PEPCO GROUP

Reuters: PCOP.WA Bloomberg: PCO PW

CEE Equity Research

Retail, Poland

09/11/2022 08:07 CET

Boldly navigating tough times

Outperform maintained, TP down to PLN45.8

We are reiterating Outperform recommendation with TP at PLN45.8 vs. prior PLN55.7 reflecting company's FY23 guidance pointing at higher capex, new cost of capital assumptions and new weights between DCF and multiple valuation (now at 30%/70%). We are increasing our FY22/23 sales and EBITDA forecast by 1.0%/8.5% and 2.5%/1.5%, respectively. We see company's delivery in FY22 (year-to-Sep) as strong as it was achieved in highly unsupportive surroundings, namely supply chain crunch and inflation of costs outbreak. Pepco as a variety discounter focusing on keeping low prices could have answered only through better costs management and it seems it managed the impossible, namely delivered only a modest EBITDA margin erosion (-20bps y/y) in FY22E. We see company's FY23 guidance as solid and achievable. Our FY23E forecast reflects it. In this light, we see valuation at FY23 EV/EBITDA of 7.6x as attractive.

Strong results expected in 2H22E. As it was guided by Pepco during an announcement of 2H22 trading statement, we expect a solid end of the company's fiscal year (year-to-Sep) with EBITDA at EUR397m. Besides, we expect sales growth at 14.4% y/y to EUR2,432m in 2H22E. We view Pepco's Group results as strong as they were achieved in unsupportive circumstances. Please note that the company is seeing high inflationary pressure on costs similar to other retailers starting from logistics (albeit recently pressure is easing) through labour ending on energy bills, and keeps its ASP as low as possible to attract new market share. Note that our FY22E adj. EBITDA forecast (EUR744m) is exactly the same as our IPO's forecast (EUR745m), which should be seen positively as many have changed to the negative side (supply chain crunch, inflation outbreak, fx headwinds and war in Ukraine). Pepco managed to deliver forecast mainly thanks to new market share resulted from (1) higher traffic in its stores, (2) operating excellence in managing store costs, (3) strong execution in procurement (rising importance of PGS) in Group deliveries.

Guidance indicating market share growth. During the Investor Day, the company presented FY23 guidance (summarized in fig. 2). Our forecast points at sales growth by 16.6% y/y to EUR5.6bn, EBITDA growth by 15.0% y/y to EUR831m (margin at 14.8%, -20bps y/y) and net profit at EUR270m (+14.0% y/y). Our forecast reflects company's plans as we think Pepco is capable to deliver profitable market share gains in all geographies. We think that Pepco should benefit from its price competitive advantage and attract even more customers driving its LFL, which, along with operating excellence in costs management and new savings initiatives (ongoing store remodelling in CEE), should support the company to mitigate inflationary costs pressures. We also think that new, more effective store format decreases the risk of unprofitable stores rollout recently increased to 560 stores (vs. prior forecast of 400 stores).

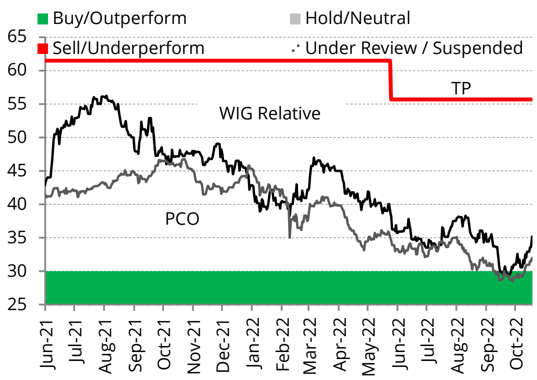
Valuation and risk. We are lowering our TP to PLN45.8 mainly due to a higher multiple valuation at PLN41.2 (+14%; 70% weight) and DCF valuation at PLN56.5 (-25%; 30% weight). We see (1) a risk of potential share overhang from the parent company, (2) consumption slowdown, (3) resurgence of the COVID-19 pandemic, (4) further growth of the online competition, (5) increased competition from other discounters, and (6) costs pressure and logistics disruption as the main risks for our rating.

Pepco: Financial summary*

EURmn (year to Sep)	2020	2021	2022E	2023E	2024E	2025E
Sales	3,518	4,122	4,804	5,600	6,409	7,274
Adj. EBITDA	442	647	744	831	956	1086
Adj. EBITDA (ex. IFRS16)	242	424	506	569	671	780
Adj. net profit	15	169	255	270	326	389
P/E (x)	n.a.	36.1	16.9	15.9	13.2	11.1
EV/EBITDA (x)	n.a.	14.4	8.5	7.5	6.3	5.3
FCF Yield	n.a.	4.9%	4.4%	2.3%	4.3%	7.2%
Dividend Yield	n.a.	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company data, Santander Brokerage Poland estimates , 2020-2021 ratios calculated on historical annual share price average*

Recommendation	Outperform
	-
Price (PLN, 07 November 2022)	35.2
Target price (Dec'23, PLN)	45.8
Market cap. (PLNmn)	20,010
Free float (%)	21.1
Number of shares (mn)	575
Average daily turnover 3M (mn)	15.1
EURPLN	4.70



The chart measures performance against the WIG index.

What has changed

- TP cut to PLN45.8 from PLN 55.7 on lower DCF due to higher cost of capital assumptions;
- FY22-23E EBITDA (ex. IFRS16) went up 8.5% and 1.5%, respectively.

Main shareholders	% of votes
IBEX Retail Investments	78.9

Source: GPW

Company description

Pepco is the CEE variety discounter leader with rising footprint in Western Europe.

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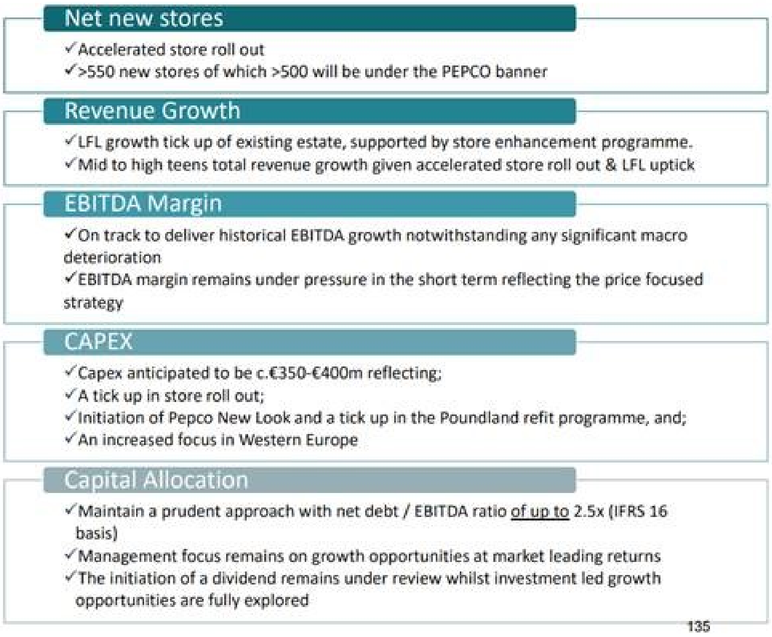
Forecast change

Fig. 1. Pepco: Forecast change

EURmn	FY22E new	FY22E old	FY22E chng.	FY23E new	FY23E old	FY23E chng.	FY24E new	FY24E old	FY24E chng.
Sales	4,804	4,756	1.0%	5,600	5,462	2.5%	6,409	6,209	3.2%
Adj. EBITDA (ex. IFRS16)	506	466	8.5%	569	561	1.5%	671	667	0.7%
Adj. net profit	255	225	13.4%	270	281	-3.9%	326	355	-8.1%
EBITDA margin	10.5%	9.8%	73	10.2%	10.3%	-10	10.5%	10.7%	-27
net profit margin	5.3%	4.7%	58	4.8%	5.2%	-33	5.1%	5.7%	-63

Source: Company data, Santander Brokerage Poland estimates

Fig. 2. Pepco: FY2023 guidance



Source: Company data

Fig. 3. Pepco: Key assumptions

EURmn	1H21	2H21	2021	1H22	2H22E	2022E	1H23E	2H23E	2023E	1H24E	2H24E	2024E
Pepco	**1,017**	**1,150**	**2,166**	**1,282**	**1,411**	**2,693**	**1,595**	**1,754**	**3,349**	**1,925**	**2,078**	**4,003**
chng.	9.5%	42.0%	24.6%	26.1%	22.8%	24.3%	24.4%	24.3%	24.4%	20.7%	18.4%	19.5%
LFL	-1.2%	23.5%	11.9%	7.2%	6.5%	6.8%	7.6%	8.0%	7.8%	5.0%	5.0%	5.0%
Stores	**2,229**	**2,464**	**2,464**	**2,666**	**2,910**	**2,910**	**3,130**	**3,430**	**3,430**	**3,650**	**3,950**	**3,950**
new (q/q)	129	235		202	244	446	220	300	520	220	300	520
new (y/y)	299	364	364	437	446	446	464	520	520	520	520	520
% chng	15.5%	17.3%	17.3%	19.6%	18.1%	18.1%	17.4%	17.9%	17.9%	16.6%	15.2%	15.2%
floor (k sqm)	1,003	1,109	1,109	1,200	1,310	1,310	1,409	1,544	1,544	1,643	1,778	1,778
avg, store size	*450*	*450*	*450*	*450*	*450*	*450*	*450*	*450*	*450*	*450*	*450*	*450*
P/D	**979**	**977**	**1,956**	**1,090**	**1,021**	**2,111**	**1,156**	**1,095**	**2,251**	**1,233**	**1,173**	**2,406**
chng.	-0.5%	22.7%	9.9%	11.4%	4.5%	7.9%	6.1%	7.2%	6.6%	6.7%	7.1%	6.9%
LFL	-2.9%	10.9%	4.0%	3.3%	3.6%	3.4%	3.5%	4.0%	3.7%	3.5%	4.0%	3.7%
Stores	**1017**	**1040**	**1,040**	**1,030**	**1,051**	**1,051**	**1,061**	**1,091**	**1,091**	**1,101**	**1,131**	**1,131**
new (q/q)	96	23		-10	21	11	10	30	40	10	30	40
new (y/y)	103	119	119	13	11	11	31	40	40	40	40	40
% chng	11.3%	12.9%	12.9%	1.3%	1.1%	1.1%	3.0%	3.8%	3.8%	3.8%	3.7%	3.7%
floor (k sqm)	712	728	728	721	736	736	743	764	764	771	792	792
avg, store size	*700*	*700*	*700*	*700*	*700*	*700*	*700*	*700*	*700*	*700*	*700*	*700*
Sales	**1,995**	**2,127**	**4,122**	**2,372**	**2,432**	**4,804**	**2,751**	**2,849**	**5,600**	**3,158**	**3,251**	**6,409**
chng.	4.4%	32.4%	17.2%	18.9%	14.4%	16.6%	16.0%	17.1%	16.6%	14.8%	14.1%	14.4%
LFL	**-2.0%**	**17.7%**	**8.1%**	**5.4%**	**5.3%**	**5.3%**	**5.9%**	**6.5%**	**6.2%**	**4.4%**	**4.6%**	**4.5%**
Stores	**3,246**	**3,504**	**3,504**	**3,696**	**3,961**	**3,961**	**4,191**	**4,521**	**4,521**	**4,751**	**5,081**	**5,081**
chng.				13.9%	13.0%	13.0%	13.4%	14.1%	14.1%	13.4%	12.4%	12.4%
new				450	457	457	495	560	560	560	560	560
EBITDA	**317**	**333**	**651**	**326**	**397**	**723**	**367**	**464**	**831**	**424**	**532**	**956**
chng	15%	109%	50%	3%	19%	11%	13%	17%	15%	15%	15%	15%
margin	15.9%	15.7%	15.8%	13.7%	16.3%	15.0%	13.3%	16.3%	14.8%	13.4%	16.4%	14.9%
Pepco	208	248	455	234	305	539	271	365	636	322	426	747
chng	15%	110%	52%	13%	23%	18%	16%	20%	18%	19%	17%	18%
margin	20.4%	21.5%	21.0%	18.3%	21.6%	20.0%	17.0%	20.8%	19.0%	16.7%	20.5%	18.7%
P/D	107	80	188	95	92	187	96	99	195	102	106	208
chng	11%	105%	39%	-12%	15%	0%	1%	7%	4%	7%	7%	7%
margin	10.9%	8.2%	9.6%	8.7%	9.0%	8.8%	8.3%	9.0%	8.7%	8.3%	9.0%	8.7%
other	3	5	8	-3	0	-3	0	0	0	0	0	0
Adj. EBITDA	**324**	**323**	**647**	**347**	**397**	**744**	**367**	**464**	**831**	**424**	**532**	**956**
chng			46.3%	7.3%	23.0%	15.1%	5.7%	16.8%	11.6%	15.5%	14.7%	15.0%
margin			15.7%	14.6%	16.3%	15.5%	13.3%	16.3%	14.8%	13.4%	16.4%	14.9%
Pepco	215	242	457	240	305	545	271	365	636	322	426	747
chng			52.8%	11.5%	26.1%	19.2%	13.1%	19.7%	16.8%	18.6%	16.7%	17.5%
margin	21.2%	21.0%	21.1%	18.7%	21.6%	20.2%	17.0%	20.8%	19.0%	16.7%	20.5%	18.7%
P/D	108	87	195	106	92	198	96	99	195	102	106	208
chng			37.3%	-1.9%	6.2%	1.7%	-9.7%	7.2%	-1.8%	6.7%	7.1%	6.9%
margin	11.1%	8.9%	10.0%	9.7%	9.0%	9.4%	8.3%	9.0%	8.7%	8.3%	9.0%	8.7%
Other	0	-6	-5	1	0	1	0	0	0	0	0	0

Source: Company data, Santander Brokerage Poland estimates

Valuation

Fig. 4. Pepco: Valuation summary*

PLN/shr	New	Previous	Change
DCF valuation	56.5	75.1	-25%
SOTP	41.2	36.2	14%
Target Price	**45.8**	**55.7**	**-18%**

*Source: Santander Brokerage Poland estimates, * we changed valuation weights to 70% SOTP and 30% to DCF from 50%/50% to focus more on mid-term perspectives and market valuation multiples, which we see fair for the company (please see discussion below)*

Fig. 5. Pepco: SOTP valuation *

EURmn	Multiple	EBITDA	
Pepco			
	11.0x	461	We are leaving our target EV/EBITDA for Pepco unchanged at 11.0x NTM EBITDA (ex. IFRS16). This implies 10% premium to LPP (target EV/EBITDA employed in our TP is 10.0x). We think it is justified as (1) Pepco has a more proven variety discount business in Western Europe (break even reached already in Italy) than LPP (already starting rollout in Italy/Greece, of which outcome is still uncertain) and (2) is 100% variety discounter (differentiating factor to LPP, where Sinsay accounts for only 38% of sales). We also think that Pepco might be gradually more compared to DM Variety Discount segment, which is valued at higher EV/EBITDA (avg. 12.8x) than fast fashion (6.0x). Projected growth comparison between Pepco and DM Variety sector and LPP provide another rationale behind premium for Pepco. Pepco with its 3Y CAGR of sales/EBITDA ex. IFRS16 at 16%/17% is better than DM Variety Discounters (3Y CAGR of sales/EBITDA ex. IFRS16 at 9%/8% and in line with LPP's 16%/16% growth rates (excl. Russia impact).
EV		**5,074**	
P/D			
	5.4x	53	P/D's EV calculation at EUR289mn assumes 15% discount to 2023E EV/EBITDA of Tesco at 6.4x.
EV		**289**	
Total		**5,363**	
(-) net debt (cash)		320	
Equity Value (EURmn)		**5,043**	
EURPLN		4.7	
Equity Value (PLNmn)		**23,702**	
no. of shares		575	
Target Price (Dec'23, PLN)		**41.2**	

*Source: Santander Brokerage Poland estimates, * EBITDA (ex. IFRS16, NTM)*

Fig. 6. Pepco: Variety Discounters multiples

Name	CCY	Price	Cap. (USD)	P/E 2022E	P/E 2023E	P/E 2024E	EV/EBITDA 2022E	EV/EBITDA 2023E	EV/EBITDA 2024E	FCF'23E yield
DOLLAR GENERAL	USD	249.7	56,321	21.1	19.5	17.6	14.2	13.4	12.5	4.7%
FIVE BELOW	USD	143.0	7,936	32.3	25.8	20.5	17.8	14.5	11.7	1.6%
DOLLARAMA	CAD	79.7	16,820	29.7	25.1	21.1	18.1	16.4	14.8	2.0%
B&M EUROPEAN	GBp	343.9	3,953	9.8	10.5	9.1	7.1	6.8	7.0	9.7%
Median				**25.4**	**22.3**	**19.0**	**16.0**	**14.0**	**12.1**	**3.4%**
Average				**23.2**	**20.2**	**17.1**	**14.3**	**12.8**	**11.5**	**4.5%**

Source: Bloomberg, Santander Brokerage Poland estimates

Fig. 7. Pepco: Variety Discounters industry growth ratios

	Sales CAGR'21/24E	EBITDA CAGR'21/24E	Net profit CAGR'21/24E
DOLLAR GENERAL	7.9%	8.4%	7.9%
FIVE BELOW	14.1%	12.0%	11.7%
DOLLARAMA	9.5%	12.6%	14.6%
B&M EUROPEAN	4.7%	-1.4%	-2.3%
Median	**8.7%**	**10.2%**	**9.8%**
Average	**9.0%**	**7.9%**	**7.9%**

Source: Bloomberg, Santander Brokerage Poland estimates

Fig. 8. Pepco: DCF valuation

PLNmn	2023E	2024E	2025E	2026E	2027E	2028E	TV
Revenue	5,600	6,409	7,274	8,141	9,036	9,993	
EBITDA (ex. IFRS16)	569	671	780	890	1,003	1,096	
EBIT	400	472	550	626	705	763	
tax	80	94	110	125	141	153	
NOPAT	**320**	**378**	**440**	**501**	**564**	**610**	
D&A	170	199	231	263	297	333	
WC	10	9	8	6	5	14	
CAPEX	-350	-350	-319	-249	-257	-339	
FCF	**150**	**235**	**360**	**522**	**610**	**619**	**640**
WACC	13.5%			11.7%			11.7%
PV FCF 2023-28E	1,961						
Terminal growth	3.5%						
Terminal Value (TV)	7,841						
PV TV	4,044						
Total EV	**6,005**						
Net debt	-81						
Equity Value	6,086						
Equity Value (year end)	**6,910**						
EURPLN	4.7						
Equity Value (PLN)	**32,477**						
Number of shares (m)	575						
YE target price (PLN)	**56.5**						
DPS	0						
YE TP (ex-div, PLN)	**56.5**						

Source: Company data, Santander Brokerage Poland estimates

Fig. 9. Pepco: WACC *

With this report we increase rfr to 7%/5% from 6%/4% before; ERP to 7.2% from 5.0% before; and terminal growth to 3.5% from 2.5%.

	23/25E fcst	26/28E + TV
Risk free rate (10-year Polish T-bond yield)	7.0%	5.0%
Unlevered beta	1.0	1.0
Levered beta	1.4	1.4
Equity risk premium	7.2%	7.2%
Cost of equity	**17.4%**	**15.4%**
Risk free rate (10-year Polish T-bond yield)	7.0%	5.0%
Debt risk premium	1.0%	1.0%
Tax rate	19%	19%
After tax cost of Debt	**6.5%**	**4.9%**
%D	35%	35%
%E	65%	65%
WACC	**13.5%**	**11.7%**

Source: Company data, Santander Brokerage Poland estimates,

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Financial forecasts

Fig. 10. Pepco: P&L forecast

EURmn	2020	2021	2022E	2023E	2024E	2025E
Sales	**3,518**	**4,122**	**4,804**	**5,600**	**6,409**	**7,274**
chng.	3%	17%	17%	17%	14%	13%
Pepco	**1,738**	**2,166**	**2,693**	**3,349**	**4,003**	**4,704**
chng.	7%	25%	24%	24%	20%	18%
P/D	**1,780**	**1,956**	**2,111**	**2,251**	**2,406**	**2,570**
chng.	0%	10%	8%	7%	7%	7%
Gross profit	1,433	1,769	2,005	2,345	2,689	3,056
chng.	-1%	23%	13%	17%	15%	14%
margin	40.7%	42.9%	41.7%	41.9%	42.0%	42.0%
Opex	1,301	1,465	1,659	1,945	2,217	2,507
chng.	9%	13%	13%	17%	14%	13%
Profit on sales	132	304	347	400	472	550
chng.	-47%	130%	14%	15%	18%	16%
margin	3.8%	7.4%	7.2%	7.1%	7.4%	7.6%
other op. costs	12	21	0	0	0	0
EBIT	120	282	347	400	472	550
chng.	-53%	135%	23%	15%	18%	16%
margin	3.4%	6.9%	7.2%	7.1%	7.4%	7.6%
D&A	290	326	376	431	484	536
EBITDA	**423**	**629**	**723**	**831**	**956**	**1,086**
chng.	n.a.	49%	15%	15%	15%	14%
margin	12.0%	15.3%	15.0%	14.8%	14.9%	14.9%
Adj. EBITDA	**442**	**647**	**744**	**831**	**956**	**1,086**
chng.	33%	46%	15%	12%	15%	14%
margin	12.6%	15.7%	15.5%	14.8%	14.9%	14.9%
Pepco	299	457	545	636	747	864
chng.	n.a.	53%	19%	17%	18%	16%
margin	17.2%	21.1%	20.2%	19.0%	18.7%	18.4%
P/D	142	195	198	195	208	222
chng.	n.a.	37%	2%	-2%	7%	7%
margin	8.0%	10.0%	9.4%	8.7%	8.7%	8.7%
other	1	-5	1	0	0	0
Adj. EBITDA (ex. IFRS16)	**242**	**424**	**506**	**569**	**671**	**780**
chng.	n.a.	75%	19%	13%	18%	16%
margin	6.9%	10.3%	10.5%	10.2%	10.5%	10.7%
Financial income	4	1	2	3	4	5
Financial costs	106	87	47	65	68	68
PBT	18	196	302	338	408	487
chng.	n.a.	1013%	54%	12%	21%	19%
margin	0.5%	4.8%	6.3%	6.0%	6.4%	6.7%
tax	17	41	64	68	82	97
X/O	1	0	0	0	0	0
Net profit	**-1**	**155**	**238**	**270**	**326**	**389**
chng.	n.a.	n.a.	54%	14%	21%	19%
margin	n.a.	3.8%	5.0%	4.8%	5.1%	5.4%
Adj. net profit	**15**	**169**	**255**	**270**	**326**	**389**
chng.	n.a.	1014%	51%	6%	21%	19%
margin	0.4%	4.1%	5.3%	4.8%	5.1%	5.4%
Adj. EPS	0.0	0.3	0.4	0.5	0.6	0.7
chng.		1014%	51%	6%	21%	19%

Source: Company data, Santander Brokerage Poland estimates

Fig. 11. Pepco Group: Balance sheet forecasts

EURmn	2020	2021	2022E	2023E	2024E	2025E
Current assets	1,020	1,232	1,536	1,770	2,091	2,548
cash and equivalents	400	508	697	798	982	1,291
other short term investments	0	0	0	0	0	0
accounts receivable	49	61	72	83	95	108
inventories	567	597	701	823	948	1,083
prepaid expenses	4	66	66	66	66	66
Fixed assets	2,050	2,349	2,407	2,587	2,738	2,826
PPE	379	440	479	641	774	843
long-term investments	0	0	0	0	0	0
intangibles	810	890	908	926	944	963
goodwill	0	0	0	0	0	0
long-term receivables	3	3	3	3	3	3
right-of-use asset	807	957	957	957	957	957
other	51	60	60	60	60	60
Long-term deferred charges	0	0	0	0	0	0
Total assets	**3,070**	**3,582**	**3,943**	**4,357**	**4,829**	**5,375**
Current liabilities	883	1,114	1,237	1,381	1,527	1,683
bank debt	10	71	71	71	71	71
accounts payable	611	744	867	1,011	1,157	1,313
lease liabilities	247	260	260	260	260	260
Deferred income	15	39	39	39	39	39
Long-term liabilities	1,434	1,460	1,460	1,460	1,460	1,460
bank debt	707	545	545	545	545	545
lease liabilities	672	839	839	839	839	839
Provisions	55	76	76	76	76	76
Equity	754	1,008	1,245	1,516	1,842	2,231
share capital	6	6	6	6	6	6
capital reserves	748	847	1,002	1,240	1,510	1,836
net income	-1	155	238	270	326	389
Minority Interest	0	0	0	0	0	0
Total liabilities and equity	**3,070**	**3,582**	**3,943**	**4,357**	**4,829**	**5,375**
Bank debt	717	616	616	616	616	616
lease liabilities	919	1,099	1,099	1,099	1,099	1,099
Net debt (ex. IFRS16)	317	109	-81	-182	-365	-675
Net debt/EBITDA (ex. IFRS16)	1.3	0.3	-0.2	-0.3	-0.5	-0.9
Net debt/EBITDA	2.9	1.9	1.4	1.1	0.8	0.4

Source: Company data, Santander Brokerage Poland estimates

Fig. 12. Pepco Group: Cash flow statement forecasts

EURmn	2020	2021	2022E	2023E	2024E	2025E
Cash flow from operations	**580**	**702**	**623**	**712**	**819**	**934**
Net profit	-1	155	238	270	326	389
Provisions	-12	29	0	0	0	0
Depreciation and amortisation	91	103	138	170	199	231
, of which: right-of-use asset amo.	200	222	238	261	285	306
Changes in WC, o/w	207	101	9	10	9	8
inventories	-51	-19	-104	-122	-125	-135
receivables	20	-21	-10	-12	-12	-13
payables	238	141	123	144	146	156
Other, net	94	92	0	0	0	0
Cash flow from investment	**-165**	**-184**	**-195**	**-350**	**-350**	**-319**
Additions to PPE and intangibles	-163	-181	-195	-350	-350	-319
Change in long-term investments	-2	-3	0	0	0	0
Other, net	0	0	0	0	0	0
Cash flow from financing	**-261**	**-411**	**-238**	**-261**	**-285**	**-306**
Change in long-term borrowing	0	-129	0	0	0	0
Change in short-term borrowing	0	0	0	0	0	0
Change in equity	0	0	0	0	0	0
Dividends paid	0	0	0	0	0	0
Other, net*	-261	-283	-238	-261	-285	-306
Net change in cash and equivalents	**153**	**108**	**190**	**100**	**184**	**309**
FCF	217	300	190	100	184	309

Source: Company data, Santander Brokerage Poland estimates

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The dividend discount model (DDM) valuation is based on the net present value of the future dividends that are expected to be paid out by the company. Some advantages of the DDM valuation method are that it takes into account real cash flows to equity-owners and that the methodology is used in respect to companies with long dividend payout history. Main disadvantage of the DDM valuation method is that dividend payouts are based on a large number of parameters and assumptions, including dividend payout ratio.
Residual income method is conceptually close to the discounted cash flows method (DCF) for non-financial stocks, the difference being that it is based on expected residual income (returns over COE) rather than expected future cash flows. One advantage of this valuation method is that it captures the excess of profit potentially available to shareholders and the cost of money over time. Main disadvantage of the valuation method is that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.
The warranted equity method (WEV) is based on the formula P/BV = (two year forward ROE less sustainable growth rate)/(Cost of equity less sustainable growth rate) which allows estimating a fair value (FV) of a given stock in two years' time. Subsequently the FV is discounted back to today. The main advantage of the WEV method is that it is a transparent one and based on relatively short term forecasts, hence substantially reducing the margin of forecasting error. The main disadvantage in our view is that the model is based on the principle that stock price should converge towards its fair value implied by company's ROE and COE.
SOTP valuation - different assets of a company are being valued according to different valuation methods, and the sum of these valuations represents the final valuation of the company. SOTP valuation advantages / disadvantages are identical to advantages and disadvantages of the specific valuation methods used.
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