

More discounted valuations in food retailing

“Disruption” is very much the buzzword on markets right now. The spread of new, digital-based technologies across the whole range of business activities is creating new growth opportunities for innovative companies. It is also upsetting established balances in terms of competition, creating uncertainty that is translating into heavily discounted valuations of “old-economy” firms that are not always justified. This is particularly evident in the food retailing sector, which offers new investment opportunities.

The food retailing sector has had many challenges thrown at it over the last 10 years. Consumer habits have changed as consumers turn their backs on the hypermarkets that represent over 40% of sales areas in France.

Traditional food retailers have also had to cope with the inroads made by the hard discounters, with new competitors like the German groups Aldi and Lidl emerging. Hard discounting accounts for an average 15% share of the European market, ranging from 13% in France to over 40% in Germany.

Lastly, retailers suffered from price deflation on food products over the course of 2015 and 2016 with retail prices falling as operating costs (rents and salaries) have been subject to natural inflation. Operating margin in the sector has dropped by 1 point in 15 years, from over 4% prior to 2013 to 3.2% currently.

A recent addition to this challenging environment has been the threat of new Internet players such as Amazon entering the marketplace, triggering a fresh wave of market underperformances from Europe’s food retailers, who are now trading at historically low valuation ratios approaching 40% of sales.

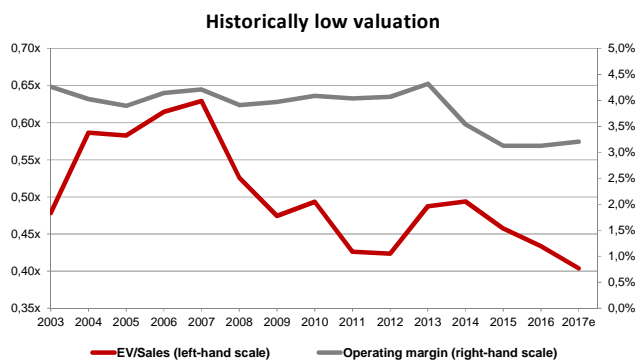
The undervaluation of many stocks constitutes an investment opportunity we have seized upon by bringing **Dia**, **Carrefour** and **Ahold Delhaize** stocks into our portfolios.

These undervaluations are all the more attractive in that the threat of the new entrants is perhaps overstated. If we look at the US market, birthplace of Amazon, we see that online food retailing accounts for just 4% of the market, with a penetration rate growing very slowly compared to online retailing as a whole, which is growing at 14% annually and now represents 11% of the US market. This weak growth is probably what convinced Amazon of the need to own its own physical distribution network, hence its purchase of the Whole Foods chain at the high price of 85% of sales for an operating margin of 4.5%.

Traditional retailers are also capable of adapting, as has been the case in the non-food sector that has had much longer exposure to online competition. French group Fnac Darty has successfully developed its mix with 17% of its sales now online and a market share of 23% on its segment in France, well ahead of Amazon, ranked in 3rd place with a 9% share of the French market. Fnac Darty has also grown its operating margin from 2.1% in 2014 to a potential 4.3% in 2018, thanks to synergies derived from the merger between Fnac and Darty.

Similarly, leading US food retailer Walmart with a 23% market share is also investing heavily. The Group has decided to allocate around a quarter of its total investment to its e-tailing business, which is already posting 40% growth. This is quite enough to take on Amazon, whose share of the food retailing market is only 2% following the acquisition of Whole Foods. These investments have certainly weighed heavily on the Group’s margin, but it is still set to remain at around 4.5% compared to 6% at its peak.

Structural changes in business activity keep recurring. They are often accompanied by periods of great uncertainty during transition phases. This is then reflected in exaggerated valuation gaps, as was the case in early 2000 at the time of the dotcom bubble and is now the case in the food retailing sector.



Average of Ahold Delhaize, Carrefour, Casino, DIA, Sainsbury and Tesco
 Source: Exane /METROPOLE Gestion – Data August 2017

Performances*

| PERFORMANCES | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 | 1 yr. | 3 yrs. | 5 yrs. | 10 yrs. | Since inception | Volat. Vol. bench NAV |
|---|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|-----------------|-----------------------|
| EUROPEAN AND EUROZONE EQUITIES | | | | | | | | | | | | |
| METROPOLE SELECTION A | | | | | | | | | | | | |
| FR0007078811 | 10.06% | -0.53% | 9.19% | -0.02% | 28.44% | 23.33% | 19.78% | 26.78% | 61.51% | 32.57% | 224.35% | 9.65% |
| STOXX Europe Large 200 NR | 10.65% | 1.88% | 7.70% | 7.09% | 19.68% | 17.19% | 18.43% | 23.21% | 61.23% | 29.46% | 142.87% | 8.83% |
| Performance gap | -0.59 | -2.41 | 1.49 | -7.11 | 8.76 | 6.14 | 1.35 | 3.57 | 0.28 | 3.11 | 81.47 | 648.69 |
| METROPOLE SELECTION EUROPE USD HEDGE | | | | | | | | | | | | |
| FR0012068492 | 10.85% | 0.24% | 7.15% | -0.57% | - | - | 20.72% | - | - | - | 18.38% | 9.67% |
| STOXX Europe Large 200 NR | 10.65% | 1.88% | 7.70% | -0.47% | - | - | 18.43% | - | - | - | 20.85% | 8.83% |
| Performance gap | 0.20 | -1.64 | -0.55 | -0.10 | - | - | 2.29 | - | - | - | -2.47 | 1,183.82 |
| METROPOLE EURO A | | | | | | | | | | | | |
| FR0007078753 | 8.52% | 3.76% | 6.87% | 3.25% | 26.73% | 21.34% | 18.29% | 25.72% | 66.22% | 20.39% | 165.03% | 10.70% |
| Euro STOXX Large NR | 14.93% | 3.97% | 8.66% | 4.30% | 22.69% | 19.21% | 22.77% | 32.50% | 75.13% | 15.86% | 130.15% | 10.20% |
| Performance gap | -6.41 | -0.21 | -1.79 | -1.05 | 4.04 | 2.13 | -4.48 | -6.78 | -8.91 | 4.53 | 34.88 | 530.06 |
| METROPOLE AVENIR EUROPE A | | | | | | | | | | | | |
| FR0007078829 | 16.28% | 3.64% | 9.49% | -1.70% | 28.99% | 25.57% | 27.14% | 39.23% | 76.16% | 71.09% | 274.88% | 9.44% |
| STOXX Europe Small 200 NR | 17.37% | 0.52% | 15.68% | 4.93% | 26.73% | 23.47% | 25.15% | 42.41% | 88.10% | 64.96% | 351.92% | 8.80% |
| Performance gap | -1.09 | 3.12 | -6.19 | -6.63 | 2.26 | 2.10 | 1.99 | -3.18 | -11.94 | 6.13 | -77.04 | 749.75 |
| METROPOLE FRONTIERE EUROPE A | | | | | | | | | | | | |
| FR0007085808 | 15.72% | 0.89% | 6.19% | -1.86% | 18.97% | 13.78% | 22.09% | 23.17% | 51.18% | -22.57% | 112.22% | 8.26% |
| STOXX Europe Large 200 NR | 10.65% | 1.88% | 7.70% | 7.09% | 19.68% | 17.19% | 18.43% | 23.21% | 61.23% | 29.46% | 158.33% | 8.83% |
| Performance gap | 5.07 | -0.99 | -1.51 | -8.95 | -0.71 | -3.41 | 3.66 | -0.04 | -10.05 | -52.03 | -46.11 | 424.45 |
| METROPOLE VALUE SRI A | | | | | | | | | | | | |
| FR0010632364 | 8.10% | 2.93% | 6.73% | 1.24% | 27.74% | 24.01% | 17.75% | 25.82% | 63.87% | - | 70.17% | 11.06% |
| Euro STOXX Large NR | 14.93% | 3.97% | 8.66% | 4.30% | 22.69% | 19.21% | 22.77% | 32.50% | 75.13% | - | 54.73% | 10.20% |
| Performance gap | -6.83 | -1.04 | -1.93 | -3.06 | 5.05 | 4.80 | -5.02 | -6.68 | -11.26 | - | 15.44 | 340.34 |
| BONDS & CONVERTIBLES | | | | | | | | | | | | |
| METROPOLE CONVERTIBLES A | | | | | | | | | | | | |
| FR0007083332 | 0.40% | 1.98% | 2.88% | 0.71% | 7.22% | 13.91% | 3.52% | 7.27% | 16.39% | 28.79% | 72.28% | 3.60% |
| ECI-EURO | 6.99% | -0.21% | 6.08% | 3.06% | 9.81% | 18.19% | 8.41% | 15.76% | 32.12% | 31.68% | 88.90% | 3.41% |
| Performance gap | -6.59 | 2.19 | -3.20 | -2.35 | -2.59 | -4.28 | -4.89 | -8.49 | -15.73 | -2.89 | -16.62 | 344.57 |
| METROPOLE CORPORATE BONDS A | | | | | | | | | | | | |
| FR0010695874 | 0.36% | 0.51% | 0.96% | 3.78% | 3.68% | 11.92% | 0.51% | 2.19% | 11.72% | - | 53.06% | 0.97% |
| FTSE MTS 3-5 Y | 0.52% | 1.46% | 1.39% | 5.93% | 2.32% | 8.66% | 0.80% | 3.98% | 13.60% | - | 31.51% | 1.35% |
| Performance gap | -0.16 | -0.95 | -0.43 | -2.15 | 1.36 | 3.26 | -0.29 | -1.79 | -1.88 | - | 21.55 | 306.12 |

Past performances are not necessarily indicative of future results. The mutual funds may lose value.

*Data as of 31 October 2017

Date of inception: the funds became sub-funds of the SICAV METROPOLE Funds by merger-absorption on 31/03/2017.

The share classes were initially created at the following dates: METROPOLE EURO A, METROPOLE SELECTION A, METROPOLE AVENIR EUROPE A : 29/11/2002, METROPOLE CONVERTIBLE A : 30/04/2003, METROPOLE FRONTIERE EUROPE : 08/08/2003, METROPOLE VALUE SRI A : 9/07/2008 et METROPOLE CORPORATE BONDS : 19/12/2008, METROPOLE SELECTION EUROPE USD HEDGE : 23/12/2014.

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