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EQUITY RESEARCH

October 2011

European retail

The more clicks, the fewer bricks

- Ahold
- Carrefour
- Casino
- Colruyt
- Delhaize
- DIA
- H&M
- Inditex
- Jeronimo Martins
- Metro
- Marks & Spencer
- Morrison
- Sainsbury's
- Tesco

- Online retailing is quickly gaining traction among consumers due to improved technologies and better access. Non-food is leading the way, with fashion sales accelerating, and offers huge potential for companies such as Inditex and H&M.
- Food retailers have so far been unaffected by pure plays. However, 'click-&-collect' is an emerging trend offered by bricks-&-mortar retailers, transforming them into multi-channel operators. We expect a high adoption rate for 'click-&-collect', with significant implications for business models and capex allocation, as well as the valuations of property portfolios.
- In the current low-growth environment, online sales represent 10-30% of incremental sales growth. Calculations suggest that in the UK alone, store-based sales per square footage could fall by 20% over the next 10 years and by up to 25-50% over the next 20 years.
- Three of our four top sector picks have flourishing online operations: Casino (BUY, TP €85), Tesco (BUY, TP 490p) and Inditex (BUY, TP €75). We also like Jeronimo Martins (BUY, TP €14.50) because of its fast-growing Polish operation.
- Our least favourite is Sainsbury's (SELL, TP 246p). We upgrade H&M (TP SEK200) to HOLD from Sell.

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Cover photograph courtesy of istock.com
Pricing date 6/10/11 unless stated otherwise
Publication date 7 October 2011

The more clicks, the fewer bricks

Online retailing is quickly gaining traction with consumers on the back of improved technologies, and better access to broadband and mobile technologies. Non-food is leading, notably in travel, books, media and electronics, but fashion is catching up, offering huge potential for the likes of Inditex and H&M. So far, food retailers have not been impacted by pure plays. However, among the new trends emerging is 'click-&-collect', offered by bricks-&-mortar retailers transforming into multi-channel operators. We expect a high adaptation rate for 'click-&-collect', which should have significant implications for business models, capex allocation, but also on the valuation of property portfolios going forward.

In fashion retail, online business models have already proved to be successful. Examples include pure-play ASOS, which has been profitable for years, and the fast rise of online activities within larger fashion groups such as GAP, Abercrombie, Marks & Spencer, and more recently H&M and Inditex.

Online food retailing may seem a remote issue given the still-low penetration rates, but the situation is changing quickly with all major UK and French groups opening pick-up locations to drive 'click-&-collect' sales. At a later stage, we anticipate a surge in stand-alone pick-up locations. This development is likely to have major implications for food retailers in terms of capex allocation and property strategy. Our calculations suggest that in the UK alone, store-based sales per square footage could fall by 20% in the next 10 years and by up to 25-50% in the next 20 years depending on scenarios. The winners will be those groups that invest heavily in brand, proprietary offerings, technology, logistics and the right pick-up strategy.

A group like **Sainsbury** (**SELL**, **TP 246p, 11% downside**), with property backing over 100% of EV, is highly leveraged because a potential long-term decline in store sales not only impacts trading profit (less flexible to downsize), but also lowers property valuations.

Three of our four top picks have flourishing online operations:
Casino (Buy, TP €85, 48% upside). Casino focuses on those regions or channels with better growth trends. It has leading positions in Brazil, Colombia and Thailand, and in France via convenience/proximity formats and e-commerce through www.cdiscount.fr.

Jeronimo Martins (BUY, TP €14.5, 30% upside). Growth in sales and profits should increasingly be dominated by its growing (20%+ pa) Polish Biedronka banner. Entering a third country is higher on its agenda than e-commerce, which does not suit hard discount.

Tesco (BUY, TP 490p, 25% upside). With over 30% of sales stemming from international markets and rapid growth in services such as Tesco Bank and online formats www.tesco.com and www.tescodirect.com, we believe Tesco has the highest growth profile of the listed UK grocers, while it is trading at peer group average multiples.

Inditex (BUY, TP €75, 22% upside). Inditex is our favourite fashion retail stock. The company has a unique ability to transform catwalk trends within weeks into affordable clothes for the mass market. We expect the store-opening programme skewed towards China, and www.zara.com online launches in the US and Western Europe, to result in double-digit top-line growth for at least another decade.

Investment summary

Food retailers on eve of radical structural changes

The way we live, work and enjoy our free time is set to change dramatically over coming decades. The key drivers of these changes are a combination of technological innovations and macro-socio-demographic changes. In this note, we focus on the impact of ongoing internet-related innovations on the way we carry out our food shopping and how this could change the business models of food retailers. In particular, we focus on the recent 'click-&-collect' innovation, which likely will have far greater implications for companies' future capex allocation and property strategies than home delivery.

In terms of potential changes in market structure and business models for the retail companies in our universe, we conclude that:

- Companies with strong brand names and positive brand image should be able to not only survive, but also pursue further growth if they adapt to viable e-commerce strategies.
- General retailers will have to fully adapt to a multi-channel approach, invest heavily in brand image, develop proprietary products and services, and may have to reconsider current store-opening programmes or downsizing and store-location strategies.
- Food retailers will have to dramatically change the way they do business through a multi-channel approach. More than ever, they need to focus on branding and private-label products. Indeed, with the expected surge in online ordering and collecting, many groups may have to reconsider their current property strategy, ie, reducing exposure to property ownership. This in view of a potential significant fall in property value. Note that convenience stores and hard discounters may be excluded to some extent from the trends described above.

Online sales growth is here to stay, in our view. Penetration is still not high, thus offering plenty of growth opportunities. In the US, online sales are growing by c.15% pa and now account for at least 6.5% of all non-food sales with some categories such as electronics well above average and fashion catching up.

The retailers in our universe are only starting to capitalise on their strong brand names and knowledge of the supply chain. None of the companies we cover achieves over 10% of group sales through online ordering, with Marks & Spencer leading the pack at 7.4% whereas groups such as Carrefour, Delhaize and Morrison are well behind.

So far, food retailers have been relatively unaffected by the internet, but we believe this is going to change dramatically over the next ten years. Home delivery is now more likely to remain a niche, whereas we believe 'click-&-collect' represents the future. France and the UK are leading the way, and all major food retailers are significantly rolling out pick-up locations.

On average, e-commerce-related sales currently account for just 3.3% of group sales for those companies in our coverage universe that already have relevant online operations. With annual growth rates of at least 10% and up to 30% expected for food retailers, and up to 100% for a group such as Inditex (from a low base), it is understandable that in the current low-growth environment, online sales represent 10-30% of incremental sales growth.

Initially, the roll-out of pick-up locations should mainly focus on existing store sites. But we believe that once store productivity begins to suffer from non-store sales, retailers will start downsizing and closing locations. We expect this to be followed by a flow of standalone pick-up locations. In the meantime, competition could heat up as those retailers with low market shares are able to easily enter new territories with standalone locations.

We analyse the potential implications of robust 'click-&-collect' growth for UK food retailers and find that the value of their property assets is at stake. Sales per square foot could easily fall by 20% in ten years' time and, depending on assumptions, by even 25-50% in twenty years, time. We anticipate similar implications for France and other markets where 'click-&-collect' is being rolled out.

Fig 1 UK supermarkets: top four modelling online impact (£)

	2010	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
Sales ex fuel (m)	83,612	87,396	90,509	93,690	96,815	99,868	102,983	106,196	109,511	112,931	116,460
Sales growth (%)	2.7	4.5	3.6	3.5	3.3	3.2	3.1	3.1	3.1	3.1	3.1
Internet grocery sales (m)	3,788	4,585	5,394	6,222	7,249	8,270	9,249	10,296	11,429	12,694	14,038
Growth internet sales (%)	25	21	18	15	17	14	12	11	11	11	11
Internet sales penetration (%)	4.5	5.2	6.0	6.6	7.5	8.3	9.0	9.7	10.4	11.2	12.1
Online share in sales growth (%)		21	26	26	33	33	31	33	34	37	38
Sales store based (m)	79,824	82,811	85,115	87,468	89,565	91,598	93,734	95,900	98,083	100,237	102,422
Growth store based sales (%)	2.0	3.7	2.8	2.8	2.4	2.3	2.3	2.3	2.3	2.2	2.2
Stores (all sizes)	4,474	5,000	5,380	5,762	6,145	6,529	6,914	7,299	7,684	8,069	8,454
Store growth (%)	7	12	8	7	7	6	6	6	5	5	5
Square footage (x1,000)	85,876	91,995	97,224	102,266	107,132	111,767	116,478	121,389	126,507	131,842	137,403
Square footage growth (%)	5.9	7.1	5.7	5.2	4.8	4.3	4.2	4.2	4.2	4.2	4.2
Avg SQF per store (all sizes, x1,000)	19.19	18.40	18.07	17.75	17.43	17.12	16.85	16.63	16.46	16.34	16.25
Sales per SQF (x1,000)	0.97	0.95	0.93	0.92	0.90	0.89	0.88	0.87	0.87	0.86	0.85
Store-based sales per SQF (x1,000)	0.93	0.90	0.88	0.86	0.84	0.82	0.80	0.79	0.78	0.76	0.75
Market share (%)	77.0	77.3	77.4	77.4	77.5	77.5	77.5	77.6	77.6	77.6	77.6

Source: Company data, ING estimates

Some retailers are over-exposed to property ownership, as can be seen in Figure 2. Different assumptions may be used, but the outcome is unlikely to change materially, especially among the UK and French groups that have large exposure as a result of which they face important property strategy decisions in the future.

Fig 2 Impact of assumed lower property values on valuations – basis assumptions

	Price (lc)	Mkt cap (lc bn)	EV (lc bn)	Mkt value property (lc bn)	As % of mkt cap	As a % of EV	Property val at 75% of curr MV (lc bn)	Mkt cap adj for lower property value (lc bn)	%ch in mkt cap
Ahold (AH NA) (€)	8.98	10.0	9.9	4.5	45	45	3.4	8.8	-11
Carrefour (CA FP) (€)	17.92	11.8	21.4	15.0	127	70	11.3	8.1	-32
Casino (CO FP) (€)	59.49	6.5	14.0	5.4	83	39	4.1	5.2	-21
Colruyt (COLR BB) (€)	31.49	4.9	4.7	2.8	56	59	2.1	4.3	-14
Delhaize (DELB BB) (€)	46.06	4.6	7.2	3.4	74	48	2.6	3.8	-18
Metro (MEO GR) (€)	32.64	10.7	17.8	11.0	103	62	8.3	7.9	-26
Morrison (MRW LN) (£)	298.20	7.7	8.9	7.6	99	85	5.7	5.8	-25
Sainsbury (SBRY LN) (£)	293.60	5.5	7.7	10.5	192	137	7.9	2.8	-48
Tesco (TSCO LN) (£)	406.00	32.6	40.5	36.0	111	89	27.0	23.6	-28
DIA (DIA MS) (€)	3.15	2.1	2.7	0.5	23	18	0.4	2.0	-6
Jeronimo Martins (JMAR PL) (€)	11.39	7.2	7.8	2.5	35	32	1.9	6.5	-9
Marks & Spencer (MKS LN) (£)	325.30	5.1	10.7	4.5	88	42	3.4	4.0	-22
H&M (HMB SS) (SEK)	202.9	335.8	310.1	0.6	0	0	0.5	335.7	0
Inditex (ITX SM) (€)	63.09	39.3	36.5	1.5	4	4	1.1	39.0	-1

Priced as at 6 October 2011

Source: Company data, ING estimates

Lower space productivity necessitates measures such as finding the appropriate balance between owning and leasing, the length of leases, the flexibility to downsize stores or more store sales-based rents. As such, the classical capital recycling model needs adaptation.

When we make the assumption that the value of retailers' property holdings in our universe would be 25% lower than the current market value due to expected lower future returns, we find this could have a significant negative impact on retailer valuations. In the case of Sainsbury, where the market implicitly values the operations at a negative value, the impact on its market cap would be c.50%. Other highly exposed retailers include Carrefour and Tesco.

The 'click-&-collect' trend is not without major industry-changing risks for current operators

'Click-&-collect' not only jeopardises store-based sales per square metre performance and property values across the board, it could also lead to new entrants in markets that historically have had a limited number of operators. **It could have the same industry-changing magnitude as when Lidl expanded into several Western European markets** (price wars, focus on private-labels, producers seeing pressure on sales and margins, etc). Consider the following three hypothetical examples:

Ahold's Albert Heijn has been trying for years to enter the Belgian market. So far, a single store, a franchise, has been opened with a second expected soon. If Albert Heijn, with its low prices by Belgian standards, were to open, say, five or more 'click-&-collect' standalone locations in Northern Belgium in a short period of time, we believe it could trigger a major price war in the country, while possibly gaining rapid market share.

In the UK, Ocado is a pure home-delivery business and, as such, not a major concern for the top four supermarkets. But what if Ocado decides to pilot standalone locations? In our view, this could revolutionise the UK market.

In the US, Target is rolling out groceries within its discount stores. Indeed, it is possible that the company could also offer groceries within a 'click-&-collect' environment. We feel an even greater concern is if Walmart launches a similar service from those regions where it only operates traditional discount stores or in new regions with standalone locations.

How are retailers reacting to online trends?

Ahold is leading the way with home delivery in the Netherlands and the US

Ahold is not only leading online food sales in the Netherlands through its slightly loss-making albert.nl business, but its slightly profitable Peapod operation is also the leader in the US. In the Netherlands, we believe subsidiary Albert Heijn is close to announcing the roll-out of 'click-&-collect' pilots. Given Albert Heijn's leading brand image, expertise with private-label and superior logistical capabilities, this should present a new driver for group growth which itself has slowed in recent years due to limited store openings and new growth initiatives. We are not aware of plans to launch 'click-&-collect' in the US in the short term, but would encourage management to take action at short notice given the risk that operators from other channels (eg, Target.com) start penetrating Ahold's market. Currently, the group's online-related sales add little incremental growth.

Carrefour: focus is more on fixing France than on e-commerce

Carrefour is not leading in France or other markets in terms of e-commerce. Given the apparent success of the Auchan 'click-&-collect' service in France, Carrefour has decided to speed up the roll-out of its own 'click-&-collect' service. For non-food, in particular electronics, the company has set-up a co-operation agreement with Dixons Retail's online retailer, Pixmania.

Casino owns the leading non-food online retailer in France

Casino has for years invested in its online non-food operation cdiscount, which is now one of the leading internet retailers in France with annual sales well in excess of €1bn. Cdiscount is not focusing on food and, given the success of Auchan, Casino is rapidly rolling out 'click-&-collect' within its French banners. In Brazil, associate GPA sells electronics online through a variety of brand names, including casasbahia.com and pontofrio.com. The latter achieved 39% LFL growth in its most recent quarter. In low-growth France, cdiscount is clearly an important source of organic sales growth. Cdiscount ranks second in non-food online sales behind leader Price/Franprix.

Colruyt has both B2C and B2B online operations in Belgium

Colruyt, Belgium's market leader by sales, is also one of the country's e-commerce leaders, in particular in food. Colruyt focuses on consumers through its Collect & Go (food) and Collishop (non-food) initiatives. In B2B, the company operates the Collivery service. We expect Colruyt's e-commerce activities to help drive group growth. However, we feel this means the group could potentially move up a gear to achieve this.

Delhaize needs to prioritise e-commerce

Delhaize is currently focusing on: 1) the integration of US logistics networks and back-office functions; 2) increasing store-opening rates, particularly in the US; and 3) shifting its attention to new growth markets with the Maxi Delta acquisition. E-commerce is not high on Delhaize's agenda. The company has launched 'click-&-collect' in Belgium and has plans to pilot the concept in the US.

DIA and e-commerce do not appear an obvious combination

DIA is an international group with hard discount operations. The hard discount format utilises a low-cost structure, limited product range and low average basket size, which is not particularly suited for home delivery and neither for 'click-&-collect'.

H&M accelerates roll-out of H&M webshops

Just as with Inditex, H&M was late in fully embracing e-commerce, although the company has had online operations in Scandinavia since 1998. H&M's online launch in the US has been postponed until autumn 2012, but it seems reasonable to say that online sales could represent 20-30% of total sales in Western European countries by 2020.

Inditex's major webshop launched in September

Inditex's first online adventure was Zara Home, launched in 2007. By comparison with its peers, Inditex has been something of a laggard and only last year launched www.zara.com in 11 European countries. The Zara online launch in the US in September 2011 should provide a further boost to online sales at Inditex.

Jeronimo Martins has a low priority for e-commerce initiatives

We expect Jeronimo Martins' growth in sales and profits to be increasingly dominated by 20%+ pa growth in its Polish Biedronka banner. But e-commerce is not something that adds value to a business with an average transaction of just over €6. In Portugal, the business is managed for cash in an environment driven by tough, austerity measures. Clearly, entering a third country is higher on the company's agenda than e-commerce.

Marks & Spencer's successful multi-channel model for General Merchandise

M&S Direct is the online business for General Merchandise (fashion) and makes up more than 10% of UK GM sales. This is a truly multi-channel model whereby shoppers can select click-and-collect or home delivery. Marks & Spencer (M&S) will end its technology partnership with Amazon in 2013-14. Recently, M&S hired e-commerce guru Laura Wade-Gery from Tesco.

Metro is late in embracing e-commerce

Metro needs to develop different skills for its various operations. In cash-&-carry, the company is focusing on delivery whereby ordering is performed electronically. In electronics, management recently reacted to market pressure from pure players and announced drastic measures to ensure the group remains on its growth path. In the short term, we believe this is unlikely given pressure on store sales, particularly in Germany where the bulk of profits are derived. Metro has also bought pure player redcoon.com and more acquisitions are likely to follow. Real is also piloting a 'click-&-collect' scheme.

No online activities at Morrison until this year
Until 2011, Morrison had no online sales, but CEO Dalton Philips has shown that he is prepared to make radical changes to the company by acquiring online businesses (Kiddicare, 10% stake in FreshDirect), adding some non-food categories and investing in convenience stores.

Sainsbury uses store-picked model for online delivery service
Sainsbury's online franchise has grown to c.3.8% of total sales and uses a store-picked model, meaning no costly infrastructure, which is positive from a returns perspective. We see Sainsbury as a traditional retailer with a bricks-&-mortar heritage that is shifting capex from floor space to online activities.

Tesco is best-in-class in terms of e-commerce
In the UK, Tesco has an online groceries market share of over 50%. The company's services activities (Tesco Telecom, Tesco.com, Tesco Direct) are profitable and represent c.5% of UK sales. Tesco has always been very entrepreneurial and was at the forefront of the online grocery delivery movement. 'Click-&-collect' for groceries is currently available at 280 UK stores. Non-food 'click-&-collect' has been implemented at 600 UK stores.

Target price and estimate adjustments
To reflect our view on property values, we adjust the value of property assets in our sum-of-the-parts calculation for those companies where this methodology partly explains our target price. Together with some fine-tuning of our Tesco and Sainsbury models post earnings releases, and some mainly currency-related adjustments for other groups, this results in the following target price and estimate adjustments, as shown in Figure 3.

Fig 3 Target price and EPS estimate changes

	Rating	Target price (lc)		2011F EPS (lc)			2012F EPS (lc)		
		New	Previous	New	Previous	%ch	New	Previous	%ch
Ahold	HOLD	9.4	9.0	0.863	0.858	1	0.966	0.922	5
Carrefour	HOLD	19	20	nc			nc		
Casino	BUY	nc	nc	4.62	4.69	-1	6.25	6.27	0
Delhaize	HOLD	52	51	5.64	5.56	1	6.22	5.99	4
Marks & Spencer	HOLD	nc	nc	34.24	33.54	2	39.21	38.48	2
Morrison	HOLD	nc	nc	25.87	25.20	3	30.34	28.35	7
Sainsbury	SELL	nc	nc	27.40	26.95	2	28.90	28.42	2
Tesco	BUY	490p	510p	38.27	37.11	3	42.92	40.74	5
H&M	HOLD (SELL)	200	190	9.88	9.90	0	11.44	11.29	1

Source: ING estimates

EPS and target price changes at Ahold and Delhaize reflect a stronger US dollar. EPS adjustment at Casino reflects FX movements. The target price reduction at Carrefour reflects lower property valuations in our SOTP calculation, which, together with DCF, results in our TP.

H&M upgrade: the main reasons behind our bearish stance until now concerned cost inflation, limited upside surprise in terms of expansion opportunities and tough comparatives. While cost inflation has eased (3Q11 gross margins were less affected than we expected), H&M has increased its expansion programme to 265 stores and the comparison base is easing. With a more aggressive expansion mode in Asia, and online launches on their way, we raise our target price from SEK190 to SEK200, and upgrade our recommendation from Sell to HOLD.

Our top picks

Casino (BUY, TP €85, 48% upside)

We like Casino's strategy of focusing on a selection of high-growth potential markets such as Brazil, Colombia and Thailand, while at the same time addressing issues on its home turf (France) by concentrating on convenience and discount banners, and e-commerce activities through www.cdiscount.fr online sales and limiting capex to its hypermarkets, which now account for c.17% of group sales (30% in 2005). In 2011-14F, profit growth should be driven by emerging markets. The recent weakness in the share price following stock market turmoil offers an excellent entry point for investors, in our view. The shares also offer a 5%+ dividend yield.

Jeronimo Martins (BUY, TP €14.5, 30% upside)

We believe the Polish (Biedronka) growth story is intact despite slightly weakening macro trends. The recent weakness in the Polish zloty came as a surprise given that for a long period, it was virtually pegged to the euro. In constant currency terms, we expect JM to continue to produce >20% EPS growth, despite a lack of growth in its Portuguese assets. Growth in sales and profits should increasingly be dominated by its 20%+ pa growing Polish Biedronka banner. Entering a third country is higher on the company's agenda than e-commerce, which does not suit hard discount formats.

Tesco (BUY, TP 490p, 25% upside)

With over 30% of sales stemming from international markets in, among others, Korea, Thailand, Poland, and rapid growth in services such as Tesco Bank and online formats www.tesco.com and www.tescodirect.com, Tesco has the highest growth profile of the listed UK grocers, while it trades at peer group average multiples. The main share price catalysts, in our view, are: 1) a reversal in Kantar market share data in the UK; 2) continued indications of sales and earnings momentum at Fresh & Easy; and 3) the launch of new bank products such as mortgages, current accounts and savings accounts.

Inditex (BUY, TP €75, 22% upside)

Inditex is our favourite fashion retail stock. It has a unique ability to transform catwalk trends within weeks into affordable clothes for mass markets. The company's store-openings programme is skewed towards China, while we expect www.zara.com online launches in the US and Western Europe to result in double-digit top-line growth for at least another decade. We believe e-commerce could have a much bigger positive impact on the company's LfL sales growth than the market currently expects (pencilling in 1ppt of extra LfLs). We estimate that the US launch alone could lift LfLs by 1ppt. In the medium term, when online business achieves more scale, we expect operating leverage to increase. We anticipate EPS estimates will be at least 3-5% higher than current consensus forecasts.

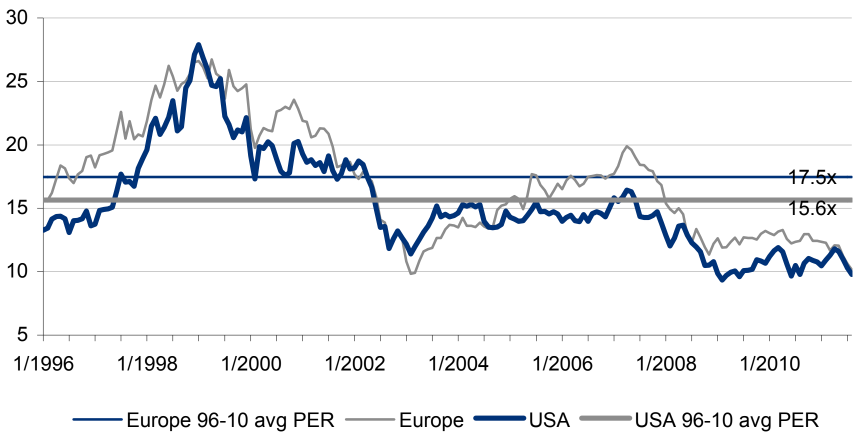
Valuation

Low-growth prospects for food retailers reflected in sector's PER trend

The 15-year PER trend in Figure 4 shows an industry that has become much more rational in the way in which it operates (ie no debt issues or merger-based growth), but that is also faced with low-growth rates in mature markets and intense competition, both as a result of pressure on consumers' disposable income. We also believe that in some cases, over-investment in property hampers ROIC performance and valuations. While growth prospects for the more mature markets in Western Europe and the US are limited, they are better in emerging markets, where many of the retailers in our coverage universe have growing interests. Nevertheless, the impact on the sector's total valuation is not yet material.

PERs for food retailers have been trending down over the past 10 years

Fig 4 Western European and US food retail PER (x)



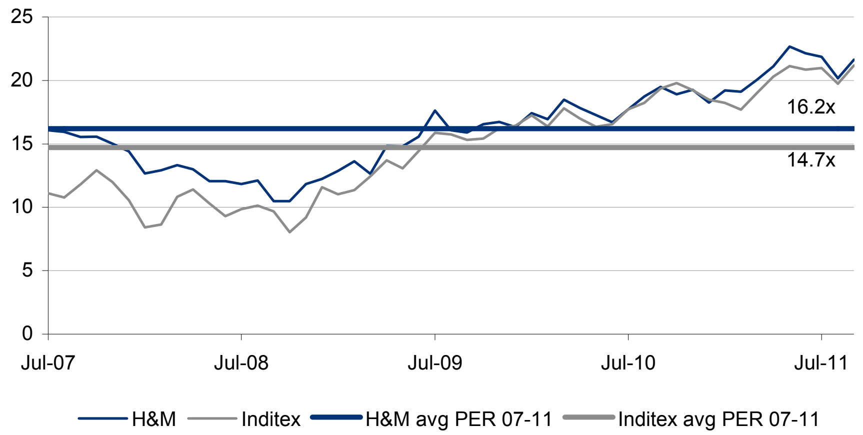
Source: Bloomberg

High PER valuations for H&M/Inditex reflect high incremental returns on expansion-driven sales growth

Fast-fashion retailers H&M and Inditex have experienced multiple expansion

Since 2007, Inditex's and H&M's PER have expanded as the companies' business models have proven to be best-in-class. In addition, both companies have increased their exposure to emerging markets, giving them both a higher growth profile and a more diversified sales and EBIT base.

Fig 5 H&M and Inditex PER (x)



Source: Bloomberg

Fig 6 Food retail valuations

	Price (lc)	Rating	Mkt cap (lc bn)	PER (x) 2011F	2012F	EV/EBIT (x) 2011F	2012F	EV/EBITDA (x) 2011F	2012F	PEG (x) 11F	EPS %CAGR 10-12F
Ahold (AH NA) (€)	8.98	Hold	10.0	10.4	9.3	7.3	6.7	4.7	4.3	0.7	14
Carrefour (CA FP) (€)	17.92	Hold	11.8	12.6	9.5	9.2	8.6	5.4	5.1	-3.2	-4
Casino (CO FP) (€)	59.49	Buy	6.5	11.0	9.5	8.9	7.7	5.9	5.2	0.7	16
Colruyt (COLR BB) (€)	31.49	Hold	4.9	14.2	13.2	9.6	9.0	7.2	6.8	2.5	6
Delhaize (DELB BB) (€)	46.06	Hold	4.6	8.2	7.4	7.2	6.3	4.5	3.9	1.9	4
Metro (MEO GR) (€)	32.64	Buy	10.7	9.5	8.2	7.0	6.6	4.6	4.4	0.7	13
Morrison (MRW LN) (£)	298.2	Hold	7.7	11.6	9.8	9.1	8.5	6.8	6.3	0.9	13
Sainsbury (SBRY LN) (£)	293.6	Sell	5.5	10.9	10.3	10.1	9.9	5.7	5.6	3.0	4
Tesco (TSCO LN) (£)	406.0	Buy	32.6	10.6	9.4	10.1	8.9	7.3	6.4	0.8	14
European average				11.0	9.6	8.7	8.0	5.8	5.3	0.9	9
Other food retailers:											
DIA (DIA MS) (€)	3.15	Hold	2.14	15.7	13.1	10.4	9.2	5.1	4.6	2.3	7
Sligro (SLIGR NA) (€)	23.80	Buy	1.05	11.9	10.7	9.8	8.7	6.8	6.1	0.6	18
Jeronimo Martins (JMT PL) (€)	11.39	Buy	7.15	19.6	16.3	15.1	12.5	10.5	9.0	0.8	25
Marks & Spencer (MKS LN) (£)	325.3	Hold	5.14	9.5	8.3	15.1	10.2	8.0	7.2	18.5	1

Priced as at 6 October 2011

Source: ING estimates

Figure 6 shows the various valuation metrics for food retailers within our retail universe. Since the beginning of the year, we have seen a sort of convergence in valuations. Taking EV/EBIT, we see lower discounts or premiums for the different groups to the sector average than at the start of the year. Ahold and Delhaize still continue to trade at a discount, albeit smaller, while Colruyt continues to trade at a premium, albeit less significant. In the case of Colruyt (net cash) and Ahold (over €2.5bn of low-yielding gross cash), the PERs are still distorted.

Fig 7 Fashion retailers valuations

	Price (lc)	Rating	Mkt cap (bn)	PER (x) 2011F	PER (x) 2012F	EV/EBIT (x) 2011F	EV/EBIT (x) 2012F	EV/EBITDA (x) 2011F	EV/EBITDA (x) 2012F	PEG (x) 11F	EPS % CAGR 10-12F
M&S (MKS LN) (GBp)	324	HOLD	5.1	9.5	8.6	8.4	7.7	5.2	4.8	1.1	9
H&M (HMB SS) (SEK)	203	SELL	336	21.0	18.0	15.1	12.9	13.1	11.4	6.5	3
Inditex (ITX SM) (€)	62.90	BUY	39.2	20.4	18.0	14.5	12.7	11.2	9.9	1.5	13
Next (NXT LN) (GBp)	2,460	NR	4.2	10.3	9.4	8.2	7.8	6.8	6.5	0.9	11
Debenhams (DEB LN) (GBp)	61.05	NR	0.8	6.8	6.6	6.1	6.3	4.1	4.0	0.8	8
Fast Retailing (9983 JT) (¥)	13,400	NR	1,421	22.9	19.1	10.5	9.0	8.9	7.8	3.3	7
Esprit (330 HK) (HKD)	10.32	NR	13.3	31.8	15.0	20.2	8.3	7.6	4.7	-1.4	-23
GAP (GPS US) (US$)	17.26	NR	8.8	11.7	10.1	6.2	6.0	4.3	4.0	9.2	1
Benetton (BEN IM) (€)	4.47	NR	0.8	9.9	9.0	9.2	8.5	5.4	5.1	-6.6	-2
Abercrombie & Fitch (ANF US) (US$)	64.82	NR	5.6	20.1	13.8	11.8	8.0	7.3	5.6	0.4	50
Average				16.4	12.8	11.0	8.7	7.4	6.4	1.6	8

Priced as at 6 October 2011

Source: Bloomberg, ING estimates

The value of property assets owned by retailers is at stake

In a stress scenario, retail property values will decline materially

Most retailers in our universe own considerable amounts of property, either pockets of single-store locations and/or (parts of) entire shopping malls in which their store brands are important anchors. Coincidently, in those countries where food retail e-commerce is developing at the fastest pace (eg, the UK and France), food retailers own relatively significant amounts of property.

If we assume that the value of the property holdings of the retailers in our universe is 25% lower than the current market value due to expected lower future returns, we find that this could have a significant negative impact on retailer valuations. In the case of Sainsbury, where the market implicitly values the operations at a negative value, the impact on its market cap would be c.50%. Other highly exposed retailers include Carrefour and Tesco. See page 29 and following for a full description of the assumptions that we use.

Fig 8 Impact of assumed lower property values on valuations – basis assumptions

	Price (lc)	Mkt cap (bn)	EV (bn)	Market value property (bn)	as % of mkt cap	as a % of EV	Property valued at 75% of current MV (bn)	Mkt cap adj for lower property value (bn)	%ch in mkt cap
Ahold (AH NA) (€)	8.98	10.0	9.9	4.5	45	45	3.4	8.8	-11
Carrefour (CA FP) (€)	17.92	11.8	21.4	15.0	127	70	11.3	8.1	-32
Casino (CO FP) (€)	59.49	6.5	14.0	5.4	83	39	4.1	5.2	-21
Colruyt (COLR BB) (€)	31.49	4.9	4.7	2.8	56	59	2.1	4.3	-14
Delhaize (DELB BB) (€)	46.06	4.6	7.2	3.4	74	48	2.6	3.8	-18
Metro (MEO GR) (€)	32.64	10.7	17.8	11.0	103	62	8.3	7.9	-26
Morrison (MRW LN) (£)	298.20	7.7	8.9	7.6	99	85	5.7	5.8	-25
Sainsbury (SBRY LN) (£)	293.60	5.5	7.7	10.5	192	137	7.9	2.8	-48
Tesco (TSCO LN) (£)	406.00	32.6	40.5	36.0	111	89	27.0	23.6	-28
DIA (DIA MS) (€)	3.15	2.1	2.7	0.5	23	18	0.4	2.0	-6
Jeronimo Martins (JMAR PL) (€)	11.39	7.2	7.8	2.5	35	32	1.9	6.5	-9
Marks & Spencer (MKS LN) (£)	325.30	5.1	10.7	4.5	88	42	3.4	4.0	-22
H&M (HMB SS) (SEK)	202.9	335.8	310.1	0.6	0	0	0.5	335.7	0
Inditex (ITX SM) (€)	63.09	39.3	36.5	1.5	4	4	1.1	39.0	-1

Priced as at 29 September 2011

Source: Company data, ING estimates

Indeed, we can go one step further. It could be argued that current market values for property are already much lower than those used in our calculations above. For example, if we assume property values that are 25% lower (compared with our current market value assumptions) and then deduct a further 25% as a result of expected poor future returns due to online/e-commerce, we still get a similar picture to that shown in Figure 9. Of course, the result is a lower potential impact on a group's market cap or EV, but the negative impact on those groups with above-average exposure would still be significant.

Fig 9 Impact of assumed lower property values on valuations – adjusted for current MV assumptions

	Price (lc)	Mkt cap (lc bn)	EV (lc bn)	25% lowered current MV property (bn)	as % of mkt cap	as % of EV	Property valued at 75% of current MV (bn)	Mkt cap adj for lower property value (bn)	%ch in mkt cap
Ahold (AH NA) (€)	8.98	10.0	9.9	3.4	34	34	2.5	9.1	-8
Carrefour (CA FP) (€)	17.92	11.8	21.4	11.3	95	53	8.4	9.0	-24
Casino (CO FP) (€)	59.49	6.5	14.0	4.1	62	29	3.0	5.5	-15
Colruyt (COLR BB) (€)	31.49	4.9	4.7	2.1	42	44	1.5	4.4	-10
Delhaize (DELB BB) (€)	46.06	4.6	7.2	2.6	55	36	1.9	4.0	-14
Metro (MEO GR) (€)	32.64	10.7	17.8	8.3	77	46	6.2	8.6	-19
Morrison (MRW LN) (£)	298.20	7.7	8.9	5.7	74	64	4.3	6.3	-19
Sainsbury (SBRY LN) (£)	293.60	5.5	7.7	7.9	144	103	5.9	3.5	-36
Tesco (TSCO LN) (£)	406.00	32.6	40.5	27.0	83	67	20.3	25.8	-21
DIA (DIA MS) (€)	3.15	2.1	2.7	0.4	18	14	0.3	2.0	-4
Jeronimo Martins (JMAR PL) (€)	11.39	7.2	7.8	1.9	26	24	1.4	6.7	-7
Marks & Spencer (MKS LN) (£)	325.30	5.1	10.7	3.4	66	32	2.5	4.3	-16
H&M (HMB SS) (SEK)	202.90	335.8	310.1	0.5	0	0	0.3	335.7	0
Inditex (ITX SM) (€)	63.09	39.3	36.5	1.1	3	3	0.8	39.0	-1

Source: Company data, ING estimates

Figure 9 shows how groups with a significant property backing are impacted in a scenario of extreme property devaluations. In our view, Carrefour, Sainsbury and Tesco would see the greatest impact.

Where we differ from consensus

Fig 10 ING vs consensus estimates

	Ratings			EPS 2011F (lc)			EPS 2012F (lc)			Target price (lc)			Consensus EPS grth (%)	
	Buy	Hold	Sell	Cons	INGF	Diff (%)	Cons	INGF	Diff (%)	Cons	INGF	Diff (%)	2011 vs 2010	2012 vs 2011
Ahold (€)	17	18	4	0.85	0.86	1	0.96	0.97	1	9.9	9.4	-5	3	13
Carrefour (€)	12	19	12	1.51	1.42	-6	1.79	1.88	5	19.6	19.0	-3	-29	18
Casino (€)	19	8	2	5.03	5.41	8	5.88	6.25	6	72.8	85.0	17	1	17
Colruyt (€)	4	12	11	2.21	2.22	1	2.36	2.39	1	32.9	33.5	2	-2	7
Delhaize (€)	10	18	7	5.44	5.64	4	5.74	6.22	8	51.0	52.0	2	1	6
Metro (€)	29	16	4	3.53	3.44	-2	4.03	4.00	-1	42.6	39.0	-8	15	14
Morrison (£)	17	13	4	25.2	25.8	2	28.9	30.3	5	331	314	-5	11	15
Sainsbury (£)	6	19	10	27.0	27.0	0	29.5	28.4	-4	311	246	-21	7	9
Tesco (£)	32	5	4	35.4	38.5	9	39.5	43.1	9	463	510	10	9	12
													1.8	12.2
Sligro (€)	5	4	1	1.94	2.00	3	2.13	2.23	5	28.0	32.0	14	11	10
Jeronimo Martins (€)	10	9	5	0.58	0.58	0	0.69	0.70	1	14.4	14.5	0	30	19
Marks & Spencer (£)	13	16	3	34.1	34.2	0	37.6	39.2	4	383	330	-14	4	10
H&M (SEK)	10	14	11	9.65	9.88	2	11.3	11.44	0	210	200	-10	-15	17
Inditex (€)	21	11	3	3.08	3.15	2	3.5	3.59	3	72	75	4	11	13

Source: Bloomberg, ING estimates

The current operating environment does not allow for major discrepancies within the forecast community. Our forecasts are in some cases slightly higher and in other cases slightly lower than those of consensus. Small discrepancies may exist between our forecasts due to either the timing (we are up to date) or actual rate assumptions for foreign currencies used in calculations.

Internet changes how we shop…

…and how retailers react

At the start of the century, many sectors including retailing were branded “old economy” and were followed by a lengthy sell-off. At the time, one question frequently asked by analysts was: “can you elaborate on your internet strategy?” A decade later, it appears that most international food retailers and many general retailers have still not fully embraced the potential of current cutting-edge technology, although recently there has been a noticeable increase in pilots and a variety of roll-outs. Among the companies in our coverage universe, e-commerce-related sales still amount to well below 10% of group sales, and in most cases less than 5%.

Fig 11 E-commerce exposure among WE European retailers

	Brand(s)	Activity*	Country	2012F e-commerce sales (lc bn)	P&L	2012F group sales (lc bn)	E-commerce as % of group sales
Ahold (AH NA) (€)				0.8	Break-even	30.9	2.5
	Peapod.com	Grocery/HD	USA	0.55	Small profit		
	Albert.nl	Grocery/HD	NL	0.35	Small loss		
Carrefour (CA FP) (€)	Carrefour Drive/Pixmania	Non-food/HD&PU	F	0.4	n/a	84.0	0.5
Casino (CO FP) (€)	Cdiscount.fr	Non-food/HD&PU	Mainly F	1.35	Small profit	36.5	3.7
Colruyt (COLR BB) (€)	Collishop, Collivery	Grocery/PU	B	0.3	Profitable	8.2	3.7
Delhaize (DELB BB) (€)				Small		22.8	
Metro (MEO GR) (€)	Redcoon, MM/Saturn	Electronics/HD&PU	AT, G, NL	0.8	Profitable	69.8	1.1
Morrison (MRW LN) (£)	Kiddicare, FreshDirect**	Baby, Grocery/HD	UK, USA	0.1	Profitable	18.1	0.6
Sainsbury (SBRY LN) (£)	sainsburys.co.uk	Food and non-food	UK	0.9	Profitable	23.4	3.8
Tesco (TSCO LN) (£)			UK, Korea	3.4	Profitable	70.8	4.8
	Tesco.com	Grocery/HD	UK, Korea				
	Tesco direct	Non-food/HD	UK				
DIA (DIA MS) (€)				n/m		10.8	
Jeronimo Martins (JMAR PL) (€)				n/m		11.4	
Marks & Spencer (MKS LN) (£)	M&S	Fashion, beauty, homeware		0.8	Profitable	10.8	7.4
H&M (HMB SS) (SEK)	hm.com	Fashion	Europe	5.0	Profitable	125.1	4.0
Inditex (ITX SM) (€)	eg Zara.com	Fashion	USA, Europe	0.5	Profitable	14	3.6

*HD/Home Delivery, PU/Pick-Up **10% stake

Source: ING estimates

Various business models

E-commerce or multi-channel retailers have different ways of reaching customers and handling the ordering process. We distinguish between:

Catalogue (via telephone, mail or internet) – Quickly becomes out-dated, expensive business model, also less desirable due to shorter lead times between current product collections and price movements due to competition or new models. Some exceptions persist such as the Victoria Secret catalogue.

Direct marketing – Examples include Tupperware or Avon parties (both also sell online these days). This is among the foremost growing markets in emerging markets.

TV – This is big business, especially in the US, but has limited growth prospects due to several constraints such as limited product offering and time restrictions. Orders can be placed via the telephone or the internet. QVC (owned by Liberty Media) is one of the largest TV sellers with worldwide revenue of close to US$8bn.

Online via:

- **PC/Mac/laptop** – Well-developed, better engines will further improve product browsing and ordering, while 3D could add a new dimension. Clients can also order via the telephone in the event of problems with technology or issues over the security of payments.

- **Tablets** – Not yet well-developed, but with one of the highest innovation rates, tablets have the potential to become the preferred tool for connection to the internet in living rooms and thus for shopping. Moreover, 3D could add a new dimension, while the size of tablets makes them ideal for future holographic shopping (seeing products projected above the tablet/on the table, and picking products from supermarket shelves and placing these in a shopping cart).
- **Smartphones** – Smartphones are less ideal for shopping than tablets due to their size, but the large number of apps are helpful for shoppers (eg, payment systems, couponing, QR codes, routing, stock information), as well as a major threat (online price checking, competitive offerings) to bricks-&-mortar offerings.

Plenty of online growth drivers

We expect online sales to continue their high-growth rates of recent years, driven by:

- Low prices;
- New technologies, eg, smartphones and tablets with thousands apps;
- Increasing availability of broadband internet, 3G, 4G and affordable hardware;
- Increasing focus from bricks-&-mortar retailers;
- Disappearance of non-food retailers as they go out of business will help push online sales, eg, office supplies, music, books, electronics, video rental and travel agencies.

Online sales are most developed in those countries with the highest internet penetration rates, such as the US, Germany, the UK, France, Scandinavia and the Netherlands. Countries such as China and Brazil are also important, and are fast-growing online markets.

Fig 12 World internet usage and population statistics (as at 31 March 2011)

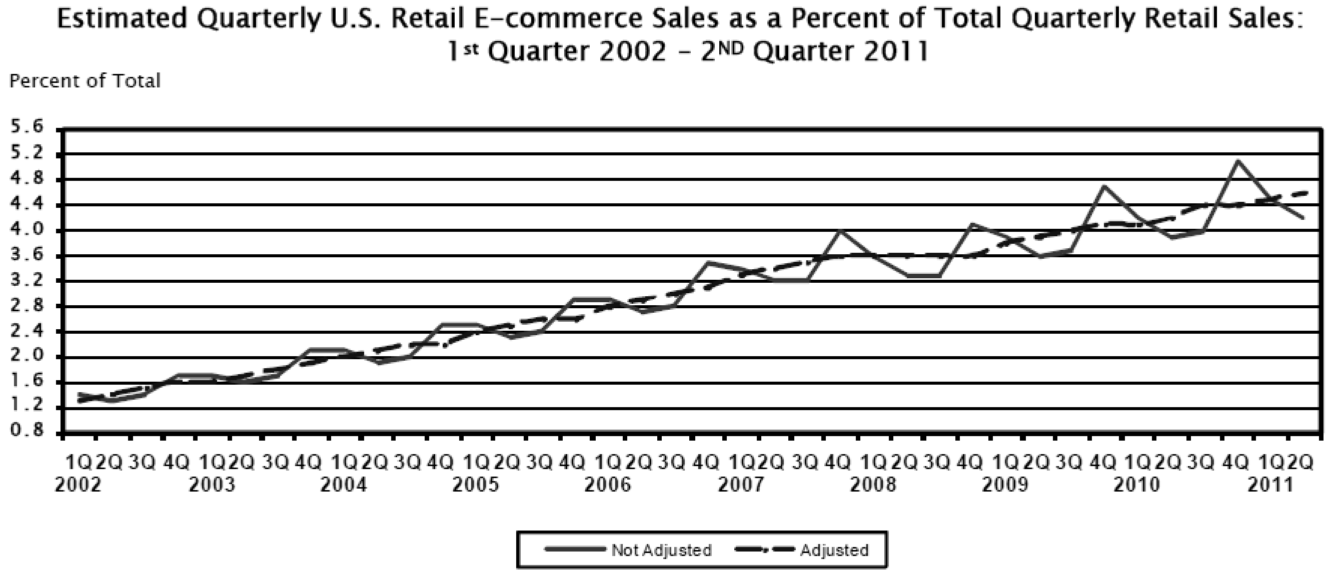
	Population in 2011	Internet users As at 31/12/00	Internet users latest data	Penetration (% population)	Growth 2000-11 (%)
Africa	1,037,524,058	4,514,400	118,609,620	11.4	2,527
Asia	3,879,740,877	114,304,000	922,329,554	23.8	707
Europe	816,426,346	105,096,093	476,213,935	58.3	353
Middle East	216,258,843	3,284,800	68,553,666	31.7	1,987
North America	347,394,870	108,096,800	272,066,000	78.3	152
Latin America / Carib.	597,283,165	18,068,919	215,939,400	36.2	1,037
Oceania / Australia	35,426,995	7,620,480	21,293,830	60.1	179
WORLD TOTAL	6,930,055,154	360,985,492	2,095,006,005	30.2	480
United States	313,232,044		245,000,000	78.2	157
China (ex HK/Macao)	1,336,718,015	22,500,000	485,000,000	36.3	
Brazil	203,429,773		75,982,000	37.4	
United Kingdom	62,698,362		51,442,100	82.0	
Germany	81,471,834		65,125,000	79.9	
France	65,102,719		45,262,000	69.5	
Russia	138,739,892		59,700,000	43.0	
Netherlands	16,847,007		14,872,200	88.3	
Norway	4,691,849		4,431,100	94.4	
Sweden	9,088,728		8,397,900	92.4	

Source: World internet usage and population statistics

Internet sales growth is not a fad, as shown in the US

The relevance of internet sales is shown in Figures 13 and 14. Figure 13 shows the long year trend in internet retail sales in the US. Figure 14 compares the current growth rates for internet sales with overall retail sales.

Fig 13 US B2C internet sales



Source: US Census

Fig 14 Estimated quarterly US retail sales: total and e-commerce (US$bn)

Seasonally adjusted	Total retail	e-commerce	E-commerce % of total	QoQ (%ch) Total	QoQ (%ch) E-commerce	YoY (%ch) Total	YoY (%ch) E-commerce
2Q11	1,041.7	47.5	4.6	1.2	3.0	8.1	17.6
1Q11	1,029.6	46.1	4.5	2.6	3.6	8.6	17.8
4Q10	1,003.6	44.5	4.4	3.2	5.0	8.1	16.3
3Q10	972.6	42.4	4.4	0.9	4.9	5.8	14.8
2Q10	963.7	40.4	4.2	1.6	3.2	7.4	15.0

Source: US Census

Non-food online sales already at 6.5% in the US…

As a percentage of total retail sales, internet sales now account for 4.6% (see Figure 14).

However, retail sales consists of both food and non-food sales.

We assume the relatively undeveloped US online food retail market generates sales of just US$10bn, ie, non-food accounts for US$170bn on a rolling four-quarter basis.

On the same basis, total retail sales amount to US$4,048bn, with an estimated US$600bn from food and beverages and US$820bn from auto-related sales.

This means that in non-food (ex-auto-related), e-commerce already accounts for c.6.7% (US$170bn/US$2628bn[1]) of total US sales.

…but in some categories it is much higher

The c.7% penetration rate for non-food is the average of several categories (eg, in media, it is much higher). Figure 15 shows a number of categories where internet penetration is likely to be higher and still growing. In these categories, many bricks-&-mortar companies have already gone out of business. By contrast, lower-cost models have caused, among others, office supply and financial institutions to do more and more business online.

[1] Assuming internet auto parts sales are not significant enough to distort the picture described above

Fig 15 US B2C categories most impacted by the internet

Category	Victims	Winners
Music	Tower Records	Apple
Video	Blockbuster	Amazon, Netflix
Books	Borders	Amazon
Electronics	Circuit City	Apple, Amazon, e-tailers. ebay
Home and Garden	Specialty stores, property owners	Amazon, online specialists, ebay
Toys and infants	Specialty stores, property owners	Amazon, online specialists
Fashion	Specialty stores, property owners	Amazon, online specialists, ebay
Sports and outdoors	Specialty stores, property owners	Amazon, online specialists, ebay
Office supplies	Property owners as large chains close stores	Staples, Office Depot, Office Max
Airline tickets/travel	One of the first that disappeared, no major impact on property market	Travelocity, Expedia and the likes
Financial services	Property owners	

Source: ING

With these developments in mind, it should not be a major surprise that Amazon, Apple and several office supply companies rank among the US largest internet sellers. Note that travel and financial services are not included in Figure 16:

Fig 16 Top US online B2C sellers (US$bn)

		2010 sales
1	Amazon	34.2
2	Staples	10.2
3	Apple	5.2
4	Dell	4.8
5	Office Depot	4.1
6	Walmart	4.1
7	Sears	4.1
8	Liberty Media	3.0
9	Office Max	2.9
10	CDW	2.7

Source: www.internetretailer.com/top500/list/

Similar trends visible in Europe

Fig 17 Products or services bought over the internet in 2008 (as % of total category sales)

Retail Europe	Travel and holiday accom	Clothes and sport goods	Books and mags	Household	Tickets for events	Film and music	Electronics and cameras
EU 27	14	13	12	11	11	9	8
Austria	11	14	16	9	9	8	9
Belgium	8	5	5	3	6	4	3
Bulgaria	0	1	1	0	0	1	0
Cyprus	3	2	2	1	0	2	2
Czech Republic	3	9	6	5	7	2	7
Denmark	30	24	17	10	28	20	17
Estonia	3	3	2	2	6	1	1
Finland	31	27	20	14	25	16	11
France	18	19	14	16	13	11	5
Germany	22	26	28	26	19	17	18
Greece	2	2	2	1	1	1	2
Hungary	3	3	6	2	3	2	2
Ireland	21	7	9	3	12	10	5
Italy	4	3	3	2	2	2	2
Latvia	3	5	1	5	5	1	6
Lithuania	2	1	1	1	2	1	1
Luxembourg	27	15	29	11	22	18	10
Malta	4	6	6	3	2	6	6
Netherlands	26	22	21	12	21	13	14
Poland	2	8	5	6	2	3	4
Portugal	4	3	3	1	2	2	2
Romania	1	1	2	0	0	2	0
Slovenia	5	5	4	5	3	2	4
Slovakia	4	9	5	5	4	3	4
Sweden	27	18	19	7	22	16	11
UK	27	24	21	23	21	24	15

Source: Eurostat

Figure 18 shows the main categories in Europe where the internet is making quick inroads. Compared with the US, the top ten online sellers generate c.50% of the sales volume of their US counterparts with the exception of leader Amazon, whose US operations are almost three times as big. However, given the major investments that Amazon is making in Europe (building warehouses in the UK and Germany, setting up new country organisations in Spain, etc), we expect Europe to catch up.

Fig 18 Top European online B2C sellers (US$bn)

		2010 sales
1	Amazon	9.4
2	Otto Group	3.8
3	Tesco	3.2
4	Staples	2.8
5	PPR	2.3
6	Home Retail Group	1.4
7	3 Suisses	1.2
8	Cdiscount	1.2
9	Neckermann	1.1
10	Dixons (UK)	1.1

Source: www.internetretailer.com/2011/03/15/europes-top-10

Fashion and textile is Germany's prime online growth category

Fig 19 German non-store retail sales (€m)

	2Q11 sales
Fashion, textile, shoes	3,740
Media	720
Electronics	630
Computer (related)	430
Hobby	380

Source: bvh

Non-store-based retail sales totalled €8bn in Germany in 2Q11. Of this, €5.2bn came from online sales. The balance was from catalogue (traditionally a big business in Germany) and TV sales.

The fastest growth compared with 1Q11 was seen in the fashion, textile, shoe category at 20%. Fast growth was also recorded by home furnishing (+18%) and health and beauty (14%).

Media Markt/Saturn example shows how fast traditional retailers can come under pressure

In July 2011, Metro presented a strategy update for its Media Markt/Saturn division. Figure 20 clearly shows the problem that Media Markt is dealing with. Not only is the internet taking away sales, thereby pressuring Media Markt's sales densities and operational result, it is also selling at lower prices thanks to its different, lower-cost business model. Media Markt thus faces a double whammy. To survive, the group embarked on a multi-year cost-savings programme, announced price reductions, a more modest store-opening programme in mature markets and plans to transform into a multi-channel retailer. But we believe the jury is out. Short-term profits will be pressured by implementing the new strategy, and there is no guarantee that it will work. In the US, peer Best Buy has yet to recover from its first market share losses in the country since 2H10 despite already having a multi-channel strategy in place before pressure from the internet started to impact its store sales.

In terms of different growth rates per channel, Media Markt-Saturn predicts the following for 2010-16 for the EU countries in which it operates:

- Bricks-and-mortar: market volume up from €137bn to €145bn; CAGR of 1%;
- Online: market volume rises from €17bn to €31bn; CAGR of 11%;

Implicitly, Media Markt/Saturn expects the share of online sales to jump from 11% in 2010 to 17.6% by 2016.

Fig 20 Market share trends (%)

	Media Markt-Saturn			Online		
	Jan-May 2010	Jan-May 2011	YoY %ch	Jan-May 2010	Jan-May 2011	YoY %ch
Germany	18.5	17.4	-1.1	16.0	17.3	1.3
Italy	13.1	13.7	0.6	4.9	5.2	0.3
Spain	11.9	11.8	-0.1	2.2	2.6	0.4
Poland	16.5	15.1	-1.4	9.4	11.8	2.4
Austria	26.6	26.0	-0.6	11.7	12.3	0.6
Netherlands	15.0	16.2	1.2	15.4	16.6	1.2
Hungary	19.4	17.2	-2.2	7.5	11.6	4.1
Belgium	11.2	12.0	0.8	3.8	4.1	0.3
Switzerland	15.1	13.6	-1.5	17.1	17.2	0.1
Greece	9.3	10.7	1.4	1.9	2.4	0.5
Portugal	6.4	6.7	0.3	2.3	2.2	-0.1
Russia	3.7	3.5	-0.2	4.9	5.8	0.9
Sweden	7.7	7.4	-0.3	n/a	n/a	n/a
Turkey	4.0	4.7	0.7	1.7	2.1	0.4
Luxembourg	16.1	26.0	9.9	n/a	n/a	n/a

Source: Metro. Metro notes that online market shares for GR, RU, TR are based on GfK estimates, LU and SE online were not available

Food retailers need to adapt their business model

Online food retailing is not a new phenomenon

Online home delivery started 10 years ago, but technology was not powerful enough

At the start of the century, the US was the centre of online grocery activity with several start-ups (or existing businesses adapted to the internet) among the largest food retail groups setting up online delivery services. A number of pure-play business such as Webvan, Peapod and HomeGrocer also emerged.

However, the time was not right for online retailing (and predictions were too ambitious) given a lack of powerful (wireless) technology and broadband penetration (dial-up internet was the standard). Most initiatives from bricks-&-mortar groups (eg, Albertsons and Publix) were ended, while Webvan filed for bankruptcy in 2001 after having "burned tons of money". Webvan's problem was that it had grown too fast. Its IPO raised US$375m and, at its peak, the company had a market cap of US$1.2bn. Peapod was acquired by Ahold USA and currently serves as the group's online home delivery service. HomeGrocer was acquired by Amazon.

Food retailers have seen little impact as yet, but that will change

While many general retailers have already been impacted by internet competition from either pure players or multi-channel players, the situation so far has been fairly relaxed for food retailers. But why is this?

- Lack of large-scale professional groups. Some of the bigger online grocers have been operating on the backburner for some time before stepping up their online activities, eg, Ocado in the UK and Fresh Direct in the US.
- Several initiatives were aimed at early adopters, more affluent shoppers instead of the mass market, which is needed to generate volumes/scale.
- Lack of suitable technology and broadband internet penetration. The average Amazon order consists of a few items at most, whereas orders to an online grocer usually involved 30 items or more. New and faster technology now stimulates online fashion sales growth trends.
- More complicated distribution infrastructure. Items sold by general retailers can be delivered by any general distributor. Groceries, however, come in three different temperature zones: room temperature for dry groceries, chilled for fresh products and below zero for frozen products.
- Expensive order picking. The picking of cans, boxes and bottles could be automated, however, the picking of higher-margin fresh products is preferably done manually. Sorting frozen products remains difficult with automated systems.

All major operators are substantially increasing their focus on the online market

So why should the status quo change dramatically over the next decade?

In markets with little growth, online could add incremental growth

In many developed markets, we see little volume growth for the market as a whole in the medium term. At the same time, many groups are exploring new ways to increase volumes and lower costs (eg, self-checkout). The arrival of better technologies stimulates new initiatives.

Home delivery likely to remain a niche

In time, we believe home delivery could seize a reasonable share of the grocery market, but we doubt whether it will completely change current market structures. The service is still not as profitable (if at all) as normal store operations, and faces issues with delivery windows.

However, 'click-&-collect' is likely to change the industry

We predict a much brighter future for 'click-&-collect' than home delivery

We predict a brighter future for online ordering and store pick-up/drive-in. 'Click-&-collect' combines the best elements of online shopping and home delivery with mobility for the shopper. At the same time, 'click-&-collect' challenges retailers to change their cost structure. The quick roll-out of 'click-&-collect' facilities by the larger and better-equipped groups is likely to help them gain market share from the smaller and independent groups.

Benefits for customers include:

- Clients can order online via PC/Mac, tablet or cell phone. Certain recurring items on the shopping list can even be ordered through a sort of subscription (eg, milk, bread, rice, bottled water).
- Clients have a much more flexible pick-up window than with home delivery, for which they also have to pay a delivery fee. Note that a small pick-up fee is possible.
- Clients can combine (in many cases) a 'click-&-collect' trip with, for instance, a trip to the fuel station, the dry cleaners and the pick-up of general merchandise ordered elsewhere.
- Clients with a job can conveniently stock up on the way home from work.

Retailers will have to change their business models:

- Compared with home delivery, retailers still have to fulfil orders, for which they should use automated systems, depending on the total scale of the online operations at any given time.
- Besides extra order picking costs, pick-up models will help retailers save on home delivery costs if they replace this service. It also saves on check-out and shelf-stocking personnel. Once 'click-&-collect' reaches a certain scale, it should also save on other store opex (rents, depreciation, energy, cleaning, local taxes) given that fewer and/or smaller stores are necessary. Also shrinkage (theft, wrong cash register scans, out-of-date items) should be reduced (eg, just 0.6% at pure-play Ocado), and 'click-&-collect' could substantially reduce stock inventory and thus working capital.
- On balance, the model should allow retailers to generate profits on picked-up sales. Interestingly, the average online basket is several times bigger than within the store. In year, 2000 Peapod noted that online orders were 5-6x (US$125) the size of average in-store baskets. In 2010, Peapod's average order size had grown to US$155.
- Retailers and food producers will have to find ways to encourage consumers to buy impulse items in order to protect retailers' margin mix and benefit producers' volumes. Alternatively, retailers will need to further develop systems that encourage customers to replace branded products with store brands.

There are three main online pick-up models:

In a study in December 2010, Planet Retail describes the three different 'click-&-collect' models that are most commonly employed. These are:

- 1) Warehouse to pick-up station (drive-thru) – eg, Auchan (France), Colruyt (Belgium).

- 2) Warehouse to store; paying online, picking up at the store – eg, John Lewis (the UK), Best Buy (the US), Toys 'R' Us (the US), 7-Eleven (Japan), Carrefour/Pixmania (France), and Amazon/7-Eleven (the US).
- 3) Store-based; offering a reserve-and-collect service based on current stock – eg, Argos (the UK).

Model one is particularly suitable for food retailers given the complexity of orders (different temperature zones) and the number of items ordered (including bulky items). Small pick-up fees may apply in the future.

Model two is more suited to general retailers, deepening and broadening their assortment, while also benefitting from potential impulse buys. It also allows retailers to keep less stock in smaller stores (eg, Best Buy).

Model three may work for a group like Argos, but does not appear suitable for many general retailers given the complexity and chance that items are not picked up after all.

Recent initiatives by food retailers

Auchan is triggering rapid 'click-&-collect' roll-out by its peers in France

Many food retailers especially in Western Europe, notably France and the UK, are developing 'click-&-collect' strategies that are triggering other companies to follow. A good example is Auchan, whose apparently successful 'click-&-collect' concept has prompted Carrefour to accelerate its recent similar initiative, Carrefour Drive. Auchan is also rolling out 'click-&-collect' to other international markets in which it operates, eg, to Spain and Taiwan. See Figure 24.

'Click-&-collect' is particularly suited to those markets with a high level of car penetration such as the US and Western Europe.

While financial details are currently sparse in the sector, given the massive roll-out compared with very few home delivery initiatives, we believe 'click-&-collect' is a viable business model. Perhaps unsurprisingly retailer Intermarche (France) has said that the 'click-&-collect' model is more profitable than home delivery.

A win-win combination with fuel stations

Many retailers in countries such as the US, the UK and France currently attract customers by offering cheap fuel at their sites. For example, at Carrefour (>1,200 stations), Morrison and Tesco, fuel sales account for an estimated 15% (French hypers only), 20% and 15%, respectively, of domestic sales. In the UK alone, food retailers exploit 41% of the total number of fuel stations (see Figure 21**).** In France, the situation is similar.

Fig 21 UK petrol stations

Company	No. of petrol filling stations	% of total stations
Shell	582	15.8
Esso	529	14.3
Total	505	13.7
Tesco UK	**450**	**12.2**
BP	351	9.5
Morrison	**292**	**7.9**
Sainsbury's	**254**	**6.9**
Asda	**179**	**4.8**
Murco	172	4.7
Somerfield	141	3.8
M&S Simply Food	125	3.4
The Co-operative	67	1.8
Maxol	31	0.8
Waitrose	14	0.4
Total	3,692	100.0

Source: IMD research, June 2010, ING estimates

As we have said, 'click-&-collect' would in many cases allow customers to also fill up their cars with fuel. Figures 22 and 23 highlight already the important market shares that supermarket groups have in countries such as the UK and France. Moreover, if there is space for a fuel station on the retailer's parking lot, there is likely to also be space for a 'click-&-collect' depot. Alternatively, retailers could construct a standalone depot with or without a fuel station.

Fig 22 Fuel station penetration at French grocery store locations

	2004	2005	2006	2007	2008	2009	2010
Hypermarkets	1,321	1,372	1,435	1,526	1,594	1,667	1,745
Fuel stations at hypers	1,219	1,258	1,324	1,409	1,480	1,558	1,634
as a % of total	92	92	92	92	93	93	94
Supermarkets	5,621	5,573	5,525	5,501	5,478	5,437	5,381
Fuel stations at supers	3,295	3,263	3,210	3,176	3,183	3,164	3,092
as a % of total	59	59	58	58	58	58	57
Hard discount stores	3,447	3,741	4,074	4,223	4,350	4,531	4,708
Fuel stations at HD	94	119	94	86	89	107	142
as a % of total	3	3	2	2	2	2	3

Source: Nielsen UFIP

Fig 23 French fuel stations by banner (2010)

	Hypermarkets	Supermarkets	HD + others	Autoroutes	Total
Auchan	131	248	8		387
Carrefour	344	867	18	24	1,253
Casino	127	175	36		338
Cora	57				57
Francap		35			35
ITM	251	1,220	50		1,521
LeClerc	472	46	24	10	552
Match	7	52			59
Systeme U	243	449			692
Divers	2		6		8
Total	1,634	3,092	142	34	4,902

Source: Nielsen UFIP

Initially near stores, but later standalone should develop

In France, we expect most food retailers, with the exception of Auchan, to create mainly pick-up locations at existing retail locations.

Theoretically, this should be a viable business model assuming: 1) lower store opex costs and lower working capital requirements, set against the cost of collecting orders; and 2) higher overall volumes assuming market share gains from other retailers and independent/small-scale operators that do not offer a similar service.

Over time, we expect an increase in standalone pick-up locations

In time, we expect an increase in the number of standalone openings – eventually in combination with a fuel station. A pick-up pharmacy service, ATM/banking services and fast-food offering (eg, McDonald's, Subway, KFC, Burger King, etc.) could also be available. The order picking could be performed in dedicated warehouses, preferable mainly through order-picking systems. If these developments were to take place, we feel they could have industry changing consequences:

- In time, fewer store locations would be needed to service consumers, potentially causing a fall in property values and/or number of locations. There could also be a shift in capex allocation towards picking systems and dedicated warehouses.
- Well-organised retailers could start offering 'click-&-collect' services in those regions where historically they are under-represented or not represented at all.
- Finding suitable (out-of-town) locations should be easier than getting approval for supermarkets.

Fig 24 Online grocery initiatives

US	Initiative	Service	Other info
Ahold USA	Peapod.com online grocery market leader	Home delivery	Services regions in 12 north/north-eastern states. 350,000 clients in 2010, avg basket US$155
Walmart	Site to store, general merchandise	'Click-&-collect'	
Delhaize USA	Hannaford 'click-&-collect', Bloom online	'Click-&-collect', home delivery	Both are pilots. Hannaford fee US$5 for orders under US$125
Harris Teeter	Express lane	'Click-&-collect'	88 stores. US$16.95 monthly fee for unlimited usage
Kroger	Eg, Homeshop	Home delivery	Small scale by local Kroger banners
Meijer	Order-to-Store	'Click-&-collect'	No fee
Safeway	Safeway.com	Home delivery	Limited number of regions, mainly in California
Supervalu	Albertsons	'Click-&-collect'	Small scale in limited nr of markets
Amazon.com	Eg, 'Click-&-collect' at 7-Eleven	'Click-&-collect'	Limited food assortment. Amazon pilots with weekly free grocery deliveries
Price Chopper	Shops4U. Greater New England region	Home delivery and 'click-&-collect'	Pick-up pilot since Sep 2011. US$10 fee for store pick-up
Europe	**Initiative**	**Service**	**Other info**
UK			
ASDA	asda.com	Home delivery and 'click-&-collect'	
Ocado	ocado.com	Home delivery	
Sainsbury	sainsbury.com	Home delivery and 'click-&-collect'	Targets 800 stores by year-end 2011
Tesco	Tesco.com and Tesco direct	Home delivery and 'click-&-collect'	'Click-&-collect' non-food at 600 UK stores and food at 15 UK stores
Morrison	Kiddicare	Home delivery and 'click-&-collect'	Babycare products
Waitrose	waitrose.com	Home delivery and 'click-&-collect'	'Click-&-collect' in 119 stores by end-2011
France			
Auchan	Chronodrive	Food 'click-&-collect' (drive through)	Ability to see also store for "treats"
Carrefour	Carrefour Drive	Food 'click-&-collect' (drive through)	By end-2011, available at 22 hypers and 24 supers
Casino	Cdiscount, Geant Drive, Leader Price	Home delivery, 'click-&-collect'	88 locations, soon also standalone. Leader Price soon to open first pilot
Intermarche	Cybermarche	Home deliver and 'click-&-collect'	20 locations. 'Click-&-collect' more profitable than home delivery. Targets 100 drive-ins by end-2011 and 600 by end-2012
Leclerc	E.Leclerc Drive	'Click-&-collect'	65 stores, adding 2-3 each month, available at all its hypermarkets by 2015
Systeme U	CoursesU.com	Home deliver and 'click-&-collect'	Dozens
Germany			
Globus	Globus online	'Click-&-collect'	
REWE	REWE online	'Click-&-collect'	Pilot in the Frankfurt area, €2 fee
Real	Drive	'Click-&-collect'	
Benelux			
Ahold	Albert.nl	Home delivery, 'click-&-collect' planned	Joint delivery with Etos (drug store) and Gall & Gall (liquor, wines)
Colruyt	Collect & Go (food), Collishop (non-food), Collivery (food, B2B)	'Click-&-collect', home delivery (B2B)	122 Collect & Go pick-up stores. €4.5 fee. 290 pick-up locations Collishop (after three days)
Cora (Louis Delhaize)	Cora Drive	'Click-&-collect'	End-2012: 70-80% of hypers should have a drive. Currently 14 drives
Delhaize	Delhaize Direct	'Click-&-collect'	80 locations currently offer 'click-&-collect'
Other Europe			
Superquinn (Ireland)	Online shopping	Home delivery and 'click-&-collect'	'Click-&-collect' currently offered by two stores
SuperValu (Ireland)	Online shopping	Home delivery and 'click-&-collect'	c.ten pick-up stores
Sonae (Portugal)	Continente Drive	'Click-&-collect'	Pilot in Lisbon. No fee
Alcampo (Auchan, Spain)	Drive	'Click-&-collect'	No fee
Rest of the World			
Coles (Australia)	Pilot	'Click-&-collect'	Pickup at the chain's fuel stations
Woolworth (Australia)	HomeShop.com.au	Home delivery	Can service 85% of the population
RT Mart (Auchan, Taiwan)	RT-Drive	'Click-&-collect'	Introduced in 2003
Auchan Russia	Drive	'Click-&-collect'	To open in 2012

Source: Company data, ING estimates

Multi-channel operators are better positioned than pure plays

New technologies and business models could lead to new entrants in the consolidated food retail markets in most mature markets. Ocado in the UK, for instance, has tried and succeeded in gaining rapid share with its home-delivery grocery service.

In the long run, we cannot rule out any successful food retail entrants in these markets, such as Amazon.com. In the short term, we believe current operators have more to fear from their existing competitors than from new players (perhaps with the exception of Amazon.com or Target.com in the US). In order to become a successful multi-channel food retailer, or in the case of a pure online retailer, we believe companies need the following qualifications:

- Buying power – asking too high prices as a starting point or a model with too low gross margins will not work;
- Strong brand equity and marketing – the emotion factor;
- A high-quality private-label offering – customers need to have 100% trust in the label;
- Skills in fresh products (selecting and handling) – clients have preferred fresh products suppliers;
- Skilled execution – on time, right service, payment systems, no surprises;
- Scale in terms of overhead and logistics – to make the model profitable;
- Sound financial backing – important for all stakeholders;
- Proprietary product and services offering – enables firms to be distinctive;
- Socially responsible – supporting local communities, responsible buying, etc.

To have a profitable model, retailers need scale

When it comes to having a profitable model, a retailer needs a certain critical mass. We believe it is fair to assume that pure-play food retailers need a much higher sales level and a good level of delivery density in order to become profitable.

Peapod by Ahold: a slightly profitable "pure play"

Peapod is slightly profitable according to parent, Ahold. However, Peapod is not a 100% pure play given that it benefits from: 1) overhead synergies with Ahold USA; 2) procurement synergies with Ahold USA; 3) product mix benefits thanks to Ahold USA private-label products; and 4) handling synergies as part of orders are picked at Fast Pick Centers supported by Ahold USA stores. In 2000, Peapod had the following operating model in mind (see Figure 25):

Fig 25 Peapod per order economics at scale (Dec 2000, US$)

	Model*	Best-in-class (Dec 2000)	Best Peapod region
Product sales	125	128	Chicago
Delivery fee	1	5	Connecticut
Total revenue	126	133	
Cost of goods	-85	-87	Washington
Gross profit	41	46	
Gross product margin (%)	32	32	
Gross profit margin (%)	33	35	
Variable costs:			
o.w. Fulfilment and delivery	-25	-27	Chicago
o.w. Customer support	-5	-5	
Total variable costs	-30	-32	
Fixed costs	-5	-9	Boston
Per order contribution	6	5	

*Assuming a US$40m run rate (320,000 orders pa or 6,150 per week)

Source: Peapod December 2000

At the time, Peapod expected to invest c.US$5 per dedicated warehouse and US$0.6m per Fast Pick Center, giving ROI in the event of reached maturity of 59% and 35%, respectively. With hindsight, this approach was far too optimistic. Currently, a semi-automated warehouse would probably cost between US$50-100m.

Meanwhile, average orders have grown towards US$155 and delivery fees are usually a minimum of US$5. However, the service has yet to become mainstream.

Ocado: still loss-making albeit in the business for ten years

Ocado is a UK pure-play food retailer with one, semi-automated warehouse and a number of regional distribution centres servicing c.two-thirds of the UK. In its last financial year, Ocado recorded net revenues of £516m and a pre-tax loss of £12m. The average order size is £114.

Fig 26 Ocado FY10 operating model (£)

	Recurring FY10 group	FY10 per average order
Product sales	515.7	114
Other income (marketing revenue)	6.2	1
Total income	521.9	115
Cost of goods	(354)	(78)
Gross profit	167.9	37
Gross product margin (%)	32	32
Gross profit margin (%)	33	33
Distribution costs	(132.8)	(29)
Administrative costs	(36.9)	(8)
Recurring EBIT loss	(1.8)	(0.4)

Source: Ocado, ING

Ocado's CE is c.£75m with c.£100m in fixed assets and negative working capital of £25m. To achieve a 15% pre-tax return on CE, Ocado would have to earn c.£11m.

Ocado has several levers to improve profits, pursue a higher average basket, enhance its product mix and/or increase the number of orders (diluting fixed costs).

Fig 27 Ocado economics per order– levers for improvement (£)

	FY10 per avg order	5% higher avg order	5% more orders	1% higher gross profit
Product sales	114.0	119.7	114.0	114.0
Other income (marketing revenue)	1.4	1.4	1.4	1.4
Total income	115.4	121.1	115.4	115.4
Cost of goods	(78.3)	(82.1)	(78.3)	(77.1)
Gross profit	37.1	38.9	37.1	38.3
Gross product margin (%)	32.2	32.2	32.2	33.2
Gross profit margin (%)	32.6	32.5	32.6	33.6
Distribution costs	(29.4)	(30.8)	(29.1)	(30.5)
Administrative costs	(8.2)	(8.2)	(8.1)	(8.1)
Recurring EBIT loss	(0.4)	0.0	0.0	(0.3)

Source: Company data, ING estimates

Note that the calculations shown in Figure 27 suggest that Ocado is close to reaching break-even. In reality, the group is on the brink of new major investments in a second fully-automated central warehouse – at a cost of £210m – to service (less dense) parts of the country that have so far been neglected.

Fig 28 E-commerce exposure among WE European retailers

	2012F e-commerce sales (lc bn)	2012F group sales (lc bn)	E-commerce as % of group sales	E-commerce share of group growth* (%)	E-commerce indicative annual growth (%)	E-commerce P&L contribution
Ahold (AH NA) (€)	0.8	32.0	2.4	10	>10	Neutral
Carrefour (CA FP) (€)	0.6	84.0	0.7	15-20	20	Neutral
Casino (CO FP) (€)	1.35	37.5	3.6	7	15-20	Positive
Colruyt (COLR BB) (€)	0.4	8.2	5.4	10	>10	Positive
Delhaize (DELB BB) (€)	n/m	23.6	n/m	n/m	n/m	n/m
Metro (MEO GR) (€)	0.8	69.8	1.1	20	20	Positive
Morrison (MRW LN) (£)	0.1	18.8	0.5	1	30	Positive
Sainsbury (SBRY LN) (£)	0.9	23.1	3.9	21	20	Positive
Tesco (TSCO LN) (£)	3.4	70.8	4.8	12	20	Positive
Marks & Spencer (MKS LN) (£)	0.8	10.5	7.6	30	20	Positive
H&M (HMB SS) (SEK)	5.0	125.1	4.0	25	50	Positive
Inditex (ITX SM) (€)	0.5	14.0	3.6	20	100	Positive

*eg, 10% indicates that if a group's sales rise by €100m, €10m stems from e-commerce

Source: ING estimates

At Carrefour, the growth outcome appears high, but also reflects a lack of substantial growth in the brick-&-mortar operations and a low current level of e-commerce sales.

At Casino, the picture appears troubled due to strong growth in its emerging markets and an increase in its stake in GPA (Brazil). If we look solely at France, e-commerce accounts for c.25% of incremental revenue growth in 2012F and 7% of French sales.

Less need for space

For traditional supermarkets, a slowdown in weekly store-based sales is unavoidable, in our view, as consumers replace part of their current offline sales with online sales. In the UK, c.10% of retail sales is already carried out via the internet. While online sales are only slowly gaining market share, the trend appears unstoppable and we believe traditional retailers need to act.

Not only do we expect food sales in supermarkets to fall, we anticipate a negative spread-over effect on other businesses. In shopping centres and malls with a (large) supermarket as an anchor, the rise of e-commerce could lead to a decrease in footfall and lower sales for the shopping centre as a whole. Subsequently, this could lead to lower rents and property valuations.

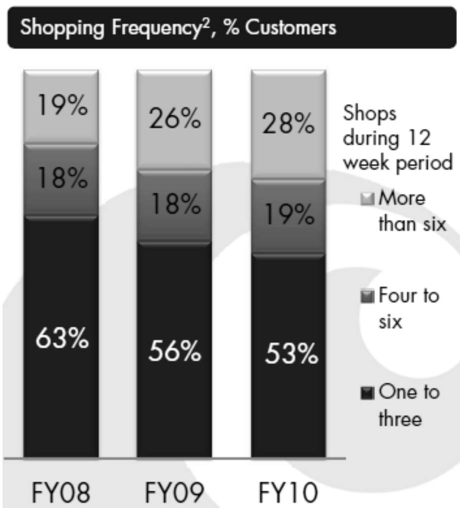
Retailers will have to rethink property strategies

Retailers should analyse their property portfolios in terms of vulnerability to e-commerce

We expect retailers and especially those food retailers that own a lot of property to have to rethink their property strategies. Property portfolios should be analysed in terms of vulnerability to e-commerce. Generally, we assume that overall demand for space will decrease as the rise of e-commerce leads to:

- Fewer shopping trips – exaggerated as online average baskets tend to be higher (see Figure 29 which suggests Ocado clients are becoming more loyal to online buying);
- Less inventory – and lower working capital requirements;
- Smaller stores with fewer personnel;
- Lower affordable rent levels.

Fig 29 Ocado online consumer adoption



2: Shopping frequency for active customers at year-end over the previous 12 weeks

Source: Ocado.

Online bulk-buying results in larger baskets and fewer shopping trips

We expect that shopping frequency at offline stores will decrease and thus anticipate lower footfall, especially in shopping centre locations anchored by a supermarket, although we expect the impact to vary dramatically per individual case. Top-of-the-bill shopping centres with only AAA retail brands and a "fun factor" (entertainment) are unlikely to be impacted at all, whereas small village shopping streets could well see traditional retailers close their doors. Unibail-Rodamco's 1H11 results confirmed the 'decoupled' trend in shopping centres: large malls with more than 6m visitors pa saw a rental uplift of 19% (at renewals, after five years) while shopping centres with less than

6m visitors only recorded a 3% uplift. Vacancies among large centres were 1.7% and 3.6% for small shopping centres. The impact of e-commerce will also differ according to individual shopping centres and even within a shopping centre. We look at the consequences of e-commerce on an aggregated level.

Supermarket sales and property values: a double whammy

Supermarket groups, which own both the supermarkets (instead of a franchise operator) and the property of its supermarkets, are exposed to double leverage. If the supermarket operations are doing well, then the value of the underlying real estate increases too, and vice versa.

When a tenant's sales increase strongly, it allows more room to pay the rent. This implies a positive linear relationship between the success of the supermarket and the value of the property. But such a positive relationship can also exist from higher footfall in cases where the store is part of a shopping mall. Currently, only a very limited part of the rent is directly linked to tenants' sales.

Until the rise of e-commerce, most newly developed supermarkets or extensions were successful, which led to a positive double benefit for supermarket groups in cases where they own both the retail operation as well as the property.

If a store's sales start to slow, EBIT will come under pressure, but also the value of the property

On the other hand, a contrary movement will take place if sales start to slow. Not only the value of the supermarket operation decreases, but also the value of the supermarket property decreases because at some point the tenant requires a lower rent. In such cases, a group that owns both the supermarket and the real estate will experience the negative effect of "double leverage". Moreover, the option value of parking space (ie, the possibility to extend a shopping centre by building on that space) also decreases.

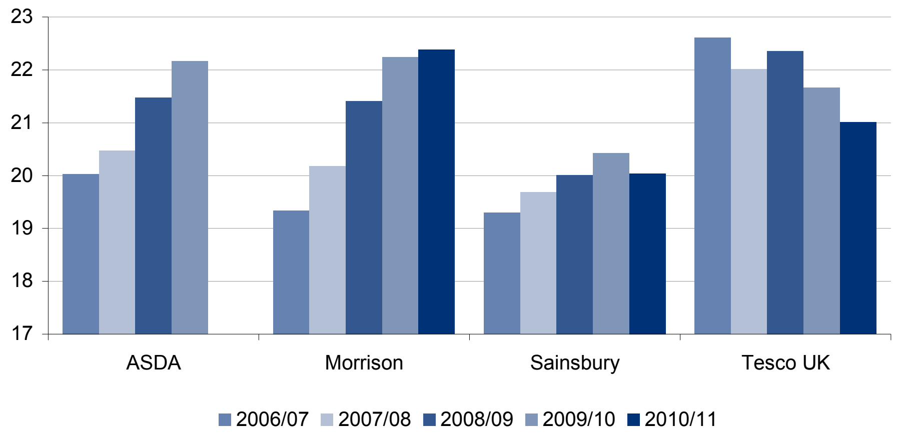
Implied yields for UK retail property do not yet discount falling sales

Implied yields for UK retail property transactions are currently stable. Recent retail property transactions indicate that yields are still very low, ie between 4% and 5%, but these are high-quality assets. For example, British Land, which generates c.22% of its total retail rent roll from Tesco and Sainsbury, reports the following implied rental yields: 5.9% for retail warehouses (£3.8bn portfolio), 6.1% for shopping centres (£2.5bn portfolio) and 5.5% for superstores (£2.5bn portfolio consisting of large Sainsbury supermarkets and Tesco Extra stores).

Property consultants such as King Sturge, Savills, CBRE and Cushman & Wakefield forecast continued growth in rental income for retail property. We believe that supermarket groups have to hang on to weaker assets simply because these are more difficult to sell. The main metrics for property valuation are rental income and rental income growth, which are functions of occupancy and sales levels among tenants. Rents are often indexed and there is occasionally a sales-related component as well.

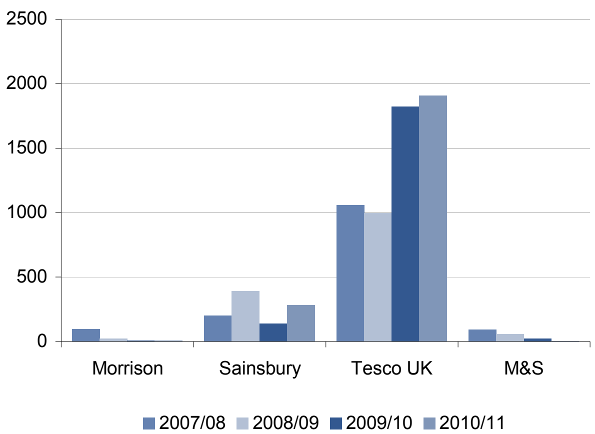
We analyse sales per square foot (SQF) for the top four UK food retailers. In recent years, this has increased for ASDA, Morrison and Sainsbury. However, we believe that sales per SQF have limited upside. We believe £23/SQF of weekly sales is the peak, similar to Tesco UK. Sainsbury's sales density level peaked in 2009.

Fig 30 UK supermarkets: top four weekly sales (£/SQF)



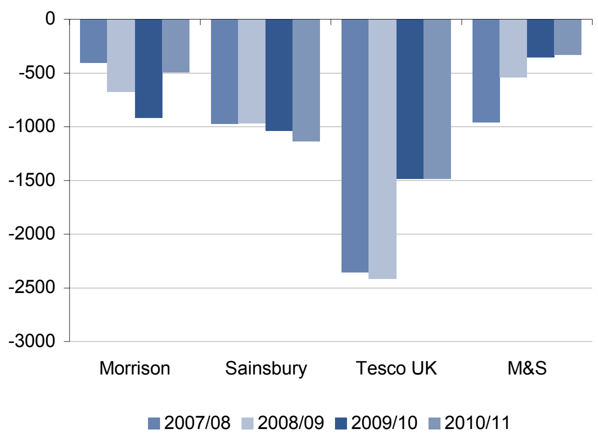
Source: Company data

Fig 31 UK top four property disposal proceeds (£m)



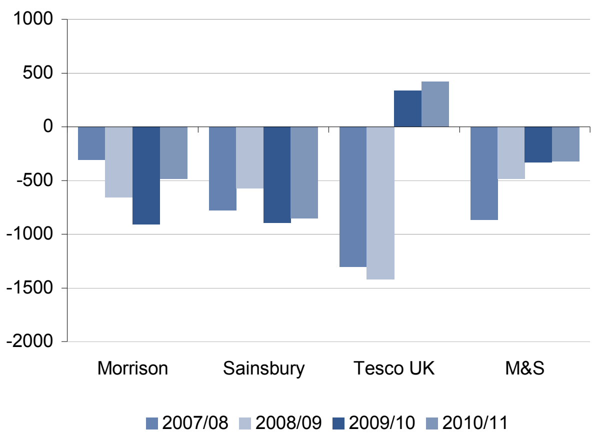
Source: Company data, ING estimates

Fig 32 UK top four capex (£m)



Source: Company data

Fig 33 UK top four property disposals minus capex (£m)



Source: Company data, ING estimates

Fig 34 UK top four property disposals and capex (£m)

		2007-08	2008-09	2009-10	2010-11F
Morrison	Prop disposal	94	22	7	8
	Capex	(402)	(678)	(916)	(494)
Sainsbury	Prop disposal	198	390	139	282
	Capex	(973)	(966)	(1,036)	(1,136)
Tesco UK	Prop disposal	1,056	994	1,820	1,906
	Capex	(2,359)	(2,417)	(1,485)	(1,486)
M&S	Prop disposal	92	58	21	4
	Capex	(958)	(541)	(352)	(327)

Source: Company data, ING estimates

UK's top four grocers are highly exposed to property

With the likely trends in falling sales and yields, how will this impact the UK's top four grocers, which together have a market share of more than 75%? Indeed, Morrison, Sainsbury and Tesco own the majority of their real estate, as shown in Figure 35. Moreover, the relevance of property backing in terms of valuation for these groups is very high.

Fig 35 Relevance of property ownership among UK retailers (£bn)

	Market cap	EV	MV property	As a % of M.cap	As a % of EV	% of property owned
Morrison	7.3	8.6	7.6	105	89	89
Sainsbury	5.0	7.2	10.5	208	147	65
Tesco	29.7	37.1	36.0	121	97	>70
M&S	5.1	10.8	4.5	87	42	70

Source: Company data, ING estimates

Fall in sales per SQF could easily reach 20% by 2020F

Store space productivity levels are likely to come under pressure

With the expected ongoing surge in online-related sales, we expect store space productivity levels to come under pressure.

On the one hand, retailers keep opening new stores and adding new square metres of space at existing locations and at a faster pace than volume growth (a function of population and consumption growth), while on the other hand, an increasing amount of sales are no longer recorded on the shop floor.

To make the decline in space productivity more visible, we use available data for the UK and certain extrapolated assumptions. We use the UK because of good data availability, a limited number of large food retailers and because, together with France, it is leading the way in online food initiatives in Europe.

Modelling productivity ten years ahead – basic scenario

Fig 36 Tesco UK: modelling the online impact – basic scenario (£)

	2010	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
Sales ex fuel (m)	34,099	34,968	36,367	37,821	39,240	40,613	42,035	43,506	45,029	46,605	48,236
Sales growth (%)	1.1	2.5	4.0	4.0	3.8	3.5	3.5	3.5	3.5	3.5	3.5
LFL sales growth (incl online, %)	1.0	0.5	1.0	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
o.w. volume (%)	-1.0	-2.5	-1.0	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
o.w. price (%)	2.0	3.0	2.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Space contribution (%)	3.1	2.0	3.0	2.8	2.5	2.3	2.3	2.3	2.3	2.3	2.3
Internet grocery sales (m)	2,500	3,000	3,450	3,795	4,175	4,592	5,051	5,556	6,112	6,723	7,395
Growth internet sales (%)	20	20	15	10	10	10	10	10	10	10	10
Internet sales % of total sales (%)	7.3	8.6	9.5	10.0	10.6	11.3	12.0	12.8	13.6	14.4	15.3
Online share in sales growth (%)	115	58	32	24	27	30	32	34	36	39	41
Sales store based (m)	31,599	31,968	32,917	34,026	35,065	36,021	36,983	37,950	38,917	39,881	40,840
Growth store based sales (%)	-0.2	1.2	3.0	3.4	3.1	2.7	2.7	2.6	2.5	2.5	2.4
Stores (all sizes)	2,715	2,978	3,228	3,478	3,728	3,978	4,228	4,478	4,728	4,978	5,228
Store growth (%)	8	9.7	8.4	7.7	7.2	6.7	6.3	5.9	5.6	5.3	5.0
Square footage (x1,000)	36,722	39,228	41,582	43,869	46,062	48,135	50,301	52,565	54,930	57,402	59,985
Square footage growth (%)	7.3	6.8	6.0	5.5	5.0	4.5	4.5	4.5	4.5	4.5	4.5
Avg store SQF (all sizes, x1,000)	13.53	13.17	12.88	12.61	12.36	12.10	11.90	11.74	11.62	11.53	11.47
Sales per SQF (x1,000)	0.93	0.89	0.87	0.86	0.85	0.84	0.84	0.83	0.82	0.81	0.80
Store-based sales per SQF (x1,000)	0.86	0.81	0.79	0.78	0.76	0.75	0.74	0.72	0.71	0.69	0.68

Source: Company data, ING estimates

Tesco is leading UK food retailers in terms of online sales penetration. In the next ten years, we expect it to double its online penetration rate towards 15% of UK sales. Without a material change in store planning, store-based sales per square foot could fall by as much as 21%, in our view.

Fig 37 ASDA: modelling the online impact – basic scenario (£)

	2010	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
Sales ex fuel (m)	18,639	19,928	20,566	21,234	21,882	22,506	23,147	23,807	24,485	25,183	25,901
Sales growth (%)	2.0	6.9	3.2	3.3	3.1	2.9	2.9	2.9	2.9	2.9	2.9
LFL sales growth (incl online, %)	1.0	2.0	1.0	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
o.w. volume (%)	-1.0	-1.0	-1.0	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
o.w. price (%)	2.0	3.0	2.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Space contribution (%)	1.0	4.9	2.2	2.0	1.8	1.6	1.6	1.6	1.6	1.6	1.6
Internet grocery sales (m)	625	750	900	1,080	1,296	1,490	1,639	1,803	1,984	2,182	2,400
Growth internet sales (%)	25	20	20	20	20	15	10	10	10	10	10
Internet sales % of total sales (ex fuel, %)	3	4	4	5	6	7	7	8	8	9	9
Online share in sales growth (%)	34	10	24	27	33	31	23	25	27	28	30
Sales store based (m)	18,014	19,178	19,666	20,154	20,586	21,015	21,508	22,003	22,502	23,001	23,500
Growth store based sales (%)	1.4	6.5	2.5	2.5	2.1	2.1	2.3	2.3	2.3	2.2	2.2
Stores (all sizes)	386	554	589	624	659	694	729	764	799	834	869
Store growth (%)	4.0	43.5	6.3	5.9	5.6	5.3	5.0	4.8	4.6	4.4	4.2
Square footage (x1,000)	17,785	19,535	20,609	21,640	22,614	23,518	24,459	25,437	26,455	27,513	28,614
Square footage growth (%)	3	9.8	5.5	5.0	4.5	4.0	4.0	4.0	4.0	4.0	4.0
Avg SQF per store (all sizes, x1,000)	46.08	35.26	34.99	34.68	34.32	33.89	33.55	33.29	33.11	32.99	32.93
Sales per SQF (x1,000)	1.05	1.02	1.00	0.98	0.97	0.96	0.95	0.94	0.93	0.92	0.91
Store-based sales per SQF (x1,000)	1.01	0.98	0.95	0.93	0.91	0.89	0.88	0.87	0.85	0.84	0.82

Source: Company data, ING estimates

We believe ASDA, the number two food retailer in the UK and a part of Walmart, should be able to triple internet sales penetration coming from a low base.

Fig 38 Sainsbury: modelling the online impact – basic scenario (£)

	2010	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
Sales ex fuel (m)	17,937	19,013	19,583	20,187	20,776	21,347	21,899	22,464	23,045	23,640	24,251
Sales growth (%)	5.7	6.0	3.0	3.1	2.9	2.8	2.6	2.6	2.6	2.6	2.6
LFL sales growth (incl online, %)	2.3	2.5	1.0	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
o.w. volume (%)	-0.5	-1.0	-1.0	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
o.w. price (%)	2.5	3.5	2.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Space contribution (%)	2.6	3.5	2.0	1.8	1.7	1.5	1.3	1.3	1.3	1.3	1.3
Internet grocery sales (m)	663	795	954	1,145	1,374	1,580	1,738	1,912	2,103	2,313	2,544
Growth internet sales (%)	25	20	20	20	20	15	10	10	10	10	10
Internet sales % of total sales (ex fuel, %)	4	4	5	6	7	7	8	9	9	10	10
Online share in sales growth (%)	14	12	28	32	39	36	29	31	33	35	38
Sales store based (m)	17,274	18,218	18,629	19,042	19,402	19,767	20,161	20,553	20,942	21,327	21,706
Growth store based sales (%)	5.1	5.5	2.3	2.2	1.9	1.9	2.0	1.9	1.9	1.8	1.8
Stores (all sizes)	934	1,004	1,074	1,144	1,214	1,284	1,354	1,424	1,494	1,564	1,634
Store growth (%)	7.1	7.5	7.0	6.5	6.1	5.8	5.5	5.2	4.9	4.7	4.5
Square footage (x1,000)	19,108	20,358	21,579	22,766	23,905	24,980	25,980	27,019	28,100	29,224	30,392
Square footage growth (%)	7.7	6.5	6.0	5.5	5.0	4.5	4.0	4.0	4.0	4.0	4.0
Avg SQF per store (all sizes, x1,000)	20.46	20.28	20.09	19.90	19.69	19.46	19.19	18.97	18.81	18.69	18.60
Sales per SQF (x1,000)	0.94	0.93	0.91	0.89	0.87	0.85	0.84	0.83	0.82	0.81	0.80
Store-based sales per SQF (x1,000)	0.90	0.89	0.86	0.84	0.81	0.79	0.78	0.76	0.75	0.73	0.71

Source: Company data, ING estimates

Sainsbury is rapidly rolling out its 'click-&-collect' model, putting pressure on others to follow suit. Together with ASDA and pure-play Ocado, Sainsbury competes for second place behind Tesco in the UK online grocery market. In our basic scenario, store-based sales per square foot could see a similar decline as at Tesco, falling 21% in ten years' time.

Fig 39 Morrison: modelling the online impact – basic scenario (£)

	2010	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
Sales ex fuel (m)	12,937	13,487	13,993	14,447	14,917	15,402	15,902	16,419	16,953	17,504	18,072
Sales growth (%)	4.1	4.3	3.8	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3
LFL sales growth (incl online, %)	0.9	1.5	1.5	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
o.w. volume (%)		-2.0	-2.0	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
o.w. price (%)		3.5	3.5	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Space contribution (%)	3.2	2.8	2.3	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Internet grocery sales (m)	0	40	90	203	405	608	820	1,025	1,230	1,476	1,698
Growth internet sales		n/m	125	125	100	50	35	25	20	20	15
Internet sales % of total sales (ex fuel)	0	0	1	1	3	4	5	6	7	8	9
Online share in sales growth (%)	0	7	10	25	43	42	42	40	38	45	39
Sales store based (m)	12,937	13,447	13,903	14,245	14,512	14,794	15,082	15,394	15,722	16,027	16,375
Growth store based sales (%)	4.1	3.9	3.4	2.5	1.9	1.9	1.9	2.1	2.1	1.9	2.2
Stores (all sizes)	439	464	489	516	544	573	603	633	663	693	723
Store growth (%)	3	5.7	5.4	5.5	5.4	5.3	5.2	5.0	4.7	4.5	4.3
Square footage (x1,000)	12,261	12,874	13,453	13,992	14,551	15,133	15,739	16,368	17,023	17,704	18,412
Square footage growth (%)	3.3	5.0	4.5	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Avg SQF per store (all sizes, x1,000)	27.93	27.75	27.51	27.12	26.75	26.41	26.10	25.86	25.68	25.55	25.47
Sales per SQF (x1,000)	1.06	1.05	1.04	1.03	1.03	1.02	1.01	1.00	1.00	0.99	0.98
Store-based sales per SQF (x1,000)	1.06	1.04	1.03	1.02	1.00	0.98	0.96	0.94	0.92	0.91	0.89

Source: Company data, ING estimates

Morrison has been a relatively late entrant into online sales, but has made two online acquisitions and will soon start piloting 'click-&-collect'.

Fig 40 Top four: modelling the online impact (£)

	2010	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
Sales ex fuel (m)	83,612	87,396	90,509	93,690	96,815	99,868	102,983	106,196	109,511	112,931	116,460
Sales growth (%)	2.7	4.5	3.6	3.5	3.3	3.2	3.1	3.1	3.1	3.1	3.1
Internet grocery sales (m)	3,788	4,585	5,394	6,222	7,249	8,270	9,249	10,296	11,429	12,694	14,038
Growth internet sales (%)	25	21	18	15	17	14	12	11	11	11	11
Internet sales penetration (%)	4.5	5.2	6.0	6.6	7.5	8.3	9.0	9.7	10.4	11.2	12.1
Online share in sales growth (%)		21	26	26	33	33	31	33	34	37	38
Sales store based (m)	79,824	82,811	85,115	87,468	89,565	91,598	93,734	95,900	98,083	100,237	102,422
Growth store based sales (%)	2.0	3.7	2.8	2.8	2.4	2.3	2.3	2.3	2.3	2.2	2.2
Stores (all sizes)	4,474	5,000	5,380	5,762	6,145	6,529	6,914	7,299	7,684	8,069	8,454
Store growth (%)	7	12	8	7	7	6	6	6	5	5	5
Square footage (x1,000)	85,876	91,995	97,224	102,266	107,132	111,767	116,478	121,389	126,507	131,842	137,403
Square footage growth (%)	5.9	7.1	5.7	5.2	4.8	4.3	4.2	4.2	4.2	4.2	4.2
Avg SQF per store (all sizes, x1,000)	19.19	18.40	18.07	17.75	17.43	17.12	16.85	16.63	16.46	16.34	16.25
Sales per SQF (x1,000)	0.97	0.95	0.93	0.92	0.90	0.89	0.88	0.87	0.87	0.86	0.85
Store-based sales per SQF (x1,000)	0.93	0.90	0.88	0.86	0.84	0.82	0.80	0.79	0.78	0.76	0.75
Market share (%)	77.0	77.3	77.4	77.4	77.5	77.5	77.5	77.6	77.6	77.6	77.6

Source: Company data, ING estimates

In the above models, we take last year's reported data as a basis to extrapolate certain growth rates for store-based and online sales, and square footage growth. We use somewhat different growth rates for the various metrics for the selected top four UK food retailers. Given that some retailers are now catching up with e-commerce, we use somewhat different growth rates for online sales in the short term (see company models in Figures 36 to 40).

In our base-case scenario, we see a 20% fall in sales per SQF

In our base-case scenario, we estimate a 20% drop in sales per square foot for the sector over the next ten years. If we extrapolate over twenty years, we find that without any material change in, for example square footage growth, sales per square foot could decline by 38%. Outcomes like these imply a material negative impact on both company operating profits as well as property valuations.

The assumptions in our models could be (materially) different per company. Figure 41 provides a sensitivity analysis for different scenarios for the big four combined.

Fig 41 Sensitivity in big four sales per SQF vs base scenario, ten-year period (%)

Change in store-based sales grth	1% lower space grth	Base scenario	1% more space grth
1% lower sales growth	-20	-27	-31
0.5% lower store sales growth	-16	-24	-29
Basis scenario	-12	-20	-27
0.5% higher store sales growth	-9	-16	-23
1% higher store sales growth	-7	-12	-20

Source: ING estimates

Fig 42 Sensitivity in big four sales per SQF vs base scenario, 20-year period (%)

Change in store-based sales grth	1% lower space grth	Base scenario	1% more space grth
1% lower sales growth	-38	-49	-54
Basis scenario	-25	-38	-49
1% higher store sales growth	-15	-24	-38

Source: ING estimates

In a scenario that differs from our base scenario (with 1% higher or lower online sales growth), sales per SQF still fall at a similar rate. The problem for lower sales per SQF not only relates to the emergence of online sales, but also to aggressive store-opening/enlargement programmes by the main operators.

Lower space productivity necessitates new approach

A likely result of expected e-commerce trends is that, at some point, food retailers will stop adding more space, but start downsizing in order to protect space productivity.

With that in mind, retailers should consider:

- Finding the appropriate balance between store ownership and store leases. For UK retailers, this implies substantially reducing property ownership exposure. Retailers have to sell significantly more assets than current disposal programmes.
- Do not use 20-30-year financial leasing contracts.
- Where appropriate, renegotiate store rents.
- More flexible lease contracts, eg, option to downsize stores.
- Opt for more sales-based leases instead of indexed leases.
- The classical capital recycling model needs adaptation. We believe that not all of the property proceeds are purely reinvested in new SQF, but increasingly in technology (websites, mobile apps) and online-related assets (eg, warehouses, order picking).

The value of retailers' property assets is at stake

Most retailers in our universe own considerable amounts of property

Most retailers in our universe own considerable amounts of property, either pockets of single-store locations and/or (parts of) entire shopping malls in which their store brands are important anchors. Coincidently, in those countries where food retail e-commerce is developing at the fastest pace (the UK and France), food retailers own relatively significant amounts of property. The relevance of property ownership is shown in Figure 43.

Fig 43 Impact of assumed lower property values on valuations – basis assumptions

	Price (lc)	Market cap (bn)	EV	Market value property (bn)	as % of mkt cap	as a % of EV	Property valued at 75% of current MV (bn)	Mkt cap adj for lower property value (bn)	%ch in mkt cap
Ahold (AH NA) (€)	8.98	10.0	9.9	4.5	45	45	3.4	8.8	-11
Carrefour (CA FP) (€)	17.92	11.8	21.4	15.0	127	70	11.3	8.1	-32
Casino (CO FP) (€)	59.49	6.5	14.0	5.4	83	39	4.1	5.2	-21
Colruyt (COLR BB) (€)	31.49	4.9	4.7	2.8	56	59	2.1	4.3	-14
Delhaize (DELB BB) (€)	46.06	4.6	7.2	3.4	74	48	2.6	3.8	-18
Metro (MEO GR) (€)	32.64	10.7	17.8	11.0	103	62	8.3	7.9	-26
Morrison (MRW LN) (£)	298.20	7.7	8.9	7.6	99	85	5.7	5.8	-25
Sainsbury (SBRY LN) (£)	293.60	5.5	7.7	10.5	192	137	7.9	2.8	-48
Tesco (TSCO LN) (£)	406.00	32.6	40.5	36.0	111	89	27.0	23.6	-28
DIA (DIA MS) (€)	3.15	2.1	2.7	0.5	23	18	0.4	2.0	-6
Jeronimo Martins (JMAR PL) (€)	11.39	7.2	7.8	2.5	35	32	1.9	6.5	-9
Marks & Spencer (MKS LN) (£)	325.30	5.1	10.7	4.5	88	42	3.4	4.0	-22
H&M (HMB SS) (SEK)	201.6	333.7	310.1	0.6	0	0	0.5	333.5	0
Inditex (ITX SM) (€)	62.89	39.2	36.5	1.5	4	4	1.1	38.8	-1

Priced as at 6 October 2011

Source: Company data, ING estimates

The market value of property for the companies in Figure 43 is based on available information from the respective companies and our own calculations. In the case of Carrefour, we use a lower value than the real estate gross asset value of €17.2bn, which the company released in early 2011.

At Sainsbury, the market value of its property is higher than the group's EV, implying a negative value for the operations. The magnitude of Sainsbury's property assets has repeatedly led to takeover speculation in the past with Qatar Investment Authority owning 26%.

Assume current property values fall 25% due to expected lower returns in future

In Figure 43, we assume that the value of retailers' property holdings in our coverage universe is 25% lower due to expected lower returns in the future. Lower returns are the result of:

- Lower future rental income as rental rates decline to make up for lower floor space productivity; and/or
- Lower future book gains, if any, given less demand for assets or even over-capacity.

Clearly, our assumed 25% fall is subject to debate:

- Some of the space that becomes available can be leased to other operators. Nevertheless, other operators of retail space will also feel the pressure from fast-growing online pure-play and multi-channel operators. Also bear in mind that food retailers often pay higher prices for floor space than general retailers for grocery-specific locations. The potential re-renting of floor space at lower rents should also impact current valuations.
- Food retailers at some point will stop adding new SQF, thereby limiting the impact on floor productivity. However, online sales will continue to take market share away from stores, thus pressure on floor space productivity should remain.

- Why do we assume 25%? Why not 10% or a much higher percentage? We take the UK market as a proxy and find that with not-overly-aggressive assumptions, sales per SQF could easily fall by 20% in the next ten years. In a country such as France, where all operators are massively rolling out pick-up formulas and adding substantial new square metres each year, the situation could be very similar. On a 20-year basis UK floor productivity could easily fall further towards levels ranging from 25% to 50% compared with current levels. As such, we believe 25% is a relevant assumption.

Sensitivity analysis: UK food retailers' exposure to property

Fig 44 Sensitivity analysis of market cap to property valuations

	MV property (£bn)	Scenario 1: -10% Impact on mkt cap	Scenario 2: -15% Impact on mkt cap	Scenario 3: -20% Impact on mkt cap	Scenario 4: -25% Impact on mkt cap
Morrison	7.6	-10	-15	-20	-25
Sainsbury	10.5	-19	-29	-38	-48
Tesco	36.0	-11	-17	-22	-28
M&S	4.5	-9	-13	-18	-22

Source: ING estimates

Sainsbury is most exposed to a potential fall in property values

A 25% fall in property values would impact Sainsbury's market cap by c.50%

Figure 44 shows that a 25% fall in property values would impact Sainsbury's market cap by c.50%. While our findings are unlikely to impact share prices overnight, investors with a longer-term view should take note. Apart from Sainsbury, Carrefour and Tesco also have above-average property exposure. Indeed, the situation is even more complicated at Carrefour and Tesco as these often operate stores in shopping malls in which they own (part of) the shares. At Tesco, this is especially the case in its growth markets, while Carrefour also (partly) owns many shopping centres in France.

While it was often considered to be a disadvantage in the past, groups such as Ahold and Delhaize have much less exposure to property, making these more flexible to operate over the next 10-20 years. Groups like these could even benefit more than others from the introduction of lease accounting. We do not expect lease accounting to be introduced before 2013, but it is likely to materially impact retailers' P&L and balance sheets, although cash generation should not change. By limiting P&L and balance-sheet impacts, store lease contracts should become more flexible with shorter fixed-leased periods.

Assuming current market values for property are much lower does not materially change the picture

Figure 45 looks similar to Figure 44. However, we assume that the current market values property at a much lower level (25%) than we assume in Figure 44, thus leading to property accounting for a lower percentage of a group's market cap or EV. We still assume that property values decline over time for reasons that we discussed earlier, and use the same 25% assumption. The result is a lower potential impact on a respective group's market cap or EV, but negative impacts for those groups with above-average exposure would still be significant.

Fig 45 Impact of assumed lower property values on valuations – adjusted for current MV assumptions

	Price (lc)	Mkt cap (bn)	EV (bn)	25% lowered curr MV property (bn)	as % of mkt cap	as % of EV	Property valued at 75% of current MV (bn)	Mkt cap adj for lower property value (bn)	%ch in mkt cap
Ahold (AH NA) (€)	8.98	10.0	9.9	3.4	34	34	2.5	9.1	-8
Carrefour (CA FP) (€)	17.92	11.8	21.4	11.3	95	53	8.4	9.0	-24
Casino (CO FP) (€)	59.49	6.5	14.0	4.1	62	29	3.0	5.5	-15
Colruyt (COLR BB) (€)	31.49	4.9	4.7	2.1	42	44	1.5	4.4	-10
Delhaize (DELB BB) (€)	46.06	4.6	7.2	2.6	55	36	1.9	4.0	-14
Metro (MEO GR) (€)	32.64	10.7	17.8	8.3	77	46	6.2	8.6	-19
Morrison (MRW LN) (£)	298.20	7.7	8.9	5.7	74	64	4.3	6.3	-19
Sainsbury (SBRY LN) (£)	293.60	5.5	7.7	7.9	144	103	5.9	3.5	-36
Tesco (TSCO LN) (£)	406.00	32.6	40.5	27.0	83	67	20.3	25.8	-21
DIA (DIA MS) (€)	3.15	2.1	2.7	0.4	18	14	0.3	2.0	-4
Jeronimo Martins (JMAR PL) (€)	11.39	7.2	7.8	1.9	26	24	1.4	6.7	-7
Marks & Spencer (MKS LN) (£)	325.30	5.1	10.7	3.4	66	32	2.5	4.3	-16
H&M (HMB SS) (SEK)	201.60	333.7	310.1	0.5	0	0	0.3	333.6	0
Inditex (ITX SM) (€)	62.89	39.2	36.5	1.1	3	3	0.8	38.9	-1

Priced as at 6 October 2011

Source: Company data, ING estimates

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Companies

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Ahold

Online focus can help achieve faster growth

Hold (maintained)

Price (06/10/11)
€8.98

Target price (12-mth)
€9.40 (previously €9.00)

Forecast total return
8.6%

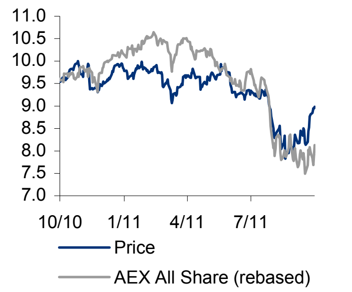
Retail
Netherlands
Bloomberg: AH NA
Reuters: AHLN.AS

Share data

Avg daily volume (3-mth)	4,713,876
Free float (%)	100.0
Market cap (€m)	10,210.3
Net debt (1F, €m)	893
Enterprise value (1F, €m)	9,894
Dividend yield (1F, %)	3.9

Source: Company data, ING estimates

Share price performance



Source: ING

Ahold has strong and defendable positions in the US and Holland, however, growth rates have declined in recent years due to a lack of growth initiatives, in particular store openings in the US, but also in the areas of new store formats, financial services and e-commerce. We expect Ahold to increase focus on its leading online food positions in both the Netherlands and the US by quickly rolling out 'click-&-collect' and other new services.

Ahold leads online food sales in the Netherlands with its slightly loss-making albert.nl business, while it is also leads in the US with its slightly profitable Peapod operation. In the Netherlands, we believe subsidiary Albert Heijn is close to announcing the roll-out of 'click-&-collect' pilots. Given Albert Heijn's strong brand, expertise in private label and superior logistics, this should represent a new driver for group growth, which has slowed in recent years. Lessons learned in the Netherlands should quickly be rolled-out to the US. Currently, Ahold's online-related sales add little incremental growth.

All eyes on 21 November. Ahold will report 3Q11 results on 17 November. In view of the adverse weather conditions on both sides of the Atlantic and comments from CEO Boer that trends so far have been similar in 3Q compared with 2Q, we do not expect 3Q results to act as a catalyst for share price performance. On 21 November, Ahold will update the market on its strategy. With the hiring of James McCann (who started in September) as Chief Commercial & Development Officer, we believe Ahold is sending out a message that it wants to grow faster, especially in e-commerce, financial services, non-food and format development. In our view, there is a lot of low hanging fruit that McCann can harvest, however, the question remains how fast and at what costs? The latter because Ahold will have to hire a lot of talent, while at the moment the P&L does not bear a lot of development and growth costs. For further balance sheet restructuring announcements (eg, gross cash reduction, US pension schemes, JMR, ICA, financial leases, preference shares, Schuitema preference shares), it may be too early to determine how the company will move forward as the new CFO only takes up his role on 12 November. Lastly, we believe Ahold needs more emerging market exposure; currently just 6% of group sales.

HOLD maintained. Given limited upside to our slightly raised DCF-based target price of €9.4 (from €9.0), we maintain our HOLD rating. The increase reflects 0.6% and 4% EPS increases in 2011/12F, respectively, on the back of stronger USD assumptions (2012F: 1.32 vs 1.40) and fewer shares outstanding due to share repurchases at lower prices.

Forecasts and ratios

Year end Dec (€m)	2009	2010	2011F	2012F	2013F
Revenues	27,925	29,530	30,180	31,996	32,860
Normalised EBITDA	2,079	2,173	2,118	2,227	2,277
Normalised net profit	971	863	957	1,023	1,064
Normalised EPS (€)	0.82	0.74	0.86	0.97	1.01
Normalised PER (x)	10.9	12.2	10.4	9.3	8.9
EV/normalised EBITDA (x)	4.6	4.5	4.7	4.3	4.0
FCF yield (%)	11.9	13.0	10.7	11.2	12.2
Dividend yield (%)	2.6	3.2	3.9	4.2	4.5
Price/book (x)	1.9	1.7	1.7	1.5	1.4
Normalised ROE (%)	17.5	14.0	15.1	15.8	15.1

Source: Company data, ING estimates

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Financials

Year end Dec (€m)	2006	2007	2008	2009	2010	2011F	2012F	2013F
Income statement								
Revenues	27,826	28,152	25,648	27,925	29,530	30,180	31,996	32,860
Cost of goods sold	(19,420)	(19,896)	(17,888)	(19,376)	(20,517)	(21,760)	(23,069)	(23,692)
Gross profit	**8,406**	**8,256**	**7,760**	**8,549**	**9,013**	**8,420**	**8,927**	**9,168**
Operating costs	(6,592)	(6,392)	(5,900)	(6,520)	(6,892)	(6,314)	(6,719)	(6,910)
EBITDA	**1,814**	**1,864**	**1,860**	**2,029**	**2,121**	**2,106**	**2,208**	**2,258**
Depreciation & amortisation	(754)	(730)	(662)	(732)	(785)	(763)	(790)	(801)
EBIT	**1,060**	**1,134**	**1,198**	**1,297**	**1,336**	**1,343**	**1,417**	**1,457**
Net interest	(479)	(308)	(214)	(284)	(259)	(227)	(218)	(208)
Associates	152	138	109	106	57	118	129	134
Pre-tax profit	**733**	**964**	**1,093**	**1,119**	**1,134**	**1,233**	**1,329**	**1,383**
Tax	(39)	(167)	(225)	(148)	(271)	(277)	(306)	(318)
Minorities	(16)	(14)	(5)	0	0	0	0	0
Other post-tax items	218	2,148	211	(78)	(10)	(14)	0	0
Net profit	**896**	**2,931**	**1,074**	**893**	**853**	**943**	**1,023**	**1,064**
Normalised EBITDA	**1,810**	**1,856**	**1,874**	**2,079**	**2,173**	**2,118**	**2,227**	**2,277**
Normalised EBIT	**1,056**	**1,126**	**1,212**	**1,347**	**1,388**	**1,355**	**1,436**	**1,476**
Normalised net profit	**803**	**804**	**863**	**971**	**863**	**957**	**1,023**	**1,064**
Balance sheet								
Tangible fixed assets	6,952	6,259	6,334	6,473	6,899	6,990	7,103	7,228
Intangible fixed assets	592	603	598	619	762	732	732	732
Other non-current assets	1,350	1,255	1,364	1,736	1,870	1,824	1,824	1,824
Cash & equivalents	1,725	3,263	2,863	3,089	2,923	2,767	3,061	3,655
Other current assets	7,823	2,564	2,433	2,016	2,271	2,385	2,453	2,523
Total assets	**18,442**	**13,944**	**13,592**	**13,933**	**14,725**	**14,697**	**15,173**	**15,961**
Short-term debt	782	1,342	579	564	216	216	216	216
Other current liabilities	5,259	3,591	3,559	3,461	3,876	3,966	4,051	4,138
Long-term debt	5,380	3,690	3,285	2,745	2,947	2,947	2,947	2,947
Other long-term liabilities	1,254	937	996	1,226	1,279	1,279	1,279	1,279
Total liabilities	**12,675**	**9,560**	**8,419**	**7,996**	**8,318**	**8,408**	**8,493**	**8,580**
Total equity	5,767	4,384	5,173	5,937	6,407	6,290	6,680	7,381
Total liabilities & equity	**18,442**	**13,944**	**13,592**	**13,933**	**14,725**	**14,697**	**15,173**	**15,961**
Capital employed	11,929	9,416	9,037	9,246	9,570	9,453	9,843	10,544
Net working capital	(1,084)	(1,107)	(1,204)	(1,314)	(1,368)	(1,392)	(1,409)	(1,426)
Net debt (cash)	4,934	2,266	1,498	717	737	893	599	5
Cash flow								
Cash flow EBITDA	1,668	1,573	1,542	1,742	1,675	1,720	1,813	1,865
Change in working capital	25	(262)	9	(151)	67	24	17	17
Other non-cash items	(83)	479	339	335	484	386	395	392
Operating cash flow	**1,610**	**1,790**	**1,890**	**1,926**	**2,226**	**2,129**	**2,225**	**2,275**
Cash interest paid	(523)	(445)	(349)	(310)	(287)	(232)	(218)	(208)
Cash taxes paid	114	50	(147)	(34)	(123)	(221)	(245)	(255)
Net cash from operating activities	**1,201**	**1,395**	**1,394**	**1,582**	**1,816**	**1,676**	**1,762**	**1,812**
Capex	(1,099)	(821)	(1,019)	(770)	(870)	(879)	(929)	(951)
Net acquisitions	(132)	5,387	295	(12)	(193)	0	0	0
Other net investing cash flows	441	221	253	(171)	255	125	130	130
Cash from investing activities	**(790)**	**4,787**	**(471)**	**(953)**	**(808)**	**(754)**	**(799)**	**(821)**
Increase (decrease) in equity	0	(4,016)	0	0	(386)	(700)	(300)	0
Increase (decrease) in debt	(788)	(631)	(1,148)	(582)	(473)	(70)	0	0
Dividends & minority distribution	0	0	(188)	(212)	(272)	(318)	(369)	(398)
Other financing cash flow	34	(48)	(32)	(4)	(34)	0	0	0
Cash from financing activities	**(754)**	**(4,695)**	**(1,368)**	**(798)**	**(1,165)**	**(1,088)**	**(669)**	**(398)**
Forex & discontinued operations	0	(52)	0	0	0	0	0	0
Net change in cash & equivalents	**(343)**	**1,435**	**(445)**	**(169)**	**(157)**	**(165)**	**294**	**594**
FCF	852	1,121	812	1,144	1,265	1,055	1,077	1,094

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Dec	2006	2007	2008	2009	2010	2011F	2012F	2013F
Performance & returns								
Revenue growth (%)	-37.5	1.2	-8.9	8.9	5.7	2.2	6.0	2.7
Normalised EBITDA growth (%)	-16.1	2.5	0.96	11.0	4.5	-2.5	5.1	2.2
Normalised EBIT growth (%)	-3.1	6.6	7.7	11.1	3.0	-2.4	6.0	2.7
Normalised EPS growth (%)	5.1	34.5	5.8	11.9	-10.1	16.8	11.9	4.1
Gross margin (%)	30.2	29.3	30.3	30.6	30.5	27.9	27.9	27.9
Normalised EBITDA margin (%)	6.5	6.6	7.3	7.4	7.4	7.0	7.0	6.9
Normalised EBIT margin (%)	3.8	4.0	4.7	4.8	4.7	4.5	4.5	4.5
Reported net margin (%)	3.2	10.4	4.2	3.2	2.9	3.1	3.2	3.2
Reported ROE (%)	16.3	58.6	22.7	16.1	13.8	14.9	15.8	15.1
Normalised ROA (%)	5.5	7.0	8.8	9.8	9.7	9.2	9.6	9.5
ROAIC (%)	8.6	10.1	10.3	12.3	11.4	10.4	10.7	10.5
ROACE (%)	8.7	10.5	13.1	14.7	14.8	14.2	14.9	14.5
ROACE - WACC (%)	-1.0	0.85	3.4	5.0	5.1	4.5	5.2	4.8
Leverage & solvency								
Working capital as % of sales	-3.9	-3.9	-4.7	-4.7	-4.6	-4.6	-4.4	-4.3
Net debt (cash)/EBITDA (x)	2.7	1.2	0.81	0.35	0.35	0.42	0.27	0.00
Net debt (cash)/equity (%)	85.6	51.7	29.0	12.1	11.5	14.2	9.0	0.07
EBITDA net interest coverage (x)	3.8	6.1	8.7	7.1	8.2	9.3	10.1	10.9
Current ratio (x)	1.6	1.2	1.3	1.3	1.3	1.2	1.3	1.4
Dividend cover (cash flow) (x)	n/a	n/a	3.5	4.9	4.6	3.6	3.3	3.2
Valuation								
EV/revenue (x)	0.46	0.39	0.41	0.34	0.33	0.33	0.30	0.27
EV/normalised EBITDA (x)	7.1	5.9	5.6	4.6	4.5	4.7	4.3	4.0
EV/normalised EBIT (x)	12.1	9.7	8.6	7.1	7.0	7.3	6.7	6.1
EV/capital employed (x)	1.1	1.2	1.2	1.0	1.0	1.0	0.98	0.85
EV/invested capital (x)	0.97	1.1	1.0	0.92	0.90	0.92	0.86	0.76
Normalised PER (x)	17.4	12.9	12.2	10.9	12.2	10.4	9.3	8.9
Price/book (x)	2.7	2.8	2.3	1.9	1.7	1.7	1.5	1.4
Dividend yield (%)	0.0	1.8	2.0	2.6	3.2	3.9	4.2	4.5
FCF yield (%)	6.7	10.3	7.8	11.9	13.0	10.7	11.2	12.2
Per share data								
Reported EPS (€)	0.58	2.53	0.91	0.76	0.73	0.85	0.97	1.01
Normalised EPS (€)	0.52	0.69	0.73	0.82	0.74	0.86	0.97	1.01
Dividend per share (€)	0.00	0.16	0.18	0.23	0.29	0.35	0.38	0.40
Equity FCFPS (€)	0.21	0.58	0.39	0.71	0.84	0.74	0.81	0.84
BV/share (€)	3.34	3.25	3.98	4.61	5.16	5.28	5.91	6.58

Source: Company data, ING estimates

Company profile

Ahold is a European and US food retail group with leading market shares in the Netherlands and parts of New England, Pennsylvania and the Washington DC/Baltimore area. In the Netherlands, Albert Heijn generates annual sales of more than €9bn. In the US, Stop & Shop, Giant-Landover and Giant-Carlisle have annual sales of c.US$23bn. Ahold has a small Czech/Slovak operation (€1.7bn sales) and a 60% stake in Scandinavian market leader, ICA. In Portugal, Ahold has a 49% stake in Jeronimo Martins Retail. Ahold's long-term financial goal is 5% organic sales growth and a 5% retail EBIT margin.

Risks

The main downside risks to our recommendation include changes in consumption trends, prolonged periods of deflation or high inflation, competitor behaviour, management decisions, acquisition strategy, operational execution, equity market volatility and adverse currency movements. The main upside risks to our recommendation include improving consumer spending trends and larger-than-anticipated balance-sheet optimisation initiatives such as share buybacks or a 'super' dividend.

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Carrefour

Carrefour Planet, an anti-e-commerce angle

Hold (maintained)

Price (06/10/11)
€17.92

Target price (12-mth)
€19.00 (previously €20.00)

Forecast total return
10.8%

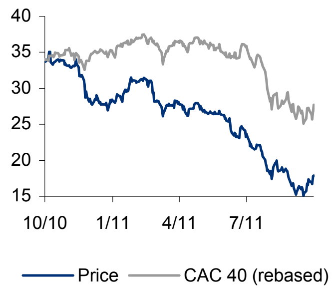
Retail
France
Bloomberg: CA FP
Reuters: CARR.PA

Share data

Avg daily volume (3-mth)	5,620,225
Free float (%)	100.0
Market cap (€m)	12,146.4
Net debt (1F, €m)	7,916
Enterprise value (1F, €m)	21,392
Dividend yield (1F, %)	4.7

Source: Company data, ING estimates

Share price performance



Source: ING

To say that Carrefour has more important things on its mind than increasing its e-commerce focus is not particularly true. This is especially the case in France where consumer adaptation to 'click-&-collect', which is now being rolled out by retailers everywhere, could pose a new threat to Carrefour's French operations. But upgrading hypers just as a growing number of sales are made outside stores is tricky. As a result, we lower our TP from €20 to €19.

Carrefour's e-commerce offering does not lead in France or other markets. Given the apparent success of the Auchan and Leclerc 'click-&-collect' service in France, Carrefour has decided to speed up the roll-out of its own 'click-&-collect' service. By end-2011, click & collect services should be available at 22 hypermarkets and 22 supermarkets. For non-food, in particular electronics, Carrefour has set-up a co-operation agreement with Dixons Retail's online retailer, Pixmania. Nevertheless, Carrefour is rather late in recognising the online non-food trend compared with peer Casino, which is leading with its cdiscount.fr operation. While Carrefour has continued to suffer non-food LFL sales decreases in the mid-single digits in its hypermarkets for some time now, peer Casino has been able to balance these against fast-growing sales at cdiscount.fr.

Carrefour's Planet roll-out is tricky given current online and other trends. After just a handful of successful pilots, we question why is Carrefour converting or remodelling the bulk of its European hypers into a format that could be perceived as more upmarket in an environment with strong trends towards (soft)discounting? Another concern we have is that despite previous plans to downsize its hypermarkets, Carrefour is currently maintaining space, or in some cases enlarging, to add more upgraded categories. With the ongoing surge in online sales set to continue over the next decade, we feel this almost guarantees new problems as space productivity is likely to fall considerably. Short-term sales and profit uplifts may sound fantastic, but we wonder whether these are sustainable in the longer term in a channel that has been out of favour for over a decade?

HOLD rating maintained. Aside from being late into e-commerce and concerns over its hypermarket strategy, Carrefour is also losing market share in almost every country in which it operates. Short- to mid-term visibility is low due to the roll-out of the Planet concept and execution of new initiatives, but also because of a deteriorating macro environment in debt-laden Southern Europe, notably Greece. We lower our DCF/SOTP-based target price to €19 from €20, largely reflecting lower property value assumptions (€14bn vs €15bn) in our SOTP calculations. We also cut our 2013F EPS by 2% to €2.05.

Forecasts and ratios

Year end Dec (€m)	2009	2010	2011F	2012F	2013F
Revenues	87,379	91,512	83,078	83,956	86,266
Normalised EBITDA	4,656	4,906	3,969	4,217	4,373
Normalised net profit	1,152	1,380	935	1,238	1,353
Normalised EPS (€)	1.68	2.04	1.42	1.88	2.05
Normalised PER (x)	10.7	8.8	12.6	9.5	8.7
EV/normalised EBITDA (x)	5.2	4.5	5.4	5.1	4.7
FCF yield (%)	6.1	4.0	5.4	1.7	7.7
Dividend yield (%)	6.0	6.0	4.7	4.7	4.7
Price/book (x)	1.2	1.3	1.6	1.4	1.3
Normalised ROE (%)	11.3	13.9	10.9	15.6	15.6

Source: Company data, ING estimates

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Financials

Year end Dec (€m)	2006	2007	2008	2009	2010	2011F	2012F	2013F
Income statement								
Revenues	78,944	83,296	88,239	87,379	91,512	83,078	83,956	86,266
Cost of goods sold	(61,204)	(64,610)	(68,719)	(68,098)	(71,640)	(65,217)	(65,905)	(67,633)
Gross profit	**17,740**	**18,686**	**19,520**	**19,281**	**19,872**	**17,862**	**18,051**	**18,633**
Operating costs	(12,879)	(13,626)	(14,870)	(15,697)	(16,116)	(14,893)	(14,134)	(14,261)
EBITDA	**4,861**	**5,061**	**4,650**	**3,584**	**3,756**	**2,969**	**3,917**	**4,373**
Depreciation & amortisation	(1,587)	(1,723)	(1,861)	(1,879)	(1,921)	(1,655)	(1,710)	(1,737)
EBIT	**3,274**	**3,338**	**2,789**	**1,705**	**1,835**	**1,313**	**2,206**	**2,636**
Net interest	(480)	(526)	(561)	(610)	(657)	(640)	(640)	(590)
Associates	36	43	52	38	35	40	42	44
Pre-tax profit	**2,830**	**2,855**	**2,280**	**1,133**	**1,213**	**713**	**1,608**	**2,090**
Tax	(810)	(807)	(740)	(638)	(697)	(925)	(517)	(675)
Minorities	(163)	(180)	(266)	(110)	(135)	(49)	(54)	(62)
Other post-tax items	411	431	(5)	(57)	52	679	0	0
Net profit	**2,268**	**2,299**	**1,269**	**328**	**433**	**418**	**1,037**	**1,353**
Normalised EBITDA	**4,845**	**5,013**	**5,168**	**4,656**	**4,906**	**3,969**	**4,217**	**4,373**
Normalised EBIT	**3,258**	**3,290**	**3,307**	**2,777**	**2,985**	**2,313**	**2,506**	**2,636**
Normalised net profit	**1,857**	**1,868**	**1,771**	**1,152**	**1,380**	**935**	**1,238**	**1,353**
Balance sheet								
Tangible fixed assets	14,153	15,187	15,238	15,245	15,553	14,038	14,267	14,457
Intangible fixed assets	11,890	12,847	12,417	12,556	12,930	11,366	11,366	11,366
Other non-current assets	4,144	4,522	4,436	4,486	4,956	5,062	5,172	5,289
Cash & equivalents	3,697	4,164	5,317	5,101	5,082	4,164	3,917	4,884
Other current assets	13,648	15,211	14,880	14,165	15,129	14,257	14,528	14,804
Total assets	**47,532**	**51,931**	**52,288**	**51,553**	**53,650**	**48,886**	**49,250**	**50,800**
Short-term debt	2,474	3,247	2,709	2,018	2,715	2,715	2,715	2,715
Other current liabilities	23,971	25,600	25,958	25,018	25,766	24,231	23,927	24,641
Long-term debt	7,532	8,276	9,506	9,794	10,365	9,365	9,365	9,365
Other long-term liabilities	3,052	3,038	3,193	3,608	4,241	4,044	4,044	4,044
Total liabilities	**37,029**	**40,161**	**41,366**	**40,438**	**43,087**	**40,355**	**40,051**	**40,765**
Total equity	10,503	11,770	10,922	11,115	10,563	8,531	9,199	10,035
Total liabilities & equity	**47,532**	**51,931**	**52,288**	**51,553**	**53,650**	**48,886**	**49,250**	**50,800**
Capital employed	20,509	23,293	23,137	22,927	23,643	20,611	21,279	22,115
Net working capital	(9,492)	(9,555)	(9,867)	(10,155)	(9,705)	(8,859)	(8,256)	(8,665)
Net debt (cash)	6,309	7,359	6,898	6,711	7,998	7,916	8,163	7,196
Cash flow								
Cash flow EBITDA	3,686	3,838	3,486	2,479	2,549	1,443	2,802	3,152
Change in working capital	101	(88)	964	320	(598)	205	(603)	409
Other non-cash items	(318)	163	437	685	786	1,297	108	(44)
Operating cash flow	**3,469**	**3,913**	**4,887**	**3,484**	**2,737**	**2,945**	**2,307**	**3,517**
Net cash from operating activities	**3,469**	**3,913**	**4,887**	**3,484**	**2,737**	**2,945**	**2,307**	**3,517**
Capex	(3,368)	(3,069)	(2,918)	(2,137)	(2,122)	(2,100)	(2,189)	(2,178)
Net acquisitions	751	(805)	(248)	(107)	(130)	(178)	0	0
Other net investing cash flows	584	385	569	(140)	(55)	449	250	250
Cash from investing activities	**(2,033)**	**(3,489)**	**(2,597)**	**(2,384)**	**(2,307)**	**(1,829)**	**(1,939)**	**(1,928)**
Increase (decrease) in equity	6	14	3	7	(926)	(778)	0	0
Increase (decrease) in debt	(799)	1,298	346	(2,304)	1,146	(1,000)	0	0
Dividends & minority distribution	(814)	(828)	(942)	(902)	(864)	(775)	(614)	(622)
Other financing cash flow	122	(439)	(435)	35	300	1,000	0	0
Cash from financing activities	**(1,485)**	**45**	**(1,028)**	**(3,164)**	**(344)**	**(1,553)**	**(614)**	**(622)**
Forex & discontinued operations	14	0	(110)	48	(115)	0	0	0
Net change in cash & equivalents	**(35)**	**469**	**1,152**	**(2,016)**	**(29)**	**(437)**	**(246)**	**967**
FCF	834	1,382	2,723	1,482	869	1,145	368	1,589

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Dec	2006	2007	2008	2009	2010	2011F	2012F	2013F
Performance & returns								
Revenue growth (%)	6.6	5.5	5.9	-0.97	4.7	-9.2	1.1	2.8
Normalised EBITDA growth (%)	5.7	3.5	3.1	-9.9	5.4	-19.1	6.3	3.7
Normalised EBIT growth (%)	3.3	0.98	0.52	-16.0	7.5	-22.5	8.3	5.2
Normalised EPS growth (%)	2.5	1.3	-3.3	-34.9	21.2	-30.3	32.4	9.2
Gross margin (%)	22.5	22.4	22.1	22.1	21.7	21.5	21.5	21.6
Normalised EBITDA margin (%)	6.1	6.0	5.9	5.3	5.4	4.8	5.0	5.1
Normalised EBIT margin (%)	4.1	3.9	3.7	3.2	3.3	2.8	3.0	3.1
Reported net margin (%)	2.9	2.8	1.4	0.38	0.47	0.50	1.2	1.6
Reported ROE (%)	25.4	22.8	12.2	3.2	4.4	4.9	13.1	15.6
Normalised ROA (%)	6.9	6.6	6.3	5.3	5.7	4.5	5.1	5.3
ROAIC (%)	14.1	13.4	10.6	6.5	6.7	5.0	8.8	10.2
ROACE (%)	16.1	15.0	14.2	12.1	12.8	10.5	12.0	12.1
ROACE - WACC (%)	7.0	5.9	5.1	3.0	3.7	1.4	2.9	3.0
Leverage & solvency								
Working capital as % of sales	-12.0	-11.5	-11.2	-11.6	-10.6	-10.7	-9.8	-10.0
Net debt (cash)/EBITDA (x)	1.3	1.5	1.5	1.9	2.1	2.7	2.1	1.6
Net debt (cash)/equity (%)	60.1	62.5	63.2	60.4	75.7	92.8	88.7	71.7
EBITDA net interest coverage (x)	10.1	9.6	8.3	5.9	5.7	4.6	6.1	7.4
Current ratio (x)	0.66	0.67	0.70	0.71	0.71	0.68	0.69	0.72
Dividend cover (cash flow) (x)	2.0	2.7	3.9	2.6	2.0	2.5	1.6	3.6
Valuation								
EV/revenue (x)	0.31	0.30	0.28	0.28	0.24	0.26	0.26	0.24
EV/normalised EBITDA (x)	5.0	4.9	4.8	5.2	4.5	5.4	5.1	4.7
EV/normalised EBIT (x)	7.5	7.5	7.4	8.8	7.3	9.2	8.6	7.9
EV/capital employed (x)	1.2	1.1	1.1	1.1	0.93	1.0	1.0	0.94
EV/invested capital (x)	1.0	0.93	0.93	0.92	0.79	0.87	0.85	0.79
Normalised PER (x)	6.8	6.7	6.9	10.7	8.8	12.6	9.5	8.7
Price/book (x)	1.3	1.2	1.2	1.2	1.3	1.6	1.4	1.3
Dividend yield (%)	5.7	6.0	6.0	6.0	6.0	4.7	4.7	4.7
FCF yield (%)	3.4	5.6	11.1	6.1	4.0	5.4	1.7	7.7
Per share data								
Reported EPS (€)	3.22	3.28	1.85	0.48	0.64	0.63	1.57	2.05
Normalised EPS (€)	2.64	2.67	2.58	1.68	2.04	1.42	1.88	2.05
Dividend per share (€)	1.03	1.08	1.08	1.08	1.08	0.85	0.85	0.85
Equity FCFPS (€)	1.18	1.97	3.97	2.16	1.28	1.74	0.56	2.41
BV/share (€)	13.46	15.23	14.76	15.04	14.25	11.52	12.54	13.77

Source: Company data, ING estimates

Company profile

Carrefour is the world's second largest food retailer with 2011F net sales of €82bn and over 3,500 directly managed stores and 9,500 stores including franchises. Active in over 20 countries, the Group has leading positions in Europe (No.1 in France and No.2 in Spain), S America (No.1 in Argentina and No.2 in Brazil and Colombia) and significant positions in Asia (China and Taiwan). Blue Capital (Colony Capital and Groupe Arnault) is the main shareholder with a 14.1% stake and 20.2% voting rights.

Risks

The main downside risks to our HOLD recommendation include: changes in consumption trends, prolonged periods of food deflation or high food inflation, competitor behaviour, management decisions, operational execution, equity market volatility and adverse currency movements. The main upside risks to our recommendation include much better-than-expected sales and margin trends at converted Carrefour Planet hypermarkets over the next two years.

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Casino

Ahead of the curve

Buy (maintained)

Price (06/10/11)
€59.49

Target price (12-mth)
€85.00 (maintained)

Forecast total return
48.1%

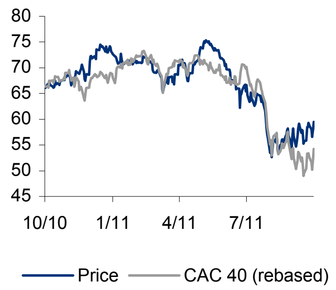
Retail
France
Bloomberg: CO FP
Reuters: CASP.PA

Share data

Avg daily volume (3-mth)	324,410
Free float (%)	49.6
Market cap (€m)	6,543.9
Net debt (1F, €m)	4,990
Enterprise value (1F, €m)	13,867
Dividend yield (1F, %)	5.2

Source: Company data, ING estimates

Share price performance



Source: ING

Some investors believe that Casino's group structure, with fully- and partly-owned assets of which several are also quoted, limits synergy potential. In our view, this is old school thinking. Actually, we believe Casino has a sixth sense for consumer and property trends. The company focuses on those regions or channels with better growth trends. Casino is one of the international retailers with the most emerging markets exposure, and in France, its focus is on convenience/discount formats and e-commerce.

Casino does realise synergies within its portfolio of assets in areas such as buying, private brands and property. Furthermore, its Colombian subsidiary recently acquired Casino's operations in Uruguay to generate synergies in the Latam region.

A sixth sense for trends. Casino has been saying for years that hypermarkets are ex-growth, and the company has focused on cost control and property redevelopment. Some 45% of group sales are derived from emerging markets, and Casino has leading positions in Brazil, Colombia, Thailand and Vietnam. In terms of EBIT contribution, these growth markets account for c.55%. In France, the business environment is very tough, and the group focuses on convenience and proximity formats, and e-commerce through www.cdiscount.fr. The latter more than recovers negative non-food sales trends in hypermarkets. Cdiscount.fr accounts for 25% of 2012F incremental French revenue growth and 7% of French sales.

Casino has for years invested in its online non-food operation, cdiscount.fr, which is now one of the leading internet sellers in France with annual sales well in excess of €1bn. Cdiscount does not focus on food so, with the success of Auchan in mind, Casino is rolling out 'click-&-collect', although the group is not yet convinced of the business model. In Brazil, associate GPA sells electronics online through a variety of brand names.

A top pick (BUY) with a DCF-derived target price of €85. We like Casino's strategy of focusing on a selection of high-growth potential markets such as Brazil, Colombia and Thailand, while at the same time addressing issues in its home turf (France) by focusing on convenience and discount banners, online sales and limiting capex to its hypermarkets, which now account for c.17% of group sales (30% in 2005). In 2011-14F profit growth should be driven by emerging markets. In our view, recent weakness in the share price following the recent market turmoil offers an excellent entry point for investors. The shares also offer a 5%+ dividend yield.

Forecasts and ratios

Year end Dec (€m)	2009	2010	2011F	2012F	2013F
Revenues	26,757	29,078	34,511	37,523	40,094
Normalised EBITDA	1,969	1,997	2,339	2,624	2,863
Normalised net profit	516	514	596	690	790
Normalised EPS (€)	4.69	4.66	5.41	6.25	7.16
Normalised PER (x)	12.7	12.8	11.0	9.5	8.3
EV/normalised EBITDA (x)	7.3	6.6	5.9	5.2	4.7
FCF yield (%)	7.1	4.5	1.6	2.6	2.9
Dividend yield (%)	4.5	4.7	5.2	6.6	7.5
Price/book (x)	1.0	0.93	1.0	0.95	0.90
Normalised ROE (%)	8.4	7.6	8.8	10.3	11.2

Source: Company data, ING estimates

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Financials

Year end Dec (€m)	2006	2007	2008	2009	2010	2011F	2012F	2013F
Income statement								
Revenues	22,761	25,258	28,704	26,757	29,078	34,511	37,523	40,094
Cost of goods sold	(16,759)	(18,440)	(21,502)	(19,836)	(21,753)	(25,780)	(27,992)	(29,870)
Gross profit	**6,002**	**6,818**	**7,202**	**6,921**	**7,325**	**8,731**	**9,531**	**10,224**
Operating costs	(4,386)	(4,773)	(5,270)	(4,989)	(5,313)	(6,517)	(6,907)	(7,361)
EBITDA	**1,616**	**2,045**	**1,932**	**1,932**	**2,012**	**2,214**	**2,624**	**2,863**
Depreciation & amortisation	(607)	(710)	(723)	(760)	(697)	(781)	(846)	(887)
EBIT	**1,009**	**1,335**	**1,209**	**1,172**	**1,315**	**1,434**	**1,777**	**1,975**
Net interest	(183)	(293)	(395)	(345)	(362)	(495)	(530)	(550)
Associates	7	17	13	6	13	0	6	6
Other pre-tax items	0	0	0	0	9	0	0	0
Pre-tax profit	**833**	**1,059**	**827**	**833**	**975**	**939**	**1,253**	**1,431**
Tax	(284)	(293)	(214)	(201)	(214)	(272)	(387)	(442)
Minorities	(126)	(107)	(103)	(269)	(202)	(142)	(162)	(185)
Other post-tax items	143	123	(40)	210	(24)	(15)	(15)	(15)
Net profit	**566**	**782**	**470**	**573**	**535**	**509**	**690**	**790**
Normalised EBITDA	**1,672**	**1,906**	**2,006**	**1,969**	**1,997**	**2,339**	**2,624**	**2,863**
Normalised EBIT	**1,065**	**1,196**	**1,283**	**1,209**	**1,300**	**1,559**	**1,777**	**1,975**
Normalised net profit	**442**	**479**	**513**	**516**	**514**	**596**	**690**	**790**
Balance sheet								
Tangible fixed assets	5,285	6,003	6,034	5,914	6,321	6,640	6,949	7,275
Intangible fixed assets	5,838	6,709	6,871	7,096	7,804	7,804	7,804	7,804
Other non-current assets	1,464	1,711	1,815	1,938	2,257	2,257	2,257	2,257
Cash & equivalents	2,165	2,697	2,025	2,832	2,925	2,313	2,607	2,907
Other current assets	5,016	5,334	5,601	5,378	6,480	6,765	7,062	7,374
Total assets	**19,768**	**22,454**	**22,346**	**23,158**	**25,787**	**25,779**	**26,680**	**27,617**
Short-term debt	2,014	2,499	1,943	1,369	1,754	1,754	1,754	1,754
Other current liabilities	6,556	7,407	7,495	7,408	8,435	8,841	9,292	9,751
Long-term debt	4,620	4,662	5,050	5,710	5,549	5,549	5,549	5,549
Other long-term liabilities	606	762	821	755	987	987	987	987
Total liabilities	**13,796**	**15,330**	**15,309**	**15,242**	**16,725**	**17,131**	**17,582**	**18,041**
Total equity	5,972	7,124	7,037	7,916	9,064	8,649	9,098	9,576
Total liabilities & equity	**19,768**	**22,454**	**22,346**	**23,158**	**25,789**	**25,779**	**26,680**	**27,617**
Capital employed	12,606	14,285	14,030	14,995	16,367	15,952	16,401	16,879
Net working capital	(1,693)	(1,730)	(1,658)	(1,761)	(1,616)	(1,736)	(1,863)	(1,998)
Net debt (cash)	4,469	4,464	4,968	4,247	4,378	4,990	4,696	4,396
Cash flow								
Cash flow EBITDA	1,110	1,389	1,336	1,392	1,458	1,447	1,713	1,877
Change in working capital	128	183	181	321	54	147	180	174
Operating cash flow	**1,238**	**1,572**	**1,517**	**1,713**	**1,512**	**1,594**	**1,893**	**2,051**
Cash interest paid	236	283	352	342	331	495	530	550
Cash taxes paid	(289)	(256)	(274)	(163)	(262)	(272)	(387)	(442)
Net cash from operating activities	**1,185**	**1,599**	**1,595**	**1,892**	**1,581**	**1,817**	**2,037**	**2,159**
Capex	(961)	(1,065)	(1,214)	(802)	(937)	(1,100)	(1,155)	(1,213)
Net acquisitions	958	(410)	(418)	(468)	21	(411)	400	450
Other net investing cash flows	102	732	151	196	199	0	0	0
Cash from investing activities	**99**	**(743)**	**(1,481)**	**(1,074)**	**(717)**	**(1,511)**	**(755)**	**(763)**
Increase (decrease) in equity	94	240	86	148	20	15	15	15
Increase (decrease) in debt	(1,085)	(336)	(304)	105	(404)	(495)	(530)	(550)
Dividends & minority distribution	(319)	(327)	(379)	(360)	(423)	(438)	(473)	(561)
Cash from financing activities	**(1,310)**	**(423)**	**(597)**	**(107)**	**(807)**	**(918)**	**(988)**	**(1,096)**
Forex & discontinued operations	(6)	(16)	(41)	112	76	0	0	0
Net change in cash & equivalents	**(32)**	**417**	**(524)**	**823**	**133**	**(612)**	**294**	**300**
FCF	209	1,052	236	1,010	591	222	352	396

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Dec	2006	2007	2008	2009	2010	2011F	2012F	2013F
Performance & returns								
Revenue growth (%)	10.3	11.0	13.6	-6.8	8.7	18.7	8.7	6.9
Normalised EBITDA growth (%)	9.6	14.0	5.2	-1.8	1.4	17.1	12.2	9.1
Normalised EBIT growth (%)	8.6	12.3	7.3	-5.8	7.5	19.9	14.0	11.1
Normalised EPS growth (%)	53.1	8.1	7.3	1.8	-0.56	16.0	15.6	14.5
Gross margin (%)	26.4	27.0	25.1	25.9	25.2	25.3	25.4	25.5
Normalised EBITDA margin (%)	7.3	7.5	7.0	7.4	6.9	6.8	7.0	7.1
Normalised EBIT margin (%)	4.7	4.7	4.5	4.5	4.5	4.5	4.7	4.9
Reported net margin (%)	2.5	3.1	1.6	2.1	1.8	1.5	1.8	2.0
Reported ROE (%)	10.7	13.6	7.8	9.3	8.0	7.5	10.3	11.2
Normalised ROA (%)	5.3	5.7	5.7	5.3	5.3	6.0	6.8	7.3
ROAIC (%)	5.3	7.6	6.3	6.6	6.4	6.8	8.1	8.7
ROACE (%)	8.2	8.9	9.1	8.3	8.3	9.6	11.0	11.9
ROACE - WACC (%)	0.09	0.30	0.46	-0.27	-0.31	1.0	2.4	3.3
Leverage & solvency								
Working capital as % of sales	-7.4	-6.8	-5.8	-6.6	-5.6	-5.0	-5.0	-5.0
Net debt (cash)/EBITDA (x)	2.8	2.2	2.6	2.2	2.2	2.3	1.8	1.5
Net debt (cash)/equity (%)	74.8	62.7	70.6	53.7	48.3	57.7	51.6	45.9
EBITDA net interest coverage (x)	8.8	7.0	4.9	5.6	5.6	4.5	5.0	5.2
Current ratio (x)	0.84	0.81	0.81	0.94	0.92	0.86	0.88	0.89
Dividend cover (cash flow) (x)	2.6	5.7	2.8	5.3	3.9	3.2	3.4	3.1
Valuation								
EV/revenue (x)	0.57	0.53	0.49	0.53	0.46	0.40	0.36	0.34
EV/normalised EBITDA (x)	7.8	7.0	7.0	7.3	6.6	5.9	5.2	4.7
EV/normalised EBIT (x)	12.2	11.2	11.0	11.8	10.2	8.9	7.7	6.8
EV/capital employed (x)	1.0	0.94	1.0	0.95	0.81	0.87	0.83	0.80
EV/invested capital (x)	0.99	0.89	0.95	0.91	0.76	0.82	0.79	0.75
Normalised PER (x)	15.0	13.9	12.9	12.7	12.8	11.0	9.5	8.3
Price/book (x)	1.2	1.1	1.1	1.0	0.93	1.0	0.95	0.90
Dividend yield (%)	3.6	3.9	4.3	4.5	4.7	5.2	6.6	7.5
FCF yield (%)	1.6	7.8	1.7	7.1	4.5	1.6	2.6	2.9
Per share data								
Reported EPS (€)	5.08	7.00	4.22	5.20	4.85	4.62	6.25	7.16
Normalised EPS (€)	3.97	4.29	4.60	4.69	4.66	5.41	6.25	7.16
Dividend per share (€)	2.15	2.30	2.53	2.65	2.78	3.10	3.90	4.45
Equity FCFPS (€)	3.99	11.96	5.28	12.27	8.36	6.50	7.99	8.58
BV/share (€)	48.53	54.83	52.92	57.99	64.07	59.40	62.52	65.86

Source: Company data, ING estimates

Company profile

Casino is France's fifth-ranked food retailer (behind Carrefour, Leclerc, Intermarché and Auchan), with 2009 sales (ex sales tax) of €26.8bn and over 10,000 stores. The group is also active abroad, where it generated net sales of €9.1bn in 2009. It has leading positions in Thailand (63% stake), Vietnam (fully owned), Brazil (33.7% stake) and Colombia (54.8% stake). In 2009, France accounted for 66.5% of Group sales. In France, Casino's portfolio consists of Geant hypers (122), Casino supermarkets (390) Leader Price (560), Monoprix (463), Franprix (790) and Petit Casino convenience (1,800+).

Risks

The main downside risks to our BUY recommendation include: changes in consumption trends, prolonged periods of high inflation, interest rate hikes, competitor behaviour, operational execution, equity market volatility, political instability and adverse currency movements.

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Colruyt

'Click-&-collect' should help drive market share

Colruyt, the Belgian food retail market leader, is also leading in e-commerce, in particular in food. Colruyt focuses both on consumers through its Collect & Go (food) and Collishop (non-food) initiatives. In B2B, the company operates the Collivery service. Colruyt's e-commerce activities help drive group growth. However, we believe the Group still has the means to shift up a gear. Short-term share performance is impacted by the current low-growth environment.

Hold (maintained)

Price (06/10/11)
€31.49

Target price (12-mth)
€33.50 (maintained)

Forecast total return
9.4%

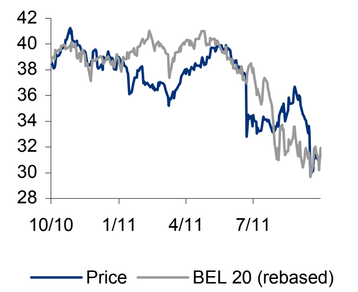
Retail
Belgium
Bloomberg: COLR BB
Reuters: COLR.BR

Share data

Avg daily volume (3-mth)	245,598
Free float (%)	43.0
Market cap (€m)	4,974.2
Net debt (1F, €m)	(290)
Enterprise value (1F, €m)	4,698
Dividend yield (1F, %)	3.1

Source: Company data, ING estimates

Share price performance



Source: ING

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Colruyt is Belgium's leading online food seller with several e-commerce initiatives aimed at consumers and businesses. In just over half of its Colruyt banner stores, the company operates a 'click-&-collect' service called Collect & Go. Orders can be made via computer (www.collectandgo.be) or recently introduced iPhone and Android apps. These apps even allow consumers to scan products at home, which are automatically added to shopping lists. Aside from Colruyt, the only other major Belgian group active in 'click-&-collect' is Delhaize with c.10% of its stores currently offering the service. Carrefour is only just starting to put the service on the map in France. We feel Aldi and Lidl pose no threat.

The lack of 'click-&-collect' competition has its pros and cons. On the one hand, it should help Colruyt to gradually gain further market share, but on the other, there is no strong incentive for the group to drive much faster growth as this would start putting pressure on its store-based sales per square metre. A major risk would be a roll-out of standalone locations by Ahold's Albert Heijn, which offers very competitive prices.

In non-food, Collishop competes with Amazon and with Collivery (food), Colruyt reaches businesses. Potentially, this latter business (foodservice) could develop into a new important growth driver. The Belgian foodservice market is still highly fragmented. In the past two years, Colruyt has made two small acquisitions to put a toe in the water.

HOLD with a DCF-based target price of €33.5. We rate Colruyt a HOLD given a demanding valuation in combination with short-term low profit growth prospects. Uncertainty over potential austerity measures from a potential new government is also weighing on the shares. In spite of the economic climate, Colruyt continues to exhibit a set of unparalleled characteristics. These include best-in-class organic sales growth of more than 6% pa, high EBIT margins (above 6%), and high ROIC (c.40% in 2011/12F, pre-tax). We expect EPS growth in the mid-single digits for the next few years. A less positive development that needs some attention from management is the negative trend in ROIC as a result of much higher capex in recent years. Indeed, more online-based growth could limit capex budgets.

Forecasts and ratios

Year end Mar (€m)	2009	2010	2011F	2012F	2013F
Revenues	6,261	6,753	7,280	7,801	8,273
Normalised EBITDA	547	600	621	646	683
Normalised net profit	304	329	338	344	365
Normalised EPS (€)	1.90	2.09	2.14	2.20	2.37
Normalised PER (x)	16.6	15.1	14.7	14.3	13.3
EV/normalised EBITDA (x)	8.5	7.9	7.6	7.3	6.8
FCF yield (%)	4.4	4.1	4.2	5.1	5.4
Dividend yield (%)	2.6	2.9	3.1	3.1	3.4
Price/book (x)	4.6	4.0	3.4	3.1	2.8
Normalised ROE (%)	29.4	28.0	24.8	22.3	21.7

Source: Company data, ING estimates

Financials

Year end Mar (€m)	2006	2007	2008	2009	2010	2011F	2012F	2013F
Income statement								
Revenues	4,776	5,209	5,674	6,261	6,753	7,280	7,801	8,273
Cost of goods sold	(3,651)	(3,910)	(4,298)	(4,714)	(5,054)	(5,448)	(5,861)	(6,210)
Gross profit	**1,124**	**1,298**	**1,376**	**1,547**	**1,699**	**1,833**	**1,940**	**2,063**
Operating costs	(712)	(833)	(872)	(999)	(1,099)	(1,211)	(1,294)	(1,381)
EBITDA	**412**	**466**	**504**	**547**	**600**	**621**	**646**	**683**
Depreciation & amortisation	(80)	(94)	(102)	(117)	(130)	(149)	(162)	(170)
EBIT	**332**	**371**	**402**	**430**	**470**	**472**	**484**	**513**
Net interest	8	12	14	3	6	0.2	3	4
Associates	0.6	0.4	1	(2)	(0.7)	5	5	5
Other pre-tax items	0	0	0	0	0	0	0	0
Pre-tax profit	**341**	**384**	**417**	**431**	**475**	**478**	**492**	**522**
Tax	(110)	(121)	(129)	(127)	(146)	(140)	(148)	(156)
Minorities	(0.1)	(0.1)	0	(0.1)	0.1	0.1	0.1	0.1
Net profit	**230**	**263**	**288**	**304**	**329**	**338**	**344**	**365**
Normalised EBITDA	**412**	**466**	**504**	**547**	**600**	**621**	**646**	**683**
Normalised EBIT	**332**	**371**	**402**	**430**	**470**	**472**	**484**	**513**
Normalised net profit	**230**	**263**	**288**	**304**	**329**	**338**	**344**	**365**
Balance sheet								
Tangible fixed assets	715	814	948	1,066	1,278	1,422	1,568	1,718
Intangible fixed assets	49	47	64	73	84	95	95	95
Other non-current assets	21	23	61	54	98	168	168	168
Cash & equivalents	364	452	353	348	286	313	325	346
Other current assets	568	625	759	821	886	1,020	1,064	1,116
Total assets	**1,716**	**1,961**	**2,185**	**2,362**	**2,632**	**3,017**	**3,219**	**3,442**
Short-term debt	3	2	3	4	7	6	6	6
Other current liabilities	850	935	1,088	1,133	1,234	1,370	1,440	1,513
Long-term debt	13	12	19	19	18	17	17	17
Other long-term liabilities	78	92	104	108	122	135	135	135
Total liabilities	**945**	**1,042**	**1,214**	**1,263**	**1,380**	**1,529**	**1,598**	**1,672**
Total equity	771	919	971	1,099	1,252	1,489	1,621	1,770
Total liabilities & equity	**1,716**	**1,961**	**2,185**	**2,362**	**2,632**	**3,017**	**3,219**	**3,442**
Capital employed	788	934	993	1,122	1,277	1,512	1,644	1,793
Net working capital	(258)	(285)	(298)	(280)	(305)	(294)	(315)	(332)
Net debt (cash)	(347)	(437)	(331)	(326)	(262)	(290)	(302)	(323)
Cash flow								
Cash flow EBITDA	310	357	391	422	459	487	506	535
Change in working capital	55	28	25	(5)	17	(8)	26	22
Other non-cash items	106	142	125	136	157	144	155	163
Operating cash flow	**471**	**528**	**540**	**553**	**634**	**623**	**686**	**720**
Cash interest paid	13	0.5	15	13	4	3	0	0
Cash taxes paid	(124)	(118)	(113)	(128)	(127)	(136)	(148)	(156)
Net cash from operating activities	**359**	**410**	**442**	**438**	**510**	**490**	**539**	**564**
Capex	(152)	(199)	(228)	(231)	(318)	(302)	(308)	(320)
Net acquisitions	(15)	(5)	(53)	(18)	(36)	(34)	0	0
Other net investing cash flows	9	2	(13)	(2)	(10)	24	7	7
Cash from investing activities	**(157)**	**(201)**	**(294)**	**(251)**	**(365)**	**(311)**	**(301)**	**(313)**
Increase (decrease) in equity	(148)	(28)	(137)	(68)	(60)	17	(70)	(75)
Increase (decrease) in debt	(3)	(3)	(4)	(3)	(3)	(11)	0	0
Dividends & minority distribution	(85)	(94)	(107)	(122)	(130)	(145)	(153)	(155)
Cash from financing activities	**(237)**	**(125)**	**(249)**	**(192)**	**(194)**	**(139)**	**(223)**	**(230)**
Forex & discontinued operations	0	0	0	0.2	0.2	0.2	0	0
Net change in cash & equivalents	**(35)**	**84**	**(101)**	**(5)**	**(48)**	**39**	**15**	**21**
FCF	203	218	206	203	196	195	238	251

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Mar	2006	2007	2008	2009	2010	2011F	2012F	2013F
Performance & returns								
Revenue growth (%)	n/a	9.1	8.9	10.4	7.9	7.8	7.2	6.1
Normalised EBITDA growth (%)	n/a	13.1	8.2	8.6	9.6	3.6	3.9	5.7
Normalised EBIT growth (%)	n/a	11.8	8.2	7.1	9.2	0.51	2.4	6.0
Normalised EPS growth (%)	n/a	15.8	11.7	7.1	9.9	2.4	2.9	7.6
Gross margin (%)	23.5	24.9	24.3	24.7	25.2	25.2	24.9	24.9
Normalised EBITDA margin (%)	8.6	8.9	8.9	8.7	8.9	8.5	8.3	8.3
Normalised EBIT margin (%)	7.0	7.1	7.1	6.9	7.0	6.5	6.2	6.2
Reported net margin (%)	4.8	5.0	5.1	4.9	4.9	4.6	4.4	4.4
Reported ROE (%)	n/a	31.1	30.5	29.4	28.0	24.8	22.3	21.7
Normalised ROA (%)	n/a	20.2	19.4	18.9	18.8	16.7	15.5	15.4
ROAIC (%)	n/a	26.8	27.2	26.0	26.1	22.1	19.6	19.2
ROACE (%)	n/a	43.1	41.7	40.7	39.2	33.9	30.7	29.8
ROACE - WACC (%)	n/a	35.1	33.7	32.7	31.2	25.9	22.7	21.8
Leverage & solvency								
Working capital as % of sales	-5.4	-5.5	-5.2	-4.5	-4.5	-4.0	-4.0	-4.0
Net debt (cash)/EBITDA (x)	(0.84)	(0.94)	(0.66)	(0.59)	(0.44)	(0.47)	(0.47)	(0.47)
Net debt (cash)/equity (%)	-45.0	-47.5	-34.1	-29.6	-20.9	-19.5	-18.6	-18.2
EBITDA net interest coverage (x)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current ratio (x)	1.1	1.1	1.0	1.0	0.95	0.97	0.96	0.96
Dividend cover (cash flow) (x)	3.5	3.3	3.1	2.8	2.5	2.4	2.6	2.6
Valuation								
EV/revenue (x)	0.97	0.87	0.82	0.74	0.70	0.65	0.60	0.56
EV/normalised EBITDA (x)	11.2	9.7	9.2	8.5	7.9	7.6	7.3	6.8
EV/normalised EBIT (x)	13.9	12.2	11.6	10.8	10.0	9.9	9.7	9.1
EV/capital employed (x)	5.9	4.9	4.7	4.1	3.7	3.1	2.9	2.6
EV/invested capital (x)	5.3	4.4	4.2	3.8	3.4	2.9	2.6	2.4
Normalised PER (x)	23.0	19.8	17.8	16.6	15.1	14.7	14.3	13.3
Price/book (x)	6.9	5.7	5.3	4.6	4.0	3.4	3.1	2.8
Dividend yield (%)	1.8	2.1	2.3	2.6	2.9	3.1	3.1	3.4
FCF yield (%)	4.4	4.8	4.4	4.4	4.1	4.2	5.1	5.4
Per share data								
Reported EPS (€)	1.37	1.59	1.77	1.90	2.09	2.14	2.20	2.37
Normalised EPS (€)	1.37	1.59	1.77	1.90	2.09	2.14	2.20	2.37
Dividend per share (€)	0.55	0.65	0.73	0.81	0.92	0.96	0.99	1.07
Equity FCFPS (€)	1.29	1.32	1.36	1.35	1.26	1.25	1.52	1.63
BV/share (€)	4.59	5.55	5.97	6.89	7.94	9.31	10.28	11.39

Source: Company data, ING estimates

Company profile

Colruyt is the leading Belgian food retail group. Its main operation, the Colruyt supermarkets, has a unique full-range discount concept. Stores have a 'no-frills' layout, but a complete product mix. Colruyt has achieved impressive sales growth and profitability over the past decade, with one of Europe's highest operating margins and return on capital employed. In addition to its retail activities (77% of group sales and 93% of EBIT), Colruyt operates several wholesale businesses and a limited number of other small businesses, such as an in-house printing operation and low-cost fuel stations.

Risks

The main risks to our HOLD recommendation include: changes in consumption trends, prolonged periods of deflation, competitor behaviour, management decisions, operational execution and equity market volatility.

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Delhaize

E-commerce not yet one of the main priorities

Hold (maintained)

Price (06/10/11)
€46.06

Target price (12-mth)
€52.00 (previously €51.00)

Forecast total return
16.6%

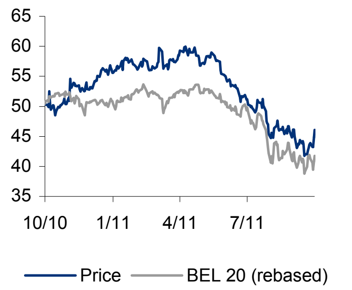
Retail
Belgium
Bloomberg: DELB BB
Reuters: DELB.BR

Share data

Avg daily volume (3-mth)	311,811
Free float (%)	100.0
Market cap (€m)	4,629.2
Net debt (1F, €m)	2,527
Enterprise value (1F, €m)	7,157
Dividend yield (1F, %)	3.7

Source: Company data, ING estimates

Share price performance



Source: ING

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Delhaize is focusing on: 1) integration of US logistic networks and back-office functions; 2) increasing store-opening rates, in particular in the US; and 3) shifting its attention to new growth markets with the Maxi Delta acquisition. But e-commerce is not high on the agenda. Delhaize has launched 'click-&-collect' in Belgium with the service now available in c.10% of the store base.

Delhaize Direct is now available in c.80 locations in Belgium, equivalent to c.10% of the store base. Press coverage is limited and so are management comments during investor meetings. Delhaize has to invest in this service because Colruyt is already leading in terms of store penetration (offering the service) and sales generated. Delhaize should also be prepared in the event that Albert Heijn enters Belgium with a standalone 'click-&-collect' service. This is a real possibility given that Albert Heijn's store network remains just one with a second set to open soon.

Tough trading conditions in core markets. Delhaize is highly exposed to the US, where it is facing tough trading conditions at two of its three divisions. These divisions generate c.two-thirds of US revenue, and face a very competitive environment caused by ongoing high unemployment and the resulting consumer caution. At the same time, one of Delhaize's smaller markets, Greece, is very weak following the near collapse of the country's financial system in 2009 and the current debt crisis. While 1H11 results proved resilient, sales growth is still well below the mid-single to double digits we have seen in recent years. Lastly, the Belgian operations are currently experiencing some headwinds from the combination of rising wage costs and prudent consumer spending. Moreover, Carrefour Belgium, which last year closed several hypermarkets and stores, anticipates improving sales trends, hence the competitive environment is heating up.

Focus on growth areas. Delhaize is slowly transforming its portfolio towards regions or channels with better growth prospects. The Delta Maxi (DM) deal, worth €933m, should improve Delhaize's growth and earnings profile thanks to more emerging market exposure; DM should account for 6% of group sales. Including Greece, growth markets combined should account for 15% of group sales. In the US and Belgium, Delhaize is rolling out relatively new soft discount banners, Bottom Dollar and Red Markets.

Hold with a TP of €52. We rate Delhaize a HOLD given a lack of substantial upside to our slightly-raised DCF-based target price of €52 (from €51) and low short-term possibility of positive earnings surprises. Our TP increase reflects a stronger US dollar (1.32 vs. 1.40 for 2012F and beyond).

Forecasts and ratios

Year end Dec (€m)	2009	2010	2011F	2012F	2013F
Revenues	19,938	20,850	21,413	23,620	24,407
Normalised EBITDA	1,506	1,599	1,601	1,774	1,862
Normalised net profit	538	575	566	625	689
Normalised EPS (€)	5.39	5.73	5.64	6.22	6.85
Normalised PER (x)	8.5	8.0	8.2	7.4	6.7
EV/normalised EBITDA (x)	4.5	4.0	4.5	3.9	3.6
FCF yield (%)	12.9	13.6	7.8	8.8	9.7
Dividend yield (%)	3.5	3.7	3.7	4.0	4.4
Price/book (x)	1.0	0.91	0.92	0.84	0.77
Normalised ROE (%)	12.6	12.2	11.2	11.8	12.0

Source: Company data, ING estimates

Financials

Year end Dec (€m)	2006	2007	2008	2009	2010	2011F	2012F	2013F
Income statement								
Revenues	19,225	18,957	19,024	19,938	20,850	21,413	23,620	24,407
Cost of goods sold	(14,372)	(14,162)	(14,204)	(14,813)	(15,497)	(15,888)	(17,503)	(18,062)
Gross profit	**4,853**	**4,795**	**4,820**	**5,125**	**5,353**	**5,525**	**6,118**	**6,346**
Operating costs	(3,411)	(3,382)	(3,442)	(3,667)	(3,754)	(3,923)	(4,344)	(4,484)
EBITDA	**1,442**	**1,413**	**1,378**	**1,458**	**1,599**	**1,601**	**1,774**	**1,862**
Depreciation & amortisation	(496)	(476)	(474)	(515)	(575)	(602)	(672)	(694)
EBIT	**946**	**937**	**904**	**943**	**1,024**	**999**	**1,101**	**1,168**
Net interest	(276)	(333)	(202)	(202)	(203)	(204)	(209)	(184)
Pre-tax profit	**671**	**605**	**702**	**741**	**821**	**795**	**892**	**984**
Tax	(245)	(204)	(217)	(228)	(245)	(229)	(268)	(295)
Minorities	(8)	(14)	(12)	(6)	(1)	0	0	0
Other post-tax items	(65)	24	(6)	8	(1)	0	0	0
Net profit	**352**	**410**	**467**	**515**	**574**	**566**	**625**	**689**
Normalised EBITDA	**1,442**	**1,413**	**1,345**	**1,506**	**1,599**	**1,601**	**1,774**	**1,862**
Normalised EBIT	**946**	**937**	**871**	**991**	**1,024**	**999**	**1,101**	**1,168**
Normalised net profit	**417**	**449**	**502**	**538**	**575**	**566**	**625**	**689**
Balance sheet								
Tangible fixed assets	3,412	3,393	3,855	3,801	4,092	4,562	4,805	5,055
Intangible fixed assets	3,302	2,998	3,204	3,214	3,462	3,737	3,737	3,737
Other non-current assets	38	40	58	92	174	174	174	174
Cash & equivalents	460	479	529	673	992	940	1,177	1,469
Other current assets	2,084	1,912	2,054	1,968	2,182	2,384	2,442	2,501
Total assets	**9,295**	**8,822**	**9,700**	**9,748**	**10,902**	**11,798**	**12,334**	**12,936**
Short-term debt	320	191	522	151	113	113	113	113
Other current liabilities	2,129	1,889	1,972	2,091	2,210	2,431	2,518	2,609
Long-term debt	2,775	2,508	2,409	2,585	2,666	3,354	3,354	3,354
Other long-term liabilities	511	559	602	512	844	844	844	844
Total liabilities	**5,734**	**5,146**	**5,505**	**5,339**	**5,833**	**6,742**	**6,829**	**6,920**
Total equity	3,561	3,676	4,195	4,409	5,069	5,056	5,505	6,016
Total liabilities & equity	**9,295**	**8,822**	**9,700**	**9,748**	**10,902**	**11,798**	**12,334**	**12,936**
Capital employed	6,656	6,374	7,126	7,145	7,848	8,523	8,972	9,483
Net working capital	(121)	57	132	(99)	(44)	(60)	(88)	(118)
Net debt (cash)	2,635	2,219	2,402	2,063	1,787	2,527	2,290	1,998
Cash flow								
Cash flow EBITDA	929	877	961	1,028	1,151	1,168	1,297	1,383
Change in working capital	(42)	(63)	(188)	92	(67)	(18)	(30)	(32)
Other non-cash items	581	596	482	503	493	469	514	517
Operating cash flow	**1,468**	**1,410**	**1,255**	**1,623**	**1,577**	**1,619**	**1,781**	**1,868**
Cash interest paid	(292)	(254)	(198)	(199)	(202)	(204)	(209)	(184)
Cash taxes paid	(265)	(223)	(130)	(248)	(58)	(229)	(268)	(295)
Net cash from operating activities	**910**	**933**	**927**	**1,176**	**1,317**	**1,186**	**1,304**	**1,389**
Capex	(700)	(729)	(714)	(520)	(660)	(842)	(915)	(945)
Net acquisitions	0.5	119	(100)	(147)	(19)	0	0	0
Other net investing cash flows	(23)	(19)	44	4	14	14	14	14
Cash from investing activities	**(722)**	**(630)**	**(770)**	**(663)**	**(665)**	**(828)**	**(901)**	**(931)**
Increase (decrease) in equity	26	30	1	6	6	5	6	7
Dividends & minority distribution	(115)	(133)	(147)	(152)	(162)	(173)	(173)	(173)
Other financing cash flow	(548)	(230)	53	(242)	(187)	(242)	0	0
Cash from financing activities	**(637)**	**(334)**	**(93)**	**(388)**	**(343)**	**(410)**	**(167)**	**(166)**
Forex & discontinued operations	(42)	(34)	8	(7)	10	0	0	0
Net change in cash & equivalents	**(491)**	**(65)**	**72**	**118**	**319**	**(52)**	**236**	**292**
FCF	518	482	441	865	873	562	612	642

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Dec	2006	2007	2008	2009	2010	2011F	2012F	2013F
Performance & returns								
Revenue growth (%)	4.8	-1.4	0.35	4.8	4.6	2.7	10.3	3.3
Normalised EBITDA growth (%)	4.9	-2.0	-4.8	12.0	6.2	0.15	10.8	5.0
Normalised EBIT growth (%)	5.2	-0.96	-7.1	13.8	3.3	-2.4	10.2	6.0
Normalised EPS growth (%)	10.2	4.6	9.8	6.8	6.3	-1.7	10.3	10.2
Gross margin (%)	25.2	25.3	25.3	25.7	25.7	25.8	25.9	26.0
Normalised EBITDA margin (%)	7.5	7.5	7.1	7.6	7.7	7.5	7.5	7.6
Normalised EBIT margin (%)	4.9	4.9	4.6	5.0	4.9	4.7	4.7	4.8
Reported net margin (%)	1.8	2.2	2.5	2.6	2.8	2.6	2.6	2.8
Reported ROE (%)	9.9	11.5	12.0	12.1	12.1	11.2	11.8	12.0
Normalised ROA (%)	9.7	10.3	9.4	10.2	9.9	8.8	9.1	9.2
ROAIC (%)	8.9	10.1	10.6	9.0	11.8	8.5	8.7	8.7
ROACE (%)	13.4	14.4	12.9	13.9	13.7	12.2	12.6	12.7
ROACE - WACC (%)	4.7	5.7	4.2	4.9	4.7	3.2	3.6	3.7
Leverage & solvency								
Working capital as % of sales	-0.63	0.30	0.69	-0.50	-0.21	-0.28	-0.37	-0.48
Net debt (cash)/EBITDA (x)	1.8	1.6	1.7	1.4	1.1	1.6	1.3	1.1
Net debt (cash)/equity (%)	74.0	60.4	57.3	46.8	35.3	50.0	41.6	33.2
EBITDA net interest coverage (x)	5.2	4.2	6.8	7.2	7.9	7.9	8.5	10.1
Current ratio (x)	1.0	1.1	1.0	1.2	1.4	1.3	1.4	1.5
Dividend cover (cash flow) (x)	3.0	2.7	2.7	5.4	5.1	3.1	3.3	3.6
Valuation								
EV/revenue (x)	0.38	0.36	0.37	0.34	0.31	0.33	0.29	0.27
EV/normalised EBITDA (x)	5.1	4.9	5.3	4.5	4.0	4.5	3.9	3.6
EV/normalised EBIT (x)	7.7	7.4	8.1	6.8	6.3	7.2	6.3	5.7
EV/capital employed (x)	1.1	1.1	0.99	0.94	0.82	0.84	0.77	0.70
EV/invested capital (x)	1.0	0.99	0.92	0.88	0.74	0.76	0.71	0.64
Normalised PER (x)	10.5	10.0	9.1	8.5	8.0	8.2	7.4	6.7
Price/book (x)	1.2	1.3	1.1	1.0	0.91	0.92	0.84	0.77
Dividend yield (%)	2.9	3.1	3.2	3.5	3.7	3.7	4.0	4.4
FCF yield (%)	7.1	7.0	6.2	12.9	13.6	7.8	8.8	9.7
Per share data								
Reported EPS (€)	3.71	4.20	4.70	5.16	5.72	5.64	6.22	6.85
Normalised EPS (€)	4.39	4.60	5.05	5.39	5.73	5.64	6.22	6.85
Dividend per share (€)	1.32	1.44	1.48	1.60	1.72	1.72	1.86	2.04
Equity FCFPS (€)	2.38	2.33	2.45	6.67	6.69	3.56	4.01	4.56
BV/share (€)	36.90	36.51	41.19	43.96	50.39	50.27	54.73	59.81

Source: Company data, ING estimates

Company profile

Delhaize Group is a Belgium-based food retail group with operations in the US (62% of sales in 2012F), Belgium (22%), Greece (7%), Romania and Indonesia (2% combined) and, through Maxi Delta, the Balkans (6%). Delhaize's strategy is to develop strong leadership in local markets with different banners, also using group synergies. Delhaize America is the No.2 food retailer on the US East Coast, with c.1,600 stores at end-2010. Delhaize ranks No.2 in Belgium, with c.800 stores and a c.25% market share.

Risks

Investment risks to our HOLD recommendation include: changes in the euro/US dollar exchange rate, changes in consumption trends, competitor actions, management decisions, operational execution and equity market volatility.

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DIA

Hard discount to benefit from convenience trend

Hold (maintained)

Price (06/10/11)
€3.15

Target price (12-mth)
€3.40 (maintained)

Forecast total return
9.6%

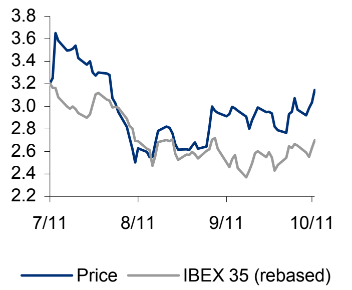
Retail
Spain
Bloomberg: DIA SM
Reuters: DIDA.MC

Share data

Avg daily volume (3-mth)	11,753,378
Free float (%)	100.0
Market cap (€m)	2,136.4
Net debt (1F, €m)	470
Enterprise value (1F, €m)	2,748
Dividend yield (1F, %)	1.5

Source: Company data, ING estimates

Share price performance



Source: ING

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DIA is an international group of hard discount operations. We believe the hard discount format, with its low-cost structure, limited product range and low average basket size, is not particularly suited for home delivery and 'click-&-collect' operations. In the long term, DIA's store network could increasingly serve as proximity/convenience locations, especially for fresh products, as we expect an increasing trend towards online, especially in bulk and dry grocery buying.

DIA has a different sales and profit growth model compared with hard discount peers Jeronimo Martins and BIM. DIA generates 75% of sales and 90% of EBITDA in Iberia and France, two low-growth regions where, in the medium term, a substantial part of profit growth is derived from the transfer of company-controlled stores to franchisees. Beyond this process, growth has to come from emerging markets, where DIA still lacks scale, evidenced by EBIT of around break-even. Indeed, e-commerce is currently not high on the agenda for obvious reasons. In the long term, DIA locations could serve as proximity stores for consumers in need of additional fresh shopping besides online bulk buying.

DIA's growth strategy is based on a combination of LFL sales growth, store openings, store modernisations and cost containment, including the targeted transfer of a large number of company-controlled stores to franchisees. We expect this to lead to a sales CAGR of 5.6% and net profit CAGR of 10.5% for 2010-13F. The basis for our double-digit net profit growth forecast lies in high single-digit underlying EBITDA growth.

In a break-up scenario, we feel DIA is worth much more than our current DCF-based target price of €3.4. If we assume a break-up scenario where assets are valued at c.50% of sales (note that BIM and Jeronimo Martins trade above 70%), we would arrive at a value of €7. In the short- to mid-term, however, we do not anticipate such a scenario emerging, otherwise Carrefour could have already taken the initiative.

HOLD rating. Our DCF-derived target price of €3.40 corresponds with a 2012F EV/EBIT of 11x. On 2012F PER and EV/EBIT, DIA trades at a premium to European retailers of c.30% and 10%, respectively. DIA's valuation is substantially below those of quoted hard discount peers BIM and Jeronimo Martins. In our view, the discount reflects a lower growth and ROCE profile, in combination with lower earnings visibility and exposure to mature regions.

Forecasts and ratios

Year end Dec (€m)	2009	2010	2011F	2012F	2013F
Revenues	9,293	9,673	9,890	10,260	10,963
Normalised EBITDA	461	507	535	577	621
Normalised net profit	126	140	139	161	184
Normalised EPS (€)	0.19	0.21	0.20	0.24	0.27
Normalised PER (x)	16.9	15.2	15.4	13.3	11.6
EV/normalised EBITDA (x)	4.9	5.0	5.1	4.6	4.2
FCF yield (%)	4.3	13.7	7.0	6.0	7.1
Dividend yield (%)	0.0	0.0	1.5	2.0	2.8
Price/book (x)	2.6	5.0	7.0	4.9	3.8
Normalised ROE (%)	16.2	22.6	37.8	43.6	36.9

Source: Company data, ING estimates

Financials

Year end Dec (€m)	2008	2009	2010	2011F	2012F	2013F
Income statement						
Revenues	9,304	9,293	9,673	9,890	10,260	10,963
Cost of goods sold	(7,417)	(7,363)	(7,652)	(7,803)	(8,075)	(8,628)
Gross profit	**1,887**	**1,930**	**2,021**	**2,087**	**2,185**	**2,335**
Operating costs	(1,519)	(1,521)	(1,613)	(1,661)	(1,694)	(1,765)
EBITDA	**368**	**409**	**408**	**426**	**492**	**571**
Depreciation & amortisation	(225)	(234)	(270)	(239)	(256)	(263)
EBIT	**143**	**175**	**138**	**187**	**236**	**307**
Net interest	(21)	(12)	(13)	(42)	(60)	(60)
Associates	0.0	(0.3)	(0.6)	3	3	3
Pre-tax profit	**122**	**163**	**125**	**148**	**179**	**251**
Tax	(40)	(37)	(87)	(58)	(56)	(78)
Minorities	6	4	4	2	0	(2)
Other post-tax items	(6)	(7)	81	0	0	0
Net profit	**82**	**124**	**122**	**92**	**124**	**171**
Normalised EBITDA	**437**	**461**	**507**	**535**	**577**	**621**
Normalised EBIT	**186**	**198**	**207**	**265**	**289**	**324**
Normalised net profit	**78**	**126**	**140**	**139**	**161**	**184**
Balance sheet						
Tangible fixed assets	1,627	1,633	1,598	1,666	1,735	1,814
Intangible fixed assets	461	458	460	458	458	458
Other non-current assets	81	75	84	87	87	87
Cash & equivalents	323	265	338	493	581	679
Other current assets	852	848	773	865	926	994
Total assets	**3,344**	**3,278**	**3,253**	**3,569**	**3,788**	**4,032**
Short-term debt	277	215	540	510	510	510
Other current liabilities	2,078	2,044	2,068	2,120	2,210	2,324
Long-term debt	48	29	36	453	453	453
Other long-term liabilities	196	186	186	189	189	189
Total liabilities	**2,599**	**2,474**	**2,831**	**3,272**	**3,362**	**3,476**
Total equity	745	805	422	297	425	556
Total liabilities & equity	**3,344**	**3,278**	**3,253**	**3,569**	**3,788**	**4,032**
Capital employed	1,070	1,048	999	1,260	1,388	1,519
Net working capital	(993)	(954)	(1,008)	(974)	(1,002)	(1,046)
Net debt (cash)	2	(21)	238	470	382	283
Cash flow						
Cash flow EBITDA	327	391	330	360	411	469
Change in working capital	(52)	(24)	66	27	(29)	(46)
Other non-cash items	52	33	137	115	103	101
Operating cash flow	**327**	**400**	**533**	**502**	**485**	**524**
Cash interest paid	22	11	15	15	15	15
Net cash from operating activities	**349**	**411**	**548**	**517**	**500**	**539**
Capex	(442)	(341)	(290)	(311)	(325)	(342)
Net acquisitions	(2)	(3)	(6)	(2)	0	0
Other net investing cash flows	73	42	106	6	5	5
Cash from investing activities	**(371)**	**(302)**	**(191)**	**(307)**	**(320)**	**(337)**
Increase (decrease) in debt	103	(79)	230	409	0	0
Dividends & minority distribution	(70)	(75)	(532)	(409)	(32)	(43)
Other financing cash flow	(6)	(7)	(4)	(42)	(60)	(60)
Cash from financing activities	**28**	**(161)**	**(306)**	**(42)**	**(92)**	**(103)**
Forex & discontinued operations	(5)	(2)	15	(13)	0	0
Net change in cash & equivalents	**0.9**	**(54)**	**66**	**155**	**88**	**99**
FCF	(47)	97	346	191	160	182

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Dec	2008	2009	2010	2011F	2012F	2013F
Performance & returns						
Revenue growth (%)	n/a	-0.12	4.1	2.2	3.7	6.9
Normalised EBITDA growth (%)	n/a	5.4	10.0	5.6	7.7	7.6
Normalised EBIT growth (%)	n/a	6.4	4.4	28.2	9.1	12.2
Normalised EPS growth (%)	n/a	62.4	11.3	-0.95	15.8	14.2
Gross margin (%)	20.3	20.8	20.9	21.1	21.3	21.3
Normalised EBITDA margin (%)	4.7	5.0	5.2	5.4	5.6	5.7
Normalised EBIT margin (%)	2.0	2.1	2.1	2.7	2.8	3.0
Reported net margin (%)	0.88	1.3	1.3	0.93	1.2	1.6
Reported ROE (%)	n/a	15.9	19.7	24.9	33.4	34.2
Normalised ROA (%)	n/a	6.0	6.3	7.8	7.9	8.3
ROAIC (%)	n/a	14.0	11.4	14.2	15.6	18.7
ROACE (%)	n/a	18.7	20.2	23.5	21.8	22.3
ROACE - WACC (%)	n/a	n/a	n/a	n/a	n/a	n/a
Leverage & solvency						
Working capital as % of sales	-10.7	-10.3	-10.4	-9.8	-9.8	-9.5
Net debt (cash)/EBITDA (x)	0.01	(0.05)	0.58	1.1	0.78	0.50
Net debt (cash)/equity (%)	0.27	-2.7	56.4	158.1	89.8	50.9
EBITDA net interest coverage (x)	17.1	34.9	32.2	10.1	8.2	9.5
Current ratio (x)	0.50	0.49	0.43	0.52	0.55	0.59
Dividend cover (cash flow) (x)	0.64	2.4	1.7	1.5	6.5	5.6
Valuation						
EV/revenue (x)	0.25	0.24	0.26	0.28	0.26	0.24
EV/normalised EBITDA (x)	5.2	4.9	5.0	5.1	4.6	4.2
EV/normalised EBIT (x)	12.3	11.4	12.2	10.4	9.2	7.9
EV/capital employed (x)	2.1	2.2	2.5	2.2	1.9	1.7
EV/invested capital (x)	1.8	1.8	2.1	1.9	1.7	1.5
Normalised PER (x)	27.5	16.9	15.2	15.4	13.3	11.6
Price/book (x)	2.9	2.6	5.0	7.0	4.9	3.8
Dividend yield (%)	0.0	0.0	0.0	1.5	2.0	2.8
FCF yield (%)	n/a	4.3	13.7	7.0	6.0	7.1
Per share data						
Reported EPS (€)	0.12	0.18	0.18	0.14	0.18	0.25
Normalised EPS (€)	0.11	0.19	0.21	0.20	0.24	0.27
Dividend per share (€)	0.00	0.00	0.00	0.05	0.06	0.09
Equity FCFPS (€)	(0.04)	0.16	0.53	0.30	0.26	0.29
BV/share (€)	1.10	1.19	0.63	0.45	0.64	0.83

Source: Company data, ING estimates

Company profile

DIA, a spin-off from Carrefour, is one of the world's largest hard discount groups in terms of annual sales (€9.6bn in 2010) and number of stores (6,373 at the end of 2010). The group is market leader in Spain and No.2 in Portugal in hard discount. In France, DIA has a No.3 position. The group's strategy is focused on improving profitability in Iberia and France, in part through store remodellings and the transfer of less profitable locations to franchisees, and to achieve critical mass in emerging markets, notably Turkey and China, which are considered top priority regions.

Risks

Besides country and currency risks (eg, Turkey and Argentina), our HOLD recommendation could be threatened by a prolonged period of lack of market and profit pool growth in countries such as Spain/Portugal and France, which combined account for an estimated 75% of group sales and 90% of group EBITDA in 2011F. Aside from a lack of growth, there is also still a risk of a further substantial decrease in consumer spending in Spain and Portugal due to these countries' national debt situations. Financial risks seem more limited given a modest amount of net debt (€483m at year-end 2011F) and net debt/EBITDA of 1.1x for 2011F.

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H&M

Catching the e-wave

Hold (previously Sell)

Price (06/10/11)
SEK202.9

Target price (12-mth)
SEK200.0 (previously SEK190.0)

Forecast total return
3.4%

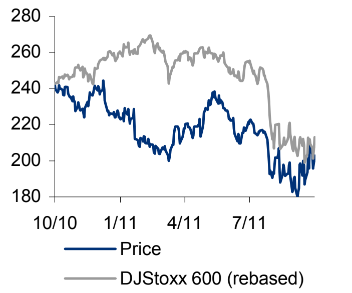
Retail
Sweden
Bloomberg: HMB SS
Reuters: HMb.ST

Share data

Avg daily volume (3-mth)	5,429,825
Free float (%)	57.8
Market cap (SEKm)	335,814
Net debt (1F, SEKm)	(16,130)
Enterprise value (1F, SEKm)	319,684
Dividend yield (1F, %)	4.8

Source: Company data, ING estimates

Share price performance



Source: ING

We strongly believe that fashion retail companies' top-line as well as bottom-line can significantly benefit from e-commerce. We see H&M as a fashion retailer with the right brand equity, right scale and right infrastructure to ride the e-commerce wave. The company's results should show a marked improvement thanks to recent and upcoming online launches. We estimate online sales will make up 15% of group revenue by 2015F.

Online growth: H&M launched its webshops in Scandinavia in 1998, but it seems that it is only since 2010 that the roll-out to more countries has become a key priority. In autumn 2012, the company will launch a US webshop, which will lead to a major sales boost, in our view. We will closely watch Zara's US webshop results as we think H&M's launch will have a similar effect. According to Dutch internet magazine *Twinkle*, H&M achieved online sales of €95m in the Netherlands in 2010, implying a penetration rate of c.15%. We expect online sales in 2015 to be in the range of SEK13-15bn, applying the reported Dutch penetrations rate to all developed markets.

Investment case: the main reasons behind our bearish stance until now concerned cost inflation, limited upside surprise in terms of expansion opportunities and tough comparatives. While cost inflation has eased (3Q11 gross margins were less affected than we expected), H&M has increased its expansion programme to 265 stores and the comparison base is easing. With a more aggressive expansion mode in Asia, and online launches on their way, we raise our DCF-based target price from SEK190 to SEK200 and upgrade our recommendation from Sell to HOLD.

EPS changes: Following the 3Q11 results, we fractionally lower our EPS estimate for 2011F to SEK9.88 (from SEK9.90), but increase our 2012F and 2013F estimates to SEK11.44 (from SEK11.29) and SEK13.33 (from SEK12.92), respectively. We believe the input cost impact on gross margins will be less severe than we first thought, and now anticipate new web launches adding at least 1ppt to the top-line.

Risk factors include further increases in commodity prices and continued wage rises in China and surrounding countries. Another risk is of a double-dip recession and continuing low consumer spending in Germany. We feel that large acquisitions are unlikely as H&M has not undertaken any significant M&A in the past. A final risk comes from increased competition in the low-end segment of the market, for example from Primark.

Forecasts and ratios

Year end Nov (SEKm)	2009	2010	2011F	2012F	2013F
Revenues	101,393	108,483	113,266	126,858	144,618
Normalised EBITDA	24,474	27,720	24,858	28,695	33,287
Normalised net profit	16,384	18,681	16,347	18,937	22,061
Normalised EPS (SEK)	9.90	11.29	9.88	11.44	13.33
Normalised PER (x)	20.5	18.0	20.5	17.7	15.2
EV/normalised EBITDA (x)	12.9	11.5	12.9	11.1	9.4
FCF yield (%)	2.9	3.7	4.7	5.6	6.7
Dividend yield (%)	3.9	4.7	4.8	4.9	5.4
Price/book (x)	8.3	7.6	7.2	6.5	5.7
Normalised ROE (%)	42.2	44.1	36.1	38.7	39.9

Source: Company data, ING estimates

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Financials

Year end Nov (SEKm)	2006	2007	2008	2009	2010	2011F	2012F	2013F
Income statement								
Revenues	68,400	78,346	88,532	101,393	108,483	113,266	126,858	144,618
Cost of goods sold	(27,736)	(30,499)	(34,064)	(38,919)	(40,214)	(45,153)	(50,109)	(56,835)
Gross profit	**40,664**	**47,847**	**54,468**	**62,474**	**68,269**	**68,113**	**76,749**	**87,783**
Operating costs	(23,742)	(27,651)	(32,128)	(38,000)	(40,549)	(43,255)	(48,054)	(54,496)
EBITDA	**16,922**	**20,196**	**22,340**	**24,474**	**27,720**	**24,858**	**28,695**	**33,287**
Depreciation & amortisation	(1,624)	(1,814)	(2,202)	(2,830)	(3,061)	(3,367)	(3,704)	(4,074)
EBIT	**15,298**	**18,382**	**20,138**	**21,644**	**24,659**	**21,491**	**24,991**	**29,213**
Net interest	510	788	1,052	459	349	600	600	600
Pre-tax profit	**15,808**	**19,170**	**21,190**	**22,103**	**25,008**	**22,091**	**25,591**	**29,813**
Tax	(5,011)	(5,582)	(5,896)	(5,719)	(6,327)	(5,744)	(6,654)	(7,751)
Net profit	**10,797**	**13,588**	**15,294**	**16,384**	**18,681**	**16,347**	**18,937**	**22,061**
Normalised EBITDA	**16,922**	**20,196**	**22,340**	**24,474**	**27,720**	**24,858**	**28,695**	**33,287**
Normalised EBIT	**15,298**	**18,382**	**20,138**	**21,644**	**24,659**	**21,491**	**24,991**	**29,213**
Normalised net profit	**10,797**	**13,588**	**15,294**	**16,384**	**18,681**	**16,347**	**18,937**	**22,061**
Balance sheet								
Tangible fixed assets	7,554	9,287	12,441	14,811	15,469	17,557	19,853	22,380
Other non-current assets	222	266	1,656	1,674	1,198	1,134	1,134	1,134
Cash & equivalents	9,877	16,064	22,726	19,024	16,691	16,130	17,816	22,144
Other current assets	17,902	16,117	14,420	18,854	25,824	27,040	28,374	29,836
Total assets	**35,555**	**41,734**	**51,243**	**54,363**	**59,182**	**61,861**	**67,177**	**75,493**
Other current liabilities	6,996	8,834	11,879	11,090	13,847	14,244	14,680	15,159
Other long-term liabilities	780	807	2,414	2,660	1,163	1,163	1,163	1,163
Total liabilities	**7,776**	**9,641**	**14,293**	**13,750**	**15,010**	**15,407**	**15,843**	**16,322**
Total equity	27,779	32,093	36,950	40,613	44,172	46,455	51,334	59,170
Total liabilities & equity	**35,555**	**41,734**	**51,243**	**54,363**	**59,182**	**61,861**	**67,177**	**75,493**
Capital employed	27,779	32,093	36,950	40,613	44,172	46,455	51,334	59,170
Net working capital	6,400	7,744	8,608	10,360	11,363	12,183	13,080	14,062
Net debt (cash)	(9,877)	(16,064)	(22,726)	(19,024)	(16,691)	(16,130)	(17,816)	(22,144)
Cash flow								
Cash flow EBITDA	17,942	21,772	24,444	25,392	28,418	26,058	29,895	34,487
Change in working capital	188	(46)	514	(492)	(780)	(820)	(897)	(982)
Other non-cash items	(510)	(788)	(1,052)	(459)	(349)	(600)	(600)	(600)
Operating cash flow	**17,620**	**20,938**	**23,906**	**24,441**	**27,289**	**24,638**	**28,398**	**32,905**
Cash taxes paid	(5,565)	(5,557)	(5,940)	(6,468)	(5,451)	(4,020)	(4,658)	(5,426)
Net cash from operating activities	**12,055**	**15,381**	**17,966**	**17,973**	**21,838**	**20,617**	**23,740**	**27,479**
Capex	(4,401)	(3,648)	(5,193)	(5,686)	(4,959)	(5,455)	(6,000)	(6,600)
Other net investing cash flows	6	3,792	4,103	(3,069)	(5,170)	0	0	0
Cash from investing activities	**(4,395)**	**144**	**(1,090)**	**(8,755)**	**(10,129)**	**(5,455)**	**(6,000)**	**(6,600)**
Dividends & minority distribution	(7,861)	(9,515)	(11,584)	(12,825)	(13,239)	(15,723)	(16,054)	(16,551)
Cash from financing activities	**(7,861)**	**(9,515)**	**(11,584)**	**(12,825)**	**(13,239)**	**(15,723)**	**(16,054)**	**(16,551)**
Net change in cash & equivalents	**(201)**	**6,010**	**5,292**	**(3,607)**	**(1,530)**	**(561)**	**1,685**	**4,328**
FCF	7,660	15,525	16,876	9,218	11,709	15,162	17,740	20,879

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Nov	2006	2007	2008	2009	2010	2011F	2012F	2013F
Performance & returns								
Revenue growth (%)	11.7	14.5	13.0	14.5	7.0	4.4	12.0	14.0
Normalised EBITDA growth (%)	-72.4	19.3	10.6	9.6	13.3	-10.3	15.4	16.0
Normalised EBIT growth (%)	-75.0	20.2	9.6	7.5	13.9	-12.8	16.3	16.9
Normalised EPS growth (%)	n/a	25.8	12.6	7.1	14.0	-12.5	15.8	16.5
Gross margin (%)	59.5	61.1	61.5	61.6	62.9	60.1	60.5	60.7
Normalised EBITDA margin (%)	24.7	25.8	25.2	24.1	25.6	21.9	22.6	23.0
Normalised EBIT margin (%)	22.4	23.5	22.7	21.3	22.7	19.0	19.7	20.2
Reported net margin (%)	15.8	17.3	17.3	16.2	17.2	14.4	14.9	15.3
Reported ROE (%)	77.7	45.4	44.3	42.2	44.1	36.1	38.7	39.9
Normalised ROA (%)	86.1	47.6	43.3	41.0	43.4	35.5	38.7	41.0
ROAIC (%)	68.2	41.7	39.3	36.7	43.4	37.6	40.6	42.2
ROACE (%)	110.1	61.4	58.3	55.8	58.2	47.4	51.1	52.9
ROACE - WACC (%)	101.8	53.1	50.0	47.5	49.8	39.1	42.8	44.5
Leverage & solvency								
Working capital as % of sales	9.4	9.9	9.7	10.2	10.5	10.8	10.3	9.7
Net debt (cash)/EBITDA (x)	(0.58)	(0.80)	(1.0)	(0.78)	(0.60)	(0.65)	(0.62)	(0.67)
Net debt (cash)/equity (%)	-35.6	-50.1	-61.5	-46.8	-37.8	-34.7	-34.7	-37.4
EBITDA net interest coverage (x)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Current ratio (x)	4.0	3.6	3.1	3.4	3.1	3.0	3.1	3.4
Dividend cover (cash flow) (x)	2.0	2.6	2.5	1.7	1.9	2.0	2.1	2.3
Valuation								
EV/revenue (x)	4.8	4.1	3.5	3.1	2.9	2.8	2.5	2.2
EV/normalised EBITDA (x)	19.3	15.8	14.0	12.9	11.5	12.9	11.1	9.4
EV/normalised EBIT (x)	21.3	17.4	15.5	14.6	12.9	14.9	12.7	10.7
EV/capital employed (x)	11.7	10.0	8.5	7.8	7.2	6.9	6.2	5.3
EV/invested capital (x)	11.4	9.7	8.0	7.3	7.0	6.7	6.1	5.2
Normalised PER (x)	31.1	24.7	22.0	20.5	18.0	20.5	17.7	15.2
Price/book (x)	12.1	10.5	9.1	8.3	7.6	7.2	6.5	5.7
Dividend yield (%)	2.8	3.4	3.8	3.9	4.7	4.8	4.9	5.4
FCF yield (%)	2.4	4.9	5.4	2.9	3.7	4.7	5.6	6.7
Per share data								
Reported EPS (SEK)	6.52	8.21	9.24	9.90	11.29	9.88	11.44	13.33
Normalised EPS (SEK)	6.52	8.21	9.24	9.90	11.29	9.88	11.44	13.33
Dividend per share (SEK)	5.75	7.00	7.75	8.00	9.50	9.70	10.00	10.93
Equity FCFPS (SEK)	4.63	9.38	10.20	5.57	7.07	9.16	10.72	12.61
BV/share (SEK)	16.78	19.39	22.33	24.54	26.69	28.07	31.02	35.75

Source: Company data, ING estimates

Company profile

H&M is an international fashion retailer with 2,212 stores (Feb 2011). 2010 revenues were SEK108bn. H&M was established in Sweden in 1947 by Erling Persson. The collections are created centrally by c.100 in-house designers together with buyers and pattern makers. H&M does not own any factories but buys its goods from around 700 independent suppliers, primarily in Asia and Europe. More than 90% of stores are operated under the H&M brand. Other concepts are COS, Monki, Weekday and Cheap Monday. H&M's growth target is to increase store numbers by 10-15% in China, the UK and the US, in particular.

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Inditex

Online to boost top-line as well as bottom-line

Buy (maintained)

Price (06/10/11)
€63.09

Target price (12-mth)
€75.00 (maintained)

Forecast total return
21.8%

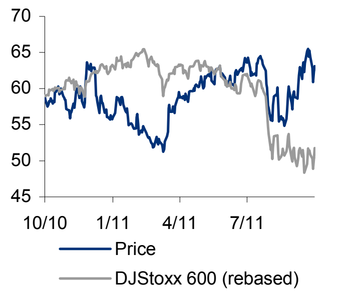
Retail
Spain
Bloomberg: ITX SM
Reuters: ITX.MC

Share data

Avg daily volume (3-mth)	1,983,861
Free float (%)	34.8
Market cap (€m)	39,311.4
Net debt (1F, €m)	(4,433)
Enterprise value (1F, €m)	34,879
Dividend yield (1F, %)	2.9

Source: Company data, ING estimates

Share price performance



Source: ING

Inditex launched its online business in the US (Zara) and Europe (all remaining banners) in early September. While the company has been relatively late to react to the e-commerce trend, we expect that by 2015, its online business will have caught up with US (GAP, Abercrombie) and UK peers (M&S, Next) who currently achieve online penetration rates ranging from 9% to 13%. The combination of stores in AAA locations and a high-quality webshop makes flagship brand Zara a perfect fit for the next decade, in our view.

Online growth: in our report, *"Online push could lead to a capex shift",* 5 September, we suggest that online sales could help to triple the current US revenue base in four years' time. While this may seem a bold statement, we believe that online could make up the majority of total US sales. Other regions with significant online potential are Western Europe (the UK, Germany, France, Benelux) and Asia. In Southern Europe, we expect penetration rates to remain below 5% over the next couple of years.

Investment case: Inditex is our favourite share in the fashion retail sector because its store roll-out model should produce many more years of double-digit top-line and EPS growth. The two most important growth drivers are: 1) online sales, which we expect to add more than 1ppt to the top-line. In the medium term, operating margins should expand because rising online sales requires no extra rent or personnel costs; 2) the Chinese expansion opportunity. Inditex is opening more than 100 stores pa: one out of four new store openings takes place in China; 3) the store expansion opportunity in Europe. Inditex brands are under-represented in Northern Europe; and 4) the (im)maturity of non-Zara concepts and the ability to add new banners and scale, which can be scaled up.

Valuation and EPS estimates: we see Inditex as a 'growth trap' (as opposed to a 'value trap'), meaning that the shares look expensive, whereas in fact the company's earnings power is under-estimated. On a 12-month view, we believe the current share price represents an attractive level to BUY Inditex shares. The shares trade in line with H&M in terms of PER, while we think Inditex deserves a slight premium thanks to the sustainability of its business model. We maintain a DCF-based target price of €75 and leave our EPS estimates unchanged.

Risk factors: on the negative side, we see the prospect of a double-dip recession and continued low consumer spending in Southern Europe as important risks. Other risks include unnecessary capital expenditure and increased competition from 'copy-cats'.

Forecasts and ratios

Year end Jan (€m)	**2010**	**2011**	**2012F**	**2013F**	**2014F**
Revenues	11,084	12,527	14,045	15,917	18,080
Normalised EBITDA	2,374	2,966	3,277	3,768	4,332
Normalised net profit	1,314	1,732	1,964	2,240	2,577
Normalised EPS (€)	2.11	2.78	3.15	3.59	4.14
Normalised PER (x)	29.9	22.7	20.0	17.5	15.3
EV/normalised EBITDA (x)	15.5	12.1	10.6	8.9	7.3
FCF yield (%)	3.8	3.4	3.8	5.4	6.7
Dividend yield (%)	1.9	2.5	2.9	3.4	3.9
Price/book (x)	7.3	6.1	5.2	4.4	3.8
Normalised ROE (%)	26.0	29.4	28.1	27.2	26.6

Source: Company data, ING estimates

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Financials

Year end Jan (€m)	2007	2008	2009	2010	2011	2012F	2013F	2014F
Income statement								
Revenues	8,196	9,435	10,407	11,084	12,527	14,045	15,917	18,080
Cost of goods sold	(3,589)	(4,086)	(4,493)	(4,756)	(5,105)	(5,843)	(6,589)	(7,467)
Gross profit	**4,607**	**5,349**	**5,914**	**6,328**	**7,422**	**8,202**	**9,327**	**10,613**
Operating costs	(2,817)	(3,199)	(3,726)	(3,954)	(4,456)	(4,925)	(5,559)	(6,280)
EBITDA	**1,789**	**2,149**	**2,188**	**2,374**	**2,966**	**3,277**	**3,768**	**4,332**
Depreciation & amortisation	(433)	(497)	(578)	(646)	(676)	(730)	(818)	(950)
EBIT	**1,356**	**1,653**	**1,609**	**1,728**	**2,290**	**2,547**	**2,950**	**3,382**
Net interest	(14)	1.0	(22)	4	32	50	70	90
Associates	(3)	(8)	0	0	0	0	0	0
Pre-tax profit	**1,339**	**1,646**	**1,588**	**1,732**	**2,322**	**2,597**	**3,020**	**3,472**
Tax	(330)	(388)	(325)	(410)	(581)	(623)	(770)	(885)
Net profit	**1,010**	**1,258**	**1,263**	**1,322**	**1,741**	**1,974**	**2,250**	**2,587**
Normalised EBITDA	**1,789**	**2,149**	**2,188**	**2,374**	**2,966**	**3,277**	**3,768**	**4,332**
Normalised EBIT	**1,356**	**1,653**	**1,609**	**1,728**	**2,290**	**2,547**	**2,950**	**3,382**
Normalised net profit	**1,001**	**1,251**	**1,254**	**1,314**	**1,732**	**1,964**	**2,240**	**2,577**
Balance sheet								
Tangible fixed assets	2,789	3,182	3,442	3,294	3,414	3,714	3,761	3,748
Intangible fixed assets	114	139	148	151	0	0	0	0
Other non-current assets	712	805	937	963	1,209	1,230	1,251	1,273
Cash & equivalents	906	1,466	1,466	2,420	3,433	4,437	5,909	7,673
Other current assets	1,221	1,514	1,782	1,508	1,770	1,883	2,007	2,142
Total assets	**5,742**	**7,106**	**7,777**	**8,335**	**9,826**	**11,263**	**12,928**	**14,835**
Other current liabilities	1,885	2,458	2,391	2,305	2,675	2,891	3,132	3,394
Long-term debt	47	42	13	5	4	4	4	4
Other long-term liabilities	340	388	624	655	724	796	876	964
Total liabilities	**2,272**	**2,889**	**3,028**	**2,965**	**3,403**	**3,691**	**4,012**	**4,362**
Total equity	3,471	4,217	4,749	5,371	6,423	7,572	8,916	10,474
Total liabilities & equity	**5,742**	**7,106**	**7,777**	**8,335**	**9,826**	**11,263**	**12,928**	**14,835**
Capital employed	3,518	4,259	4,762	5,376	6,427	7,576	8,920	10,478
Net working capital	(431)	(504)	(433)	(689)	(975)	(1,078)	(1,195)	(1,322)
Net debt (cash)	(859)	(1,423)	(1,453)	(2,415)	(3,429)	(4,433)	(5,905)	(7,669)
Cash flow								
Cash flow EBITDA	1,429	1,756	1,819	1,951	2,409	2,754	3,138	3,627
Change in working capital	(94)	60	(75)	261	16	31	37	40
Other non-cash items	62	2	32	90	58	40	20	0
Operating cash flow	**1,397**	**1,818**	**1,776**	**2,302**	**2,483**	**2,825**	**3,195**	**3,667**
Cash interest paid	0	0	0	4	32	50	70	90
Cash taxes paid	(330)	(388)	(325)	(391)	(508)	(468)	(539)	(620)
Net cash from operating activities	**1,068**	**1,430**	**1,451**	**1,915**	**2,007**	**2,407**	**2,726**	**3,137**
Capex	(914)	(982)	(938)	(510)	(754)	(1,030)	(865)	(937)
Other net investing cash flows	27	40	0.7	0	0	0	0	0
Cash from investing activities	**(887)**	**(942)**	**(937)**	**(510)**	**(754)**	**(1,030)**	**(865)**	**(937)**
Increase (decrease) in debt	(159)	214	(157)	(197)	(67)	0	0	0
Dividends & minority distribution	(418)	(522)	(662)	(662)	(751)	(997)	(1,159)	(1,322)
Cash from financing activities	**(577)**	**(307)**	**(818)**	**(859)**	**(818)**	**(997)**	**(1,159)**	**(1,322)**
Net change in cash & equivalents	**(397)**	**181**	**(305)**	**546**	**435**	**380**	**702**	**878**
FCF	181	488	513	1,401	1,221	1,327	1,791	2,110

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Jan	2007	2008	2009	2010	2011	2012F	2013F	2014F
Performance & returns								
Revenue growth (%)	21.6	15.1	10.3	6.5	13.0	12.1	13.3	13.6
Normalised EBITDA growth (%)	n/a	20.1	1.8	8.5	25.0	10.5	15.0	15.0
Normalised EBIT growth (%)	n/a	21.9	-2.6	7.3	32.6	11.2	15.8	14.7
Normalised EPS growth (%)	n/a	24.9	0.17	4.5	31.9	13.4	14.1	15.0
Gross margin (%)	56.2	56.7	56.8	57.1	59.2	58.4	58.6	58.7
Normalised EBITDA margin (%)	21.8	22.8	21.0	21.4	23.7	23.3	23.7	24.0
Normalised EBIT margin (%)	16.5	17.5	15.5	15.6	18.3	18.1	18.5	18.7
Reported net margin (%)	12.3	13.3	12.1	11.9	13.9	14.1	14.1	14.3
Reported ROE (%)	58.2	32.7	28.2	26.1	29.5	28.2	27.3	26.7
Normalised ROA (%)	47.2	25.7	21.6	21.4	25.2	24.2	24.4	24.4
ROAIC (%)	53.2	29.7	25.6	23.4	27.0	26.8	26.5	26.0
ROACE (%)	77.1	42.5	35.7	34.1	38.8	36.4	35.8	34.9
ROACE - WACC (%)	68.8	34.2	27.4	25.8	30.5	28.1	27.4	26.5
Leverage & solvency								
Working capital as % of sales	-5.3	-5.3	-4.2	-6.2	-7.8	-7.7	-7.5	-7.3
Net debt (cash)/EBITDA (x)	(0.48)	(0.66)	(0.66)	(1.0)	(1.2)	(1.4)	(1.6)	(1.8)
Net debt (cash)/equity (%)	-24.7	-33.8	-30.6	-45.0	-53.4	-58.5	-66.2	-73.2
EBITDA net interest coverage (x)	88.9	305.5	85.5	2,374	n/a	n/a	n/a	n/a
Current ratio (x)	1.1	1.2	1.4	1.7	1.9	2.2	2.5	2.9
Dividend cover (cash flow) (x)	1.4	1.9	1.8	3.1	2.7	2.4	2.6	2.7
Valuation								
EV/revenue (x)	4.7	4.0	3.6	3.3	2.9	2.5	2.1	1.8
EV/normalised EBITDA (x)	21.5	17.6	17.3	15.5	12.1	10.6	8.9	7.3
EV/normalised EBIT (x)	28.4	22.9	23.5	21.4	15.7	13.7	11.3	9.4
EV/capital employed (x)	10.9	8.9	8.0	6.9	5.6	4.6	3.7	3.0
EV/invested capital (x)	10.0	8.2	7.0	6.1	5.0	4.2	3.4	2.8
Normalised PER (x)	39.1	31.3	31.3	29.9	22.7	20.0	17.5	15.3
Price/book (x)	11.3	9.3	8.3	7.3	6.1	5.2	4.4	3.8
Dividend yield (%)	1.3	1.7	1.7	1.9	2.5	2.9	3.4	3.9
FCF yield (%)	0.47	1.3	1.4	3.8	3.4	3.8	5.4	6.7
Per share data								
Reported EPS (€)	1.63	2.03	2.03	2.12	2.79	3.17	3.61	4.15
Normalised EPS (€)	1.61	2.01	2.02	2.11	2.78	3.15	3.59	4.14
Dividend per share (€)	0.84	1.05	1.05	1.20	1.60	1.86	2.12	2.48
Equity FCFPS (€)	0.29	0.79	0.83	2.25	2.01	2.21	2.99	3.53
BV/share (€)	5.59	6.79	7.64	8.62	10.31	12.15	14.31	16.81

Source: Company data, ING estimates

Company profile

Inditex is an international fashion retailer with 5,154 stores (Apr 2011). Revenues were €12.5bn in 2010 and flagship brand Zara contributed 67% of group EBIT. The first Zara store opened in 1975 and international expansion began in 1998. Inditex has five other formats: Pull & Bear (1991), Berskha (1998), Oysho (2001), Zara Home (2003) and Uterque (2008). Massimo Dutti and Stradivarius were acquired in 1991 and 1999. Inditex runs a highly centralised operation from Spain and runs a responsive consumer demand-led pull model. Mr Ortega co-founded the company and is a majority shareholder (59%).

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Jeronimo Martins

Mid-term growth not reliant on e-commerce

Buy (maintained)

Price (06/10/11)
€11.39

Target price (12-mth)
€14.50 (maintained)

Forecast total return
29.7%

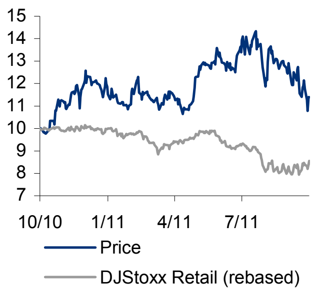
Retail
Portugal
Bloomberg: JMT PL
Reuters: JMT.LS

Share data

Avg daily volume (3-mth)	1,059,407
Free float (%)	44.0
Market cap (€m)	7,168.9
Net debt (1F, €m)	303
Enterprise value (1F, €m)	7,773
Dividend yield (1F, %)	2.4

Source: Company data, ING estimates

Share price performance



Source: ING

We expect Jeronimo Martins' (JM) growth in sales and profits to be increasingly dominated by the company's Polish Biedronka banner, which is growing at 20%+ pa. E-commerce is not something that adds value to a business with an average transaction size of just over €6. In Portugal, JM is managed for cash in a tough environment driven by austerity measures. Entering a third country is currently higher up JM's agenda than e-commerce initiatives in Portugal.

Low priority for e-commerce initiatives. E-commerce is not something that would add much value to JM's current or medium-term operations. In Portugal, the focus is on gaining market share through a combination of low prices, strong execution and cost containment. Online purchases in general are still modest in Portugal compared with north-western Europe. The situation is similar in Poland. Online buying penetration is just as low as in Portugal, but on top comes our view that 'click-&-collect' is unsuitable for a hard discount format – with an average basket size in stores of just above €6, it does not seem to make sense, even if potential online order sizes were 5-6x larger.

Strong August food sales in Poland. We expect Biedronka to continue to be well positioned in Poland, despite consensus GDP growth forecasts declining a little of late. The European debt crises and other negative factors have led to consumers trading down in many countries, and Poland is no exception. With its low prices, Biedronka is, and we expect it to remain, the single largest winner of market share. This is largely due to a combination of c.10% LFL annual growth, and similar growth in selling space. While Polish (food) retail sales in August were excellent, ING's economics team anticipates a slowdown in retail sales following lower wage inflation.

One of our top sector picks: BUY rating maintained. We maintain our DCF-based target price of €14.5. We believe JM's Polish (Biedronka) growth story is intact despite weakening macro trends. The recent weakness in the Polish zloty is something of a surprise given that it has been virtually pegged to the euro for a long period. In constant currency terms, JM should continue to produce >20% EPS growth despite a lack of growth in its Portuguese assets. Entering a third country is currently higher on the company's agenda than e-commerce, which does not suit hard discount formats in the short or medium term in a country such as Portugal which is behind the curve in online sales penetration.

Forecasts and ratios

Year end Dec (€m)	2009	2010	2011F	2012F	2013F
Revenues	7,317	8,691	9,920	10,767	12,259
Normalised EBITDA	528	662	741	825	965
Normalised net profit	200	280	367	439	548
Normalised EPS (€)	0.32	0.45	0.58	0.70	0.87
Normalised PER (x)	35.8	25.5	19.5	16.3	13.1
EV/normalised EBITDA (x)	15.4	12.1	10.5	9.0	7.3
FCF yield (%)	3.0	4.4	5.1	6.7	8.7
Dividend yield (%)	1.3	1.8	2.4	2.9	3.6
Price/book (x)	9.2	8.5	6.3	4.8	3.7
Normalised ROE (%)	28.0	34.5	37.0	33.5	32.2

Source: Company data, ING estimates

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Financials

Year end Dec (€m)	2006	2007	2008	2009	2010	2011F	2012F	2013F
Income statement								
Revenues	4,407	5,350	6,894	7,317	8,691	9,920	10,767	12,259
Cost of goods sold	(3,535)	(4,331)	(5,595)	(5,926)	(7,057)	(8,073)	(8,759)	(9,986)
Gross profit	**872**	**1,018**	**1,299**	**1,391**	**1,634**	**1,847**	**2,008**	**2,273**
Operating costs	(550)	(686)	(838)	(873)	(982)	(1,115)	(1,183)	(1,308)
EBITDA	**323**	**332**	**460**	**518**	**652**	**731**	**825**	**965**
Depreciation & amortisation	(107)	(107)	(158)	(168)	(200)	(216)	(227)	(247)
EBIT	**216**	**225**	**303**	**350**	**452**	**516**	**598**	**719**
Net interest	(27)	(38)	(81)	(71)	(74)	(30)	(18)	0
Pre-tax profit	**189**	**188**	**222**	**279**	**378**	**486**	**580**	**719**
Tax	(38)	(37)	(46)	(56)	(79)	(102)	(122)	(151)
Minorities	(35)	(20)	(13)	(23)	(19)	(17)	(19)	(20)
Net profit	**116**	**131**	**163**	**200**	**280**	**367**	**439**	**548**
Normalised EBITDA	**319**	**332**	**473**	**528**	**662**	**741**	**825**	**965**
Normalised EBIT	**212**	**225**	**315**	**360**	**453**	**516**	**598**	**719**
Normalised net profit	**116**	**131**	**163**	**200**	**280**	**367**	**439**	**548**
Balance sheet								
Tangible fixed assets	1,318	1,671	1,876	2,004	2,194	2,446	2,719	3,041
Intangible fixed assets	446	496	827	835	863	863	863	863
Other non-current assets	212	199	203	212	198	202	205	209
Cash & equivalents	176	269	228	225	304	574	902	1,314
Other current assets	453	491	593	548	600	654	715	785
Total assets	**2,605**	**3,127**	**3,726**	**3,824**	**4,159**	**4,740**	**5,405**	**6,212**
Short-term debt	90	117	308	128	227	227	227	227
Other current liabilities	1,074	1,329	1,618	1,709	1,998	2,268	2,576	2,927
Long-term debt	590	726	759	786	651	651	651	651
Other long-term liabilities	83	91	110	136	152	152	152	152
Total liabilities	**1,837**	**2,263**	**2,795**	**2,759**	**3,027**	**3,298**	**3,605**	**3,956**
Total equity	767	864	931	1,066	1,132	1,442	1,800	2,256
Total liabilities & equity	**2,605**	**3,127**	**3,726**	**3,824**	**4,159**	**4,740**	**5,405**	**6,212**
Capital employed	1,448	1,707	1,998	1,980	2,010	2,320	2,677	3,134
Net working capital	(636)	(827)	(1,002)	(1,122)	(1,345)	(1,561)	(1,808)	(2,088)
Net debt (cash)	505	574	839	689	574	303	(24)	(436)
Cash flow								
Cash flow EBITDA	258	277	333	391	490	600	685	814
Change in working capital	100	154	218	135	140	216	247	280
Other non-cash items	26	19	55	55	109	102	122	151
Operating cash flow	**384**	**450**	**606**	**581**	**739**	**918**	**1,054**	**1,245**
Cash interest paid	(2)	3	(20)	(9)	(5)	0	0	0
Cash taxes paid	(17)	(27)	(38)	(29)	(46)	(51)	(56)	(62)
Net cash from operating activities	**364**	**427**	**548**	**544**	**687**	**866**	**998**	**1,183**
Capex	(306)	(459)	(471)	(327)	(396)	(468)	(500)	(568)
Net acquisitions	(0.2)	(7)	(425)	(2)	0.0	0	0	0
Other net investing cash flows	43	61	75	19	65	3	3	3
Cash from investing activities	**(264)**	**(405)**	**(821)**	**(309)**	**(330)**	**(465)**	**(497)**	**(565)**
Increase (decrease) in debt	(51)	129	261	(156)	(41)	0	0	0
Dividends & minority distribution	(66)	(68)	(74)	(84)	(239)	(132)	(173)	(206)
Cash from financing activities	**(117)**	**61**	**187**	**(240)**	**(281)**	**(132)**	**(173)**	**(206)**
Forex & discontinued operations	0.9	10	44	2	5	0	0	0
Net change in cash & equivalents	**(16)**	**93**	**(42)**	**(4)**	**80**	**270**	**328**	**412**
FCF	99	22	163	243	357	399	497	615

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Dec	2006	2007	2008	2009	2010	2011F	2012F	2013F
Performance & returns								
Revenue growth (%)	15.1	21.4	28.9	6.1	18.8	14.1	8.5	13.9
Normalised EBITDA growth (%)	3.4	4.1	42.6	11.6	25.4	11.9	11.2	17.0
Normalised EBIT growth (%)	1.5	6.1	40.4	14.1	26.0	13.8	15.9	20.2
Normalised EPS growth (%)	5.2	13.0	24.3	22.8	40.1	31.1	19.5	24.9
Gross margin (%)	19.8	19.0	18.8	19.0	18.8	18.6	18.6	18.5
Normalised EBITDA margin (%)	7.2	6.2	6.9	7.2	7.6	7.5	7.7	7.9
Normalised EBIT margin (%)	4.8	4.2	4.6	4.9	5.2	5.2	5.6	5.9
Reported net margin (%)	2.6	2.4	2.4	2.7	3.2	3.7	4.1	4.5
Reported ROE (%)	25.4	24.5	26.6	28.0	34.5	37.0	33.5	32.2
Normalised ROA (%)	8.5	7.8	9.2	9.5	11.4	11.6	11.8	12.4
ROAIC (%)	13.3	11.9	13.6	15.2	19.0	20.1	20.4	21.5
ROACE (%)	15.0	14.2	17.0	18.1	22.7	23.8	23.9	24.7
ROACE - WACC (%)	5.5	4.7	7.5	8.6	13.2	14.3	14.4	15.2
Leverage & solvency								
Working capital as % of sales	-14.4	-15.5	-14.5	-15.3	-15.5	-15.7	-16.8	-17.0
Net debt (cash)/EBITDA (x)	1.6	1.7	1.8	1.3	0.88	0.41	(0.03)	(0.45)
Net debt (cash)/equity (%)	65.8	66.4	90.1	64.7	50.7	21.0	-1.4	-19.3
EBITDA net interest coverage (x)	12.1	8.8	5.7	7.3	8.8	24.8	45.8	n/a
Current ratio (x)	0.54	0.53	0.43	0.42	0.41	0.49	0.58	0.67
Dividend cover (cash flow) (x)	2.5	1.4	2.9	3.8	2.5	4.0	3.9	4.0
Valuation								
EV/revenue (x)	1.8	1.5	1.2	1.1	0.92	0.78	0.69	0.58
EV/normalised EBITDA (x)	24.9	24.2	17.5	15.4	12.1	10.5	9.0	7.3
EV/normalised EBIT (x)	37.5	35.7	26.3	22.6	17.7	15.1	12.5	9.8
EV/capital employed (x)	5.5	4.7	4.1	4.1	4.0	3.4	2.8	2.3
EV/invested capital (x)	5.2	4.5	3.9	3.8	3.7	3.1	2.6	2.2
Normalised PER (x)	61.7	54.6	43.9	35.8	25.5	19.5	16.3	13.1
Price/book (x)	14.6	12.4	11.0	9.2	8.5	6.3	4.8	3.7
Dividend yield (%)	0.77	0.84	0.97	1.3	1.8	2.4	2.9	3.6
FCF yield (%)	1.2	0.28	2.0	3.0	4.4	5.1	6.7	8.7
Per share data								
Reported EPS (€)	0.18	0.21	0.26	0.32	0.45	0.58	0.70	0.87
Normalised EPS (€)	0.18	0.21	0.26	0.32	0.45	0.58	0.70	0.87
Dividend per share (€)	0.09	0.10	0.11	0.14	0.21	0.27	0.33	0.41
Equity FCFPS (€)	0.15	0.04	0.23	0.37	0.56	0.63	0.79	0.98
BV/share (€)	0.78	0.92	1.03	1.24	1.34	1.82	2.36	3.06

Source: Company data, ING estimates

Company profile

Jeronimo Martins has its origins in Portugal where it operates the Pingo Doce supermarket group (annual sales €2.7bn) through a 51% stake in a joint venture with Ahold, the Recheio Cash & Carry banner with annual sales of €0.7bn and Food manufacturing (€0.2bn) through a 45% stake in a joint venture with Unilever. JM also has some relatively small operations in areas such as marketing services and representation and speciality stores in ice cream and sweets & chocolates. The JM Group is now dominated by the growth wonder it has created in Poland, Biedronka, with annual sales close to €5bn.

Risk factors

The main downside risks to our BUY recommendation include: changes in consumption trends, prolonged periods of deflation or high inflation, competitor behaviour, management decisions, acquisition strategy, operational execution, equity market volatility, political risk, store-planning risk and adverse currency movements, notably that of the Polish zloty.

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Marks & Spencer

Exporting the multi-channel approach

Marks & Spencer (M&S) has a clear multi-channel strategy for General Merchandise in the UK. We believe the company's multi-channel approach has great potential in international markets. Until now, the Food business has not offered a home-delivery service, however, it is adding more SKUs to its 'click-&-collect' offering. M&S has adopted a 'wait-and-see', approach while Ocado and Waitrose are leading the upmarket online food delivery market.

Online growth: M&S is targeting online sales of £1bn by fiscal 2014. Its largest growth opportunity is exporting its 'bricks-&-clicks' model to international markets. At the end of 2011, M&S will launch a French webshop, together with a flagship store on the Champs Elysees and Simply Food convenience stores in and around Paris, to be operated by a franchise partner. This is a good example of what the ideal operating model will look like as it adapts to the rise of e-commerce while optimising returns.

Property valuation: M&S own 70% of freehold and long leaseholds in its stores. Assuming a scenario in which UK store-based sales declined, we estimate its property value could fall by up to 22%. Given that property is not perceived as an important floor, this in itself is not a great concern to us. We are more worried about the company's operating leases. Some 55% of leases are for longer than ten years and 25% are over 25 years. This could be a problem if the rent is no longer justified for stores that experience falling sales. Note that UK lease contracts are predominantly upward only.

Investment case: we recently upgraded our rating to HOLD on the back of a milder gross margin climate for the fashion part of the business, but we are still wary of going further due to the following reasons: 1) two out of four long-term targets (UK revenue target and the total group revenue) remain challenging; 2) the big four grocers, Ocado and Waitrose are investing heavily in their online food activities. At some point, M&S could find itself too far behind to ride the same wave; and 3) the leases, as explained.

EPS changes: we are becoming more optimistic about M&S' 'click-&-collect' growth opportunities and thus we slightly increase our EPS estimates to 34.24p for 2012F (from 33.54p), to 39.21p for 2013F (from 38.48p) and to 42.43p for 2014F (from 41.66p). We maintain our target price of 330p, which is based on DCF analysis.

Risks: upside risks include a significant improvement in consumer confidence in the UK, lower petrol prices and a potential takeover by private equity. On the downside, austerity measures such as higher taxes and public spending cuts could harm consumer spending.

Forecasts and ratios

Year end Mar (£m)	2010	2011	2012F	2013F	2014F
Revenues	9,537	9,740	10,106	10,512	10,936
Normalised EBITDA	1,246	1,253	1,335	1,440	1,512
Normalised net profit	518	612	540	618	669
Normalised EPS (p)	32.96	38.81	34.24	39.21	42.43
Normalised PER (x)	9.9	8.4	9.5	8.3	7.7
EV/normalised EBITDA (x)	8.8	8.5	8.0	7.2	6.6
FCF yield (%)	3.2	4.3	n/a	2.8	2.7
Dividend yield (%)	4.6	5.2	4.7	5.4	5.9
Price/book (x)	2.3	1.9	1.7	1.4	1.2
Normalised ROE (%)	24.2	25.2	18.7	18.3	17.1

Source: Company data, ING estimates

Hold (maintained)

Price (06/10/11)
325.3p

Target price (12-mth)
330.0p (maintained)

Forecast total return
6.2%

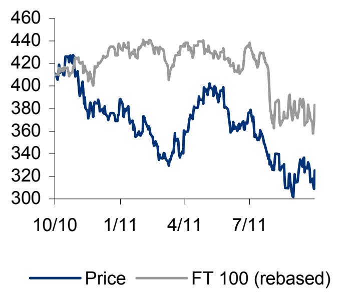
Retail
United Kingdom
Bloomberg: MKS LN
Reuters: MKS.L

Share data

Avg daily volume (3-mth)	6,533,270
Free float (%)	83.6
Market cap (£m)	8,644.0
Net debt (1F, £m)	2,058
Enterprise value (1F, £m)	10,702
Dividend yield (1F, %)	4.7

Source: Company data, ING estimates

Share price performance



Source: ING

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Financials

Year end Mar (£m)	2007	2008	2009	2010	2011	2012F	2013F	2014F
Income statement								
Revenues	8,588	9,022	9,062	9,537	9,740	10,106	10,512	10,936
Cost of goods sold	(5,247)	(5,535)	(5,690)	(5,918)	(6,016)	(6,245)	(6,486)	(6,748)
Gross profit	**3,341**	**3,487**	**3,372**	**3,619**	**3,725**	**3,860**	**4,026**	**4,189**
Operating costs	(2,013)	(2,053)	(2,215)	(2,372)	(2,471)	(2,525)	(2,586)	(2,677)
EBITDA	**1,329**	**1,434**	**1,157**	**1,246**	**1,253**	**1,335**	**1,440**	**1,512**
Depreciation & amortisation	(283)	(318)	(382)	(394)	(417)	(505)	(515)	(525)
Impairments	0	95	95	0	0	0	0	0
EBIT	**1,046**	**1,211**	**871**	**852**	**837**	**830**	**925**	**987**
Net interest	(109)	(82)	(165)	(149)	(56)	(110)	(100)	(95)
Pre-tax profit	**937**	**1,129**	**706**	**703**	**781**	**720**	**825**	**892**
Tax	(278)	(308)	(199)	(180)	(182)	(180)	(206)	(223)
Minorities	0	0.7	1	3	13	0	0	0
Other post-tax items	0.7	0	0	0	0	0	0	0
Net profit	**660**	**822**	**508**	**526**	**612**	**540**	**618**	**669**
Normalised EBITDA	**1,329**	**1,434**	**1,157**	**1,246**	**1,253**	**1,335**	**1,440**	**1,512**
Normalised EBIT	**1,047**	**1,211**	**870**	**852**	**1,100**	**710**	**1,011**	**(2,946)**
Normalised net profit	**682**	**728**	**441**	**518**	**612**	**540**	**618**	**669**
Balance sheet								
Tangible fixed assets	4,045	4,704	4,834	4,722	4,662	5,057	5,317	5,590
Intangible fixed assets	194	306	400	453	528	528	528	528
Other non-current assets	296	970	634	458	513	513	513	513
Cash & equivalents	183	336	516	454	489	468	824	1,130
Other current assets	664	845	874	1,066	1,153	1,243	1,212	1,235
Total assets	**5,381**	**7,161**	**7,258**	**7,153**	**7,344**	**7,808**	**8,393**	**8,995**
Short-term debt	461	879	943	483	602	602	602	602
Other current liabilities	1,145	1,110	1,364	1,408	1,608	1,648	1,690	1,733
Long-term debt	1,235	1,937	2,118	2,278	1,924	1,924	1,924	1,924
Other long-term liabilities	892	1,272	733	799	532	532	532	532
Total liabilities	**3,733**	**5,197**	**5,158**	**4,967**	**4,667**	**4,707**	**4,749**	**4,792**
Total equity	1,648	1,964	2,101	2,186	2,677	3,101	3,644	4,203
Total liabilities & equity	**5,381**	**7,161**	**7,258**	**7,153**	**7,344**	**7,808**	**8,393**	**8,995**
Capital employed	3,344	4,779	5,161	4,947	5,204	5,627	6,171	6,730
Net working capital	(431)	(180)	(252)	(259)	(412)	(363)	(435)	(455)
Net debt (cash)	1,513	2,479	2,545	2,307	2,038	2,058	1,702	1,396
Cash flow								
Cash flow EBITDA	833	1,056	751	802	1,010	935	1,033	1,099
Change in working capital	106	(150)	221	84	73	(49)	72	20
Other non-cash items	117	(61)	36	136	64	117	107	102
Operating cash flow	**1,056**	**846**	**1,008**	**1,021**	**1,147**	**1,003**	**1,213**	**1,222**
Cash taxes paid	(151)	(166)	(81)	(121)	(185)	(126)	(144)	(156)
Net cash from operating activities	**905**	**680**	**927**	**900**	**962**	**877**	**1,069**	**1,066**
Capex	(713)	(971)	(668)	(553)	(498)	(900)	(775)	(798)
Other net investing cash flows	(713)	0	0	0	0	0	0	0
Cash from investing activities	**(1,426)**	**(971)**	**(668)**	**(553)**	**(498)**	**(900)**	**(775)**	**(798)**
Increase (decrease) in equity	0	0	0	0	33	0	0	0
Increase (decrease) in debt	(479)	955	(16)	112	(84)	0	0	0
Dividends & minority distribution	0	(344)	(355)	(236)	(248)	(269)	(244)	(280)
Other financing cash flow	9	(556)	(36)	(7)	(4)	0	0	0
Cash from financing activities	**(470)**	**55**	**(406)**	**(131)**	**(302)**	**(269)**	**(244)**	**(280)**
Net change in cash & equivalents	**(991)**	**(237)**	**(148)**	**216**	**162**	**(292)**	**50**	**(12)**
FCF	(521)	(292)	259	347	463	(23)	294	268

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Mar	2007	2008	2009	2010	2011	2012F	2013F	2014F
Performance & returns								
Revenue growth (%)	10.1	5.1	0.44	5.2	2.1	3.8	4.0	4.0
Normalised EBITDA growth (%)	18.2	7.9	-19.3	7.7	0.58	6.5	7.8	5.0
Normalised EBIT growth (%)	21.9	15.6	-28.2	-2.1	29.1	-35.5	42.5	n/a
Normalised EPS growth (%)	28.2	7.8	-35.7	17.7	17.7	-11.8	14.5	8.2
Gross margin (%)	38.9	38.6	37.2	37.9	38.2	38.2	38.3	38.3
Normalised EBITDA margin (%)	15.5	15.9	12.8	13.1	12.9	13.2	13.7	13.8
Normalised EBIT margin (%)	12.2	13.4	9.6	8.9	11.3	7.0	9.6	-26.9
Reported net margin (%)	7.7	9.1	5.6	5.5	6.3	5.3	5.9	6.1
Reported ROE (%)	46.3	45.5	25.0	24.6	25.2	18.7	18.3	17.1
Normalised ROA (%)	19.7	19.3	12.1	11.8	15.2	9.4	12.5	-33.9
ROAIC (%)	21.0	20.3	13.2	12.6	11.4	11.8	12.1	11.9
ROACE (%)	31.1	29.8	17.5	16.9	21.7	13.1	17.1	-45.7
ROACE - WACC (%)	22.2	20.9	8.6	7.9	12.7	4.2	8.2	-54.6
Leverage & solvency								
Working capital as % of sales	-5.0	-2.0	-2.8	-2.7	-4.2	-3.6	-4.1	-4.2
Net debt (cash)/EBITDA (x)	1.1	1.7	2.2	1.9	1.6	1.5	1.2	0.92
Net debt (cash)/equity (%)	91.8	126.2	121.2	105.5	76.1	66.4	46.7	33.2
EBITDA net interest coverage (x)	11.5	15.9	6.9	8.1	20.4	11.6	13.7	15.9
Current ratio (x)	0.53	0.59	0.60	0.80	0.74	0.76	0.89	1.0
Dividend cover (cash flow) (x)	n/a	0.15	1.7	2.5	2.9	0.92	2.2	2.0
Valuation								
EV/revenue (x)	1.2	1.2	1.2	1.1	1.1	1.1	0.98	0.92
EV/normalised EBITDA (x)	7.6	7.8	9.7	8.8	8.5	8.0	7.2	6.6
EV/normalised EBIT (x)	9.7	9.2	12.9	12.9	9.7	15.1	10.2	(3.4)
EV/capital employed (x)	3.0	2.3	2.2	2.2	2.1	1.9	1.7	1.5
EV/invested capital (x)	2.4	1.8	1.9	1.9	1.9	1.7	1.5	1.4
Normalised PER (x)	8.1	7.5	11.6	9.9	8.4	9.5	8.3	7.7
Price/book (x)	3.3	2.8	2.4	2.3	1.9	1.7	1.4	1.2
Dividend yield (%)	4.8	6.2	6.9	4.6	5.2	4.7	5.4	5.9
FCF yield (%)	n/a	n/a	2.3	3.2	4.3	n/a	2.8	2.7
Per share data								
Reported EPS (p)	39.07	49.17	32.28	33.48	38.81	34.24	39.21	42.43
Normalised EPS (p)	40.41	43.57	28.01	32.96	38.81	34.24	39.21	42.43
Dividend per share (p)	15.50	20.30	22.50	15.00	17.00	15.41	17.65	19.09
Equity FCFPS (p)	(30.83)	(17.44)	16.44	22.06	29.39	(1.43)	18.63	16.97
BV/share (p)	97.61	117.5	133.5	139.0	169.8	196.6	231.1	266.5

Source: Company data, ING estimates

Company profile

Marks & Spencer Group is an international retail company with revenue of £9.7bn in FY11, 90% attributable to the UK. Around 52% of UK sales stem from food products and 48% general merchandise. International contributes 10% to group sales and the total number of stores is 361. M&S is expanding rapidly, especially in emerging markets. In FY11, it opened 49 international stores. The businesses are operated through wholly-owned, partly-owned and franchise stores. The fully-owned operations are located in Shanghai, Hong Kong and Ireland. In India, M&S partners with Reliance Retail.

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Metro

Late in embracing e-commerce

Buy (maintained)

Price (06/10/11)
€32.64

Target price (12-mth)
€39.00 (maintained)

Forecast total return
24.1%

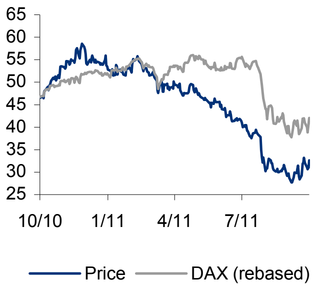
Retail
Germany
Bloomberg: MEO GY
Reuters: MEOG.F

Share data

Avg daily volume (3-mth)	8,814
Free float (%)	49.9
Market cap (€m)	10,666.3
Net debt (1F, €m)	3,117
Enterprise value (1F, €m)	17,816
Dividend yield (1F, %)	4.6

Source: Company data, ING estimates

Share price performance



Source: ING

We believe Metro needs to develop different skills for its various operations. In cash-&-carry, the company is focusing on delivery where ordering is performed electronically. In electronics, management has recently reacted to market pressure from pure players and announced significant measures to ensure the group remains on its growth path. Short term, however, this is unlikely given pressure on store sales, particularly in Germany where the bulk of profits are derived. Metro has also bought pure-player redcoon.com and more acquisitions are likely. Real is also finally piloting 'click-&-collect'.

Arriving late at the game. While the internet is rapidly changing retail trends, Metro has long been wrapped up in the unparalleled success of its Media Markt/Saturn (MM/S) unit, which revelled in positive LFL sales figures and further robust growth from new store openings for a decade. For years, MM/S gained market share in almost every market that it operated, either as an established player or as a relatively new operator. The increase in market share from online electronics sellers could not harm the growth machine until the inflection point. Late in 2010, MM/S started to lose market share for the first time in its most important market, Germany, which accounts for 43% of MM/S sales. Metro has addressed the poor trend by appointing new management, which is rolling-out multi-channel initiatives, lowering prices via cost cutting and making pure-play acquisitions. Indeed, the MM/S example illustrates how fast businesses may have to adapt to internet trends.

BUY rating with a target price of €39. Our €39 TP is based on DCF and SOTP analysis, and we have a BUY rating as we feel there is substantial value in the shares, which will be unlocked at some point. While there is a short-term risk of a profit warning, note that our 2011F EBIT forecast (€2,537m, +5%) is already below company guidance of 10% growth in 2011F as are consensus estimates (€2,520, +4%). If and when financial and consumer markets recover, we expect Metro to be one of the best performers in the sector, offering a combination of substantial emerging market exposure, notably Central and Eastern Europe, and catalysts such as the sale of the department and hypermarket divisions. On one hand, the outlook for MM/S is mixed due to further pressure from the internet in its more mature markets. On the other, if the execution of the new multi-channel strategy materialises, probably after some further fine-tuning, we believe MM/S could become a winner again. The division's brand equity still stands out in Europe.

Forecasts and ratios

Year end Dec (€m)	2009	2010	2011F	2012F	2013F
Revenues	65,529	67,258	67,722	69,806	72,526
Normalised EBITDA	3,328	3,795	3,872	4,004	4,244
Normalised net profit	686	1,019	1,125	1,308	1,386
Normalised EPS (€)	2.10	3.12	3.44	4.00	4.24
Normalised PER (x)	15.5	10.5	9.5	8.2	7.7
EV/normalised EBITDA (x)	5.8	4.8	4.6	4.4	4.1
FCF yield (%)	8.2	10.4	8.7	8.2	9.0
Dividend yield (%)	3.6	4.1	4.6	5.2	5.8
Price/book (x)	1.9	1.7	1.5	1.3	1.2
Normalised ROE (%)	11.9	16.9	16.5	16.8	15.9

Source: Company data, ING estimates

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Financials

Year end Dec (€m)	2006	2007	2008	2009	2010	2011F	2012F	2013F
Income statement								
Revenues	59,882	64,210	67,956	65,529	67,258	67,722	69,806	72,526
Cost of goods sold	(47,390)	(50,810)	(53,636)	(51,664)	(52,865)	(53,365)	(54,937)	(57,005)
Gross profit	**12,492**	**13,400**	**14,320**	**13,865**	**14,393**	**14,357**	**14,869**	**15,521**
Operating costs	(9,259)	(10,039)	(10,980)	(10,788)	(10,802)	(10,718)	(10,989)	(11,376)
EBITDA	**3,233**	**3,361**	**3,340**	**3,077**	**3,591**	**3,639**	**3,879**	**4,144**
Depreciation & amortisation	(1,250)	(1,283)	(1,352)	(1,396)	(1,380)	(1,335)	(1,333)	(1,448)
EBIT	**1,983**	**2,078**	**1,988**	**1,681**	**2,211**	**2,304**	**2,546**	**2,696**
Net interest	(449)	(517)	(573)	(631)	(581)	(623)	(580)	(570)
Pre-tax profit	**1,534**	**1,561**	**1,415**	**1,050**	**1,630**	**1,681**	**1,966**	**2,126**
Tax	(484)	(560)	(426)	(531)	(694)	(630)	(649)	(702)
Minorities	(137)	(158)	(157)	(136)	(86)	(85)	(95)	(107)
Other post-tax items	143	(18)	(429)	0	0	0	0	0
Net profit	**1,056**	**825**	**403**	**383**	**850**	**966**	**1,222**	**1,318**
Normalised EBITDA	**3,233**	**3,361**	**3,543**	**3,328**	**3,795**	**3,872**	**4,004**	**4,244**
Normalised EBIT	**1,983**	**2,078**	**2,225**	**2,024**	**2,415**	**2,537**	**2,671**	**2,796**
Normalised net profit	**863**	**905**	**994**	**686**	**1,019**	**1,125**	**1,308**	**1,386**
Balance sheet								
Tangible fixed assets	12,226	12,484	12,668	12,357	12,730	13,402	14,271	15,180
Intangible fixed assets	4,857	4,843	4,512	4,489	4,500	4,479	4,479	4,479
Other non-current assets	1,895	1,555	1,628	1,618	1,682	1,656	1,656	1,656
Cash & equivalents	2,753	3,461	3,882	4,034	4,802	5,166	5,430	5,741
Other current assets	10,417	11,529	11,135	11,169	11,353	11,530	12,076	12,764
Total assets	**32,148**	**33,872**	**33,825**	**33,667**	**35,067**	**36,233**	**37,912**	**39,821**
Short-term debt	1,740	2,708	3,448	1,491	1,750	1,750	1,750	1,750
Other current liabilities	15,492	17,298	16,934	17,078	17,867	18,008	18,765	19,715
Long-term debt	6,279	5,030	5,031	6,743	6,533	6,533	6,533	6,533
Other long-term liabilities	2,590	2,327	2,338	2,363	2,457	2,499	2,499	2,499
Total liabilities	**26,101**	**27,363**	**27,751**	**27,675**	**28,607**	**28,790**	**29,547**	**30,497**
Total equity	6,047	6,509	6,074	5,992	6,460	7,443	8,365	9,324
Total liabilities & equity	**32,148**	**33,872**	**33,825**	**33,667**	**35,067**	**36,233**	**37,912**	**39,821**
Capital employed	14,066	14,247	14,553	14,226	14,743	15,726	16,648	17,607
Net working capital	(4,776)	(5,780)	(5,687)	(5,870)	(6,434)	(6,666)	(6,877)	(7,138)
Net debt (cash)	5,266	4,277	4,597	4,200	3,481	3,117	2,853	2,542
Cash flow								
Cash flow EBITDA	2,300	2,284	2,341	1,915	2,316	2,386	2,650	2,807
Change in working capital	1,137	864	294	130	(288)	232	210	262
Other non-cash items	369	578	656	1,068	1,083	920	979	1,022
Operating cash flow	**3,806**	**3,726**	**3,291**	**3,113**	**3,111**	**3,539**	**3,840**	**4,091**
Cash interest paid	(441)	(488)	(448)	(553)	(584)	(623)	(580)	(570)
Cash taxes paid	(543)	(534)	(640)	(560)	(597)	(630)	(649)	(702)
Net cash from operating activities	**2,822**	**2,704**	**2,203**	**2,000**	**1,930**	**2,285**	**2,611**	**2,819**
Capex	(1,824)	(1,832)	(2,281)	(1,189)	(1,412)	(1,800)	(2,202)	(2,292)
Net acquisitions	387	186	(7)	(8)	0	0	0	0
Other net investing cash flows	135	380	548	35	451	387	450	450
Cash from investing activities	**(1,302)**	**(1,266)**	**(1,740)**	**(1,162)**	**(961)**	**(1,413)**	**(1,752)**	**(1,842)**
Increase (decrease) in debt	(148)	(254)	763	(202)	404	0	0	0
Dividends & minority distribution	(456)	(494)	(530)	(510)	(529)	(542)	(595)	(666)
Other financing cash flow	50	(21)	(180)	(37)	(25)	0	0	0
Cash from financing activities	**(554)**	**(769)**	**53**	**(749)**	**(150)**	**(542)**	**(595)**	**(666)**
Forex & discontinued operations	(1)	42	(60)	33	13	(11)	0	0
Net change in cash & equivalents	**965**	**711**	**456**	**122**	**832**	**319**	**264**	**312**
FCF	1,842	2,065	1,176	1,590	1,886	1,558	1,439	1,547

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Dec	2006	2007	2008	2009	2010	2011F	2012F	2013F
Performance & returns								
Revenue growth (%)	7.5	7.2	5.8	-3.6	2.6	0.69	3.1	3.9
Normalised EBITDA growth (%)	10.0	4.0	5.4	-6.1	14.0	2.0	3.4	6.0
Normalised EBIT growth (%)	14.1	4.8	7.1	-9.0	19.3	5.1	5.3	4.7
Normalised EPS growth (%)	6.9	4.9	9.8	-31.0	48.5	10.5	16.2	6.0
Gross margin (%)	20.9	20.9	21.1	21.2	21.4	21.2	21.3	21.4
Normalised EBITDA margin (%)	5.4	5.2	5.2	5.1	5.6	5.7	5.7	5.9
Normalised EBIT margin (%)	3.3	3.2	3.3	3.1	3.6	3.7	3.8	3.9
Reported net margin (%)	1.8	1.3	0.59	0.58	1.3	1.4	1.8	1.8
Reported ROE (%)	19.3	13.7	6.7	6.6	14.1	14.2	15.7	15.1
Normalised ROA (%)	6.5	6.3	6.6	6.0	7.0	7.1	7.2	7.2
ROAIC (%)	9.0	9.3	8.1	6.7	9.6	9.5	10.2	10.2
ROACE (%)	14.7	14.7	15.5	14.1	16.7	16.7	16.5	16.3
ROACE - WACC (%)	5.8	5.8	6.6	5.2	7.8	7.8	7.6	7.4
Leverage & solvency								
Working capital as % of sales	-8.0	-9.0	-8.4	-9.0	-9.6	-9.8	-9.9	-9.8
Net debt (cash)/EBITDA (x)	1.6	1.3	1.4	1.4	0.97	0.86	0.74	0.61
Net debt (cash)/equity (%)	87.1	65.7	75.7	70.1	53.9	41.9	34.1	27.3
EBITDA net interest coverage (x)	7.2	6.5	5.8	4.9	6.2	5.8	6.7	7.3
Current ratio (x)	0.76	0.75	0.74	0.82	0.82	0.85	0.85	0.86
Dividend cover (cash flow) (x)	5.2	5.3	2.9	3.7	4.4	3.1	2.8	2.8
Valuation								
EV/revenue (x)	0.34	0.31	0.29	0.30	0.27	0.26	0.25	0.24
EV/normalised EBITDA (x)	6.3	6.0	5.6	5.8	4.8	4.6	4.4	4.1
EV/normalised EBIT (x)	10.3	9.6	8.9	9.6	7.5	7.0	6.6	6.2
EV/capital employed (x)	1.4	1.4	1.4	1.4	1.2	1.1	1.1	0.98
EV/invested capital (x)	1.2	1.2	1.2	1.2	1.1	0.98	0.92	0.86
Normalised PER (x)	12.4	11.8	10.7	15.5	10.5	9.5	8.2	7.7
Price/book (x)	1.8	1.7	1.8	1.9	1.7	1.5	1.3	1.2
Dividend yield (%)	3.4	3.6	3.6	3.6	4.1	4.6	5.2	5.8
FCF yield (%)	9.0	10.3	5.9	8.2	10.4	8.7	8.2	9.0
Per share data								
Reported EPS (€)	3.23	2.52	1.23	1.17	2.60	2.96	3.74	4.03
Normalised EPS (€)	2.64	2.77	3.04	2.10	3.12	3.44	4.00	4.24
Dividend per share (€)	1.12	1.18	1.18	1.18	1.35	1.50	1.70	1.90
Equity FCFPS (€)	4.29	4.83	2.23	3.17	3.98	2.86	2.63	2.99
BV/share (€)	17.84	19.14	17.81	17.61	19.30	22.42	25.20	28.10

Source: Company data, ING estimates

Company profile

Metro was founded in 1996 through the merger of three companies. Metro has since streamlined its operations from a retail conglomerate into a more focused company. Its strategy is to focus investments on the high-potential divisions Cash & Carry (Metro & Makro brands account for 47% of Group sales) and Consumer Electronics (Media Markt & Saturn brands account for 30% of Group sales) and reduce exposure to Germany. Other divisions are Real (hypermarkets, 17%) and Kaufhof department stores (5%). 50.01% of the shares are owned by two of the three founding families (Haniel and Schmidt-Ruthenbeck).

Risks

Risks to our BUY recommendation include: changes in consumption trends (possibly influenced by changes in economic activity), strategy (eg, delivery services in Cash & Carry and a multi-channel approach in electronics), online competition, competitors' actions, operational execution, relationships with minority shareholders in Media Markt/Saturn and joint venture partners (China), currency risk and equity market volatility.

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Morrison

Fresh food DNA a benefit in e-tail era

Hold (maintained)

Price (06/10/11)
298.2p

Target price (12-mth)
314.0p (maintained)

Forecast total return
8.9%

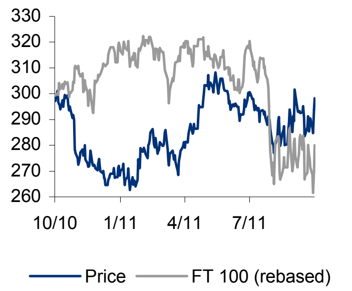
Retail
United Kingdom
Bloomberg: MRW LN
Reuters: MRW.L

Share data

Avg daily volume (3-mth)	8,390,033
Free float (%)	83.6
Market cap (£m)	7,923.9
Net debt (1F, £m)	991
Enterprise value (1F, £m)	8,915
Dividend yield (1F, %)	3.6

Source: Company data, ING estimates

Share price performance



Source: ING

The growth of e-commerce means that Morrison is an attractive proposition for consumers compared with rivals Tesco, Sainsbury and ASDA as Morrison realises c.95% of its sales in food (including HPC) and has an outstanding reputation for fresh food. In addition, the company has adopted a focused approach to non-food: its first steps were the acquisition of baby products webshop Kiddicare and a stake in US online grocer FreshDirect, to learn more about online fresh food sales (which is a high-risk business, in our view).

Iceland Foods (796 stores, £2.4bn revenue in 2010 and a price tag of £1.5-2bn, according to Planet Retail): we believe Morrison's takeover of Iceland on its own is an unwise and unlikely move. Our main concerns are the high price, different formats, costly remodelling trajectory, unfavourable lease contracts and company's dependence on Malcolm Walker. The most likely scenario, in our view, is that Walker and his team take it over and sell some stores to Morrison/ASDA to finance the deal as he likely has some sort of right of first refusal. An alternative scenario for Iceland Foods would be a tie-up with ASDA and Morrison, jointly taking over Iceland Foods. This could make sense, as it would maximise the selling price avoid competition issues. Morrison would then be able to expand into convenience stores.

Impact on property valuation: we believe that over the next 10 years, the retail property values of tier 2 and tier 3 locations will fall due to the rise of e-commerce. In our least pessimistic scenario (pencilling in a 10% decline in property value), we expect a market cap loss amounting to 10% or £0.8bn. In a worst-case scenario (a 25% decline in value), the loss is calculated at £1.9bn, which implies downside of 26%. Note that we use the book value of property. Given that most customers shop at Morrison because of its excellent fresh food offering, we anticipate footfall, sales and thus property prices only falling by 10-15% in a stressed scenario.

Valuation and estimates: at 6.3x EV/EBITDA and a 2013F PER of 9.8x, we believe Morrison is fairly valued. However, consensus estimates do not fully reflect the impact of the share buyback programme. Our EPS estimates are 2%, 5% and 3% higher than consensus estimates, respectively. We think that this will be adjusted over the next couple of weeks, making Morrison an attractive short-term play. On a 12-month basis, we contend that the share price has limited upside and limited downside, and thus reiterate our HOLD recommendation. Our target price of 314p is based on DCF analysis.

Forecasts and ratios

Year end Jan (£m)	2010	2011	2012F	2013F	2014F
Revenues	15,410	16,479	17,707	18,778	19,717
Normalised EBITDA	1,120	1,223	1,313	1,399	1,499
Normalised net profit	537	632	666	732	792
Normalised EPS (p)	20.47	23.93	25.78	30.34	34.05
Normalised PER (x)	14.6	12.5	11.6	9.8	8.8
EV/normalised EBITDA (x)	7.7	7.1	6.8	6.3	5.8
FCF yield (%)	n/a	4.2	2.0	5.2	6.4
Dividend yield (%)	2.7	3.2	3.6	4.0	4.5
Price/book (x)	1.6	1.5	1.3	1.3	1.2
Normalised ROE (%)	11.3	12.2	11.9	12.4	12.6

Source: Company data, ING estimates

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Change in estimates

Following Morrison's half-year figures, we change our estimates, as shown in Figure 46. On sales and even profits before tax, we are only fractionally above consensus. Our EPS estimates are 3% to 5% higher as we argue that consensus does not reflect the full impact of the two-year, £1bn share buyback programme.

Fig 46 ING estimates old vs new vs consensus (£)

	2010-11	2011-12F	2012-13F	2013-14F
Sales				
old	16,479	17,293	18,089	18,996
new	16,479	17,707	18,778	19,717
consensus	16,479	17,582	18,589	19,794
Δ%		1	1	0
Profit before tax				
old	874	920	965	1,051
new	874	934	1002	1,084
consensus	874	926	991	1,076
Δ%		1	1	1
EPS (p)				
old	23.93	25.20	28.35	32.02
new	23.93	25.87	30.34	34.05
consensus	23.93	25.26	29.00	32.93
Δ%		2	5	3

Source: Company data, ING estimates

Risks

Upside risks:

- A takeover by private equity, note that Ken Morrison, and Nigel and Susan Pritchard have been selling shares.
- The start of a property disposal programme (dry assets), an improvement in consumer sentiment resulting in higher consumer spending.

Downside risks:

- A takeover of Iceland Foods would be negative.
- Ambitious space growth projects at all UK grocers combined with rising online sales may lead to lower sales densities and lower margins for the industry as a whole.
- Declining property markets and valuations for UK retail property. This could lead to the postponement of asset disposals or disappointing proceeds.
- Owning many food-processing factories, higher commodity costs will have an impact on the profitability of Morrison.
- A double-dip scenario for the UK. Austerity measures such as higher taxes and public spending cuts could harm small and mid-sized enterprises, and the pay cheques of many families.

Financials

Year end Jan (£m)	2007	2008	2009	2010	2011	2012F	2013F	2014F
Income statement								
Revenues	12,462	12,969	14,528	15,410	16,479	17,707	18,778	19,717
Cost of goods sold	(11,544)	(11,862)	(13,325)	(14,044)	(15,012)	(16,113)	(17,059)	(17,913)
Gross profit	**918**	**1,107**	**1,203**	**1,366**	**1,467**	**1,594**	**1,718**	**1,804**
Operating costs	(213)	(206)	(242)	(155)	(244)	(281)	(319)	(305)
EBITDA	**705**	**901**	**961**	**1,211**	**1,223**	**1,313**	**1,399**	**1,499**
Depreciation & amortisation	(282)	(289)	(290)	(304)	(319)	(336)	(357)	(375)
Impairments	0	0	0	0	0	0	0	0
EBIT	**423**	**612**	**671**	**907**	**904**	**976**	**1,042**	**1,124**
Net interest	(54)	0	(16)	(49)	(30)	(42)	(40)	(40)
Associates	0	0	0	0	0	0	0	0
Other pre-tax items	0	0	0	0	0	0	0	0
Pre-tax profit	**369**	**612**	**655**	**858**	**874**	**934**	**1,002**	**1,084**
Tax	(121)	(58)	(195)	(260)	(242)	(268)	(271)	(293)
Minorities								
Other post-tax items	0	0	0	0	0	0	0	0
Net profit	**248**	**554**	**460**	**598**	**632**	**666**	**732**	**792**
Normalised EBITDA	**705**	**901**	**961**	**1,120**	**1,223**	**1,313**	**1,399**	**1,499**
Normalised EBIT	**423**	**612**	**671**	**816**	**904**	**976**	**1,042**	**1,124**
Normalised net profit	**248**	**383**	**441**	**537**	**632**	**666**	**732**	**792**
Balance sheet								
Tangible fixed assets	6,117	6,205	6,587	7,180	7,557	8,121	8,564	8,989
Intangible fixed assets	0	0	0	0	0	0	0	0
Other non-current assets	488	521	573	486	454	454	454	454
Cash & equivalents	231	191	327	316	232	114	253	447
Other current assets	535	719	739	778	906	978	1,000	1,023
Total assets	**7,371**	**7,636**	**8,226**	**8,760**	**9,149**	**9,666**	**10,271**	**10,913**
Short-term debt	0	0	0	0	0	0	0	0
Other current liabilities	1,855	1,853	2,024	2,152	2,086	2,182	2,322	2,473
Long-term debt	769	774	1,049	1,027	1,052	1,105	1,138	1,172
Other long-term liabilities	820	631	633	632	591	650	715	787
Total liabilities	**3,444**	**3,258**	**3,706**	**3,811**	**3,729**	**3,936**	**4,175**	**4,431**
Total equity	3,927	4,378	4,520	4,949	5,420	5,730	6,096	6,482
Total liabilities & equity	**7,371**	**7,636**	**8,226**	**8,760**	**9,149**	**9,666**	**10,271**	**10,913**
Capital employed	4,696	5,152	5,569	5,976	6,472	6,834	7,234	7,653
Net working capital	(983)	(1,038)	(1,176)	(1,067)	(1,008)	(1,032)	(1,150)	(1,278)
Net debt (cash)	538	583	722	711	820	991	884	725
Cash flow								
Cash flow EBITDA	597	901	929	1,113	1,163	1,229	1,319	1,419
Change in working capital	76	29	91	(105)	(84)	(35)	53	56
Other non-cash items	31	(174)	(56)	(4)	62	74	72	72
Operating cash flow	**704**	**756**	**964**	**1,004**	**1,141**	**1,268**	**1,444**	**1,547**
Cash interest paid	(68)	(70)	(70)	(60)	(52)	(42)	(40)	(40)
Cash taxes paid	(54)	(107)	(104)	(209)	(191)	(188)	(189)	(205)
Net cash from operating activities	**583**	**579**	**790**	**735**	**898**	**1,038**	**1,215**	**1,302**
Capex	(257)	(402)	(678)	(906)	(595)	(900)	(800)	(800)
Net acquisitions	0	0	0	0	0	0	0	0
Other net investing cash flows	171	144	51	15	13	0	0	8
Cash from investing activities	**(86)**	**(258)**	**(627)**	**(891)**	**(582)**	**(900)**	**(800)**	**(792)**
Increase (decrease) in equity	5	17	3	34	16	0	0	0
Increase (decrease) in debt	(261)	(340)	322	199	(129)	0	0	0
Dividends & minority distribution	(98)	(108)	(131)	(159)	(220)	(255)	(275)	(308)
Other financing cash flow	(3)	(3)	(148)	0	0	0	0	0
Cash from financing activities	**(356)**	**(434)**	**46**	**74**	**(333)**	**(255)**	**(275)**	**(308)**
Forex & discontinued operations								
Net change in cash & equivalents	**140**	**(113)**	**209**	**(82)**	**(17)**	**(118)**	**140**	**202**
FCF	552	341	204	(104)	363	180	455	550

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Jan	2007	2008	2009	2010	2011	2012F	2013F	2014F
Performance & returns								
Revenue growth (%)	2.9	4.1	12.0	6.1	6.9	7.5	6.0	5.0
Normalised EBITDA growth (%)	n/a	27.8	6.7	16.5	9.2	7.3	6.6	7.1
Normalised EBIT growth (%)	n/a	44.6	9.6	21.6	10.8	8.0	6.7	7.9
Normalised EPS growth (%)	n/a	54.3	16.0	22.8	16.9	7.7	17.7	12.2
Gross margin (%)	7.4	8.5	8.3	8.9	8.9	9.0	9.2	9.2
Normalised EBITDA margin (%)	5.7	6.9	6.6	7.3	7.4	7.4	7.5	7.6
Normalised EBIT margin (%)	3.4	4.7	4.6	5.3	5.5	5.5	5.6	5.7
Reported net margin (%)	2.0	4.3	3.2	3.9	3.8	3.8	3.9	4.0
Reported ROE (%)	6.5	13.3	10.3	12.6	12.2	11.9	12.4	12.6
Normalised ROA (%)	5.7	8.2	8.5	9.6	10.1	10.4	10.5	10.6
ROAIC (%)	6.6	8.9	9.5	10.9	10.4	10.8	11.1	11.2
ROACE (%)	9.0	12.4	12.5	14.1	14.5	14.7	14.8	15.1
ROACE - WACC (%)	-0.29	3.1	3.2	4.8	5.2	5.3	5.5	5.8
Leverage & solvency								
Working capital as % of sales	-7.9	-8.0	-8.1	-6.9	-6.1	-5.8	-6.1	-6.5
Net debt (cash)/EBITDA (x)	0.76	0.65	0.75	0.59	0.67	0.75	0.63	0.48
Net debt (cash)/equity (%)	13.7	13.3	16.0	14.4	15.1	17.3	14.5	11.2
EBITDA net interest coverage (x)	11.7	112.6	48.1	22.4	34.9	27.9	31.1	33.3
Current ratio (x)	0.41	0.49	0.53	0.51	0.55	0.50	0.54	0.59
Dividend cover (cash flow) (x)	5.9	3.5	2.0	n/a	2.4	1.5	2.5	2.7
Valuation								
EV/revenue (x)	0.68	0.66	0.60	0.56	0.53	0.50	0.47	0.44
EV/normalised EBITDA (x)	12.0	9.4	9.0	7.7	7.1	6.8	6.3	5.8
EV/normalised EBIT (x)	20.0	13.9	12.9	10.6	9.7	9.1	8.5	7.7
EV/capital employed (x)	1.8	1.7	1.6	1.4	1.4	1.3	1.2	1.1
EV/invested capital (x)	1.5	1.5	1.4	1.3	1.2	1.2	1.1	1.0
Normalised PER (x)	32.0	20.7	17.9	14.6	12.5	11.6	9.8	8.8
Price/book (x)	2.0	1.8	1.7	1.6	1.5	1.3	1.3	1.2
Dividend yield (%)	1.3	1.6	1.9	2.7	3.2	3.6	4.0	4.5
FCF yield (%)	6.5	4.0	2.4	n/a	4.2	2.0	5.2	6.4
Per share data								
Reported EPS (p)	9.32	20.79	17.39	22.80	23.93	25.78	30.34	34.05
Normalised EPS (p)	9.32	14.38	16.67	20.47	23.93	25.78	30.34	34.05
Dividend per share (p)	4.00	4.80	5.80	8.20	9.60	10.66	11.93	13.37
Equity FCFPS (p)	18.21	10.17	5.07	(6.25)	11.78	5.33	17.21	21.94
BV/share (p)	147.8	164.3	171.9	186.7	203.9	221.8	236.0	250.9

Source: Company data, ING estimates

Company profile

The UK's #4 supermarket chain (425 stores, c.11% share), incl. branded and own-label. Morrison aims to provide best VFM; pricing is the same in all its large stores. Unlike its rivals, it runs almost all its operations in-house, incl. fresh fruit/veg, fresh food, meat processing and transport. Fresh produce arrives at its warehouses/packing plants for dispatch to stores. It owns a fresh food factory (pizzas, pies, cooked meats, packing cheese and bacon), and meat processors where beef, pork and lamb are prepared and sent to its in-store butchers. HQ is in Bradford; CEO is Dalton Philips.

J.Sainsbury

Property backing not only a blessing

Sell (maintained)

Price (06/10/11)
293.6p

Target price (12-mth)
246.0p (maintained)

Forecast total return
-10.9%

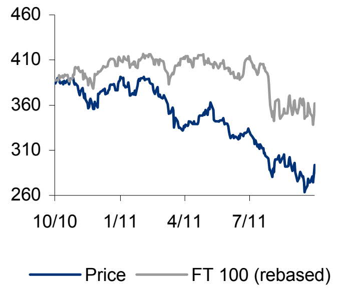
Retail
United Kingdom
Bloomberg: SBRY LN
Reuters: SBRY.L

Share data

Avg daily volume (3-mth)	5,524,640
Free float (%)	83.6
Market cap (£m)	5,461.0
Net debt (1F, £m)	2,191
Enterprise value (1F, £m)	7,652
Dividend yield (1F, %)	5.3

Source: Company data, ING estimates

Share price performance



Source: ING

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We believe Sainsbury is a potential casualty of the accelerated acceptance of e-commerce and the race for space. As a traditional retailer with over 95% of sales made in-store, and with the lowest trading margins out of listed UK retailers, we are concerned that Sainsbury is spending too much money on expansion capex in 'old-school' retail. As both an owner and operator of retail property, it faces the negative consequences of double leverage in a scenario of falling property values.

Online growth: the company's online business makes up c.3% (INGF) of total sales. Sainsbury is rapidly rolling out its 'click-&-collect' service for non-food, especially in convenience stores. At the end of 2011, 800 stores are set to offer the service. We believe that the company is also looking at 'click-&-collect' for groceries. Using a 'click-&-collect' model, Sainsbury can sweat its existing assets, mitigating the effect of slowing store-based sales.

Property valuation: while 'click-&-collect' seems to be a huge success, Sainsbury's property value could come under pressure in a stress scenario. The market value of its property is worth more than enterprise value, which raises the question whether the share price is hugely undervalued or whether alleged property value is overstated. We see material downward risks for Sainsbury's property value. A 10% decrease in property values results in the company's market cap falling by 20%, on our calculations.

Investment case: given an anticipated acceleration in the online food retail market, we are concerned about Sainsbury's large capex programmes, as the current free operating cash flow is insufficient to service dividend payments, let alone medium-sized or large acquisitions. This is due to capital expenditures related to opening new stores and store extensions.

EPS changes: following Sainsbury's better-than-expected 2Q11 trading update, we slightly increase our estimates for 2012F to 27.40p (from 26.95p), for 2013F to 28.90p (from 28.42p) and for 2014F to 31.18p (from 30.67p). We reiterate our SELL recommendation and DCF-based target price of 246p.

Risk factors: the main risk on the positive side is returning interest from Qatar, possibly leading to a new bid. On the negative side, the ambitious space growth projects of all UK grocers, combined with rising online sales, could lead to lower sales densities and lower margins for the industry as a whole.

Forecasts and ratios

Year end Mar (£m)	2010	2011	2012F	2013F	2014F
Revenues	19,964	21,102	22,655	23,448	24,855
Normalised EBITDA	1,176	1,319	1,369	1,413	1,492
Normalised net profit	436	492	509	537	579
Normalised EPS (p)	23.93	26.47	27.40	28.90	31.18
Normalised PER (x)	12.3	11.1	10.7	10.2	9.4
EV/normalised EBITDA (x)	6.0	5.6	5.6	5.5	5.2
FCF yield (%)	2.3	n/a	n/a	n/a	3.3
Dividend yield (%)	4.6	5.1	5.3	5.6	6.1
Price/book (x)	0.26	0.27	0.27	0.27	0.27
Normalised ROE (%)	9.3	9.5	9.2	9.1	9.3

Source: Company data, ING estimates

Financials

Year end Mar (£m)	2007	2008	2009	2010	2011	2012F	2013F	2014F
Income statement								
Revenues	17,151	17,837	18,911	19,964	21,102	22,655	23,448	24,855
Cost of goods sold	(15,979)	(16,835)	(17,875)	(18,882)	(19,942)	(21,432)	(22,182)	(23,513)
Gross profit	**1,172**	**1,002**	**1,036**	**1,082**	**1,160**	**1,223**	**1,266**	**1,342**
Operating costs	(173)	(9)	90	94	159	95	97	100
EBITDA	**999**	**993**	**1,126**	**1,176**	**1,319**	**1,319**	**1,363**	**1,442**
Depreciation & amortisation	(479)	(463)	(453)	(466)	(468)	(498)	(516)	(547)
EBIT	**520**	**530**	**673**	**710**	**851**	**820**	**847**	**895**
Net interest	(43)	(49)	(96)	(115)	(84)	(110)	(100)	(100)
Associates	0	(2)	(111)	138	60	27	30	30
Pre-tax profit	**477**	**479**	**466**	**733**	**827**	**737**	**777**	**825**
Tax	(153)	(150)	(177)	(148)	(187)	(178)	(182)	(196)
Net profit	**324**	**329**	**289**	**585**	**640**	**559**	**595**	**629**
Normalised EBITDA	**999**	**993**	**1,126**	**1,176**	**1,319**	**1,369**	**1,413**	**1,492**
Normalised EBIT	**503**	**500**	**616**	**671**	**738**	**770**	**797**	**845**
Normalised net profit	**308**	**352**	**368**	**436**	**492**	**509**	**537**	**579**
Balance sheet								
Tangible fixed assets	7,176	7,424	7,821	8,203	8,784	9,403	9,971	10,454
Intangible fixed assets	175	165	160	144	151	151	151	151
Other non-current assets	285	804	461	655	743	743	743	743
Cash & equivalents	1,128	719	627	837	501	222	90	79
Other current assets	812	1,003	964	1,016	1,220	1,247	1,274	1,302
Total assets	**9,576**	**10,115**	**10,033**	**10,855**	**11,399**	**11,765**	**12,229**	**12,729**
Short-term debt	373	165	154	73	74	74	74	74
Other current liabilities	2,348	2,487	2,765	2,720	2,868	2,966	3,068	3,175
Long-term debt	2,090	2,037	2,177	2,357	2,339	2,339	2,339	2,339
Other long-term liabilities	416	491	561	739	694	694	694	694
Total liabilities	**5,227**	**5,180**	**5,657**	**5,889**	**5,975**	**6,073**	**6,175**	**6,282**
Total equity	4,349	4,935	4,376	4,966	5,424	5,692	6,054	6,447
Total liabilities & equity	**9,576**	**10,115**	**10,033**	**10,855**	**11,399**	**11,765**	**12,229**	**12,729**
Capital employed	6,812	7,137	6,707	7,396	7,837	8,105	8,467	8,860
Net working capital	(1,480)	(1,393)	(1,604)	(1,549)	(1,442)	(1,493)	(1,546)	(1,601)
Net debt (cash)	1,335	1,483	1,704	1,593	1,912	2,191	2,323	2,334
Cash flow								
Cash flow EBITDA	781	761	661	985	1,025	948	1,011	1,076
Change in working capital	(217)	(31)	167	92	(78)	71	75	79
Other non-cash items	70	67	(6)	79	22	110	(117)	(17)
Operating cash flow	**634**	**797**	**822**	**1,156**	**969**	**1,129**	**969**	**1,138**
Cash interest paid	(95)	(123)	(128)	(111)	(126)	(110)	(100)	(100)
Cash taxes paid	9	(64)	(160)	(89)	(158)	(125)	(128)	(137)
Net cash from operating activities	**548**	**610**	**534**	**956**	**685**	**895**	**742**	**902**
Capex	(785)	(979)	(976)	(1,047)	(1,152)	(1,117)	(1,084)	(1,030)
Other net investing cash flows	105	188	97	147	250	80	150	282
Cash from investing activities	**(680)**	**(791)**	**(879)**	**(900)**	**(902)**	**(1,037)**	**(934)**	**(748)**
Increase (decrease) in equity	81	43	15	250	17	0	0	0
Increase (decrease) in debt	(75)	(36)	165	125	(27)	0	0	0
Dividends & minority distribution	(140)	(178)	(218)	(241)	(269)	(281)	(291)	(306)
Other financing cash flow	(7)	(13)	(3)	(5)	(7)	0	0	0
Cash from financing activities	**(141)**	**(184)**	**(41)**	**129**	**(286)**	**(281)**	**(291)**	**(306)**
Net change in cash & equivalents	**(273)**	**(365)**	**(386)**	**185**	**(503)**	**(423)**	**(483)**	**(152)**
FCF	(36)	(48)	76	159	(59)	(33)	(92)	254

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Mar	2007	2008	2009	2010	2011	2012F	2013F	2014F
Performance & returns								
Revenue growth (%)	6.8	4.0	6.0	5.6	5.7	7.4	3.5	6.0
Normalised EBITDA growth (%)	47.3	-0.60	13.4	4.4	12.2	3.8	3.2	5.6
Normalised EBIT growth (%)	120.6	-0.60	23.2	8.9	10.0	4.4	3.5	6.0
Normalised EPS growth (%)	377.8	12.5	3.4	13.1	10.6	3.5	5.4	7.9
Gross margin (%)	6.8	5.6	5.5	5.4	5.5	5.4	5.4	5.4
Normalised EBITDA margin (%)	5.8	5.6	6.0	5.9	6.3	6.0	6.0	6.0
Normalised EBIT margin (%)	2.9	2.8	3.3	3.4	3.5	3.4	3.4	3.4
Reported net margin (%)	1.9	1.8	1.5	2.9	3.0	2.5	2.5	2.5
Reported ROE (%)	7.8	7.1	6.2	12.5	12.3	10.1	10.1	10.1
Normalised ROA (%)	4.5	5.1	6.1	6.4	6.6	6.7	6.6	6.8
ROAIC (%)	6.9	6.3	6.9	8.1	8.3	8.0	8.0	8.1
ROACE (%)	7.6	7.2	8.9	9.5	9.7	9.7	9.6	9.8
ROACE - WACC (%)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Leverage & solvency								
Working capital as % of sales	-8.6	-7.8	-8.5	-7.8	-6.8	-6.6	-6.6	-6.4
Net debt (cash)/EBITDA (x)	1.3	1.5	1.5	1.4	1.4	1.7	1.7	1.6
Net debt (cash)/equity (%)	30.7	30.1	38.9	32.1	35.3	38.5	38.4	36.2
EBITDA net interest coverage (x)	20.3	17.4	11.3	9.8	14.8	11.5	13.0	13.7
Current ratio (x)	0.71	0.65	0.55	0.66	0.58	0.48	0.43	0.42
Dividend cover (cash flow) (x)	0.06	0.04	0.76	1.2	0.31	0.49	0.34	1.5
Valuation								
EV/revenue (x)	0.40	0.39	0.38	0.35	0.35	0.34	0.33	0.31
EV/normalised EBITDA (x)	6.8	7.0	6.4	6.0	5.6	5.6	5.5	5.2
EV/normalised EBIT (x)	13.5	13.9	11.6	10.5	10.0	9.9	9.8	9.2
EV/capital employed (x)	1.00	0.97	1.1	0.95	0.94	0.94	0.92	0.88
EV/invested capital (x)	0.94	0.91	0.99	0.87	0.86	0.87	0.85	0.82
Normalised PER (x)	16.1	14.3	13.9	12.3	11.1	10.7	10.2	9.4
Price/book (x)	n/a	n/a	n/a	0.26	0.27	0.27	0.27	0.27
Dividend yield (%)	2.8	3.5	4.3	4.6	5.1	5.3	5.6	6.1
FCF yield (%)	n/a	n/a	1.1	2.3	n/a	n/a	n/a	3.3
Per share data								
Reported EPS (p)	19.16	19.14	16.62	32.11	34.43	30.09	32.02	33.87
Normalised EPS (p)	18.21	20.48	21.17	23.93	26.47	27.40	28.90	31.18
Dividend per share (p)	8.25	10.35	12.60	13.60	15.10	15.65	16.46	17.77
Equity FCFPS (p)	(7.75)	(9.95)	(2.99)	2.63	(9.95)	(7.68)	(10.35)	8.28
BV/share (p)	n/a	n/a	n/a	1,124	1,080	1,094	1,107	1,094

Source: Company data, ING estimates

Company profile

Sainsbury is a UK quoted food retailer operating a total of 872 stores all in the UK, of which 537 are supermarkets. The Sainsbury's brand is built upon a heritage of providing customers with healthy, safe, fresh and tasty food. The retailer serves over 19m customers a week and has a grocery market share of 16%. The company has two property JV's with Land Securities Gp. Plc and The British Land Co. plc.

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Tesco

Property mix debate is on the agenda

Buy (maintained)

Price (06/10/11)
406.0p

Target price (12-mth)
490.0p (previously 510.0p)

Forecast total return
24.7%

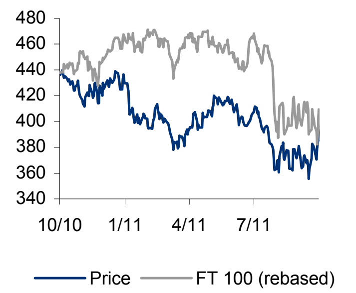
Retail
United Kingdom
Bloomberg: TSCO LN
Reuters: TSCO.L

Share data

Avg daily volume (3-mth)	17,929,251
Free float (%)	100.0
Market cap (£m)	32,208.0
Net debt (1F, £m)	8,339
Enterprise value (1F, £m)	40,547
Dividend yield (1F, %)	4.0

Source: Company data, ING estimates

Share price performance



Source: ING

Tesco has the largest and most advanced online business among Western European 'bricks-and-mortar' grocers. It now exports its successful online activities to other countries within the group. With 40% of UK sales from non-food categories, Tesco is negatively exposed to the rise of e-commerce. We anticipate Tesco will decrease its freehold/leasehold ratio by selling mature assets and opening more convenience stores. This should also give a boost to the company's target of a 14.6% return on capital in 2014/15F.

Online growth: Tesco has been active as an internet retailer since 1994 and achieved revenue of £2.5bn (INGF) in the last fiscal year through its online formats, www.tesco.com and www.tescodirect.com. Its market share in the UK online market is over 50%. Tesco also has online operations in the Republic of Ireland and South Korea, and will launch the service in Poland and the Czech Republic by the end of next year.

Property valuation: Tesco has the characteristics of a property development company as it develops new supermarkets and sells mature ones. Tesco is also involved in mall development, which is a risky business because owning both the operations and the property represents a form of double leverage. We are more conservative in our valuation of Tesco's property assets and expect a further move toward leasehold property, as evidenced by the shifted focus in China and the acquisition of Zabka franchise stores in the Czech Republic. Anticipating an acceleration of home delivery and 'click-&-collect', we see most yield improvement potential for distribution centres and AAA shopping locations.

Investment case: Tesco has the highest growth profile among the listed UK grocers and trades at peer group average multiples. In our view, the main share price catalysts are: 1) a reversal in Kantar market share data in the UK; 2.) continued indications of sales and earnings momentum at Fresh & Easy; and 3) the launch of new bank products such as mortgages, current accounts and savings accounts.

EPS estimates: we update our underlying diluted EPS estimates following the 1H11 results. Our new estimates are 38.27p (from 37.11p) in 2012F, 42.54p (from 40.74p) in 2013F and 47.11p (from 44.44p) in 2014F. We cut our DCF-based target price to 490p from 510p on the back of lower property profits in the future.

Risks: a double-dip scenario for the UK would have a negative impact on sales growth. Austerity measures, such as higher taxes and public spending cuts, could harm small- and mid-sized enterprises, and dent the salaries of many families.

Forecasts and ratios

Year end Feb (£m)	2010	2011	2012F	2013F	2014F
Revenues	56,910	60,931	65,496	70,816	76,411
Normalised EBITDA	4,564	5,240	5,574	6,103	6,571
Normalised net profit	2,327	2,669	3,085	3,429	3,797
Normalised EPS (p)	29.33	33.27	38.46	42.76	47.35
Underlying diluted EPS (p)	29.19	33.10	38.27	42.54	47.11
Normalised PER (x)	13.8	12.2	10.6	9.5	8.6
EV/normalised EBITDA (x)	9.3	7.9	7.3	6.4	5.7
FCF yield (%)	5.4	3.4	5.2	6.6	8.0
Dividend yield (%)	3.2	3.6	4.0	4.5	5.0
Price/book (x)	2.2	2.0	1.8	1.6	1.5
Normalised ROE (%)	16.9	17.0	17.6	17.7	17.7

Source: Company data, ING estimates

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Financials

Year end Feb (£m)	2007	2008	2009	2010	2011	2012F	2013F	2014F
Income statement								
Revenues	42,641	47,298	53,898	56,910	60,931	65,496	70,816	76,411
Cost of goods sold	(39,178)	(43,668)	(49,713)	(52,303)	(55,871)	(59,995)	(64,796)	(69,840)
Gross profit	**3,463**	**3,630**	**4,185**	**4,607**	**5,060**	**5,502**	**6,019**	**6,571**
Operating costs	(30)	37	20	(43)	180	72	83	(0.5)
EBITDA	**3,433**	**3,667**	**4,205**	**4,564**	**5,240**	**5,574**	**6,103**	**6,571**
Depreciation & amortisation	(785)	(876)	(1,036)	(1,107)	(1,429)	(1,548)	(1,674)	(1,674)
EBIT	**2,648**	**2,791**	**3,169**	**3,457**	**3,811**	**4,026**	**4,429**	**4,897**
Net interest	(126)	(63)	(362)	(314)	(333)	(200)	(100)	(100)
Associates	131	75	110	33	57	70	80	90
Pre-tax profit	**2,653**	**2,803**	**2,917**	**3,176**	**3,535**	**3,896**	**4,409**	**4,887**
Tax	(772)	(673)	(779)	(840)	(864)	(937)	(1,104)	(1,223)
Minorities					(3)	(11)	(12)	(12)
Net profit	**1,881**	**2,130**	**2,138**	**2,336**	**2,669**	**2,947**	**3,293**	**3,652**
Normalised EBITDA	**3,433**	**3,667**	**4,205**	**4,564**	**5,240**	**5,574**	**6,103**	**6,571**
Normalised EBIT	**2,648**	**2,791**	**3,169**	**3,457**	**3,811**	**4,026**	**4,429**	**4,897**
Normalised net profit	**1,881**	**2,124**	**2,133**	**2,327**	**2,669**	**3,085**	**3,429**	**3,797**
Balance sheet								
Tangible fixed assets	17,290	20,092	23,214	24,355	24,714	26,866	28,942	31,018
Intangible fixed assets	2,045	2,336	4,076	4,177	4,338	4,338	4,338	4,338
Other non-current assets	896	1,436	4,795	5,726	6,285	6,285	6,285	6,285
Cash & equivalents	1,042	1,788	3,509	2,819	1,870	4,205	7,038	10,238
Other current assets	3,534	4,512	9,970	8,946	9,999	10,128	10,264	10,403
Total assets	**24,807**	**30,164**	**45,564**	**46,023**	**47,206**	**51,822**	**56,867**	**62,282**
Short-term debt	1,554	2,084	3,471	1,529	1,386	1,886	2,386	2,886
Other current liabilities	6,598	8,261	14,124	14,486	16,345	17,393	18,547	19,815
Long-term debt	4,146	5,972	12,391	11,744	9,689	10,658	11,724	12,896
Other long-term liabilities	1,938	1,974	2,672	3,583	3,163	3,476	3,830	4,231
Total liabilities	**14,236**	**18,291**	**32,658**	**31,342**	**30,583**	**33,413**	**36,486**	**39,829**
Total equity	10,571	11,873	12,906	14,681	16,623	18,409	20,381	22,454
Total liabilities & equity	**24,807**	**30,164**	**45,564**	**46,023**	**47,206**	**51,822**	**56,867**	**62,282**
Capital employed	16,271	19,929	28,768	27,954	27,698	30,953	34,490	38,236
Net working capital	(3,036)	(3,618)	(4,176)	(4,825)	(5,008)	(5,924)	(6,941)	(8,070)
Net debt (cash)	4,658	6,268	12,353	10,454	9,205	8,339	7,071	5,544
Cash flow								
Cash flow EBITDA	2,633	3,059	2,965	3,406	3,758	4,306	4,879	5,238
Change in working capital	11	194	615	1,156	202	603	663	728
Other non-cash items	121	185	367	264	266	133	33	33
Operating cash flow	**2,765**	**3,438**	**3,947**	**4,826**	**4,226**	**5,042**	**5,575**	**5,998**
Cash interest paid	(376)	(410)	(562)	(690)	(614)	(200)	(100)	(100)
Cash taxes paid	(545)	(346)	(456)	(512)	(760)	(656)	(773)	(856)
Net cash from operating activities	**1,844**	**2,682**	**2,929**	**3,624**	**2,852**	**4,186**	**4,702**	**5,042**
Capex	(3,421)	(4,226)	(6,493)	(3,226)	(3,363)	(3,700)	(3,750)	(3,750)
Other net investing cash flows	1,078	1,272	519	1,349	1,504	1,441	1,559	1,629
Cash from investing activities	**(2,343)**	**(2,954)**	**(5,974)**	**(1,877)**	**(1,859)**	**(2,259)**	**(2,191)**	**(2,121)**
Increase (decrease) in equity	156	154	130	167	98	0	0	0
Increase (decrease) in debt	268	1,827	4,636	(2,780)	(2,020)	500	500	500
Dividends & minority distribution	(957)	(1,569)	(1,151)	(994)	(1,114)	(1,160)	(1,302)	(1,454)
Cash from financing activities	**(533)**	**412**	**3,615**	**(3,607)**	**(3,036)**	**(660)**	**(802)**	**(954)**
Net change in cash & equivalents	**(1,032)**	**140**	**570**	**(1,860)**	**(2,043)**	**1,268**	**1,709**	**1,967**
FCF	(329)	(78)	(2,642)	2,321	1,417	2,128	2,611	3,021

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Feb	2007	2008	2009	2010	2011	2012F	2013F	2014F
Performance & returns								
Revenue growth (%)	8.1	10.9	14.0	5.6	7.1	7.5	8.1	7.9
Normalised EBITDA growth (%)	12.9	6.8	14.7	8.5	14.8	6.4	9.5	7.7
Normalised EBIT growth (%)	16.1	5.4	13.5	9.1	10.2	5.6	10.0	10.6
Normalised EPS growth (%)	16.9	13.7	0.70	8.1	13.4	15.6	11.2	10.7
Gross margin (%)	8.1	7.7	7.8	8.1	8.3	8.4	8.5	8.6
Normalised EBITDA margin (%)	8.1	7.8	7.8	8.0	8.6	8.5	8.6	8.6
Normalised EBIT margin (%)	6.2	5.9	5.9	6.1	6.3	6.1	6.3	6.4
Reported net margin (%)	4.4	4.5	4.0	4.1	4.4	4.5	4.7	4.8
Reported ROE (%)	18.8	19.0	17.3	16.9	17.0	16.8	17.0	17.1
Normalised ROA (%)	11.2	10.2	8.4	7.5	8.2	8.1	8.1	8.2
ROAIC (%)	12.1	12.2	10.2	9.4	9.8	10.3	10.1	10.0
ROACE (%)	17.0	15.4	13.0	12.2	13.7	13.7	13.5	13.5
ROACE - WACC (%)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Leverage & solvency								
Working capital as % of sales	-7.1	-7.6	-7.7	-8.5	-8.2	-9.0	-9.8	-10.6
Net debt (cash)/EBITDA (x)	1.4	1.7	2.9	2.3	1.8	1.5	1.2	0.84
Net debt (cash)/equity (%)	44.1	52.8	95.7	71.2	55.4	45.3	34.7	24.7
EBITDA net interest coverage (x)	26.0	51.6	11.5	14.3	15.5	27.2	58.1	62.6
Current ratio (x)	0.56	0.61	0.77	0.73	0.67	0.74	0.83	0.91
Dividend cover (cash flow) (x)	0.26	0.69	n/a	2.6	1.7	2.7	2.9	3.0
Valuation								
EV/revenue (x)	0.86	0.81	0.83	0.75	0.68	0.62	0.55	0.49
EV/normalised EBITDA (x)	10.7	10.5	10.6	9.3	7.9	7.3	6.4	5.7
EV/normalised EBIT (x)	13.9	13.8	14.1	12.3	10.9	10.1	8.9	7.7
EV/capital employed (x)	2.3	1.9	1.5	1.5	1.5	1.3	1.1	0.99
EV/invested capital (x)	2.0	1.8	1.4	1.4	1.3	1.2	1.0	0.89
Normalised PER (x)	17.1	15.1	15.0	13.8	12.2	10.6	9.5	8.6
Price/book (x)	3.0	2.7	2.5	2.2	2.0	1.8	1.6	1.5
Dividend yield (%)	2.4	2.7	2.9	3.2	3.6	4.0	4.5	5.0
FCF yield (%)	n/a	n/a	n/a	5.4	3.4	5.2	6.6	8.0
Per share data								
Reported EPS (p)	23.70	27.03	27.20	29.45	33.27	36.75	41.06	45.53
Normalised EPS (p)	23.70	26.95	27.14	29.33	33.27	38.46	42.76	47.35
Dividend per share (p)	9.64	10.90	11.96	13.05	14.46	16.23	18.13	20.10
Equity FCFPS (p)	(8.88)	(6.19)	(40.77)	20.56	10.01	24.04	31.31	36.42
BV/share (p)	133.2	151.0	163.5	183.9	206.2	228.4	252.8	278.5

Source: Company data, ING estimates

Company profile

Tesco is one of the leading retailers in the world, with net sales in FY10 of £57bn and underlying pre-tax profit of £3.4bn. Company strategy is based on four pillars of growth: core UK market, non-food sales, services and International expansion. Outside of the UK, Tesco has built a strong position in a number of countries in Asia and Central Eastern Europe. The UK accounted for 67% of gross revenues in FY10. Tesco operates hypermarkets, large food stores, smaller supermarkets and convenience stores in the UK where its market share is 30% or around double that of the nearest competitor.

Appendix 1: Lease accounting

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) accounting organisations published an exposure draft on lease accounting in August 2010. Following extensive discussions with all parties involved, the boards decided to re-issue their revised proposals to all interested parties. The boards intend to complete their deliberations during 3Q11, and will publish a revised exposure draft shortly thereafter. We expect the new lease accounting standards to take effect on 1 January 2014 at the earliest. The changes are designed to improve transparency on a firm's effective leverage and achieve better comparability.

Main changes

- Operating leases have to be capitalised by placing a right-of-use (ROU) asset on the balance sheet at the present value of the estimated lease payments. On the liabilities side, debt will increase by the same amount.
- In the profit and loss account, rent expenses will be replaced by depreciation and interest. In essence, some of the operational costs (rent costs) will now be classified as financial costs (interest cost).
- As a result, EBITDA and EBIT will be higher under the new lease accounting. Net profit and EPS will be lower in the first years due to the front-loading of interest costs. After a few years, net profit will be higher.
- Net free cash flow does not change. The operating cash flow is likely to increase and financing cash flow should decrease because the lease costs will be replaced by depreciation and interest. This means that discounted cash flow analysis will not change either.
- As an example, we take a look at the implications for Company A's P&L account and balance sheet. We make two simplifications: we use the 8x rent rule of thumb to calculate the ROU asset, and use straight-line rent expensing.

Fig 47 Changes in P&L and balance sheet (€m)

P&L before		**P&L after**		**%ch**
Revenues	100	Revenues	100	-
CoGS	70	CoGS	70	-
Gross margin	30	Gross margin	30	-
Rental costs	**10**	**Rental costs**	**0**	-10
Other SGA	2	Other SGA	2	-
EBITDA	18	EBITDA	28	10
DA	**5**	**DA**	**12**	7
EBIT	13	EBIT	16	3
Interest	**3**	**Interest**	**6**	3
EBT	10	EBT	10	-
Tax rate (%)	25	Tax rate (%)	25	-
Taxes	2.5	Taxes	2.5	-
Earnings	7.5	Earnings	7.5	-
Shares	10	Shares	10	-
EPS (E)	0.75	EPS (E)	0.75	-

Balance sheet before				**Balance sheet after**			
Assets		**Liabilities**		**Assets**		**Liabilities**	
Non-current assets	200	Current liabilities	100	Non-curr assets	200	Current liab	100
Current assets	200	Non-current liabs	100	Current assets	200	**Non-curr liabs**	**180**
		Equity	200	**ROU asset**	**80**	Equity	200
Total	400		400	Total	480		480

Source: ING equity research

Lease accounting: Food retail vs general retail

The length of the remaining lease term is the key determinant for calculating the ROU asset. We argue that food retail and general retailers should use different lease terms to calculate the ROU asset given that the right to rent the location is in itself very valuable for food retailers, whereas for general retailers, especially high-street shops, the exact location is not the key determinant of its value.

Food retail (supermarket) locations are valuable because good locations are scarce. A prime location is a big store (at least 1,000m2), with a parking lot and in or close to a populated area. Supermarkets tend to have a kind of mini-monopoly if there are no competitors in close proximity. People who live in this area are dependent on this supermarket and will do most of their shopping in the supermarket that is closest to their homes.

In contrast, locations for fashion retailers or discounters are less scarce/more replaceable. This is an important factor in valuing the lease. The lease contract of a supermarket location has more value because the location right is valuable, whereas fashion retailer discounters can quite easily find an alternative spot in a high-street or shopping centre. Shoe retailers and bed retailers generally use small stores. Stores of 100m2 to 500m2 are very common. High-street retailers and mall retailers often move within the same high-street or shopping mall.

The business model of a small store retailer vs a big box retailer is different. For small store retailers, it is common practice to rent stores because: (1) less capital is required; and (2) there is more choice. For big box retailers (Tesco Extra, Sainsbury Superstores), locations are of strategic importance. They will only sell when the assets have been fully developed and if they do, they will use a long-term or perpetual lease.

However, food retail companies' management teams have realised that it can make sense to sell assets, for instance to fund growth elsewhere, because there is no development potential left and value is maximised to unlock hidden value (often at very old historical book values on the balance sheet or even depreciated to very low levels compared with market value), or if the company is experiencing financial difficulty.

Appendix 2: Fashion retailers' online roll-outs

The following tables provide an overview of the online history and next launches for Inditex and H&M:

Fig 48 Inditex: online history and planned roll-outs

Launch date	Concept	Countries
29-Oct-07	Zara Home	14 European countries
02-Sep-10	Zara	France, Germany, Portugal, Italy, Spain, UK
04-Nov-10	Zara	Austria, Belgium, Ireland, NL, Luxembourg
03-Mar-11	Zara	Denmark, Norway, Sweden, Monaco, Switzerland
06-Sep-11	All other concepts	EU
07-Sep-11	Zara	US
2H11	Zara	Japan, South Korea

Source: Company data

Fig 49 H&M: online history and planned roll-outs

1998	Sweden
1998-2006	Norway, Finland, Denmark
2006	The Netherlands
2007	Germany, Austria
2010	UK
2011	COS and Monki in 18 markets
Autumn 2012	US

Source: Company data

Fig 50 Inditex: online sales platforms by concept and market

	Zara	Pull & Bear	Massimo Dutti	Bershka	Stradivarius	Oysho	Zara Home	Uterque
Austria	X	-	X	-	-	-	X	-
Belgium	X	-	-	-	-	-	X	-
Denmark	X	-	X	-	-	-	X	-
France	X	X	X	X	X	X	X	X
Germany	X	X	X	X	X	X	X	X
Greece	-	-	-	-	-	-	X	-
Ireland	X	-	X	-	-	-	X	-
Italy	X	X	X	X	X	X	X	-
Luxembourg	X	-	-	-	-	-	X	-
Monaco	X	-	X	-	-	-	X	-
Netherlands	X	X	X	X	-	-	X	-
Norway	X	-	X	-	-	-	-	-
Poland	-	-	-	-	X	-	-	-
Portugal	X	X	-	X	X	X	X	X
Spain	X	X	X	X	X	X	X	X
Sweden	X	-	X	-	-	-	X	-
Switzerland	X	-	X	-	-	-	-	X
UK	X	X	X	X	-	X	X	X
US*	X	-	-	-	-	-	-	-

*From 7 September 2011

Source: Company data, ING

Facebook popularity

Zara and H&M are among the most popular clothing brands in the world, as this overview shows. About 25% of Facebook users are from the US, according to Facebook's Ad Platform. This popularity is a good indication of online buying by consumers.

Fig 51 Facebook popularity

Brand	Facebook 'Likes' (m)
Victoria's secret	15.1
Zara	10
H&M	8.1
Hollister	5.9
Kohl's	5.7
Target	5.4
Abercrombie	5.4
American Eagle Outfitters	5.4
Aeropostale	5.1
Ralph Lauren	3.9
Bershka	3.1
Tommy Hilfiger	1.7
GAP	1.6

Source: ING

Huge US online market potential

The US is the largest online market and offers a huge opportunity for fast-fashion retailers. The online penetration rate for the US apparel market is c.9%.

Fig 52 US apparel market, 2009

	(US$m)	as % of total
US apparel market	210,000	100
o.w. US e-commerce and mail-order	26,047	12
o.w. US online apparel market	19,507	9

Source: Data US Census Bureau, ING

If we look at peers that disclose the amount of direct sales (both internet and catalogue sales), we find penetration rates ranging from 5-25%.

Fig 53 Online and catalogue sales penetration peers

	Direct sales (lc m)	Total sales (lc m)	As % of total
Victoria's Secret (US$)	1,500	5918	25
GAP (US$)	1,300	14,700	9
A&F (US$)	405	3,462	12
M&S (£)	543	4,273	13
Next (£)	287	3,229	9
Debenhams (£)	104	2,120	5
Tesco (£)	2,415	44,600	5

Source: Company data, ING estimates

Appendix 3: For the non-believers

For those investors (consumers) who feel that our views or those of the market are just too revolutionary, wind the clock back and consider the following ideas 25 years ago. Who would have believed:

- Almost everyone will own a small mobile telephone;
- Mobile phones will be able to browse the internet, play music and movies, hold a GPS chip, and be used to make payments;
- Customers can book airline flights via internet;
- Kodak film will disappear;
- There will be a device, small enough to fit in your pocket, that steers people to their destination using satellites;
- There will be an internet search engine that shows searches even while you are typing them;
- Appliances will be able to run on wireless electricity;
- Scientists will identify 20,000-25,000 genes in human DNA;
- People will be able to use wireless internet at high speeds.

Disclosures Appendix

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	100%	

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