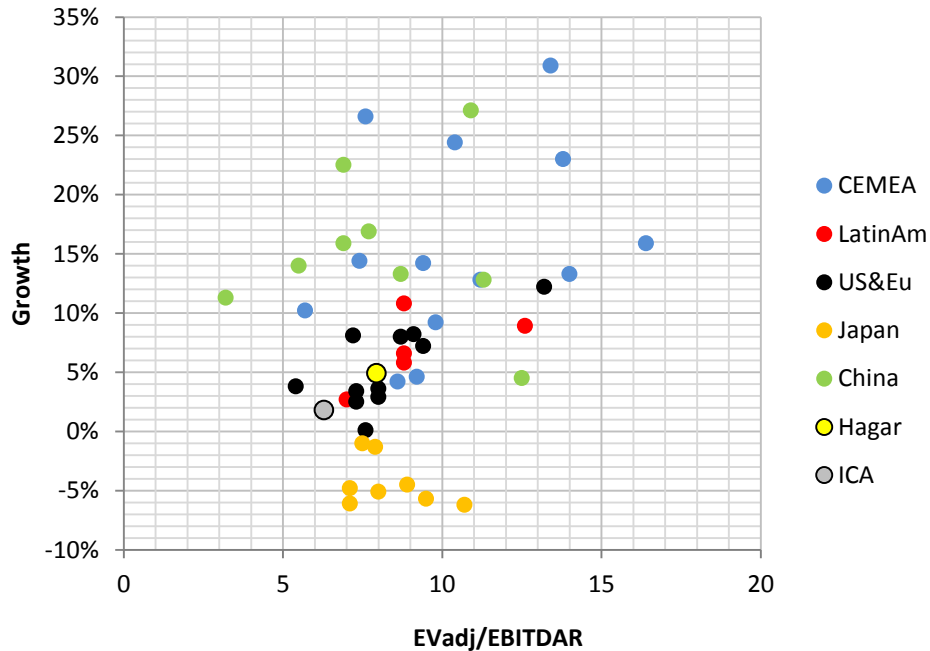
Arev has used data from Goldman Sachs (see Appendix 1) and Damodaran. In Europe the median for $(EV_{adj}(x))/EBITDAR$ is approximately 8.0. This ratio for ICA Gruppen (which owns Rimi in the Baltic States) is 6.3. For Hagar, the Icelandic retailer it is at 7.9.



² The Goldman Sachs sample in Attachment 1 is a collection of best-in-class food retailers and, therefore, the median $EV_{adj}/EBITDAR$ is biased upwards towards 8.

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Further validation of the results and market efficiency can be gauged by plotting individual food retailers by sales growth and $EV_{adj}(x)/EBITDAR$. Efficient market hypothesis implies that where financial markets are informationally efficient there should, everything else being equal, be a strong correlation between $EV/EBITDA$ and growth. Stronger growth should result in relatively higher EBITDA going forward, justifying a higher price tag. The graph below plots sales growth and $EV_{adj}(x)/EBITDAR$.



As theory would dictate, financial markets with more informational efficiency have a tighter correlation between these two variables. CEMEA (Central Europe, Middle East and Africa) and China have higher valuations, in part, due to higher expected growth rates and perhaps, to a lesser extent, due to less efficient pricing in the securities market. US and Western Europe have more subdued valuations and expected growth rates.

Höfundar eru Björn Jóhannesson og Jón. Sch. Thorsteinsson og starfa hjá Arev verðbréfafyrirtæki hf.

Food Retailers Source: Goldman Sachs, Damodaran and Company Accounts	Rating	Price ccy	Share price	TP period	Target price	Implied uplift	Mkt Cap US\$m	EV US\$m	P/E (x)			EV/Sales (x)			EVadj/EBITDAR (x)			EV/EBITDA (x)			2013 - '15 US\$ CAGR		PEG		CROICI (%)		
									2013E	2014E	2015E	2013E	2014E	2015E	2013E	2014E	2015E	2013E	2014E	2015E	Sales	Net Inc	2013E	2014E	2013E	2014E	2015E
X5 Retail Group	Buy	USD	16,8	12M	26,3	57%	4.560	8.374	15,0	11,8	9,3	0,5	0,4	0,4	7,4	6,9	6,3	7,0	6,2	5,3	14,4%	27,2%	0,6	0,5	10,3%	10,4%	10,8%
O'key Group	Buy	USD	13,0	12M	17,5	35%	3.495	3.912	20,2	16,1	12,2	0,9	0,7	0,6	10,4	8,8	7,2	11,0	9,0	7,1	24,4%	28,9%	0,7	0,6	17,5%	17,6%	18,5%
Dixy Group	Buy	RUB	456,3	12M	575,0	26%	1.728	2.701	21,5	13,6	9,8	0,5	0,4	0,3	7,6	6,7	6,0	7,2	5,6	4,4	26,6%	47,9%	0,4	0,4	11,1%	12,3%	12,6%
Magnit	Neutral	USD	58,7	12M	62,2	6%	27.700	29.754	26,6	22,8	19,1	1,6	1,3	1,1	13,8	11,9	10,2	15,2	12,8	10,7	23,0%	18,2%	1,5	1,3	19,3%	18,5%	18,4%
Jeronimo Martins*	Buy	EUR	15,1	12M	20,0	32%	12.707	13.515	23,0	18,5	15,4	0,9	0,8	0,7	11,2	9,7	8,5	12,1	10,2	8,7	12,8%	22,3%	1,0	1,1	15,8%	16,3%	16,9%
Eurocash S.A. Group	Neutral	PLN	60,0	12M	67,7	13%	2.597	2.710	26,2	21,5	18,3	0,5	0,4	0,4	14,0	12,2	10,6	15,6	13,2	11,3	13,3%	20,3%	1,3	1,3	21,7%	23,2%	24,7%
BIM	Sell	TRY	41,8	12M	36,2	-13%	6.495	6.249	24,2	28,2	24,1	1,0	0,9	0,7	16,4	14,6	12,8	20,6	17,9	15,2	15,9%	15,6%	1,6	1,7	22,4%	22,4%	22,2%
M-VIDEO	Neutral	RUB	250,2	12M	277,0	11%	1.345	1.055	8,8	7,8	7,0	0,2	0,2	0,2	5,7	5,3	5,0	3,8	3,1	2,6	10,2%	12,1%	0,7	0,7	18,5%	18,0%	17,4%
Migros Ticaret	Buy	TRY	19,4	12M	25,4	31%	1.827	2.468	350,9	17,8	14,5	0,6	0,5	0,4	9,4	8,3	7,3	10,5	8,5	6,9	14,2%	nm	na	0,9	17,4%	17,5%	18,3%
Pck'n Play Store**	Neutral	ZAR	38,2	12M	47,0	23%	1.784	1.891	32,3	29,7	24,3	0,3	0,3	0,2	8,6	8,3	7,5	9,0	8,5	7,2	4,2%	15,2%	2,1	1,6	14,0%	14,2%	14,4%
Massmart Holdings**	Sell	ZAR	154,8	12M	153,0	-1%	3.281	3.298	33,2	22,3	18,9	0,6	0,4	0,4	13,4	9,7	8,8	16,6	10,7	9,2	30,9%	32,7%	1,0	1,6	15,1%	19,2%	16,4%
Spar Group**	Sell	ZAR	113,1	12M	107,0	-5%	1.894	1.823	15,7	16,0	14,3	0,4	0,4	0,3	9,2	9,7	8,6	9,3	9,8	8,6	4,6%	5,0%	3,1	1,2	36,5%	32,3%	33,3%
Shoprite Holdings**	Buy	ZAR	163,5	12M	225,0	38%	8.550	8.143	20,6	18,0	14,2	0,8	0,7	0,6	9,8	8,8	7,4	10,4	9,1	7,2	9,2%	20,3%	1,0	0,7	19,4%	20,8%	22,3%
CBD (Pão de Açúcar)	Neutral	BRL	95,0	12M	93,7	-1%	10.360	12.888	19,2	18,1	15,5	0,5	0,5	0,5	7,0	7,1	6,5	6,6	6,8	5,9	2,7%	11,3%	1,7	na	15,8%	14,7%	15,3%
Lojas Americanas	Neutral	BRL	14,7	12M	15,1	3%	6.047	7.786	32,3	32,2	29,7	1,2	1,2	1,1	8,8	8,9	8,2	9,0	9,1	8,2	6,6%	4,2%	7,7	na	22,4%	21,6%	21,3%
Lojas Renner	Buy	BRL	57,6	12M	71,6	24%	2.957	3.356	15,8	16,1	13,7	1,8	1,8	1,5	8,8	8,7	7,7	8,9	8,9	7,6	10,8%	7,4%	2,1	na	22,9%	22,4%	22,3%
Soriana	Neutral	MXN	42,1	12M	42,4	1%	5.768	5.677	18,8	17,4	15,5	0,6	0,6	0,5	8,8	8,3	7,5	9,2	8,4	7,3	5,8%	10,2%	1,8	na	8,4%	8,3%	8,4%
Wal-Mart de Mexico	Neutral	MXN	33,6	12M	34,4	3%	45.209	44.565	23,4	21,4	18,9	1,3	1,2	1,1	12,6	11,7	10,5	13,1	12,1	10,7	8,9%	11,1%	2,1	na	9,1%	18,4%	18,4%
Sun Art Retail Group	Buy	HKD	10,7	12M	13,0	21%	13.188	12.462	29,0	24,9	22,1	0,9	0,8	0,7	11,3	10,0	9,1	12,4	10,7	9,5	12,8%	14,6%	2,0	na	13,9%	13,5%	na
China Resources Enterprise	Neutral	HKD	23,7	12M	27,0	14%	7.336	10.507	28,1	22,6	17,7	0,6	0,5	0,5	8,7	7,8	6,9	9,0	7,7	6,5	13,3%	25,9%	1,1	na	6,9%	7,2%	na
Better Life Commercial Chain	Buy	CNY	10,9	12M	15,2	39%	1.063	986	15,5	12,1	10,0	0,5	0,4	0,3	6,9	5,8	5,0	6,6	4,9	3,7	22,5%	24,3%	0,6	0,6	14,8%	14,7%	14,6%
Yonghui Superstores	Buy	CNY	11,8	12M	16,5	40%	2.947	2.874	25,2	18,5	13,6	0,6	0,4	0,3	10,9	8,8	7,2	12,8	9,2	6,8	27,1%	36,2%	0,7	0,5	12,7%	13,0%	13,7%
Renrenle Commercial Group Co.	Neutral	CNY	9,0	12M	7,5	-16%	585	336	62,0	41,9	24,9	0,1	0,1	0,1	7,7	6,5	6,1	7,1	3,3	2,8	16,9%	nm	na	0,6	7,8%	8,5%	9,2%
Zhongbai Holdings Group Co.	Neutral	CNY	5,6	12M	5,1	-10%	627	413	20,8	17,8	14,2	0,1	0,1	0,1	5,5	5,0	4,4	3,9	3,1	2,2	14,0%	21,2%	1,0	0,7	11,3%	12,0%	12,4%
Fujian New Hua Du Supercenter Co.	Neutral	CNY	5,1	12M	5,7	12%	449	255	18,2	15,1	12,0	0,2	0,2	0,1	6,9	6,0	5,2	5,6	4,0	2,6	15,9%	23,0%	0,8	1,0	13,0%	13,3%	14,1%
Beijing Hualian Hypermarket Co.	Neutral	CNY	4,1	12M	3,6	-12%	447	-154	58,9	41,5	23,4	nm	nm	nm	3,2	2,9	2,6	nm	nm	nm	11,3%	58,6%	1,0	0,8	11,7%	11,9%	12,8%
Sanjiang Shopping Club Co.	Sell	CNY	10,6	12M	5,4	-49%	708	471	31,3	31,3	29,4	0,6	0,6	0,5	12,5	11,9	11,0	15,7	14,8	13,2	4,5%	3,2%	na	3,5	13,3%	12,9%	13,2%
Carrefour	Neutral	EUR	23,5	12M	21,0	-11%	21.439	34.065	19,0	15,8	13,8	0,3	0,3	0,3	7,3	6,9	6,7	7,1	6,6	6,3	2,5%	17,3%	1,1	na	7,3%	7,2%	7,2%
Casino	Buy	EUR	74,4	12M	103	38%	11.118	30.933	13,0	10,8	9,8	0,5	0,4	0,4	7,2	6,7	6,3	6,9	6,3	5,8	8,1%	15,1%	0,9	na	9,2%	9,1%	9,4%
J Sainsbury	Sell	GBP	386	12M	295	-24%	11.394	16.693	11,5	13,2	nm	nm	0,5	0,4	8,0	7,8	7,7	7,9	7,7	7,6	2,9%	-4,5%	-2,6	5,9	7,9%	7,6%	7,6%
Metro	Not Rated	EUR	28,2	na	na	na	12.332	19.649	11,6	11,1	10,5	0,2	0,2	0,2	5,4	5,2	5,0	4,6	4,3	4,1	3,8%	4,9%	2,3	na	8,4%	8,2%	8,2%
Booker Group PLC	Neutral	GBP	127,7	12M	135,0	6%	3.375	3.238	25,6	22,9	18,3	0,5	0,4	0,4	13,2	10,9	9,6	15,5	12,1	10,3	12,2%	18,3%	1,4	1,1	13,3%	14,7%	15,7%
Sligro	Neutral	EUR	28,2	12M	26,0	-8%	1.660	1.704	15,1	13,2	12,6	0,5	0,5	0,4	8,0	7,3	6,9	8,0	7,1	6,6	3,6%	9,4%	1,6	na	11,9%	12,0%	11,9%
Morrison (Wm)	Sell	GBP	285	12M	250	-12%	11.549	15.429	11,2	11,9	11,3	0,5	0,6	0,5	7,6	7,4	7,1	7,6	7,4	7,0	0,1%	-0,1%	-127,0	2,5	9,3%	8,9%	8,8%
Colruyt	Sell	EUR	43	12M	36	-16%	8.957	8.920	19,5	18,5	17,0	0,8	0,8	0,7	9,4	8,5	8,0	9,4	8,6	7,9	7,2%	7,1%	2,7	2,5	15,0%	14,7%	14,5%
Tesco	Neutral	GBP	363	12M	390	7%	45.841	57.093	10,5	10,5	nm	0,5	0,5	0,5	7,3	6,8	6,5	7,2	6,5	6,2	3,4%	5,3%	2,0	1,0	10,7%	10,7%	na
Family Dollar Stores, Inc.	Neutral	USD	72	12M	69	-4%	8.324	8.435	19,0	17,5	15,9	0,8	0,8	na	8,7	8,2	na	9,0	8,3	na	8,0%	9,4%	2,0	na	13,4%	13,8%	na
Dollar Tree Stores, Inc.	Buy	USD	51,8	12M	58	12%	11.565	11.441	19,9	18,2	16,0	1,5	1,4	1,3	9,1	8,3	7,6	9,5	8,4	7,5	8,2%	11,7%	1,7	1,0	na	16,5%	16,6%
J. Front Retailing Co.	Neutral	JPY	720	12M	800	11%	3.897	5.768	26,2	11,9	16,0	0,4	0,5	0,4	8,9	8,3	7,9	9,4	8,4	7,9	-4,5%	28,0%	0,9	nm	5,3%	5,0%	na
Isetan Mitsukoshi Holdings	Neutral	JPY	1.244	12M	1.400	13%	5.024	6.311	16,5	19,5	18,5	0,4	0,5	0,4	9,5	9,0	8,6	10,7	9,7	9,0	-5,7%	-5,7%	nm	3,4	4,8%	4,6%	na
Takashimaya	Buy	JPY	891	12M	1.250	40%	3.009	3.270	14,9	14,8	13,2	0,3	0,3	0,3	7,1	6,6	6,2	6,3	5,6	5,1	-6,1%	6,1%	2,4	1,7	6,0%	6,3%	na
Marui Group Co.,LTD.	Neutral	JPY	906	12M	1.030	14%	2.539	4.861	15,9	15,0	13,8	1,0	1,1	1,0	10,7	10,0	9,1	12,1	10,8	9,6	-6,2%	7,4%	2,1	1,9	4,1%	4,3%	na
Aeon	Neutral	JPY	1.373	12M	1.300	-5%	10.755	30.546	11,8	14,1	13,7	0,5	0,6	0,7	8,0	8,2	8,3	8,0	8,4	8,5	-5,1%	-7,3%	nm	5,0	5,4%	5,4%	na
Ryohin Keikaku	Neutral	JPY	8.080	12M	8.300	3%	2.216	2.004	16,6	15,9	14,4	0,9	1,0	0,9	7,9	7,5	7,0	7,8	7,2	6,4	-1,3%	7,1%	2,3	1,8	9,1%	9,1%	na
FamilyMart	Neutral	JPY	4.335	12M	4.200	-3%	4.230	4.201	13,9	18,6																	