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Company Comment	Retail	Sweden	19 December 2018
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## More challenging trading likely ahead

**Following weaker than expected fiscal Q1 results, we have lowered our 2019 earnings estimates by 9%. This mainly reflects cuts to our gross margin assumptions in current trading (fiscal Q2 starting in December), as we believe KappAhl's excess inventory at the end of Q1 will have to increase promotions and markdowns. As corroborated by several profit warnings in the sector over the past weeks, we are concerned that the entire market is too high on stock-in-trade ahead of 2019.**

### We now expect KappAhl's EPS to decline by a third in fiscal 2019

Having cut our full-fiscal year 2019 (ending August) EPS forecasts by about 8%, we expect KappAhl's EPS to deteriorate by about one-third y/y. This appears to be factored in by the equity market, based on a share price decline of 53% over the past year. Looking at 12 month forward EV/Sales, we believe KappAhl's stock is now valued at 0.36x, compared with its 10-year historical average of 0.66x. We note that EBIT margins continue to decline and we believe that the long-term levels are lower, compared with in the past with years. We believe this follows from increased competition from new online formats, which results in structural pressure on retail business models and return on capital.

### Valuation: Our mid-point fundamental DFC equity value is SEK 28

Using a steady-state EBIT margin of 4% and a weighted average cost of capital (WACC) of 7.3%, our fundamental mid-point DCF equity valuation per share equals SEK 28. The sensitivities to any change in margins and cost of equity are high, as proposed by our DCF equity valuation range of SEK 22.10 to SEK 33.90 (+/- 1pp EBITDA margins over our cash flow valuation period).

Estimate Revisions			
(SEKm)	18/19E	19/20E	20/21E
<b>Revenues</b>			
Old	4,730	4,698	4,688
New	4,831	4,787	4,724
Change (%)	2	2	1
<b>Adj. EBIT</b>			
Old	226	218	211
New	208	220	214
Change (%)	(8)	1	1
<b>Adj. EPS</b>			
Old	2.22	2.13	2.07
New	2.05	2.16	2.10
Change (%)	(8)	1	2

#### Fundamental mid-point DCF equity valuation

DCF valuation (SEKm)		Weighted average cost of capital (%)		
NPV of FCF in explicit forecast period	1,233	Risk free interest rate	2.5	
NPV of continuing value	1,128	Risk premium	5.0	
Value of operation	2,362	Cost of equity	7.5	
Net debt	211	Aftertax cost of debt	5.1	
Share issue/buy-back in forecast period	-	WACC	7.3	
Value of associated companies	-			
Value of minority shareholders' equity	-	Assumptions		
Value of marketable assets	-			
DCF value of equity	2,151	Number of forecast years	10	
DCF value per share (SEK)	28.00	EBIT margin - steady state (%)	4.0	
Current share price (SEK)	18.40	EBIT multiple - steady state (x)	10.9	
DCF performance potential (%)	52	Continuing value (% of NPV)	47.8	

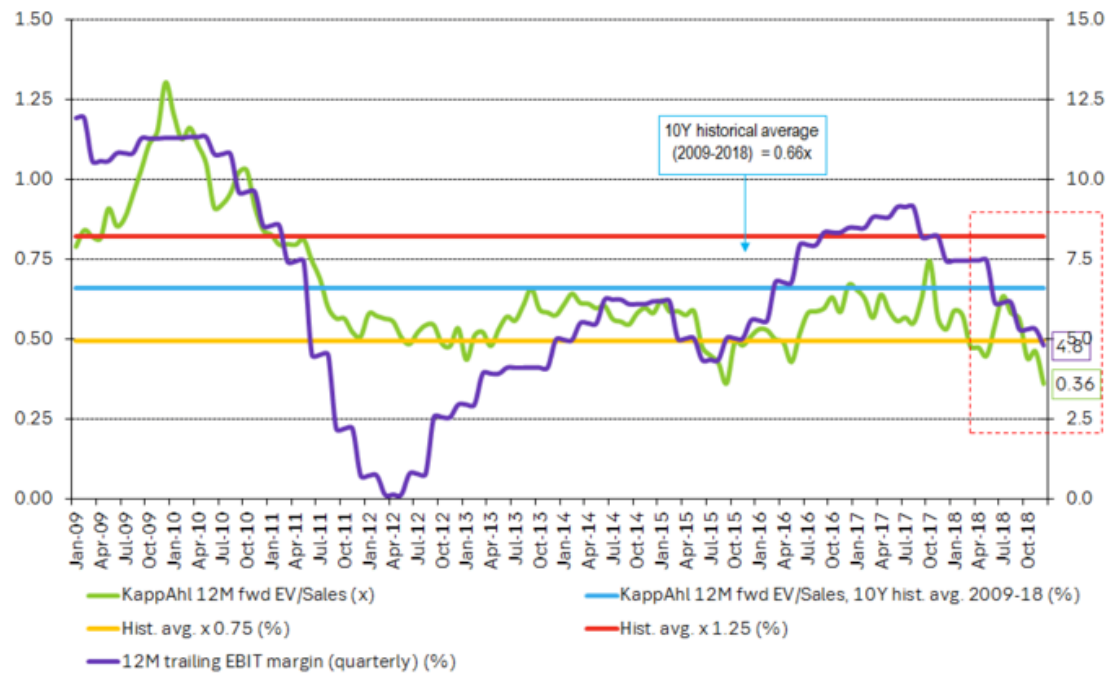
Source:SEB

#### Fundamental DCF equity valuation range and sensitivities

		Absolute change in EBITDA margin - all years				
		-2%	-1%	0	+1%	+2%
Abs. change in sales growth - all years	-2%	14.9	20.2	25.5	30.7	36.0
	-1%	15.5	21.1	26.7	32.3	37.9
	0	16.2	22.1	28.0	33.9	39.8
	+1%	16.8	23.1	29.4	35.6	41.9
	+2%	17.5	24.2	30.8	37.5	44.1

Source:SEB

## KappAhl 12-month forward EV/Sales estimates versus EBIT margins



Source:SEB

## Financial forecasts

Y/End: August (SEKm)	Q4/17	Q1/18	Q2/18	Q3/18	Q4/18	Q1/19	Q2/19E	Q3/19E	Q4/19E	2018	2019E	2020E	2021E
Net sales	1,249	1,166	1,115	1,242	1,239	1,193	1,149	1,236	1,253	4,762	4,831	4,787	4,724
Total revenue	1,249	1,166	1,115	1,242	1,239	1,193	1,149	1,236	1,253	4,762	4,831	4,787	4,724
COGS	(492)	(413)	(460)	(441)	(506)	(438)	(499)	(452)	(515)	(1,820)	(1,904)	(1,878)	(1,854)
Gross profit	757	753	655	801	733	755	650	784	738	2,942	2,927	2,909	2,870
Selling costs	(569)	(607)	(594)	(625)	(606)	(653)	(612)	(627)	(611)	(2,432)	(2,502)	(2,474)	(2,445)
Administrative costs	(50)	(56)	(56)	(55)	(51)	(51)	(55)	(54)	(57)	(218)	(216)	(214)	(212)
Other opex	0	0	0	0	0	0	0	0	0	0	0	0	0
Non-recurring items	0	0	0	0	(10)	0	0	0	0	(10)	0	0	0
EBIT	138	90	5	121	68	62	(18)	103	71	282	208	220	214
EBIT, adj.	138	90	5	121	78	62	(18)	103	71	292	208	220	214
Of which: Deprec. & amort.	(32)	(34)	(38)	(43)	(37)	(38)	(39)	(43)	(34)	(151)	(153)	(152)	(150)
EBITDA	171	124	42	164	103	90	21	146	104	433	381	372	384
Net financial expenses	(5)	1	0	0	(1)	(2)	(1)	(0)	2	1	(2)	(4)	(3)
Other financial items	(11)	0	0	0	0	0	0	0	0	0	0	0	0
Gain in sale of assets	0	0	0	0	0	0	0	0	0	0	0	0	0
Pre-tax profit	124	91	5	121	66	60	(18)	103	72	283	208	217	211
Minority interests	0	0	0	0	0	0	0	0	0	0	0	0	0
Total taxes	19	(14)	0	(27)	(17)	(9)	0	(22)	(18)	(58)	(48)	(51)	(50)
Net profit	142	77	5	94	49	41	(18)	81	56	225	167	166	162
Adjustments, net of tax	0	0	0	0	7	0	0	0	0	8	0	0	0
Adj. net profit	142	77	5	94	56	41	(18)	81	56	233	167	166	162
EPS, reported	1.85	1.00	0.07	1.23	0.63	0.53	(0.25)	1.05	0.71	2.93	2.05	2.16	2.10
EPS excl. BD	1.85	1.00	0.07	1.23	0.73	0.53	(0.25)	1.05	0.71	3.03	2.05	2.16	2.10
Net sales growth (%)	0.4	(7.5)	(6.2)	2.1	(0.9)	2.3	3.1	(0.5)	1.2	(3.1)	1.4	(0.9)	(1.3)
LFL growth (%)	(0.6)	(5.3)	(5.5)	2.7	(1.6)	(1.8)	0.4	(2.0)	(0.4)	(2.0)	(0.9)	(0.9)	(0.7)
COGS growth (%)	(6.0)	(5.5)	(5.9)	(0.2)	2.8	6.1	8.6	2.5	1.7	(2.2)	4.6	(1.4)	(1.3)
Selling cost growth (%)	4.0	(3.0)	(1.3)	3.1	6.6	7.5	3.1	0.3	0.9	1.2	2.9	(1.2)	(1.2)
Administrative cost growth (%)	(2.9)	3.7	9.8	10.0	3.0	(9.8)	(1.5)	(1.5)	11.0	6.6	(0.7)	(0.9)	(1.3)
Total SG&A cost growth, excl. NRIs (%)	3.4	(2.5)	(0.5)	3.7	6.3	6.0	2.7	0.1	1.6	1.6	2.6	(1.1)	(1.2)
Oper. lev. (sales less SG&A growth)	(3.0)	(5.0)	(5.7)	(1.6)	(7.1)	(3.7)	0.4	(0.6)	(0.5)	(4.8)	(1.2)	0.2	(0.1)
Gross profit growth (%)	5.0	(8.5)	(6.4)	3.3	(3.3)	0.2	(0.8)	(2.2)	0.8	(3.7)	(0.5)	(0.6)	(1.3)
EBIT growth (%)	45.4	(37.1)	(89.3)	1.6	(52.8)	(42.4)	(454.2)	(15.0)	7.3	(37.1)	(26.3)	6.1	(2.8)
Adj. EBIT growth (%)	12.9	(37.1)	(89.3)	1.6	(45.6)	(42.4)	(454.2)	(15.0)	(6.8)	(34.9)	(28.9)	6.1	(2.8)
Pre-tax profit growth (%)	36.4	(36.0)	(89.9)	9.9	(47.4)	(45.2)	(471.7)	(15.4)	10.9	(33.8)	(27.2)	5.3	(2.5)
EPS growth (%)	152.9	(27.5)	(84.8)	15.9	(65.9)	(47.0)	(471.7)	(14.2)	12.2	(38.1)	(30.1)	5.3	(2.5)
EPS growth, adjusted (%)	87.2	(27.5)	(84.8)	15.9	(60.6)	(47.0)	(471.7)	(14.2)	(2.7)	(38.4)	(32.5)	5.3	(2.5)
Gross margin (%)	60.6	64.6	58.7	64.5	59.2	63.3	56.8	63.4	58.9	61.8	60.6	60.8	60.8
Change, y-o-y (pp)	2.7	(0.7)	(0.1)	0.8	(1.5)	(1.3)	(2.2)	(1.1)	(0.2)	(0.4)	(1.2)	0.2	0.0
EBITDA margin (%)	13.7	10.6	3.8	13.2	8.3	7.5	1.8	11.8	8.3	9.1	7.5	7.8	7.7
SG&A as % of sales	(2.6)	(2.9)	(3.4)	(3.5)	(3.0)	(3.2)	(3.4)	(3.5)	(2.7)	(3.2)	(3.2)	(3.2)	(3.2)
EBIT margin (%)	11.1	7.7	0.4	9.8	5.3	4.4	(1.5)	8.3	5.6	5.9	4.3	4.6	4.5
Adj. EBIT margin (%)	11.1	7.7	0.4	9.8	6.1	4.4	(1.5)	8.3	5.6	6.1	4.3	4.6	4.5
Pre-tax margin (%)	9.9	7.8	0.5	9.8	5.3	4.2	(1.6)	8.3	5.8	5.9	4.3	4.5	4.5
Net margin (%)	11.4	6.6	0.5	7.6	3.9	3.4	(1.6)	6.5	4.4	4.7	3.3	3.5	3.4
COGS as % of sales	39.4	35.4	41.3	35.5	40.8	36.7	43.5	36.6	41.1	38.2	39.4	39.2	39.2
Selling costs as % of sales	45.5	52.1	53.3	50.3	48.9	54.7	53.3	50.7	48.8	51.1	51.8	51.7	51.7
Administrative costs as % of sales	4.0	4.8	5.0	4.4	4.1	4.2	4.8	4.4	4.5	4.6	4.5	4.5	4.5
Adj. SG&A as % of sales	49.5	56.9	58.3	54.7	53.0	58.9	58.1	55.1	53.3	55.6	56.3	56.2	56.2
Total opex as % of sales	88.9	92.3	99.6	90.2	93.9	95.6	101.5	91.7	94.4	93.9	95.7	95.4	95.6
Tax rate (%)	(14.9)	15.4	0.0	22.3	25.3	18.0	0.0	21.2	24.5	20.3	23.5	23.5	23.5
No of shares, f. dil., avg. (m)	76.820	76.820	76.820	76.820	76.820	76.820	76.820	76.820	76.820	76.820	76.820	76.820	76.820

Source:SEB

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