EDISON

Daily comment

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Greggs, Airbus, Premier Oil, technology – Lenovo

Greggs GRG:LN 793p Mkt cap £802m Analyst: Sohil Chotai

Earnings upgrade

Greggs has announced its third successive profit upgrade, with own-shop like-for-like sales for December up 8.2% and 4.5% for the full year (ahead of our estimate of 4.2%). Strong trading has been driven by Greggs' self-help programme: the success of the revamped product and meal deal offers, as well as store refurbishments. We upgrade our EPS estimates by 5% for FY14 and FY15. We continue to like the story at Greggs and valuation is supportive at c 8x EV/EBITDA for FY15e.

Refurbishments continue to perform well, with management stating that uplifts drive "high single-digit" l-f-l sales growth. Following 213 refits in FY14, we anticipate c 200 in FY15. We also expect a return to net store growth of 10 in FY15 (with 50 openings, and 71 closures in FY14). Strong trading and store growth potential (own shop and through franchises) gives us confidence in our top-line forecasts.

Management highlighted the success of the meal deals, with strong contributions from coffee and savoury offers, as well as new fresh soups and a steak and stilton savoury snack. We think the company is working harder to improve its product offering and expect this to continue in FY15.

Lower input costs were flagged as a positive in FY14 and are expected to persist into FY15, and a small benefit from lower oil prices is likely (fuel costs are 1% of sales and energy costs are 3-4% of sales). Greggs also stands to benefit from higher disposable incomes, with consumers benefiting from lower prices at the pumps as well as real wage growth.

In the absence of direct peers, we choose to compare Greggs to supermarkets. We feel a 20% EV/EBITDA premium to this sector is justified. This yields a fair value of 826p. On a 2015e FCF (net CFO – capex) yield basis for 2015e, the FTSE 250 trades at 3.3%, while Greggs trades at 4.5%. Valuing Greggs on a 4% FCF yield rather than the current 27% discount to the FTSE 250 yields a fair value of 886p. Taking the average of these methodologies gives us our fair value of 856p.

Airbus AIR:FP €45.5 Mkt cap €36bn Analyst: Sash Tusa

Airbus: Nobody hurt from New Year's press conference

After the share price carnage of the Global Investor Forum in December, Airbus' commercial aircraft New Year's press conference was a quiet affair. We look through the annual Airbus vs Boeing bragging match over who had the most deliveries and/or orders (for the record: Boeing; Airbus; it's exciting for journalists, but immaterial for investors). We did, however, think that three points are genuinely of interest to investors:

1. Airbus is launching a new high gross weight (97 tonne) version of the A321neo to capture the replacement market for the Boeing 757. We note that this market, with around 500 757s in service, is far smaller than the 1,050 that were actually delivered; many are already retired. But it is potentially valuable for Airbus since it would be a near-monopoly niche (Boeing cannot increase the weight of the 737 MAX due to the lack of engine clearance) for what is already by far the highest-margin variant of theA320 family.

2. Strategically, this is also a very interesting move since it puts further pressure on Boeing over its narrowbody product line. The A320 family owns 58% of orders in 2014, compared to 42% for the 737. We think it increasingly likely that Boeing could look to launch an all-new narrowbody, possibly as early as 2017, for entry into service in 2024-25, to avoid a structural disadvantage in this market segment. Such a move would clearly damage the cosy but unrealistic consensus view of “no all-new programmes/no moon shots” that all the civil primes have, to a greater of lesser extent put around.
3. Airbus forecasts “a slightly higher number of deliveries” for 2015 compared to the 629 of 2014. We note that this includes 15 A350s (vs a singleton in 2014), and a commensurate fall in A330s, as that programme moves to Rate 9. All other things being equal, this switch would dilute margins materially, albeit offset by the move of A380 from loss to break-even. Overall, however, it suggests to us that any margin improvement in 2015 will be highly dependent on productivity and pricing improvements in the narrowbody side of the business.

Full-year results are on 27 February.

Premier Oil PMO:LN 128.5p Mkt cap £656m Analyst: Ian McLelland

Premier Oil operational update

2014 looks to be a solid year for Premier Oil (PMO), and most importantly given missed multiple operational targets over recent years, the end-year operations update, for once, doesn’t come with any nasty surprises.

Production is as expected – c 4mboe/d above mid-point guidance at 63.6mboe/d, although with ongoing problems at Huntington the company is clearly being prudent with its guidance. On the development front, the only change of note since the November 2014 IMS is Solan moving back now to probably first oil in Q215 – an optimist could say nicely timed to take advantage of an anticipated oil price recovery rather than hitting the slump in Q414! Like all its peers, Premier is doing the sensible thing and deferring discretionary spending to protect the balance sheet. In saying this, 2015 is a relatively light development capex year, with $600m going out vs $1bn in 2014 – this is important as all E&Ps need to watch their balance sheets in 2015 as shortfalls in CFO leave some with heavy development programmes overly exposed. 40% of expected 2015 oil production (ex Solan) is hedged at an average $98/bbl, in line with most peers, while we’re not surprised to see the buyback programme put on hold pending a recovery in oil (and share price)!

Finally, while the 2015 exploration budget is still reasonably light at $220m pre-tax (up from $160m in 2014), PMO gets for this an eight-well drilling programme, including four in the Falklands Northern Basin targeting 174mmboe mid-case gross resources (67mmboe net to PMO). For Premier (as well as Rockhopper and FOGL) the oil price drop and commensurate fall in rig rates is going to help these 2015 exploration activities, the first in the Falklands since late 2012.

Technology – Lenovo: Cash call Analyst: Richard Windsor

Lenovo offers far more value than Xiaomi

Following the acquisition of Motorola Mobility from Google, it looks very much as if Lenovo has realised that to get a thriving handset business you need vast investment.

Lenovo has announced it is considering a public listing of its mobile device business at some point in the future. It plans to make this business more than just handsets by expanding into smart home and other types of connected devices. The aim is to finance this by money from the public markets not just from Lenovo. We suspect the reality is a little more straightforward.

To develop its mobile device business, significant investment is needed and Lenovo simply does not have the money. Following the acquisition from Motorola and the server business from IBM, Lenovo has spent almost its entire war chest and there is very little left for further investment. The PC business is faring reasonably well, but it continues to exist on wafer thin margins, which means there is no real cash cow from which to source investment into something new.

Consequently, funds need to come from outside to invest in the consolidation and development of the mobile device business. The valuation of the business is expected to be a couple of billion dollars at IPO, which comes as a great surprise.

Lenovo (including Motorola) shipped 25.2 million units in Q314 and 28.1 million units in Q414. This is somewhat ahead of Xiaomi on 18.0 million and 17.4 million respectively. It represents a smartphone share of 7.8% and 7.9% respectively, giving Lenovo third position in the global smartphone market. The business was probably slightly loss making with the inclusion of Motorola Mobility added in for those quarters.

Xiaomi ships fewer devices than Lenovo, has only slightly higher margins but somehow commands a valuation more than 20x that of Lenovo. This strikes us as more a reflection of how crazy the $45bn valuation of Xiaomi is rather than Lenovo selling itself short. Xiaomi has the potential to reap big rewards from developing its own ecosystem, but at $45bn a huge amount of success in this regard is already being priced in, leaving very little upside. Furthermore, in the Chinese market Xiaomi will have to contend with the ambitions of Tencent, Alibaba and Baidu, all of whom are working on their own ecosystems and have far more money to invest.

With a valuation of a couple of billion and a solid strategy to develop a wider range of devices, even commodity margins could lead to significant upside for Lenovo investors. I would regard an IPO of this business at the discussed valuation as extremely interesting and worthy of further investigation.

Best regards,
Jeremy Silewicz

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