5 September 2018
Europe/United Kingdom
**Equity Research**
Food Producers

# Associated British Foods (ABF.L)

COMPANY UPDATE — FOCUS LIST STOCK

| | |
|---|---|
| Rating | **OUTPERFORM** |
| Price (04 Sep 18, p) | 2243.00 |
| Target price (p) | 3300.00 |
| Market Cap (£ m) | 17,757.3 |
| Enterprise value (£ m) | 17,368.1 |

Target price is for 12 months.

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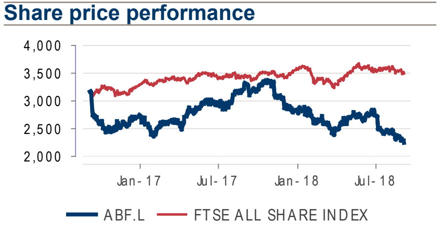
## Benchmarking Primark metrics and valuation

- **Ahead of ABF's FY trading statement on Sept 10th and FY results on Nov 6th, we have benchmarked Primark's operating metrics vs retail peers,** and compared ABF in the context of earnings downgrades and falling valuations across European apparel. On the whole, we agree that apparel retail underperformance is warranted by declining margins due to online and lower space growth due to maturity. Primark is better protected from these concerns and ABF is the only Outperform across the space, including online. We are making no changes to forecasts and reiterate our £33 target price.
- **No online no problem**. To date Primark has avoided the disruption and margin compression from ever more demanding consumers, while the fact that sales densities are stable and well above peers suggests no impact on sales. In part, this is because it has developed a best in class social media platform and we believe a transactional site with C&C can be introduced.
- **Margins are increasing**: Primark is the only European apparel retailer where we believe margins will increase this year (+50bp) and next (+40bp) as US$ sourcing gains are absorbed in a stable European environment.
- **HSD space growth is sustainable** if it confirms the US rollout and expansion into Eastern Europe reducing the risk of UK over-expansion.
- **ABF now trades on 15.4x 12m FWD PER (ex-sugar)** and it discounts Primark at £9bn, equivalent to 1.14x sales, 9.9x EBIT and 12.7x PER. We do not see the need for a conglomerate discount as one asset makes up 66% of NAV and 60% of EBIT, however, even with a 15% discount (more than double the value of sugar), Primark's valuation comes out at 1.5x sales, 12.8x EBIT and 16.4x PER, which still material undervalues Primark vs listed apparel peers.

### Share price performance




The price relative chart measures performance against the FTSE ALL SHARE INDEX which closed at 4113.3 on 04/09/18

On 04/09/18 the spot exchange rate was £.9/Eu 1.-Eu.86/US$1

| Performance | 1M | 3M | 12M |
|---|---|---|---|
| Absolute (%) | -8.2 | -16.8 | -32.0 |
| Relative (%) | -6.0 | -13.6 | -33.3 |

### Financial and valuation metrics

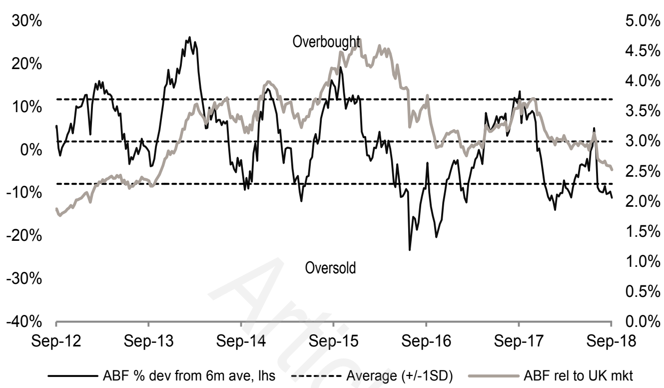
| Year | 9/17A | 9/18E | 9/19E | 9/20E |
|---|---|---|---|---|
| Revenue (£ m) | 15,304 | 16,101 | 17,093 | 18,271 |
| EBITDA (£ m) | 1,877 | 1,907 | 1,963 | 2,178 |
| Pre-tax profit adjusted (£ m) | 1,310 | 1,351 | 1,407 | 1,617 |
| CS EPS (adj.) (p) | 127.1 | 132.5 | 138.8 | 159.7 |
| Prev. EPS (p) | - | - | - | - |
| ROIC (%) | 12.7 | 13.1 | 12.9 | 14.0 |
| P/E (adj.) (x) | 17.6 | 16.9 | 16.2 | 14.0 |
| P/E rel. (%) | 119 | 125 | 129 | 119 |
| EV/EBITDA (x) | 9.2 | 9.1 | 8.7 | 7.6 |

| | | | |
|---|---|---|---|
| Dividend (09/18E, p) | 43.00 | Net debt/equity (09/18E,%) | -7.0 |
| Dividend yield (09/18E,%) | 1.9 | Net debt (09/18E, £ m) | -641.2 |
| BV/share (09/18E, £) | 11.4 | IC (09/18E, £ m) | 8,473.5 |
| Free float (%) | 45.0 | EV/IC (09/18E, (x) | 2.0 |

Source: Company data, Thomson Reuters, Credit Suisse estimates

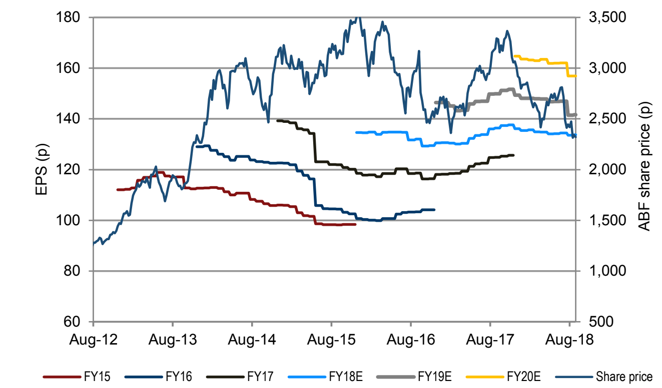
## Key Charts

### Figure 1: Price momentum is very weak



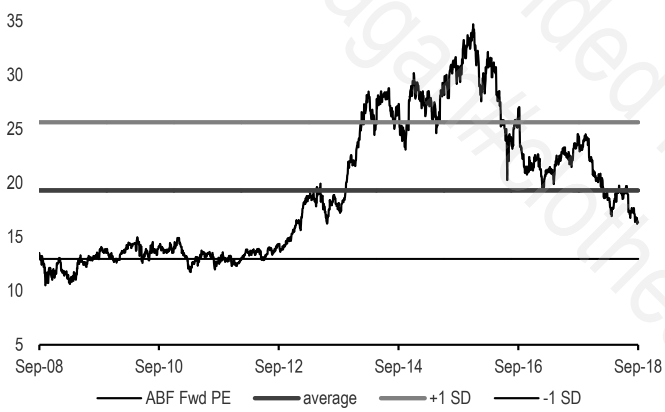

Source: Thomson Reuters Datastream

### Figure 2: EPS momentum has been quite steady




Source: Thomson Reuters Datastream

### Figure 3: 12M Fwd PE lowest levels in 6 years




Source: Thomson Reuters Datastream

### Figure 4: Fwd PE relative to FTSE 100 close to the lowest levels this decade


Source: Thomson Reuters Datastream

### Figure 5: The discounted value of Primark at the current price looks cheap vs peers even with a 15% conglomerate discount

| Local currency | share price | EV (bn) | Period | Sales | EBIT (m) | EV/sales | EV/EBIT | PER |
|---|---|---|---|---|---|---|---|---|
| H&M | 122 | 209 | 12m FWD | 215,513 | 16,927 | 0.97 | 12.4 | 15.1 |
| | | | 24m FWD | 225,613 | 18,674 | 0.93 | 11.2 | 13.7 |
| Inditex | 25.3 | 72.4 | 12m FWD | 27,641 | 4,561 | 2.62 | 15.9 | 22.0 |
| | | | 24m FWD | 29,715 | 4,837 | 2.44 | 15.0 | 20.7 |
| Primark - CS DCF | | 17.8 | 12m FWD | 7,923 | 908 | 2.24 | 19.6 | 25.1 |
| | | | 24m FWD | 8,724 | 1,025 | 2.04 | 17.3 | 22.2 |
| Primark - current price | | 9.0 | 12m FWD | 7,923 | 908 | 1.14 | 9.9 | 12.7 |
| | | | 24m FWD | 8,724 | 1,025 | 1.03 | 8.8 | 11.3 |
| Primark - 15% discount | | 11.6 | 12m FWD | 7,923 | 908 | 1.46 | 12.8 | 16.4 |
| | | | 24m FWD | 8,724 | 1,025 | 1.33 | 11.3 | 14.5 |

Source: Company data, Credit Suisse estimates

**Figure 6: It has not been a good year for European apparel retailers**

| | 1Week | 1 Month | 3 Months | YTD | Calendar 2017 |
|---|---|---|---|---|---|
| ABF | -3.2% | -6.5% | -13.4% | -19.0% | 4.8% |
| Asos | 3.1% | 1.1% | -6.6% | -8.2% | 34.0% |
| M&S | 0.1% | 3.0% | 6.9% | -3.3% | -8.7% |
| Next | 1.4% | -2.0% | -4.2% | 22.6% | -7.8% |
| Superdry | 0.2% | 0.0% | -6.0% | -40.1% | 20.0% |
| H&M | -6.8% | -6.9% | -6.5% | -26.8% | -32.0% |
| Inditex | -11.5% | -8.1% | -7.1% | -12.2% | -11.3% |
| OVS | -0.7% | -0.9% | -16.7% | -53.5% | 14.3% |
| Zalando | -3.4% | -8.7% | -2.2% | 0.9% | 18.9% |

Source: Thomson Reuters Datastream

While ABF has been a poor performer this year, it is in good company with the majority of apparel retailers weak, even the online names. While Next has been strong this year, it's partly been a reflection of the two poor years beforehand.

The underperformance of most names has been a combination of de-rating, reflecting soft demand for apparel and the perception of ongoing margin pressure due to online and the impact of discounters, and actual earnings downgrades.

However, as we show in Figure 2, ABF's consensus forecasts have been relatively stable with 18/19 consensus EPS falling 5.6% over the past 12 months and all of that coming from sugar, the lowest quality and most cyclical component of ABF's earnings. Our 17/18 EBIT forecasts for Primark have gone from £808m, with a 10.1% margin to £829m, a 10.9% over that period. **Apart from Next, Primark is the only apparel retailer where we have increased forecasts over the past year.**

That's not to say that Primark has had a seamless year.

- 1H LFL of -1.5% were weak, especially in Europe (est -5.5%) thanks to very poor trading in October and February, and there are question marks over the customer appeal of the proposition in Germany and a lesser extent Netherlands. 2H (est LFL -0.4%) should be largely back to normal.
- Space growth (est 7.6% vs 12.5% the prior year) has been disappointing with adverse phasing of openings, some new stores slipping, downsizing of three US stores and the fire in the Belfast store.

**However, we still regard Primark's L-T growth prospects as being by far the strongest of the store-based retailers** and over the next year we would expect it to confirm the rollout in the US (bearing in mind the need for c20 stores to break even), and expansion plans in Eastern Europe. We believe that Primark can grow space at a high single digit rate in the medium term while slowing growth in the UK.

**Not being online is still an advantage**. Online retailing has proven to be problematic for virtually all retailers.

- Operationally, many have had issues introducing new IT and Logistics,
- Even best in class retailers (Next/ITX) are seeing cost de-leverage from channel shift in our view,
- Consumers are becoming ever more demanding, expecting Amazon Prime-like service levels, leading to fulfilment de-leverage from smaller baskets/greater frequency and shorter delivery times.

To date, Primark's lack of a home delivery option does not seem to have impacted it in any way. Its sales densities remain well above that of most peers and have been very steady.

## Figure 7: Primark's space growth and sales densities are well above peers

| Calendar year | | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|---|---|---|---|
| Primark | space growth | 12.8% | 12.0% | 9.0% | 12.5% | 7.6% | 8.3% | 9.8% | 9.5% |
| | sales density (£psf) | 516 | 501 | 512 | 538 | 528 | 533 | 538 | 543 |
| | sales density (EURpsm) | 6,605 | 7,046 | 6,933 | 6,500 | 6,322 | 6,354 | 6,412 | 6,470 |
| H&M | space growth | 13.2% | 13.5% | 13.3% | 11.1% | 7.6% | 4.9% | 4.8% | 6.0% |
| | space contbn | 9.5% | 9.7% | 10.1% | 7.7% | 5.8% | 3.8% | 3.8% | 5.0% |
| | sales density (EURpsm) | 3,834 | 3,878 | 3,574 | 3,155 | 3,122 | 3,122 | 3,111 | 3,085 |
| Inditex | space growth | 9.6% | 8.9% | 8.4% | 7.3% | 6.7% | 5.9% | 5.7% | 5.5% |
| | space contbn | 7.0% | 6.5% | 6.5% | 5.9% | 5.2% | 4.7% | 4.6% | 4.4% |
| | sales density (EURpsm) | 5,051 | 5,350 | 5,507 | 5,578 | 5,502 | 5,561 | 5,680 | 5,781 |
| Next | space growth | 4.7% | 4.3% | 4.0% | 2.8% | 0.9% | 1.2% | 1.2% | 1.0% |
| | space contbn | 3.4% | 2.9% | 2.6% | 1.8% | 0.5% | 0.6% | 0.6% | 0.5% |
| | Retail sales (£psf) | 326 | 317 | 296 | 265 | 249 | 235 | 222 | 210 |
| | Retail sales (EURpsm) | 4,283 | 4,573 | 4,342 | 3,283 | 3,049 | 2,868 | 2,709 | 2561 |
| | Brand Sales (£psf) | 541 | 539 | 518 | 501 | 513 | 518 | 520 | 525 |
| | Brand Sales (EURpsm) | 7,101 | 7,769 | 7,598 | 6,202 | 6,294 | 6,323 | 6,352 | 6408 |

Source: Company data, Credit Suisse estimates

**We don't believe that it possible to build a supply chain and logistics platform which can accommodate multi-channel retailing efficiently** at Primark's price points, and even the pure play operators such as Boohoo and Missguided remain very small by comparison. Over time, we would expect Primark to upgrade to a transactional website and collect in store delivery, which we believe can be accommodated without compromising the efficiency of the logistics platform.

**In our view, the biggest advantage of the internet for most apparel retailers, is not the ability to transact online, it's the ability to communicate directly with customers** cheaply in real time. Here we regard Primark as being best in class, with nearly 6m followers on Instagram and an average of 7m likes per month, similar to H&M brand and the entire Inditex group.

## Figure 8: Primark's social media engagement is best in class

| Group | Brand | Followers (per month) Instagram | Page Likes (per month) Facebook | Posts (per month) Instagram | Posts (per month) Facebook | Likes (per month) Instagram | Post Likes (per month) Facebook | Comments (per month) Instagram | Post Comments (per month) Facebook |
|---|---|---|---|---|---|---|---|---|---|
| H&M | Total | 32,589,522 | 36,621,318 | 350 | 120 | 9,971,374 | 44,558 | 37,428 | 825 |
| | H&M | 25,914,474 | 35,194,242 | 87 | 30 | 7,831,059 | 17,457 | 24,371 | 439 |
| Inditex | Total | 47,577,204 | 57,382,883 | 335 | 151 | 7,493,720 | 289,057 | 27,129 | 4,493 |
| | Zara | 26,700,868 | 26,654,525 | 35 | 37 | 2,153,453 | 39,252 | 8,913 | 1,267 |
| | Bershka | 5,886,123 | 11,102,986 | 34 | 34 | 1,518,087 | 117,881 | 4,568 | 1,112 |
| **ABF** | **Primark** | **5,884,724** | **5,566,604** | **163** | **46** | **7,026,745** | **16,494** | **92,463** | **18,009** |
| Asos | - | 7,329,297 | 5,719,566 | 92 | 36 | 1,427,240 | 17,946 | 11,254 | 10,522 |
| Zalando | - | 513,045 | 6,048,948 | 55 | 30 | 107,364 | 62,858 | 714 | 5,395 |
| Boohoo | Boohoo | 4,615,224 | 2,750,190 | 213 | 487 | 2,936,288 | 418,635 | 99,843 | 261,873 |
| Missguided | - | 3,057,293 | 1,211,847 | 110 | 73 | 1,871,487 | 64,269 | 67,086 | 23,757 |
| Next | - | na | 2,245,606 | na | 60 | na | 37,295 | na | 11,555 |
| M&S | - | 822,531 | 5,219,073 | 53 | 55 | 212,197 | 99,892 | 6,124 | 26,233 |

Source: Monatair

While the entire sector has seen margin attrition in recent years, to a large degree due to US$ strength, Primark's is the only where we expect margins to start to recover this year.

**Figure 9: US$ purchasing should be materially positive for the next year**

| 9m lag | Effective FX (£/US$) | % chg | Effective FX (US$/EUR) | % chg | % chg - combined |
|---|---|---|---|---|---|
| SS 15 | 1.678 | 9.2% | 1.356 | 3.8% | 6.6% |
| AW 15 | 1.558 | -4.5% | 1.200 | -11.8% | -7.9% |
| SS 16 | 1.530 | -8.8% | 1.109 | -18.2% | -13.5% |
| AW 16 | 1.488 | -4.5% | 1.099 | -8.4% | -6.5% |
| SS 17 | 1.386 | -9.4% | 1.128 | 1.7% | -3.4% |
| AW 17 | 1.282 | -13.9% | 1.078 | -1.8% | -7.3% |
| SS 18 | 1.273 | -8.2% | 1.133 | 0.4% | -3.3% |
| AW 18 | 1.323 | 3.2% | 1.184 | 9.8% | 7.0% |
| SS 19 | 1.368 | 7.5% | 1.205 | 6.4% | 6.8% |
| AW 19 | 1.286 | -2.8% | 1.157 | -2.2% | -2.5% |

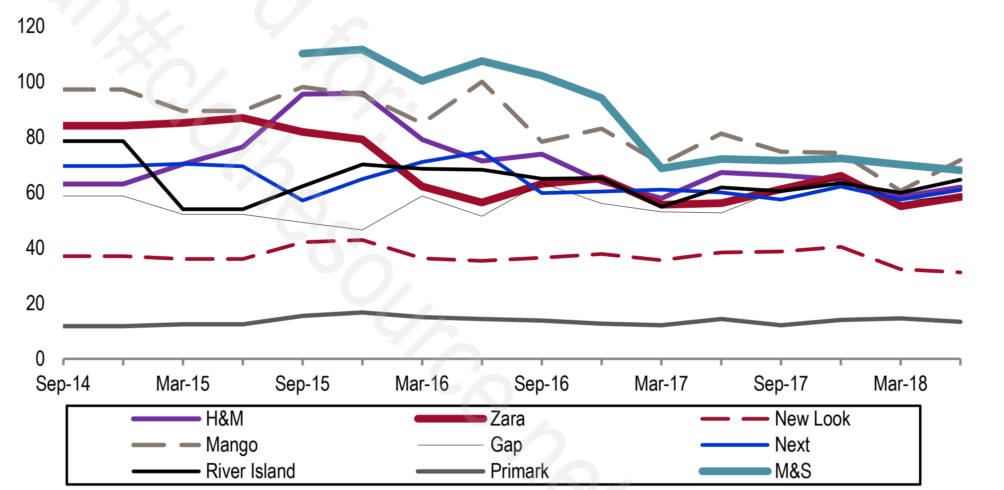
Source: Thomson Reuters Datastream, Credit Suisse estimates

This is largely due to US$ input costs which started to turn positive in Spring/Summer 18 in Europe and which will turn positive in Autumn/Winter in the UK.

**Will buying gains be retained?** We believe on the whole they will. With the US$ starting to recover, retailers will be less prone to reinvest US$ gains knowing that they will have to increase prices in less than a year.

We are seeing reasonable signs of price stability in the UK at higher price points:

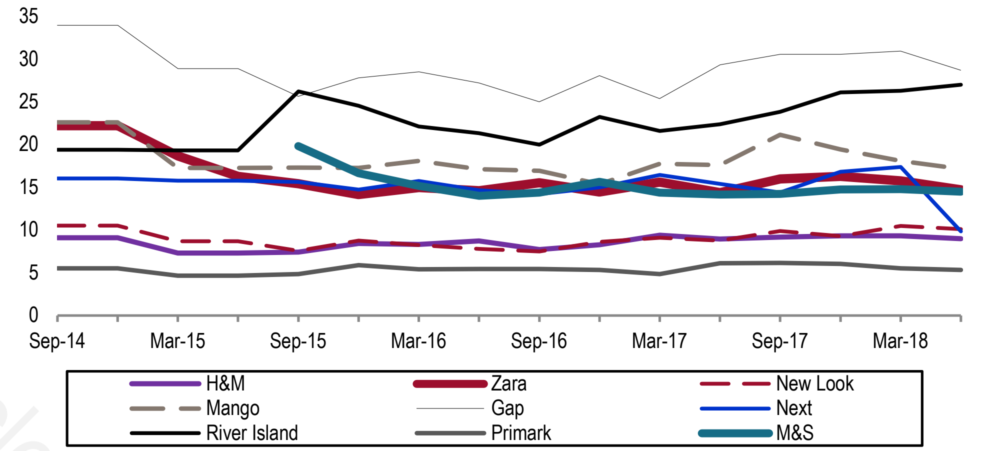
**Figure 10: Upper price points**




Source: Credit Suisse data

..and at opening price points. Noting that Primark retains significant advantage vs peers at both ends of the pricing spectrum.

## Figure 11: Opening price point basket




Source: Credit Suisse data

Consequently we continue to expect 2H 17/18 margins to be +110bp Y/Y.

For 18/19 we forecast margins +40bp, and while there might be some risk to our 1% LFL, given the UK environment, given soft comps in 1H, and that FX is materially more positive for most of the year, this should be achievable.

## Figure 12: Quarterly sales and margin forecasts

| Year to Sept | 2016 | | | | | | | 2017 | | | | | | | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | FY | 1Q | 2Q | 1H | 3Q | 4Q | 2H | FY | 1Q | 2Q | 1H | 3Q | 4Q | 2H | FY | FY |
| Weeks | | 16 | 8 | 24 | 16 | 12 | 28 | 52 | 16 | 8 | 24 | 16 | 12 | 28 | 52 | |
| | | 6/1 | 3/3 | 3/3 | 24/6 | 16/9 | 16/9 | 16/9 | 6/1 | 3/3 | 3/3 | 23/6 | | | | |
| LFL UK | **-2.0%** | 2.0% | 2.0% | 2.0% | 5.0% | 5.0% | 5.5% | **4.5%** | 3.5% | 3.5% | 3.5% | 1.0% | 2.0% | 1.5% | **2.4%** | **1.0%** |
| LFL Europe | **-2.0%** | -2.0% | -2.0% | -2.0% | -1.5% | -2.5% | -2.0% | **-2.0%** | -5.0% | -6.0% | -5.5% | -2.0% | -2.0% | -2.0% | **-3.6%** | **1.0%** |
| LFL | **-2.0%** | 0.0% | 0.0% | 0.0% | 2.2% | 1.2% | 2.0% | **1.5%** | -1.1% | -2.0% | -1.5% | -0.5% | -0.4% | -0.4% | **-0.9%** | **1.0%** |
| Space Contbn | **9.0%** | 12.0% | 11.0% | 11.0% | 13.0% | 14.0% | 13.0% | **12.5%** | 8.5% | 8.0% | 8.1% | 6.5% | 7.5% | 7.2% | **7.6%** | **8.3%** |
| LC growth | **7.0%** | 12.0% | 11.0% | 11.0% | 15.0% | 15.2% | 15.0% | **14.0%** | 7.4% | 6.0% | 6.6% | 6.0% | 7.1% | 6.8% | **6.7%** | **9.3%** |
| FX | **2.0%** | 11.0% | 6.0% | 8.8% | 6.0% | 2.0% | 4.0% | **6.7%** | 1.4% | 2.2% | 1.9% | 0.9% | -0.8% | 0.1% | **0.8%** | **0.0%** |
| % chg rep | **20.0%** | 23.0% | 17.0% | 20.8% | 21.0% | 17.2% | 19.0% | **18.6%** | 8.8% | 8.2% | 7.9% | 6.9% | 6.3% | 6.8% | **7.3%** | **9.3%** |
| Sales (£m) | **5,949** | | | 3,222 | | | 3,831 | **7,053** | | | 3,477 | | | 4,093 | **7,570** | **8,277** |
| EBIT (£m) | **689** | | | 323 | | | 412 | **735** | | | 341 | | | 488 | **829** | **935** |
| % sales | **11.6%** | | | 10.0% | | | 10.8% | **10.4%** | | | 9.8% | | | 11.9% | **10.9%** | **11.3%** |

Source: Company data, Credit Suisse estimates

This is in stark contrast to our other apparel retailers (also including Asos and Zalando) where we expect margins to be down this year and next.

## Figure 13: Primark is the online apparel retailers where we expect margins to expand

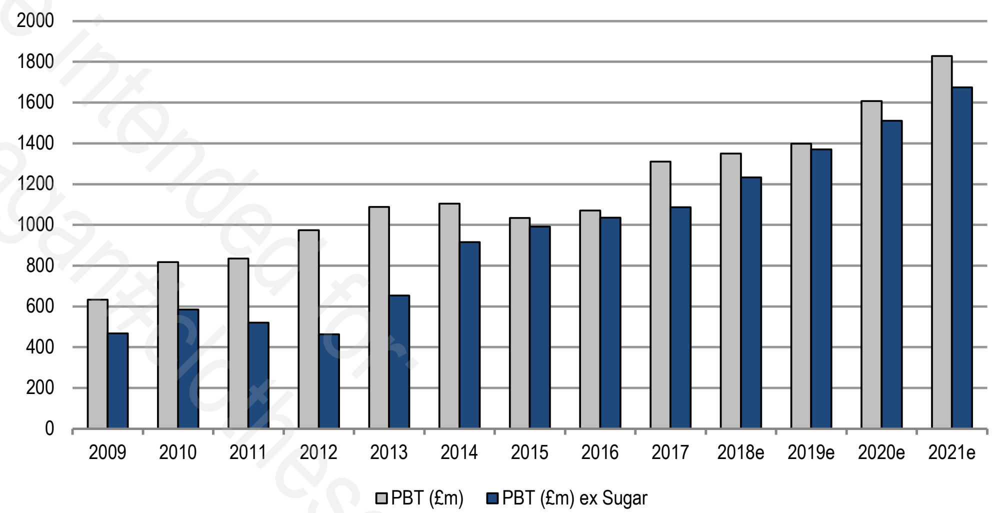
| Calendar year | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|
| Primark | 10.2% | 12.0% | 13.4% | 12.6% | 11.6% | 10.4% | 10.9% | 11.3% | 11.5% |
| H&M | 18.0% | 17.2% | 16.9% | 14.9% | 12.4% | 10.3% | 8.0% | 7.8% | 8.4% |
| Inditex | 19.5% | 18.4% | 17.7% | 17.6% | 17.2% | 17.0% | 16.7% | 16.4% | 16.2% |
| Next (Group EBIT) | 18.2% | 19.4% | 20.2% | 20.5% | 20.0% | 18.5% | 18.0% | 17.7% | 17.0% |

Source: Company data, Credit Suisse estimates

## Valuation – sugar is largely irrelevant:

In our recent report: ABF- Kitchen sinking sugar, and why it doesn't matter, we cut our 18/19 EBIT forecasts for Sugar from £126m to £28m, given low world sugar prices, and do not believe that this is necessarily a worst case scenario, depending on how long it takes excess inventory to clear. With Ilovo contributing c£100m pa in markets which are well insulated from global pricing in Africa, this implies that British Sugar and Ebro in Spain can contribute significant losses at the bottom of the cycle. Clearly, there is additional risk to the UK sugar regime given Brexit, however it's hard to conceive of a scenario where the lowest cost producer in Europe, under the current regime, does not make money in the medium term. Our valuation for sugar remains £1.75bn, ie 7x EBITDA, based on M-T EBIT of £170m vs an average of £248m pa over the past 8 years, and most of this can be attributed to Ilovo. Sugar does add materially to the volatility of profits, but, at just 6.6% of our SOTP, it's largely irrelevant.

**Figure 14: PBT growth ex sugar has been very consistent**




Source: Company data, Credit Suisse estimates

Our valuation for Grocery/Ingredients and central costs is 18x PER, based on current year earnings, excluding £30m of bread losses.

Our Primark valuation is based on a DCF with our existing EBIT forecasts, ie peaking at 11.7% in 2021/22 and declining to 10.4% in perpetuity.

The only item we flex in our Blue/Grey Sky scenarios are space growth over the next 20Y, with:

- Blue Sky growing space 4x including a full US rollout (450 stores),
- Grey sky increasing space by 73% (no US and curtailed European rollout)
- Base case adding 150% including we assume modest penetration of Eastern Europe and US.

### Figure 15: Base case and Blue/Grey Sky valuations

| | BASE CASE | | BLUE SKY | | GREY SKY | |
|---|---|---|---|---|---|---|
| | £m | £/share | £m | £/share | £m | £/share |
| Primark FCFs | 9,215 | 11.7 | 9,952 | 12.60 | 7,043 | 8.92 |
| Primark terminal value | 8,153 | 10.3 | 13,743 | 17.40 | 4,053 | 5.13 |
| Primark DCF | 17,368 | 22.0 | 23,695 | 29.99 | 11,096 | 14.05 |
| Value of Sugar | 1,750 | 2.2 | 2,059 | 2.22 | 1,453 | 2.22 |
| Value of food/ingredients | 6,466 | 8.2 | 7,543 | 8.18 | 6,286 | 8.18 |
| Bread losses | -200 | -0.3 | -200 | -0.25 | -200 | -0.25 |
| Cash/(Debt) | 673 | 0.9 | 673 | 0.85 | 673 | 0.85 |
| **APV value** | **26,057** | **33.0** | **33,770** | **43.00** | **19,308** | **24.50** |
| **Target price** | | **3,300** | | **4,300** | | **2,450** |

Source: Company data, Credit Suisse estimates

While listed apparel peers have de-rated over the past two years, we believe that has been justified given slowing space growth, declining sales densities and weak margins. However, we do not see these concerns as being relevant for Primark. Space growth should remain at c9% pa, sales densities are high, inventory is low and we remain more confident in its margin recovery potential than for peers.

With the shares trading at a 32% discount to our SOTP, it is worth considering at what price this discounts Primark.

### Figure 16: Implied price for Primark at the current share price

| Local currency | share price | EV (bn) | Period | Sales | EBIT (m) | EV/sales | EV/EBIT | PER |
|---|---|---|---|---|---|---|---|---|
| H&M | 122 | 209 | 12m FWD | 215,513 | 16,927 | 0.97 | 12.4 | 15.1 |
| | | | 24m FWD | 225,613 | 18,674 | 0.93 | 11.2 | 13.7 |
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| | | | 24m FWD | 29,715 | 4,837 | 2.44 | 15.0 | 20.7 |
| Primark - CS DCF | | 17.8 | 12m FWD | 7,923 | 908 | 2.24 | 19.6 | 25.1 |
| | | | 24m FWD | 8,724 | 1,025 | 2.04 | 17.3 | 22.2 |
| Primark - current price | | 9.0 | 12m FWD | 7,923 | 908 | 1.14 | 9.9 | 12.7 |
| | | | 24m FWD | 8,724 | 1,025 | 1.03 | 8.8 | 11.3 |
| Primark - 15% discount | | 11.6 | 12m FWD | 7,923 | 908 | 1.46 | 12.8 | 16.4 |
| | | | 24m FWD | 8,724 | 1,025 | 1.33 | 11.3 | 14.5 |

Source: Company data, Credit Suisse estimates

At the current share price, excluding the full value of the other assets, we calculate this discounts Primark at £9bn, equivalent to 1.14x sales, 9.9x EBIT and 12.7x PER.

We have never seen the need for a conglomerate discount given that one asset makes up two thirds of the asset base and 60% of EBIT, however, even if one assigns a 15% conglomerate discount (more than double the value of the sugar), Primark's valuation comes out at 1.5x sales, 12.8x EBIT and 16.4x PER, which still materially undervalues Primark vs listed apparel peers.

## Companies Mentioned *(Price as of 04-Sep-2018)*

**ASOS Plc** (ASOS.L, 6192.0p)
**Associated British Foods** (ABF.L, 2243.0p, OUTPERFORM, TP 3300.0p)
**Boohoo Group** (BOOH.L, 175.6p)
**Hennes & Mauritz** (HMb.ST, Skr122.06)
**Inditex** (ITX.MC, €25.25)
**Marks & Spencer** (MKS.L, 298.4p)
**OVS Spa** (OVS.MI, €2.53)
**Superdry** (SDRY.L, 1179.0p)
**The Gap, Inc.** (GPS.N, $30.22)
**Zalando** (ZALG.DE, €43.94)

# Disclosure Appendix

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### 3-Year Price and Rating History for Associated British Foods (ABF.L)

| ABF.L<br>Date | Closing Price<br>(p) | Target Price<br>(p) | Rating |
|---|---|---|---|
| 07-Sep-15 | 3113.00 | 3250.00 | O |
| 22-Feb-16 | 3295.00 | 3450.00 | |
| 19-Apr-16 | 3413.00 | 3550.00 | |
| 13-Apr-17 | 2709.00 | 3200.00 | |
| 06-Jul-17 | 2997.00 | 3350.00 | |
| 01-Sep-17 | 3319.00 | 3600.00 | |
| 20-Nov-17 | 3095.00 | 3700.00 | * |
| 09-Apr-18 | 2572.00 | 3300.00 | |

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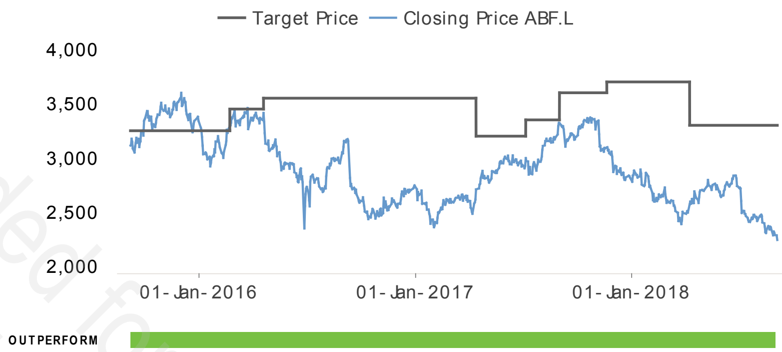


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|---|---|---|
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| Restricted | 2% | |

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### Target Price and Rating
### Valuation Methodology and Risks: (12 months) for Associated British Foods (ABF.L)

**Method:** Our target price of £33 is based on our sum-of-the-parts valuation together with a DCF on the Primark business, which assumes a cost of equity of 7.5% and long term growth of 1%. AB Foods' retail business (Primark) is now over 60% of its profits and key to earnings, and with store openings accelerating (now present in the US), we believe it is an under-valued long term growth compounder and an attractive structural growth story, which is hard to find elsewhere. Hence we rate the shares Outperform.

**Risk:** Key risks to our £33 target price and Outperform rating include: British Sugar could be impacted by the shift in EU Sugar legislation or by EU sugar prices, while Primark's risks involve the roll-out of new stores (US success is not guaranteed) and possible competition from other high street retailers at the discount end of the market.

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