

Thursday, 9 November 2023 | update

# Pepco: buy (reiterated)

PCO PW; PCOP.WA | Retail, Poland

## Growth Profile Still Attractive

Pepco Group recently revised its growth plans as the previous strategy turned out overly aggressive against a deteriorating macro backdrop. The revised strategy prioritizes profitable growth over rapid expansion, making cash generation a priority. Pepco Group is guiding for more than 400 store openings in FY2024, and it has adopted a more conservative approach to medium-term growth. With this in mind, we are lowering our long-term Pepco store count forecast by around 10%. At the same time, however, we still see room for massive growth in the overall store base. In the next three years, we expect the Group to grow the store base by almost 30%. Combined with like-for-like sales growth as European consumers rebound on the back of easing inflation, we believe this will result in sales growth of around 37% in the 2023-26 period representing a growth rate well above the current expectations for comparable companies.

As freight rates normalize, and the inventory purchased at the higher rates is cleared, we expect a recovery in gross margins in future quarters. We believe that gross margin development could be a catalyst for the stock in the near term, as if the company delivers on its promise to return to pre-covid margin levels, it creates significant room for share price growth through earnings improvement, not just expansion of multiples.

However, the rise in EBITDA margins in 2024 will likely be limited to just about 10bps y/y as increasing costs of labor and rent will offset improvement in gross margins. Nevertheless, EBITDA in the 2023-2026 period is expected to grow at a CAGR of about 12%, providing robust growth potential that makes Pepco's current valuation look attractive. On our estimates, Pepco's 2024E EV/EBITDA shows a discount of ca. 40% to the peer group which is forecast to deliver lower average annual EBITDA growth of around 8% in 2023-2026.

In our view, the discount that the market applies to Pepco due to the share overhang is unjustified. In a similar situation to Pepco is Pepkor, in which IBEX owns almost 50%. However, Pepkor trades at only a single-digit discount to its two-year average NTM EV/EBITDA, while Pepco trades at a discount of more than 30%.

### More fiscal stimulus as the opposition takes over power in Poland?

Opposition parties made many promises of fiscal stimulus to Poles during the election campaign. The most important of these promises included an increase in tax-free personal income and pay raises for teachers. The cost to the gov't budget of delivering the promises to consumers, approximate PLN 40bn/13bn, respectively. If the new coalition government delivers on its commitments, this represents additional upside to our 2024 LFL growth forecasts for Pepco of ca. 0.7pp/0.15pp. respectively.

### Dividend in 2026?

Pepco Group has a solid balance sheet with (IAS 17) net debt/EBITDA'23 at 1x, coupled with strong cash generation (expected ca. 90% CFO-leasing/EBITDA IAS 17) that can entirely finance CAPEX. We believe that, by 2026, the Group will be in a position to either accelerate the pace of rollout, or return cash to shareholders. We expect Pepco to opt for an initiation of dividend distributions from 2026 with implied dividend yield of around 8%.

(€ m)	2022	2023E	2024E	2025E	2026E
revenue	4,822.8	5,649.0	6,238.8	6,974.8	7,744.9
EBITDA (adj.)	730.7	750.0	837.7	964.5	1,067.1
margin	15.2%	13.3%	13.4%	13.8%	13.8%
EBIT	278.2	252.1	298.7	382.1	426.0
net profit	173.6	145.5	178.3	239.0	266.7
P/E	13.6	16.2	13.3	9.9	8.9
P/S	0.5	0.4	0.4	0.3	0.3
P/B	2.1	1.8	1.6	1.4	1.3
EV/EBITDA (adj.)	5.2	5.4	4.9	4.2	3.9
DPS	0.0	0.0	0.0	0.0	0.3
Dividend Yield	0.0%	0.0%	0.0%	0.0%	7.6%

current price	PLN 18.29
target price	PLN 32.70
mCap	PLN 10.5bn
free float	PLN 2.6bn
ADTV (3M)	PLN 37.6 m

\*Price as of November 08, 2023, 5:00 PM

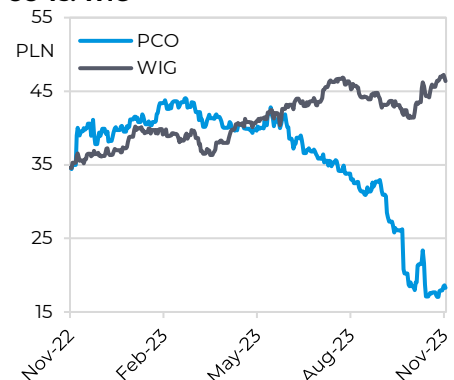
### Ownership

IBEX Retail Investments (Europe) Limited	72.2%
Andy Bond	0.7%
Others	27.1%

### About Pepco

Pepco is a chain of variety retail stores carrying a sales mix of clothing, home decor, and fast-moving goods, present in 21 European countries. The brands that form Pepco Group include Pepco, Poundland, and Dealz. Pepco is Poland's value market leader in the Kidswear category.

### PCO vs. WIG



name	target price		recommendation	
	new	old	new	old
PCO	32.70	50.2	buy	buy

name	current price	target price	upside
PCO	18.29	32.70	+78.8%

forecast update	2024E	2025E	2026E
revenue	-4.2%	-5.8%	-7.2%
EBITDA underlying	-12.6%	-12.4%	-13.3%
No. of Pepco stores	-1.7%	-3.6%	-5.5%
EBITDA Pepco	-18.4%	-18.2%	-19.2%
EBITDA P/D	+8.3%	+11.1%	+12.7%

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**List of abbreviations and ratios used by mBank:**

**EV** (Enterprise Value) – Equity Value + Net Debt; **EBIT** – Earnings Before Interest and Taxes; **EBITDA** – EBIT + Depreciation & Amortisation; **Net Debt** – Borrowings + Debt Securities + Interest-Bearing Loans - Cash and Cash Equivalents; **P/E** (Price/Earnings) – Price Per Share Divided by Earnings Per Share; **P/CE** (Price to Cash Earnings) – Price Per Share Divided by Earnings + Depreciation & Amortisation; **P/B** (Price to Book Value) – Price Per Share Divided by Book Value Per Share; **P/CF** (Price to Cash Flow) – Price Divided by Cash Flow from Operations; **ROE** (Return on Equity) – Earnings Divided by Shareholders' Equity; **ROCE** (Return on Capital Employed) – EBIT x (Average Assets - Current Liabilities); **ROIC** (Return on Invested Capital) – EBIT x (1-Tax Rate) / (Average Equity + Minority Interest + Net Debt); **FCFF** (Free Cash Flow to Firm) – Cash Flow from Operations - CAPEX - Lease Payments; **FCFE** (Free Cash Flow to Equity) – Free Cash Flow to Firm - Net Interest Expense (incl. Debt + Leases)  
**EBITDA margin** – EBITDA/Sales

**OVERWEIGHT (OW)** – a rating which indicates that we expect a stock to outperform the broad market  
**NEUTRAL (N)** – a rating which indicates that we expect the stock to perform in line with the broad market  
**UNDERWEIGHT (UW)** – a rating which indicates that we expect the stock to underperform the broad market

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**Discounted Dividends (DDM)** – discounting of future dividends; the weak point is high sensitivity to changes in the assumptions as to future dividends made in the valuation model.

**NAV** – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

**mBank issued the following recommendations for Pepco in the 12 months prior to this publication:**

**Pepco (Janusz Pięta)**

Rating	buy	buy	buy
Rating date	2023-07-03	2023-04-03	2022-12-12
Target price (PLN)	50.20	49.10	48.50
Price on rating day	36.82	41.50	39.88



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