EDISON

Greggs

H120 results

Gradual recovery expected

Retail

Greggs' interim results were heavily affected by the estate closure for the majority of Q220, due to COVID-19. The key takeaways are that operating cash burn during lockdown was in line with management expectations, and current trading, albeit with limited data, indicates gradual weekly progress in revenue, described by management as encouraging. We assume recovery through H121e, before stabilising at a revenue run-rate equivalent to 90% of the level in FY19. The resulting EV/sales multiple of 1.2x for FY21e, is in line with recent multiples. It reflects lower estimated revenue in that year and uncertainty about the rate of recovery.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/18	1,029.3	89.8	70.3	35.7	17.7	2.9
12/19	1,167.9	114.2	89.7	46.9**	13.8	3.8
12/20e	765.4	(77.9)	(63.4)	0.0	N/A	0.0
12/21e	1,040.1	60.8	48.0	15.0	25.9	1.2

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items. **Includes special dividend of 35p/share.

H120: Store closures affect profits and cash

Greggs' H120 revenue declined by 45% to £300.6m and it generated its first-ever operating loss, which reflects the fact that the majority of the estate did not trade for a large part of Q220, after a previously reported strong start to the year. Operating costs have been managed in line with expectations and, since reopening, revenue trends have been gradually improving – although down by 28% (latest week) versus FY19. The company has moved from its typical net cash position to a net debt position of £26.2m at the end of H120; therefore, no dividend has been declared for H120. As revenue recovers, management's priority is to rebuild the balance sheet, after short-term refinancing, in order to repay funding received from the government, ahead of cash returns to shareholders.

FY20 forecasts: Operating loss in H220e

Management has not provided financial guidance for FY20e, but has indicated that it expects to achieve PBT break-even at revenue levels equivalent to 80% of that achieved in FY19. In our reinstated estimates, we assume a like-for-like decline in revenue in H220e of 25.7% and a modest operating loss of £5.2m. We forecast that revenue in FY21e, including some new space growth, will be approximately 89% of that reported in FY19, and that PBT will be approximately 53% of FY19's, with the inclusion of interest payments on the new debt. We assume a dividend of 15p/share will be reinstated for H221e.

Valuation: Multiples reflect uncertain sales recovery

With a forecast loss before tax in FY20, analysis of near-term, earnings-based multiples is not possible. At 1,242p, the EV/sales multiple for FY21e is 1.2x, compared to the average since FY08 of 0.9x, and the average of 1.2x since FY15, when its growth rate accelerated as the strategy delivered positive results. The P/E multiple for FY21e of 25.9x compares with the average since FY15 of 18.6x.

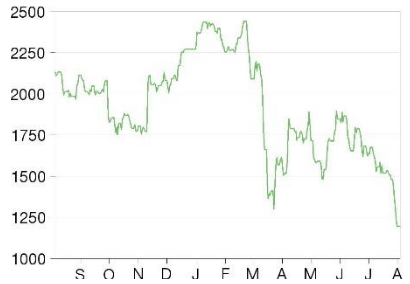
4 August 2020

Price **1,242p**

Market cap **£1,257m**

Net debt (£m) at 27 June 2020	26.2
Shares in issue	101.2m
Free float	99.6%
Code	GREG
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(28.8)	(30.4)	(45.5)
Rel (local)	(27.4)	(33.7)	(34.3)
52-week high/low		2,442.00p	1,193.00p

Business description

With 2,025 shops, eight manufacturing and distribution centres and 23,000 employees, Greggs is the leading 'food-on-the-go' retailer. It uses vertical integration to offer differentiated products at competitive prices.

Next events

Q320 trading	29 September 2020
Q420 trading	January 2021
FY20 results	March 2021

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Edison profile page

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H120 results: Heavily affected by COVID-19

Gregg's H120 results were heavily affected by the COVID-19 pandemic, as the majority of its estate and operations were closed for a large part of the interim period, from 24 March 2020.

Exhibit 1: Financial summary

£m	H119	H219	FY19	H120
Revenue	546.3	621.6	1,167.9	300.6
Growth y-o-y	14.7%	12.4%	13.5%	(45.0%)
Like-for-like growth y-o-y*	10.5%	8.1%	9.2%	(49.0%)
Gross profit	356.6	399.1	755.7	178.4
Gross margin	65.3%	64.2%	64.7%	59.3%
Operating profit/(loss) before exceptionals	43.9	69.8	120.7	(61.5)
Margin	8.0%	11.2%	10.3%	(20.5%)
Exceptionals	(4.0)	(1.9)	(5.9)	(0.7)
Reported operating profit/(loss)	39.9	67.9	114.8	(62.2)
Financial expenses	(3.2)	(3.3)	(6.5)	(3.0)
Reported profit/(loss) before tax	36.7	64.6	108.3	(65.2)
Tax	(7.5)	(13.8)	(21.3)	11.4
Tax rate	(20.5%)	(21.3%)	(19.7%)	(17.5%)
Reported profit/(loss) after tax	29.2	50.8	87.0	(53.8)
Reported EPS (fully diluted) (p)	28.5	56.5	85.0	(53.4)
DPS – ordinary (p)	12.0	0.0	12.0	0.0
DPS – special (p)	35.0			
Closing cash	85.9	91.3	91.3	52.9
Closing net debt/(cash) (excl IFRS 16)	(85.9)		(91.3)	26.2
Closing net debt/(cash) (incl IFRS 16)	191.1		184.4	305.3

Source: Greggs. Note: *Company-managed stores.

Revenue declined by 45% in H120 to £300.6m from £546.3m in H119, with a like-for-like decline in company-managed stores of 49%, indicating that trading continued to be good, against strong comparatives, ahead of the outbreak.

Prior to the outbreak, Greggs had reported that the first nine weeks of FY20 had started well with total sales growth of 11.7% and like-for-like sales growth in company-managed stores had increased by 7.5%. This was an impressive performance given the strong comparator from FY19 when the growth rates were 14.1% and 9.6%, respectively.

When allowed to reopen, the stores were opened gradually following trials on new procedures to cope with social distancing requirements in a small number of shops, which began in early May. From 18 June, ie with just under two weeks of the interim period remaining, 800 shops from the total of 2,025 shops, were opened for takeaway customers with a restricted menu of the company's best-selling products. From 2 July, the remainder of the estate was reopened; therefore, by the time of the results announcement, the whole of the estate had been trading for just three weeks.

By the end of the period, the number of stores reduced to 2,025 from 2,050 at the end of December 2019.

The gross margin declined from 65.3% in H119 to 59.3% in H120, including the impact of £9m (equivalent to 3pp of margin) from stock written off due to the sudden closure of operations as the economy headed into lockdown. There is natural deleveraging of the margin from the lack of sales during lockdown.

Gregg's PBT reduced from £36.7m in FY19 to a loss of £65.2m in H120. During lockdown, the operating cash burn was quantified as £4.4m per week, which is in line with management's prior guidance of c £4.5m per week. The swing in profitability reflects 13 weeks' lost contribution from not trading, as well as the one-off costs including stock write-offs, etc.

In Exhibit 2, we highlight how the main P&L line items have progressed on a weekly basis through FY19 and H120. The latter includes the weeks prior to lockdown, which would have generated more positive operating results.

Exhibit 2: Greggs' average weekly financials

£m (per week)	H119	H219	FY19	H120
Revenue	21.0	23.9	22.5	11.6
Cost of sales	(7.3)	(8.6)	(7.9)	(4.7)
Gross profit	13.7	15.3	14.5	6.9
Operating expenses	(9.7)	(10.3)	(10.0)	(6.8)
Total expenses	(17.0)	(18.8)	(17.9)	(11.5)
'Cash' operating profit	4.0	5.1	4.6	0.1
Share-based payments	(0.2)	0.0	(0.1)	(0.1)
Depreciation and amortisation	(2.2)	(2.1)	(2.1)	(2.4)
Reported operating profit/(loss)	1.7	3.0	2.3	(2.4)

Source: Edison Investment Research

Cash and balance sheet: Government support introduces debt

During H120, Greggs' operating cash flow turned negative with an outflow of £65.6m versus an inflow of £89.2m in H119, which is marginally ahead of the reported operating loss, reflecting higher year-on-year non-cash charges for impairments and a working capital outflow, due mainly to trade creditors.

The net investment in tangibles and intangibles declined marginally year-on-year from £39.0m in H119 to £36.7m in H120. As a result, free cash flow for H120 was an outflow of £102.3m, compared to an inflow of £50.2m in H119.

At the period end, the cash balance of £52.9m compares with £91.3m at the end of FY19. This includes the receipt of £150m of funding from the Covid Corporate Financing Facility (CCFF), of which £70m is included on the balance sheet as short-term investments, therefore the combined cash and short-term investments total £122.9m. Management would like to repay this debt as soon as possible as the terms include certain operating restrictions, therefore it is in discussions with banks to put in place a new facility to replace the CCFF. Greggs' net debt position at the end of H120 was £26.2m. In addition, it had lease liabilities of £279.1m.

As a result of the new net debt position, an interim dividend has not been declared following the cancellation of the final dividend for FY20. The priority for management is to repay the above debt and restore the balance sheet. Typically, Greggs operates with a net cash financial position.

Current trading: An encouraging start and weekly progress

With just three weeks of trading for the entire estate since reopening, the data is relatively limited. However, management is reasonably encouraged by the early signs and it believes that confidence is recovering slowly.

Versus the comparator period in FY19, during the most recent week of trading average sales across the estate were approximately 72% of that prior period, ie down by 28% on a like-for-like basis. This has built from 68% in the first week and 70% in the second week of trading; management believes this is an encouraging trend. Naturally, there is some skew within the portfolio, with shops that are accessed via car and/or are located in towns and suburban areas outperforming those that are located in larger cities and workplaces or are accessed by public transport. The former represents c 86% of Greggs' estate, and are trading at, respectively, c 85% and over 70% of the prior year sales level. The latter are trading at c 55% and c 35%, respectively.

With respect to customer type, Greggs is not overly exposed, versus its peers, to the non/slow return of office-based workers back to their offices post lockdowns. Just 5% of the customer base works in the finance, legal and IT professions, where a return to the office appears unlikely in the near term. The majority of the customer base is either unable to work from home due to the nature of their jobs, ie those employed in health, retail, education, manufacturing and retail etc, or are students, retired or not employed.

While the outlook for the impact of social distancing remains uncertain, management is accelerating its plans with respect to alternative ways of fulfilling demand, ie click-and-collect and delivery are being rolled out nationally during the second half of the year. On the other side of the equation, other initiatives, such as longer opening hours, are being reined in to match the reduced footfall.

The company continues to be in cash preservation mode, with 10 net new store openings planned for FY20.

Forecasts

Management has not provided any financial guidance for the remainder of FY20. However, it has provided an indication of the sensitivity of the company's profitability at different levels of revenue relative to FY19. At the current revenue run rate of 72% of sales in the comparator period, the company is at operating cash break-even. At revenue equivalent to c 80% of FY19's revenue of £1,168m, ie £935m, it would expect to break even at the PBT level, and as revenue recovers to 100% of FY19's level, it would expect a recovery in profitability to FY19's PBT of £114.2m (before exceptionals).

Exhibit 3 highlights our reinstated forecasts for FY20 and FY21. We withdrew our prior estimates on the announcement that the company was closing all operations due to COVID-19.

Exhibit 3: New forecasts for Greggs

£m	H120	H220e	FY20e	FY21e
Revenue	300.6	464.8	765.4	1,040.1
Growth	(45.0%)	(25.2%)	(34.5%)	35.9%
Like-for-like	(49.0%)	(25.7%)	(37.3%)	37.8%
Gross profit	178.4	265.0	443.4	658.6
Gross margin	59.3%	57.0%	57.9%	63.3%
Operating profit/(loss) before exceptionals	(61.5)	(5.3)	(66.8)	72.5
Operating margin	(20.5%)	(1.1%)	(8.7%)	7.0%
Profit/(loss) before tax and exceptionals	(64.5)	(13.4)	(77.9)	60.8
Reported profit/(loss) before tax	(65.2)	(13.4)	(78.6)	60.8
EPS – normalised and fully diluted (p)	(52.7)	(10.8)	(63.4)	48.0
DPS (p)	0.0	0.0	0.0	15.0
Cash	52.9	111.1	111.1	98.4
Net cash/(debt) – excluding leases	(26.2)	31.1	31.1	93.4

Source: Greggs, Edison Investment Research

Exhibit 4 shows our estimated sales recovery profile for FY20 and FY21, relative to FY19, and the implied like-for-like performance for Greggs.

Exhibit 4: Greggs' FY20e and FY21e monthly revenue versus FY19 (%)

Revenue vs FY19 (%)	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
FY20 vs FY19							70	72	74	75	77	78
Average												74.3
Like-for-like												(25.7)
FY21 vs FY19	80	82	84	86	88	90	90	90	90	90	90	90
Average H1/H2						85.0						90.0
Prior year sales						55.0						74.3
Like-for-like						54.5						21.1

Source: Edison Investment Research

We assume a gradual improvement in the monthly level of revenue relative to FY19, through H121e and then keep it at a relatively stable 90% of FY19's revenue for the remainder of H221e. The assumptions produce a like-for-like revenue decline for H220e of -25.7% y-o-y, H121e of +54.5%, H220e of +21.1%, and a total of 37.8% for FY21e. The FY21 revenue estimate of £1,040.1m is equivalent to 89% of the revenue reported in FY19 of £1,167.9m. We assume no further national lockdowns for COVID-19 outbreaks, and that the majority of city centre/travel locations (14% of the estate) resume trading albeit not back to FY19 levels.

Our gross margin assumptions for FY20e and FY21e are 57.9% and 63.3%, compared with 64.7% in FY19.

In H220e, we forecast that Greggs will generate an operating loss of £5.3m at a revenue level that is equivalent to c 75% of the revenue reported in H219. For FY21e, our profit before tax estimate of £60.8m is equivalent to c 53% of the profit before tax and exceptionals of £114.2m in FY19, with the inclusion of a new interest charge on the new debt for FY21e, which compares with Greggs' net cash position in FY19.

The natural challenge with an uncertain outlook for demand is managing the cost base accordingly. Trading has recommenced with a selected menu, which places less strain on the manufacturing infrastructure, and 25% of staff remain on furlough and Greggs continues to receive support via the Coronavirus Job Retention Scheme. The furlough scheme remains in place until October 2020, by which time it is hoped that revenue will have recovered well enough to bring all staff back from furlough. The anticipated increasing demand will present interesting challenges such as managing queue lengths outside a store, with a desire to prevent long queues putting off potential customers, for example. As demand increases the cost base will flex up, eg furloughed staff will return and the menu will expand again leading manufacturing costs to increase.

Offsetting these cost pressures will be helpful lower inflation in commodity costs and deflationary energy costs, expected favourable outcomes on negotiations with landlords regarding rentals, as well as lower staff cost inflation. Greggs is benefiting from business rates relief for the year to March, with a net benefit of £25m.

In FY21, we assume that the company repays £75m of the £150m received under the CCFF and that the company reinstates a dividend of 15p/share as a final dividend, which would be declared with the final results in March 2022, when the company will have a clearer view of the recovery.

Valuation

The share price has been weak since February 2020, as it anticipated the effects of COVID-19 on Greggs' profitability, and at 1,242p is currently trading below the 1,300p it reached in March. As shown above, we forecast profitability will be limited in FY20e as revenue gradually recovers from the lockdown, which makes earnings-based multiple analysis more difficult in the near term.

At 1,242p the EV/sales multiples for FY20e and FY21e are 1.6x and 1.2x, with both years suppressed by the lower revenue and gradually recovery due to COVID-19. Gregg's average EV/sales multiple since FY08 has been 0.9x, but has averaged 1.2x since FY15, when its growth rate accelerated as the strategy delivered positive results. Therefore, the shares are trading in line with this multiple, reflecting the uncertainty about the rate of recovery. Since FY15, the highest EV/sales multiple in any year ranged from 1.3–2.1x, while the lowest multiple ranged from 0.8–1.0x.

The P/E multiple for FY21 of 25.9x compares with an average since FY08 of 15.2x, and an average since FY15 of 18.6x.

Exhibit 5: Financial summary

£m	2017	2018	2019	2020e	2021e
Year-end December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	960.0	1,029.3	1,167.9	765.4	1,040.1
Cost of Sales	(348.1)	(373.5)	(412.2)	(321.9)	(381.4)
Gross Profit	611.9	655.9	755.7	443.4	658.6
EBITDA	135.7	145.7	231.9	50.9	192.4
Operating Profit (before amort. and except.)	82.2	89.8	120.7	(66.8)	72.5
Intangible Amortisation	0.0	0.0	0.0	0.0	0.0
Exceptionals	(9.9)	(7.2)	(5.9)	(0.7)	0.0
Operating Profit	72.3	82.6	114.8	(67.5)	72.5
Net Interest	(0.4)	(0.0)	(6.5)	(11.1)	(11.7)
Profit Before Tax (norm)	81.8	89.8	114.2	(77.9)	60.8
Profit Before Tax (FRS 3)	71.9	82.6	108.3	(78.6)	60.8
Tax	(16.9)	(18.2)	(22.4)	13.9	(12.5)
Profit After Tax (norm)	64.9	71.6	91.8	(63.9)	48.4
Profit After Tax (FRS 3)	56.9	65.7	87.0	(64.6)	48.4
Average Number of Shares Outstanding (m)	100.6	100.7	100.8	100.8	100.8
EPS - normalised fully diluted (p)	63.5	70.3	89.7	(63.4)	48.0
EPS - (IFRS) (p)	56.5	65.3	86.3	(64.1)	48.0
Dividend per share (p)	32.3	35.7	46.9	0.0	15.0
Gross Margin (%)	63.7	63.7	64.7	57.9	63.3
EBITDA Margin (%)	14.1	14.2	19.9	6.7	18.5
Operating Margin (before GW and except.) (%)	8.6	8.7	10.3	(8.7)	7.0
BALANCE SHEET					
Fixed Assets	334.7	347.5	646.5	634.9	639.8
Intangible Assets	14.7	16.9	16.8	15.6	14.1
Tangible Assets	319.2	330.5	353.7	347.0	353.6
Right-of-Use Assets	0.0	0.0	272.7	268.9	268.9
Other	0.8	0.2	3.3	3.3	3.3
Current Assets	106.6	140.6	142.3	217.5	214.7
Stocks	18.7	20.8	23.9	18.7	22.1
Debtors	33.4	31.6	27.1	17.8	24.1
Cash	54.5	88.2	91.3	111.1	98.4
Other	0.0	0.0	0.0	70.0	70.0
Current Liabilities	(127.9)	(145.1)	(208.7)	(177.5)	(198.1)
Creditors	(115.8)	(136.4)	(154.1)	(122.9)	(143.5)
Leases	0.0	0.0	(48.8)	(48.8)	(48.8)
Short term borrowings	0.0	0.0	0.0	0.0	0.0
Other	(12.1)	(8.7)	(5.8)	(5.8)	(5.8)
Long Term Liabilities	(14.0)	(13.8)	(233.3)	(385.0)	(310.0)
Long term borrowings	0.0	0.0	0.0	(150.0)	(75.0)
Leases	0.0	0.0	(226.9)	(226.9)	(226.9)
Other long term liabilities	(14.0)	(13.8)	(6.4)	(8.1)	(8.1)
Net Assets	299.4	329.2	346.8	289.9	346.4
CASH FLOW					
Operating Cash Flow	134.5	152.2	246.0	41.9	205.9
Net Interest	0.2	0.2	(6.3)	(11.1)	(11.7)
Tax	(17.6)	(16.1)	(20.3)	13.9	(12.5)
Capex	(70.4)	(64.9)	(87.7)	(58.0)	(73.0)
Acquisitions/disposals	0.0	0.0	0.0	0.0	0.0
Equity financing	5.4	5.3	4.9	5.4	5.4
Dividends	(32.2)	(33.1)	(72.1)	0.0	0.0
Borrowings	0.0	0.0	0.0	150.0	(75.0)
Other	(11.4)	(9.9)	(61.4)	(122.3)	(51.8)
Net Cash Flow	8.5	33.7	3.1	19.8	(12.7)
Opening cash	46.0	54.5	88.2	91.3	111.1
Other	0.0	0.0	0.0	0.0	0.0
Closing cash	54.5	88.2	91.3	111.1	98.4
Closing net debt/(cash)	(54.5)	(88.2)	(91.3)	(31.1)	(93.4)
Closing net debt/(cash) including leases	(54.5)	(88.2)	184.4	314.6	252.3

Source: Greggs accounts, Edison Investment Research

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