

**Consumer & Retail**  
**Food & Staples Retailing**  
 Equity – South Africa

## Underweight

Target price (ZAR)	155.00
Share price (ZAR)	167.00
Div yld (%)	2.5
Potential return (%)	-4.7

Note: Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield

Performance	1M	3M	12M
Absolute (%)	-4.3	18.8	-3.5
Relative^ (%)	-6.3	11.7	-20.8

Index^ JSE ALL SHARE

RIC SHPJ.J  
 Bloomberg SHP SJ

Market cap (USDm) 9,244  
 Market cap (ZARm) 95,287

Enterprise value (ZARm) 92167  
 Free float (%) 66

Note: (V) = volatile (please see disclosure appendix)

**27 May 2014**

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# Shoprite (SHP SJ)

Downgrade to UW: Highlights from the group's investor day

- ▶ **Trading momentum has picked up, aided by continued price re-investment**
- ▶ **Rolling over our unchanged earnings forecasts lifts our TP to ZAR155 (previously ZAR150)**
- ▶ **Downgrade to UW (from Neutral) after recent c.20% rally in the share price**

**Shoprite has held its bi-annual investor day:** Trading momentum has picked up on the 9.7% overall top-line growth reported for H1 FY14 (SA supermarkets: +7.6%; non-SA supermarkets: +28%). April sales rose 15.7% y-o-y (positively impacted by the timing of the Easter holidays) and May sales grew in the region of 13%, by our calculations (management reported SA supermarket sales growth of just under 12% and non-SA supermarket sales growth of 21% in May). We remain comfortable with our full-year FY14e group sales growth forecast of 12.2%, which assumes an acceleration in H2/H1 top-line growth within both SA and non-SA supermarkets (to 9.4% and 36%, respectively).

**Continued price re-investment supports improving top-line growth:** Improving sales growth within the core SA business is being aided by accelerating selling price inflation (to about 5-6% vs 3.8% in H1) and continued price re-investment, with internal cost inflation of 5.5% for the 10-month period from July 2013 to April 2014 now tracking about 1ppt ahead of internal selling inflation (4.4% for the same 10-month period), and implying a lower mark-up margin, we believe. While H1's price investment focused on key categories such as maize, rice, sugar and bread, and prompted a turnaround in the Shoprite chain's turnover growth in the run-up to Christmas, the group's subsidies have now shifted to targeting Living Standards Measure (LSM) 8-10, with Checkers' H2 sales growth (to date) once again exceeding that of Shoprite's, as a result. While this should prove favourable in terms of the GP margin mix, we expect it to be offset by overall price re-investment, and less favourable volume rebates; we remain comfortable with our forecast of a 10-bpts contraction in GP margin for FY14e (to 20.8%). While Usave is trading well, and generating high returns, its rollout of new stores is being slowed by the challenge of attaining basic services (water and electricity) in certain sites.

**Africa continues to outperform South Africa:** According to management, Africa is trading substantially better than SA, currently generating an RoI of around 24%. Nigeria's 3% bank levy on the handling of cash remains a concern, however, and is likely to negatively impact the region's profits in the current period, albeit insufficiently to dilute the overall non-SA trading margin.

**No change to our below-consensus earnings forecasts:** We have made no change to our earnings forecasts following the group's investor day, and forecast FD HEPS of ZAc730 in FY14e (+8%); ZAc838 in FY15e (+15% including an extra trading week in the period) and ZAc912 in FY16e (+9%). Rolling over our current forecasts lifts our PE-based target price from ZAR150 to ZAR155 (based on an unchanged 50-60% premium to our unchanged JSE All Share exit PE of 11x and LTM earnings of ZAc906 versus ZAc888 previously).

**Downgrade to UW from Neutral after recent rally:** Despite being SA's best-of-breed food retailer, we think Shoprite's easy wins are already in the base. The group is likely to face subsiding tailwinds (possible stabilising of market share at Pick n Pay, slowing growth in advertising recoupments) and rising headwinds (increasingly constrained consumer), supporting our view that these are arguably peak-cycle margins for this business. At the time of the group's interim results, the share price had declined 18% YtD, and in excess of 30% from its 2013-high, driving a meaningful de-rating in the stock from a 12M forward PE of 25x to 17-18x, prompting our upgrade from an UW to Neutral rating.

We now downgrade the stock to UW, as it has rallied by almost 20% since its low at the end of February – again to a PE multiple north of 20x – and is trading ahead of our updated target price of ZAR155.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppts above and below the hurdle rate for South Africa stocks of 9.5%. Our target price of ZAR155 implies a potential return of -4.7% (including a 2.5% dividend yield), which is within the Neutral band of our model; therefore, we downgrade our rating to Underweight. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

**Key upside risks** to our valuation are stronger-than-expected top-line growth driven by a healthier macro outlook than what we have assumed; a strong recovery in the rand; and greater acceleration in the momentum of the African businesses than what we have assumed to be the case.

## Financials & valuation

### Financial statements

Year to	06/2013a	06/2014e	06/2015e	06/2016e
<b>Profit &amp; loss summary (ZARm)</b>				
Revenue	92,457	102,585	116,053	126,523
EBITDA	6,693	7,300	8,250	8,890
Depreciation & amortisation	-1,336	-1,482	-1,677	-1,828
Operating profit/EBIT	5,357	5,818	6,573	7,062
Net interest	-171	-197	-117	-34
PBT	5,192	5,621	6,456	7,028
HSBC PBT	5,208	5,623	6,456	7,028
Taxation	-1,576	-1,697	-1,949	-2,122
Net profit	3,598	3,905	4,485	4,882
HSBC net profit	3,614	3,907	4,485	4,882

### Cash flow summary (ZARm)

Cash flow from operations	2,828	6,131	6,157	6,714
Capex	-3,287	-3,200	-2,901	-3,163
Cash flow from investment	-3,010	-3,200	-2,901	-3,163
Dividends	-1,707	-1,876	-2,089	-2,338
Change in net debt	1,917	-1,055	-1,167	-1,213
FCF equity	-243	2,931	3,256	3,551

### Balance sheet summary (ZARm)

Intangible fixed assets	1,039	1,039	1,039	1,039
Tangible fixed assets	11,653	13,371	14,596	15,931
Current assets	20,120	22,487	25,635	28,388
Cash & others	6,123	7,178	8,345	9,557
Total assets	33,480	37,565	41,938	46,027
Operating liabilities	13,621	15,659	17,614	19,135
Gross debt	4,159	4,159	4,159	4,159
Net debt	-1,964	-3,019	-4,186	-5,398
Shareholders funds	15,184	17,232	19,649	22,217
Invested capital	13,067	14,060	15,311	16,666

### Ratio, growth and per share analysis

Year to	06/2013a	06/2014e	06/2015e	06/2016e
<b>Y-o-y % change</b>				
Revenue	11.8	11.0	13.1	9.0
EBITDA	18.4	9.1	13.0	7.8
Operating profit	17.4	8.6	13.0	7.4
PBT	15.8	8.3	14.9	8.9
HSBC EPS	11.3	8.1	14.8	8.9

### Ratios (%)

Revenue/IC (x)	8.6	7.6	7.9	7.9
ROIC	34.6	29.9	31.2	30.8
ROE	25.9	24.1	24.3	23.3
ROA	12.1	11.9	12.1	11.8
EBITDA margin	7.2	7.1	7.1	7.0
Operating profit margin	5.8	5.7	5.7	5.6
EBITDA/net interest (x)	39.1	37.0	70.3	260.0
Net debt/equity	-12.9	-17.5	-21.2	-24.2
Net debt/EBITDA (x)	-0.3	-0.4	-0.5	-0.6
CF from operations/net debt				

### Per share data (ZAR)

EPS reported (fully diluted)	6.72	7.30	8.38	9.12
HSBC EPS (fully diluted)	6.75	7.30	8.38	9.12
DPS	3.38	3.65	4.19	4.57
Book value	28.37	32.20	36.72	41.52

### Key forecast drivers

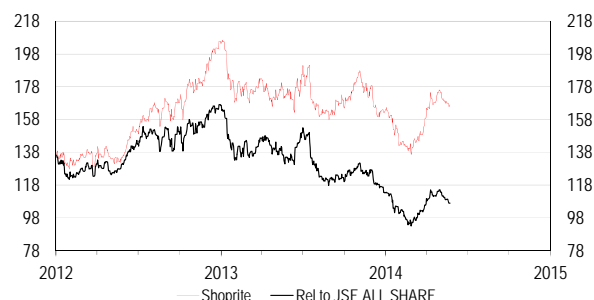
Year to	06/2013a	06/2014e	06/2015e	06/2016e
Supermarkets RSA(revenue in ZA	70 708	76 718	85 863	93 226
Other operating segments(reven	6 531	6 592	7 516	8 118
Furniture(revenue in ZARm)	3 562	3 878	4 194	4 379
Supermarkets Non RSA(revenue i	11 657	15 398	18 479	20 801

### Valuation data

Year to	06/2013a	06/2014e	06/2015e	06/2016e
EV/sales	1.0	0.9	0.8	0.7
EV/EBITDA	13.9	12.6	11.0	10.1
EV/IC	7.1	6.6	5.9	5.4
PE*	24.7	22.9	19.9	18.3
P/Book value	5.9	5.2	4.5	4.0
FCF yield (%)	-0.3	3.1	3.4	3.7
Dividend yield (%)	2.0	2.2	2.5	2.7

Note: \* = Based on HSBC EPS (fully diluted)

### Price relative



Source: HSBC

Note: price at close of 23 May 2014

# Disclosure appendix

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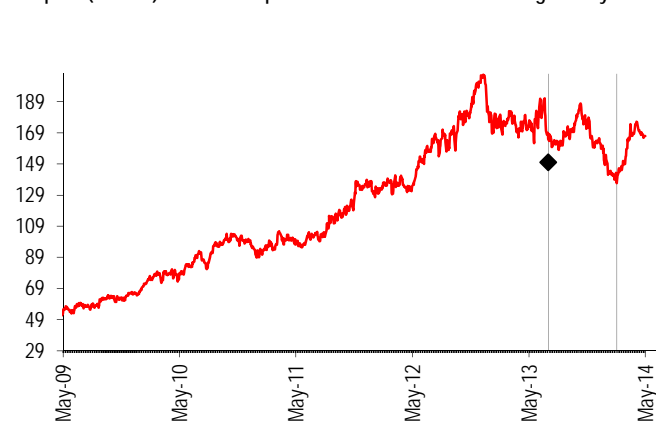
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<b>Neutral (Hold)</b>	37%	(31% of these provided with Investment Banking Services)
<b>Underweight (Sell)</b>	19%	(26% of these provided with Investment Banking Services)

## Share price and rating changes for long-term investment opportunities

Shoprite (SHPJ.J) Share Price performance ZAR Vs HSBC rating history



Recommendation & price target history

From	To	Date
N/A	Underweight	26 July 2013
Underweight	Neutral	26 February 2014
Target Price	Value	Date
Price 1	150.00	26 July 2013

Source: HSBC

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