

Retail Sector Review - January

1. Sector Overview

- The retail sector had a monthly return of 5,084% in January, which is generally higher than the 2,44% return of the S&P 500, confirming the recent positive trend in the sector.
- Fitch Ratings have questioned the business models of big European food retailers, which combined with the negative economic environment, will squeeze margins and decrease sales growth. The rating companies states that Carrefour, Tesco and Metro will be among the most hit ones.
- PWC released a report on M&A activity in the retail sector in 2012, which highlights the main role of Private Equity companies in a vast number of transactions. It also states that the number of deals has decreased but the overall deal value went up due to “mega deals”. Estimations for 2013 say that a big number of deals will continue to come from CPG companies selling non-core activities, especially in cross-border deals.
- Deckers Outdoor Corp. has been struggling after lower sales due to warmer weather and higher raw materials' costs and is now seen as a bargain by many analyst that also suggest that some PE firms or rivals may go forward with some kind of bid.
- The momentum in the retail sector is definitely with luxury brands companies, with Michael Kors' IPO as an example of success and stocks of Prada or LVMH increasing continuously lately.

Retail Universe:

- Jerónimo Martins
- PPR
- Amazon
- Tesco
- Inditex

This month's detailed company review:

- Tesco

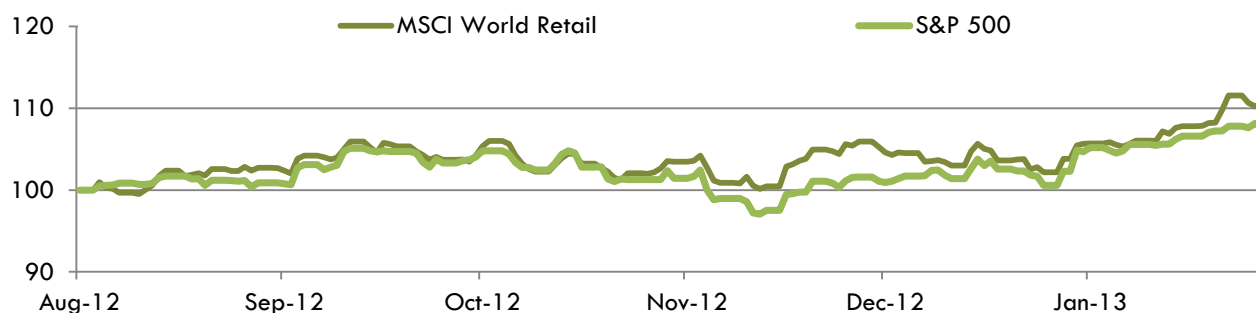


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Retail Sector vs. Overall market

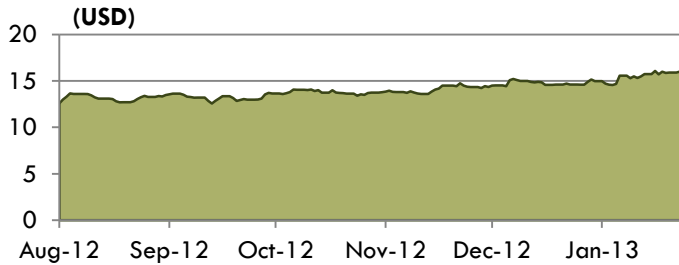


- Due to the extensive correlation between the MSCI World Retail and the S&P 500, the differences in performance are only very minor as both seem to follow the same pattern. However, recently the retail sector has been clearly outperforming the S&P 500, which is in line with recent positive expectations for the sector.

3. Followed Companies

Jerónimo Martins (Ticker: JMT PL)

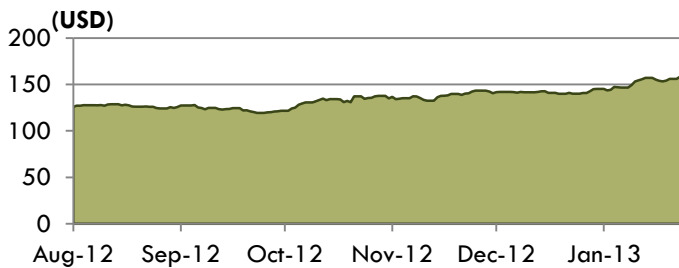
- Portuguese retail sales are expected to keep on declining for 3 more years and so Jerónimo Martins has decided to pursue an aggressive pricing strategy in its supermarket chain Pingo Doce, especially in food prices.



| | | |
|---------------------|---|-------|
| Price (USD): | ↓ | 15.96 |
| Target Price (USD): | | 15.00 |
| Up/downside: | | -6.0% |
| Performance 3M: | | 17.7% |
| P/E Ratio: | | 27.3x |
| ROC/WACC: | | 1.1x |

PPR (Ticker: PP FP)

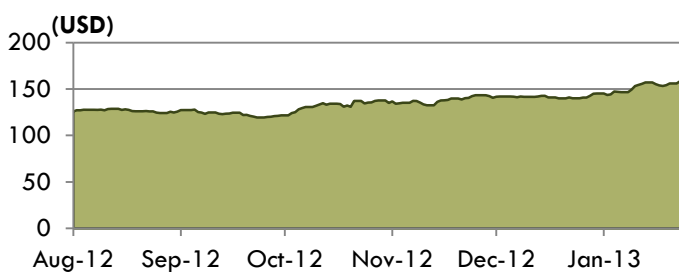
- Puma SE (PUM) had its seven-month high due to the speculation that PPR wants to increase its 82.4% stake in the company to nearly 95%. Paul Michon from PPR declined to dwell on the topic, after saying in July that Puma “was not a priority”.



| | | |
|---------------------|---|--------|
| Price (USD): | → | 159.30 |
| Target Price (USD): | | 165.50 |
| Up/downside: | | 3.9% |
| Performance 3M: | | 17.6% |
| P/E Ratio: | | 19.4x |
| ROC/WACC: | | 0.8x |

Inditex (Ticker: ITX SM)

- Inditex was involved in a human rights scandal when a fire in a factory in Bangladesh took the lives of many. Clothes with Inditex’s brand were found at the site. The company has decided to stop working with this subcontractors in a move to save the company’s image.



| | | |
|---------------------|---|--------|
| Price (USD): | → | 105.65 |
| Target Price (USD): | | 107.65 |
| Up/downside: | | 1.9% |
| Performance 3M: | | 7.2% |
| P/E Ratio: | | 28.4x |
| ROC/WACC: | | 2.2x |

Amazon (Ticker: AMZN US)

- During nearly one hour, Amazon’s home page went offline with customers without a way to make their usual shopping. On that same day stocks fell 2.7% even though the company had recently posted the most positive results since October.



| | | |
|---------------------|---|--------|
| Price (USD): | ↑ | 272.76 |
| Target Price (USD): | | 325.00 |
| Up/downside: | | 19.2% |
| Performance 3M: | | 14.5% |
| P/E Ratio: | | 729.4x |
| ROC/WACC: | | -0.5x |

3. Stock Analysis: Tesco

Corporate News

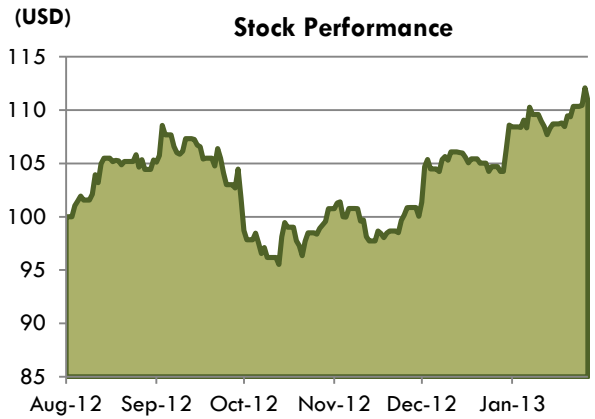
- Tesco invested in a start-up coffee chain called Harris+Hoole with the objective of bringing this quality coffee to a wider audience. Many critics said they did not understand why Harris+Hoole was not being presented as a subsidiary of Tesco.
- Horse meat was found in some of Tesco's beef burgers selling in Ireland. Once the results from the analysis came out the company immediately took the products out of their shelves.

Market Performance

- During the month of January, Tesco stock price has been in a positive trend, having increased nearly 6%, having hit its one-year high of 361.25
- Tesco's Christmas Season has exceeded expectations for the main indicator, like-for-like growth in the UK. However, outside the UK, all Tesco's performances have been negative

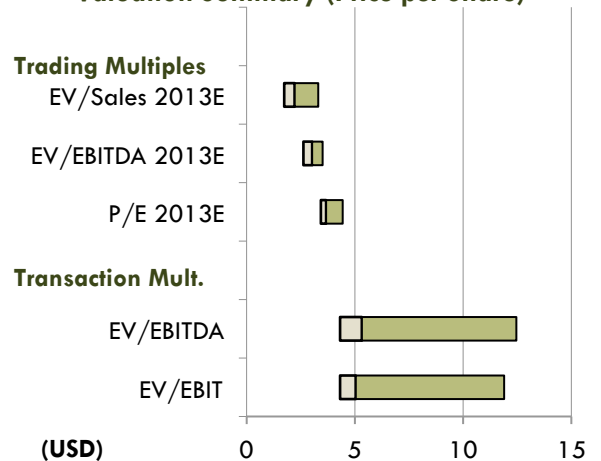
Valuation Summary

- From the different valuation metrics presented in the graph, one can easily see the higher valuation comes from transaction multiples.
- Analysts recommendations express well the generalized state of mind regarding this stock. Nearly 1/3 of the analysts recommend a buy, another 1/3 a hold and the other 1/3 a sell. The median target price is 357.00, which is slightly lower than the current stock price.



| Tesco (GBP) | |
|----------------------------|--------|
| Current Price (30/01/2013) | 357.35 |
| 52-week high % change | -2.9% |
| Median Target Price | 369.53 |
| Market Capitalisation (mn) | 29,166 |
| Return on Common Equity | 15.7% |
| Dividend Yield | 4.5% |
| Beta (vs. S&P500) | 0.6x |
| Total Debt/Equity | 66.0% |

Valuation Summary (Price per Share)



HOLD

- Despite the positive trend on the stock price throughout the month, many believe the momentum is no longer with Tesco and thus defend that the stock price will go down. The recommendation is not a sell due to recent news of overcoming expectations and expansion to new product lines.

Comparable Analysis

| Company Name | Currency | MCap (mn) | Enterprise Value (mn) | EV/Sales | | | EV/EBITDA | | | P/E | | |
|------------------|----------|-----------|-----------------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|--------------|--------------|
| | | | | LTM | 2013E | 2014E | LTM | 2013E | 2014E | LTM | 2013E | 2014E |
| Tesco | GBP | 29 166 | 37 281 | 0,5x | 0,6x | 0,5x | 7,5x | 7,4x | 7,1x | 10,4x | 11,5x | 10,9x |
| Sainsbury | GBP | 6 264 | 8 490 | 0,4x | 0,4x | 0,4x | 6,7x | 6,3x | 6,0x | 11,7x | 11,2x | 10,6x |
| William Morrison | GBP | 5 850 | 7 530 | 0,5x | 0,4x | 0,4x | 5,6x | 5,7x | 5,7x | 9,2x | 9,4x | 9,5x |
| Wal-Mart | USD | 239 118 | 292 642 | 0,7x | 0,6x | 0,6x | 8,1x | 8,0x | 7,6x | 14,9x | 14,5x | 13,2x |
| Metro | EUR | 7 991 | 15 710 | 0,2x | 0,2x | 0,2x | 5,6x | 4,8x | 4,6x | 21,0x | 10,3x | 9,9x |
| Carrefour | EUR | 14 794 | 26 040 | 0,3x | 0,3x | 0,3x | 10,0x | 6,7x | 6,4x | #N/A N/A | 14,6x | 13,0x |
| 75th Percentile | | | | 0,5x | 0,5x | 0,5x | 8,0x | 7,3x | 6,9x | 14,9x | 13,8x | 12,5x |
| Median | | | | 0,4x | 0,4x | 0,4x | 7,1x | 6,5x | 6,2x | 11,7x | 11,3x | 10,7x |
| 25th Percentile | | | | 0,3x | 0,3x | 0,3x | 5,9x | 5,8x | 5,8x | 10,4x | 10,6x | 10,1x |

- Tesco has one of the highest current EV/Sales valuations when compared to its peers, while only Wal-Mart has a higher multiple. The estimations of EV/Sales seem to show a clear above the average valuation. The current EV/EBITDA Tesco valuation is above the average but is beaten by both Wal-Mart and Carrefour. Within the companies with the highest EV/EBITDA, Tesco's forecasts show slower decay than peers.
- The current P/E ratio give us a different idea as it shows the second lowest valuation within the peer group and well below the average. The estimations are not very clear in the sense that they swing from above in 2013 to below the average in 2014. The P/E ratio might lead to flawless conclusions as it accounts for the differences in financing structure, which might explain the dissonance with the other ratios.

Precedent Transactions

| Announced Date | Target | | Buyer | | EV (EUR mn) | EV/EBITDA | EV/EBIT |
|-----------------|----------------------------|---------|-------------------------|---------|-------------|-------------|--------------|
| | Company | Country | Company | Country | | | |
| 19-Dec-12 | Welspun Global Brands Ltd. | IND | Welspun India Ltd. | IND | 85 | 2,4x | 6,0x |
| 29-Jul-12 | Olinas Mall | JPN | CapitallMalls Asia Ltd. | SNG | 23 | 0,2x | 0,4x |
| 29-Jun-12 | Jumbo Retail Argentina SA | ARG | Cencosud SA | COL | 1 252 | 0,1x | 0,3x |
| 06-Dec-10 | Trade House Kopeyka | US | X5 Reatil Group NV | US | 1 649 | 12,1x | 16,9x |
| 22-Nov-10 | MCCM | MOR | Label Vie | MOR | 1 | 14,9x | 20,3x |
| 19-Jan-10 | Almacenes Exito SA | COL | Citigroup Inc. | US | 216 | n.a. | 36,0x |
| 25-May-10 | Times Ltd. | HK | Lotte Shopping Co Ltd | SKOR | 643 | 15,2x | 21,2x |
| 08-Dec-09 | Wumart Stores Inc. | HK | Multiple Acquirers | n.a. | 200 | 6,7x | 11,5x |
| 75th Percentile | | | | | | 13,5x | 20,5x |
| Median | | | | | | 6,7x | 14,2x |
| 25th Percentile | | | | | | 1,3x | 4,6x |

- Regarding the precedent transactions, and analyzing them against the multiples from the comparable analysis table, we can see that Tesco is trading at an EV of 7.5x EBITDA, which is higher than the median EV/EBITDA multiple of 6.7x. These numbers from the precedent transactions are quite low, especially when a premium is usually paid in M&A deals of this type.