Oct 8, 2013 OCADO 'Drug-Induced' Stock Valuation Assuming Growth Through 2030

Keith Sharp's comments:

Goldman Sachs recommends buy, then stock falls, and to hold, then stock rockets up. So they got it very wrong, but indeed it's tough to know how much growth to assume for a small growing company. But it seems silly to assume growth of a two-warehouse company to a 24 warehouse company in 2030 when in fact it might be bankrupt in a few months. LinkedIn is similarly difficult to value.

EV = Enterprise Value
EBITDA=Earnings Before Interest, Tax, Depreciation and Amortization
WACC=Weighted Average Cost of Capital (used for discounting)
sellside: people trying to sell e.g. newly issued stocks and bonds to investors and institutions
D/G = downgrade
U/G=upgrade
Capex=capital expenditures
DCF=Discounted Cash Flow (often stock valuation, e.g. Gordon dividend growth model)
GS=Goldman Sachs
TP=Target Price
Dot-Comedy: 1990s Dot.com bubble and 2001 pop
all sensible, grounded stuff.: sarcastic, Goldman following ACT349 DCF methods maybe too literally
Analyst won't be around to be proved right: sarcastic, likely to be proved wrong
CFC=customer fulfilment centre =warehouse
CAGR=compound annual growth rate

FT-Alphaville Transcript October 8, 2013:
http://ftalphaville.ft.com/

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Let me try and give a clearer summary of what the wires have reported Goldman's sellside doing.

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As in, Goldman upgraded before it lost 60%, then downgraded before it rallied 400%.

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I'm not sure that can be right. Surely.

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Anyway ………….

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Well, the wires clearly have it wrong

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As that formal record of recommendations from GS shows

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Clearly. I took the data from Bloomberg.

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So, the second interesting thing here is Goldman’s valuation work.

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It’s a nice simple DCF.

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That is pathed out to …. hang on …. 2030.

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We really need that spliff icon

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No! No! Stop being cynical.

Block

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Look. Here are the inputs.

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What do we forecast for Ocado to 2030?
We have a base case forecast of Ocado to 2030, by which time we believe it will have achieved the following:
· Revenue of £15 bn (assumes a 19% revenue CAGR over 2012-30);
· c.8% share of UK grocery market;
· EBITDA from Ocado.com of £903 mn at a 6% EBITDA margin;
· 2030E EPS of 108p;
· 24 CFCs in operation.

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Yup. £15bn revenue, 24 warehouses.

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I’m speechless

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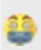
PM



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Because, why not? It’s 17 years away.

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Analyst won’t be around to be proved right, one assumes.

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Other assumptions we include in our DCF
· Terminal growth of 2%, assuming long-term food inflation;
· WACC of 8%, consistent with western European retailers;

· Terminal capex to sales of 2.5%, based on our assumption of maintenance capex;
· Terminal EBITDA margin of 6.0%.

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So … all sensible, grounded stuff.

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Ocado better hurry up with those new warehouses

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PM

Need to mint one every 9 months or so

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So what's the GS drug-induced TP here?

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Oh, did I forget the cover page?

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Here it is.

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We have a
Buy rating with a 24-month price target of 545p. Ocado's JV with Morrisons extends its capital advantage over store-based incumbents with asset turnover of its second distribution centre (CFC2) of over 7x compared to a traditional grocer's 1.4x. The JV also provides for fees payable to Ocado as it operates Morrisons' online business. These fees provide a second cash flow stream for Ocado and we estimate are sufficient to provide a low double-digit ROIC on Ocado's investment in CFC2. We also believe Ocado can invest operational leverage at scale to reduce prices and accelerate sales growth.

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In our view the catalysts for Ocado shares are accelerating sales growth and the announcement of a third CFC, which we would expect at some point in FY2014. We forecast annual sales growth in 4Q to reach 19% (15% 1H, 16% 3Q).

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Valuation, I hear you ask? Certainly.

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Valuation
We increase our forecasts to include the impact of the Morrisons JV to future cash flows. Our 24-month price target is 545p. We value the shares on a DCF basis, forecasting to 2030 and then assume a terminal EBITDA margin of 6% and terminal growth rate of 2%. At our target price, the shares would trade on 4.0x FY2014E EV/Sales and 70x EVEBITDAR.

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70x EVEBITDAR.

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PM

hang on hang on hang on

Block

PM

This is satire, right?

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The R is either for Restructuring or Rent costs. I assume the latter.

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Though in 17 years, who knows?

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I’m paging through the note to find anything else to share …………

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EV/EBITDAR Retail, Airlines Used when there are significant rental and lease expenses incurred by business operations

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Most of it is reasonably sensible, at least in comparison …………

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It’s not a bad bit of analysis once you get past page one.

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Basically, the Morrison deal saved them.

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look, there are just too many of these things around

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Stocks where the “valuation” is basically a guess on momentum

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ASOS

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Blinkx

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Linkedin

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etc

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And now a grocery business

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This is the dot comedy reborn

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PM

We’ve been here

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PM

It was nutty then

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PM

And it is nutty now

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BE

Don’t fight the trend. Lots of people made a lot of money in the dot-comedy.

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You just have to time your exit well.

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I’m welcoming theories why it’s happening again now though.

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Is it just that we’ve hit the 10-year anniversary of the puke and everyone doing the buying was too young to remember?

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Anyway, back to sanity?

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PM

Sure

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11:27AMBlock