

## Greencore: Inflation fears & strikes are not justifying such low valuation

<b>Company:</b>	Greencore (GNC LN)	<b>Market Cap:</b>	£330mio
<b>Industry:</b>	Food-to-go, sauces	<b>Net Debt:</b>	£180mio (excl. leases)
<b>Country:</b>	UK	<b>Revenue:</b>	£1.74bn
<b>Date:</b>	1 <sup>st</sup> December 2022	<b>Net Income:</b>	£45.8mio (2.6%)
<b>Dividend:</b>	£15mio share buyback (4.6%)	<b>Free Cash Flow:</b>	£58.7mio (3.4%)
<b>Entry:</b>	£350mio	<b>Target Market Cap:</b>	£500mio

### Introduction

Greencore is one of the largest convenience food producer in the UK, supplying all the major UK supermarkets, discounters, coffeeshops, foodservice, convenience and travel retail outlets with sandwiches, ready meals, sushi, salads, soups, sauces, pickles, quiches and Yorkshire Puddings as well as operating an Irish ingredients business that imports and distributes edible oils. The group has 23 manufacturing units, 18 distribution centres and transport hubs and over 650 distribution vehicles and has produced over 795mio sandwiches and other food to go items in FY 22. The largest direct competitors include 2 sisters/Boparan (dishes, poultry, chilled and bakery food), Bakkavor (fresh prepared food), Samworth Brothers (chilled and ambient food) and Premier Foods (cooking sauces). Indirect competitors include Pret A Manger and Greggs – both are expanding rapidly. Nonetheless, Greencore is present in most of the supermarkets and convenience stores. Greencore raised £87.1mio in equity in Nov 2020 to survive the pandemic.

### Greencore's target market

£5bn market	£4.6bn market	£2.7bn market	£2.5bn market	£1.2bn market
QRS	Specialists	Coffee	Convenience, forecourt & other retailers	Supermarkets & hypermarkets
McDonalds	Pret A Manger	Costa Coffee	Boots*	Tesco*
KFC	Greggs	Starbucks*	Poundland*	M&S*
Burger King	Subway	Café Nero*	WHSmith*	Sainsburys*
	EAT		Shell*	ASDA*
	Gail's		BP	Morrisons*
			One Stop	COOP*
				Waitrose*
				Aldi*
				Lidl*

Top row market sizes are not up to date (from 2015)

\* = Greencore customers

Source: Greencore

### Threats to Greencore

The competitive threat to Greencore is more likely focused on the specialists such as Pret A Manger, Gregg's or Gail's rather than 2 Sisters, Bakkavor or Samworth Brothers. Gregg's and Pret A Manger are eagerly expanding with 150 new shops this year and 200 new shops over this and next year respectively. During the Greencore earnings call, CEO Dalton Philips mentioned that they have actually ended a contract, as the client wouldn't allow prices to adjust to wage and energy inflation. Wages are pressured partly to blame for Brexit and the lack of low-skilled workers (there could be a positive surprise announcement in regards to this). Whereas energy bills are expected to stay elevated and continue climbing into next year. However, the key is that Greencore mentioned despite a time-lag of input costs rising faster than prices of food sold and therefore expecting a relatively weaker H1 FY23, the recent 8 weeks of trading actually saw revenues climb by 8-9% vs. inflation of 8%. Energy costs appear to be manageable, so do wages, which climbed by 11.7% this year, after the 11% growth in employees. Given that this year 10% more contracts are taking into account both energy and wages, the numbers should improve year-on-year.

### Greencore energy costs scenarios

Year	Utility & overhead costs in £ mio	Manufacturing energy consumption in therms	Costs in £ mio @50 pence a therm	Costs in £ mio @300 pence a therm
2022	63.2	16,668,210	8.3	50
2021	45.8	15,931,970	8	47.8

Source: Greencore

### Greencore staff costs scenarios

Year	Staff costs in £ mio	# of staff	Change of staff #
2022	439.8	13,891	11%
2021	351.2	12,480	

Year	Wages in £ mio	Minimum wage hike scenario	Change in £ mio
2022	380.9	422.42	41.52
2021	306.4		

Source: Greencore

### **Why is Greencore's valuation down 10% since the results?**

I was listening twice to the call to understand why investors were selling Greencore shares. I believe the reasons are three-fold: 1. There was no mention of growth and rather decline due to cancelling some contracts, which stands in contrast to Gregg's or Pret A Manger. 2. Input cost inflation is expected to be recouped only in H2 FY23, not fully in H1 FY23 (despite year-to-date trading showing otherwise). 3. The reason for falling towards lower end of guidance of £72-77mio operating profit in FY22 were railway strikes and the additional bank holiday due to the passing of the Queen. In my eyes, all three of these points are negligible. 1. In a recession with inflation, people will have more jobs. In fact, as CEO Philips mentioned, 5.2mio people have two jobs with some analysis suggesting this figure could rise to 10mio. People with two jobs are less likely to have time to cook at home and will buy cheap on-the-go food, which Greencore serves more so than Gregg's or Pret A Manger. 2. Energy and Labour costs are well adjusted for and some contracts even include them. Given Greencore was able to handle this last year, they will likely be able to do so this year as well. 3. While there are more rail strikes ahead and next FY will have an additional bank holiday for the Coronation of King Charles on 6<sup>th</sup> May 2023, the impact on operating profit

will likely be single digit £ mio. Finally, Greencore expects to pay back its £69.8mio Covid loan with cash, reducing net debt to ~£110mio. This gives the company an enterprise value of just £440mio (-£15mio share buyback) vs. £127mio EBITDA. This valuation is too cheap and could turn Greencore into a takeover target. Let's also not forget, travelling is now back to 2019, which wasn't the case in H1 FY22...

#### Greencore cash flow projection

Category	Cash flows in £ mio FY 22	Cash flows in £ mio FY 23*	Cash flows in £ mio FY 24*
EBITDA	121	120	120
Better Greencore	-16.1	-7.9	30
Exceptional items	4.7		
Interest paid	-16.7	-15	-10
Operating cash flow	92.9	97.1	140
Maintenance capex	-16.9	-16.9	-16.9
Exceptional capex	-33.1		
Leases	-17.3	-17.3	-17.3
Debt repayment	-40.3	-69.8	
Share purchase	-11.8	-15	-25
Cash flow	-26.5	-21.9	80.8

\*estimated

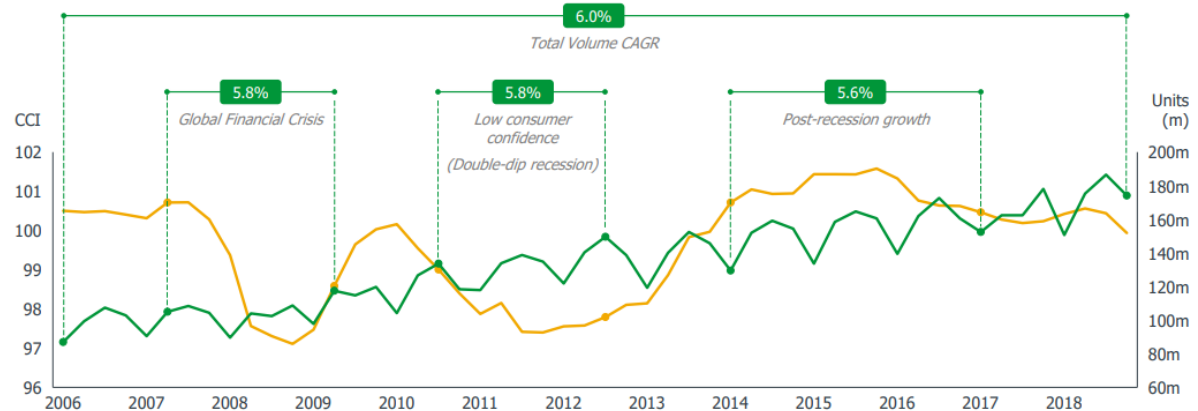
Source: Greencore, own estimates, subject to verification

Sandwiches are recession-proof

# The UK sandwich market has been resilient to macro economic headwinds



Quarterly UK Consumer Confidence Index vs volume of sandwiches, Q1 2006 – Q4 2018



1. CCI = Consumer Confidence Index; Period (1): Q2 2007 – Q2 2009; Period (2): Q3 2010 – Q3 2012; Period (3): Q1 2014 – Q1 2017

Source: OECD, Nielsen, IRI data from Epos

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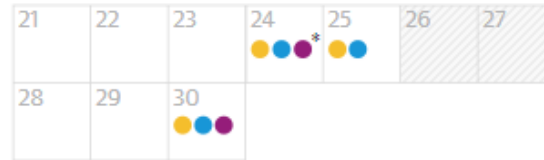
Source: Greencore

## Railway strikes can affect food-to-go demand

### Upcoming strike actions

● University 
 ● Rail 
 ● Health 
 ● Royal Mail 
 ● Schools 
 ● Firefighters

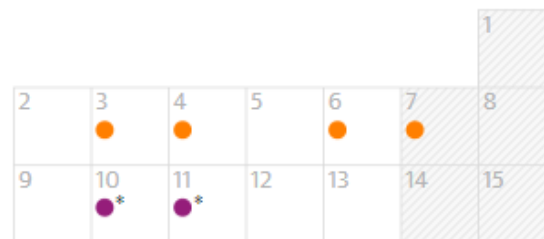
#### November



#### December



#### January 2023



Guardian graphic. Note: These are proposed dates, and might change or be cancelled. \*Scottish schools only

Source: Guardian



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