# MCCOLL’S PLC (LON:MCLS)

**FOOD RETAILERS**

**08/01/2018**

| SHARE PRICE | 52 WEEK LOW |
|---|---|
| 258p | 171p |
| **MARKET CAP** | **52 WEEK HIGH** |
| £297.1m | 300p |
| **CASH** | **NAV** |
| £27.8m | £133.5m |

## Positioned to Succeed

### NEIGHBOURHOOD POSITION

McColl’s (LON:MCLS) is one of the UK’s leading neighbourhood retailers, with a growing estate of over 1,600 managed convenience stores (80%) and newsagents (20%). The term “neighbourhood” refers to residential locations, for example villages or housing estates, which tend to mean a loyal customer base and little immediate local competition.

This positioning puts McColl’s (LON:MCLS) in the sweetspot of small box retailing, riding the growing social dynamic towards “little and often” shopping. The company has compelling drivers for growth in earnings and cash-flow in the next few years, which we outline in this report.

### MORRISONS SUPPLY-CHAIN PARTNERSHIP – SAFEWAY BRAND

In August 2017 McColl’s announced a supply chain partnership with Morrisons (MRW.L). McColl’s has maintained a strategy of using 3rd party supply and logistics, reducing demand on the company’s own capex and working capital, benefitting the company’s cash-flow (chart p2). The Morrisons deal further underpins this strategy, and also allows McColl’s to expand its fresh food offering.

As part of the deal McColl’s obtains the right to sell groceries under the Safeway brand. McColl’s has historically under-indexed in own-brand products, and the adoption of Safeway as McColl’s house brand addresses this using a name already well-known to UK consumers.

### OTHER DRIVERS

Other positive drivers for 2018 and 2019 include:

- Full-year benefit from the acquisition of 298 stores from Co-Op.
- Potential other expansion of the estate, likely to be individual store acquisitions.
- The “Refresh” program of store upgrades will be applied to around 100 stores in 2018 and more than 100 in 2019.
- Ongoing positive mix shift towards groceries, alcohol, and food-to-go, versus lower margin tobacco and newspapers, reinforced by the phased roll-out of the Safeway brand during 2018.
- The food-to-go offering is likely to benefit from further in-store Subway franchises, which have proved very popular.

### VALUATION AND CONCLUSION

The shares gained 42% during 2017 reflecting the progress of the business. However, we believe these gains may be only the first steps towards a market reappraisal of McColls, with earnings growth prospects in 2018 and 2019 driving further potential upside.

| Y/E November, £m | 2015 | 2016 | 2017E | 2018E |
|---|---|---|---|---|
| Revenue | 932.2 | 950.4 | 1120 | 1260 |
| Op Profit | 24.3 | 23.5 | 30.0 | 37.0 |
| Adj. EPS (p) | 15.9 | 16.0 | 17.2 | 22.4 |
| DPS (p) | 10.2 | 10.2 | 10.3 | 11.0 |
| Source: Capital Network | | | | |

## MAJOR SHAREHOLDERS

1) **Klarus Capital :** **11.4%**
2) **Aberforth Partners:** **9.9%**
3) **Premier Fund Managers:** **7.7%%**

| | |
|---|---|
| Shares in Issue | 115.2m |
| Avg Trading Volume | 139,164 |
| Market | London Main |
| EPIC | LON:MCLS |
| Next Key Announcement | 19th Feb 2018, FY results |
| Sector | Food Retailers |

## SHARE PRICE CHART




### Company Information

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### Analyst Details

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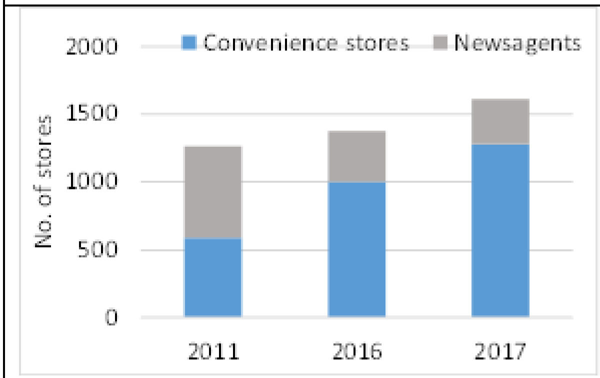
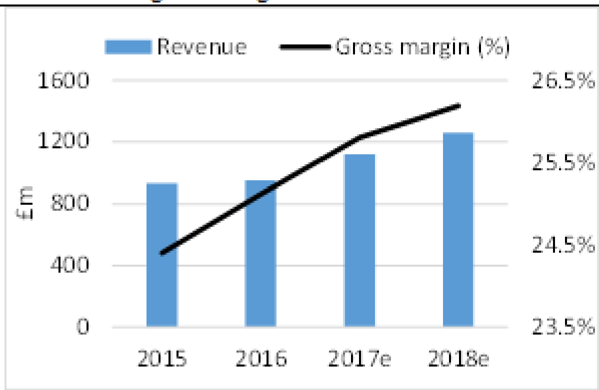
| McColl's stores | Revenue and gross margins |
|---|---|
|  |  |
| Source: Company data | Source: Company data and Capital Network forecasts |

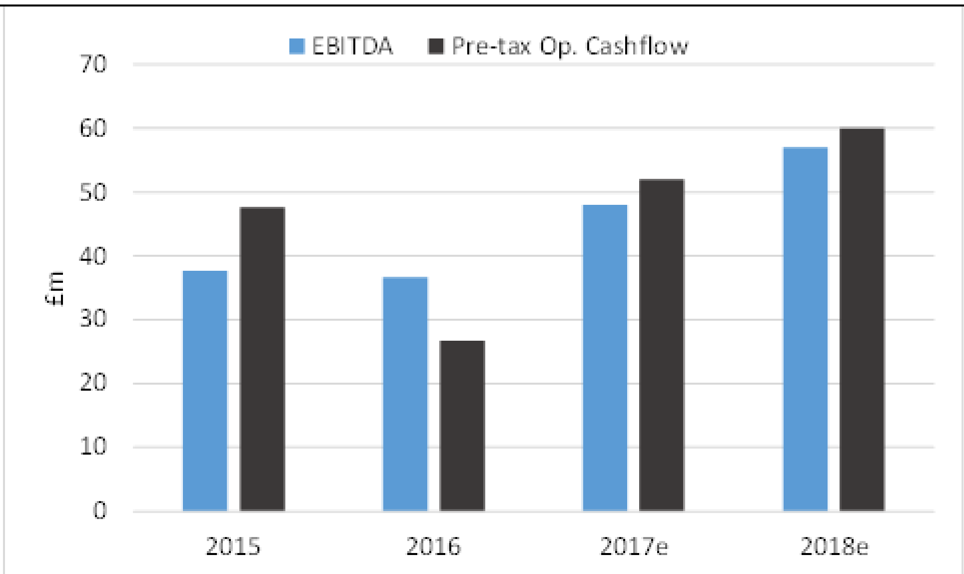
The chart above left shows growth in terms of number of stores managed by McColl's. There has been a mix shift towards convenience as opposed to lower margin newsagents, as well as growth in the total number of stores. The convenience store sector remains highly fragmented, and we believe that a continuing consolidation trend offers McColl's further opportunity to continue expanding in this direction.

The chart above right shows revenue growth together with gross margins, historic and forecast. The increasing margin reflects an improving revenue mix, in terms of both the mix of stores (more convenience stores) and an improving mix within each store, driven by groceries, alcohol, and food-to-go.

## CASH FLOW

The chart below shows the company's cash flow compared to EBITDA. We use pre-tax operating cashflow as this is most closely parallel to EBITDA. In 2015 the company benefitted from some working capital timing effects which reversed in 2016. In aggregate over 2015/2016 the conversion of EBITDA to cash is 100%. We believe this should be sustained or improved in 2017 (to be reported February 2018) and in 2018. One of the drivers of strong cash flow is McColl's strategy of using 3rd party supply and logistics – working capital requirements are more of an issue for the wholesaler rather than the retailer – and also the fast stock-turn characteristics of the convenience store business.

Cash conversion




Source: Company data