Accendo
MARKETS

Tesco, Sainsbury's and Morrisons

UK grocers set for imminent growth?

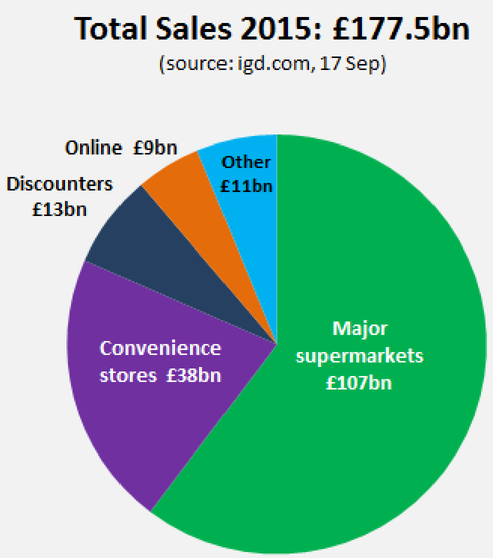
UK Supermarkets: Time to stock up?

UK Grocery Market Prospects

In this report we look at the **UK supermarket sector** and its prospects for the rest of 2015. It's been an interesting year so far, with the big four – **Tesco (TSCO)**, Asda, **J Sainsbury (SBRY)** and **WM Morrison (MRW)** – facing continued stiff competition from rampaging German discounters Aldi and Lidl. We're even seeing attempts at making frozen food cool again begin to bear fruit with the likes of Iceland stepping up to the mark to maintain pressure on the bigger guns.

The **UK consumer** is much scrutinised as an economic barometer, but never so much as to gauge the health of the general retail sector and this makes the supermarkets some of the less cryptic stocks in **the FTSE100**. Drivers tend to be much closer to home – think inflation, average earnings, consumer sentiment and interest rates – even if the supermarkets have their fingers in pies much further afield.

Supermarkets are still the big players



As the above chart shows, despite **impressive sales growth** in 2015 (Aldi +18%, Lidl +13%), the discounters have a long way to go before they pose a really serious challenge to the UK's big four supermarket chains in terms of sales value. What they *have* flagged up, and what the supermarkets missed early on, is a general public that's become much more cost-conscious and less self-conscious post financial crisis.

Additionally, no longer is Iceland seen as a pusher of sub-standard, cheaply produced frozen goods while a large portion of the Barbour-wearing, dog-walking middle classes have all but jumped into bed with Aldi and Lidl, heaping so **much praise on the German discounters** it's not uncommon for cries of 'get a room!' to traverse reception rooms at Christmas drinks parties.

What will it take to tempt customers back to the traditional heavyweights? One observation we may make right now is that **Tesco (TSCO)**, **J Sainsbury (SBRY)** and **WM Morrison (MRW)** are all facing their own bespoke challenges in addition to battling the common foe in the discounters.

UK Supermarkets: Time to stock up?

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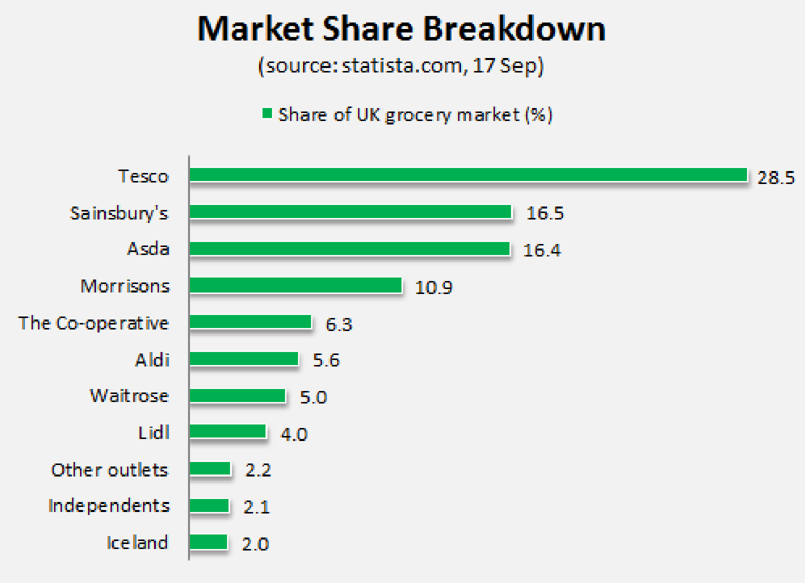
They are not suitable for everyone so please ensure you understand the risks involved and if necessary please obtain investment advice from a financial adviser before investing. This report is not a personal recommendation and does not take into account your personal circumstances or appetite for risk.

Discounted disruption

As the **price war** continues to rage with grocery price inflation now at -1.7% year-on-year **(otherwise known as deflation)** it's no wonder the growth of the sector at large has suffered. With the relentless rise of competitors with sales growth figures in the mid-teens, it's clear some form of re-balancing is taking place, and research by Kantar Worldpanel suggests we could be heading for a **'new normal'** of low yet steady industry growth.

In terms of market share, the discounters unlikely to be really testing **Tesco**, snapping at **Sainsbury's** heels or marking time with **Morrisons** in the near future, but it is interesting to note that **Aldi** has overtaken **Waitrose** in terms of market share – a stark reminder of the clout they increasingly carry in the market.



So the questions we must ask of the UK's (still) leading supermarkets are:

- Which of the big four will adapt quickest to this 'new normal'?
- Which has the fewest skeletons in the closet?
- Which is ripe for acquisition?

A note on short interest

Both **Morrisons** and **Sainsbury's** currently sit within the six most shorted UK stocks. While this reflects a significant number of bearish bets on the share prices (still far outweighed by bullish bets, nonetheless), what it also means is that any piece of news that is in any way positive could result in those with short positions all rushing for the exit at once since their potential losses are essentially unbounded – a share price can only go *down* to zero, while it can *rise* indefinitely. A swathe of buying pressure as traders place buy orders to cover their short positions is highly likely to amplify any positive share price reaction to company news or a good set of results.

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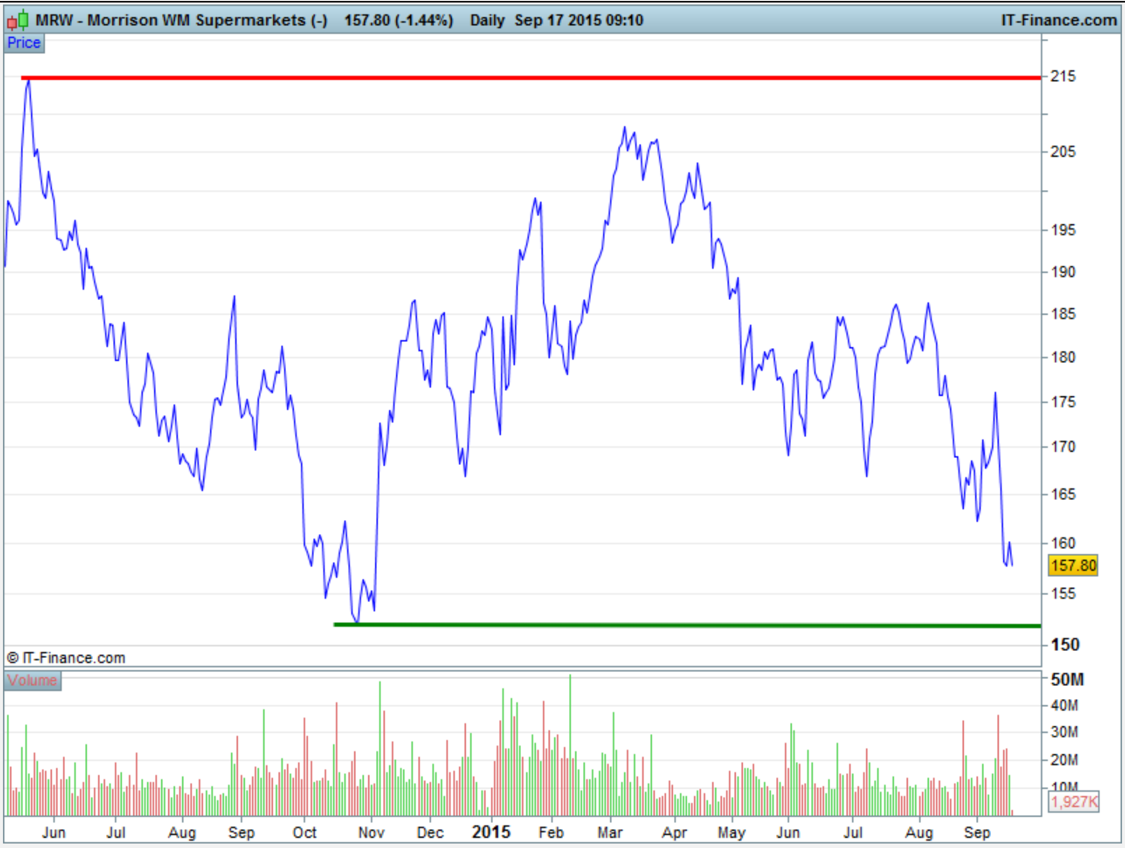
WM Morrison (MRW)

M&A deals continue to pop-up with predators making the most of a low interest rate environment and discounted valuations and it was most recently the turn of middle-of-the-road **WM Morrison (MRW)** to attract attention as a potential candidate for acquisition after South African billionaire Christo Wiese, whose $25bn investment vehicle recently bagged a 19% stake in grocery chain Iceland (as well as stakes in New Look and Virgin Active), said he was interested in the UK's supermarket sector and had a billion or so left to deploy. A continental supermarket deal between Dutch **Ahold (AMS)** and Belgian **Delhaize (DELB)** has also focussed the spotlight this year.

Short Interest: 12.57% **(source: [Short Tracker; 16 Sept)](#)**



Will the price **head up towards 24-month highs 300p,** or, will it **fall back towards lows of 152p**?

Broker Consensus: 26% Buy, 35% Hold, 39% Sell

Most Bullish: Nomura, Buy, Target 280p, +77%
Consensus: Target 178p, +12%
Most Bearish: Bernstein, sell, Target 140p, -12%

NB: All pricing and consensus data from Bloomberg on 16 Sept; Consensus breakdown available on request

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Tesco (TSCO)

An already heavily discounted $15.1bn price tag on **Tesco (TSCO)** puts it beyond the reach of South Africa's Mr. Wiese for now, but the company *is* in the midst of major restructuring to cut its £22bn debt-ridden balance sheet by selling major assets. While this has thus far proven a thorn in 'drastic' Dave Lewis' side, the £4bn offloading of South Korean ***Homeplus*** confirmed in late August will be welcomed by shareholders. The turnaround from the woes that began in 2014 has been slow at picking up, but could a long awaited sale of Tesco's **Dunnhumby** data unit (which runs Clubcard) confirm a turning point that attracts fresh investors to the stock?

Short Interest: 0.70% **(source: Short Tracker; 16 Sept)**

Will the price **bounce up towards 27-month highs 385p** or will it **pull back beneath lows of 165p**?

Broker Consensus: **37.5% Buy, 37.5% Hold, 25% Sell**

Most Bullish: HSBC, Buy, Target 295p, +65%
Consensus: Target 217p, +21%
Most Bearish: JPMorgan, Underweight, Target 150p, -16%

NB: All pricing and consensus data from Bloomberg on 16 Sept; Consensus breakdown available on request

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J Sainsbury (SBRY)

Sainsbury's is the only UK supermarket to have seen a month-on-month increase in sales (+0.1%, first growth since March) in the latest Kantar data, represents the quiet one of the three as regards major shake-ups and restructuring and is unlikely to be a target for M&A (unless from the Qataris who already own a 25% stake). **Asda's** greater focus on non-foods makes it traditionally stronger during the summer, and it's expected that the **Wal-Mart**-owned chain will surrender its current No. 2 slot to Sainsbury's towards Christmas 2015.

Short Interest: 9.57% **(source: Short Tracker; 16 Sept)**

Will the price **rally towards 345p** or will it **fall beneath lows of 224p**?

Broker Consensus: **32% Buy, 32% Hold, 36% Sell**

Most Bullish: Bernstein, outperform, Target 330p, +42%
Consensus: Target 245p, +6%
Most Bearish: Goldman Sachs, sell/neutral, Target 155p, -33%

NB: All pricing and consensus data from Bloomberg on 16 Sept; Consensus breakdown available on request

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