

PEPCO GROUP

Inflation & post-covid public benefits play

We uphold all our main theses detailed in our IPO report. Despite a 30% growth in its stock price since IPO, we still see PCO as a good play for the observed increase in inflation, which should affect the dynamics of disposable income of consumers and worsen the competitive position of some players. Consequently, we expect an increase in the share of the VFM segment, of which the Company is a leader in the CEE region. In addition, PCO should benefit from the post-Covid-19 public support programmes for less well-off households in Europe or the minimum wage increase. A good example is Poland, where the local company generates over 50% of Pepco Group's EBITDA and the government's 'Polish Deal' ('Polski Ład') programme is scheduled to be introduced in '22, while the minimum wage will increase by 7% y/y.

As the Q3 sales figures are better than expected, mainly on the back of higher LFLs in both companies, which should support the GM as well as SG&A dilution, we raise our adj. EBITDA forecast by 8% in '21 and by 2% in '22 (adj. EV/EBITDA of 12.4x and 10.6x, respectively). Against the peers median, the Company is traded at adj. EV/EBITDA with a 29% discount in both '21 and '22. We start coverage of PCO with a BUY investment recommendation.

Play for inflationary pressure in Europe. Global PPI and CPI increases are currently among the main topics of discussion in capital markets. In CEE, in our view, this will make it difficult to return to the high pre-pandemic dynamics of household disposable income, while WE, especially the countries with high unemployment rates (Greece, Spain, Italy), will struggle with maintaining pre-pandemic real wage levels. For example, in June, in Italy the HICP was 1.3% y/y (+0.2% m/m), while, according to ISTAT data, hourly wages in the economy increased by 0.5% y/y. At the same time, Asian importers signal increases in production and transportation costs, and the clothing industry also points to the growth in cotton prices (the Asian ZCE Cotton No.1 contract rose over 15% vs 4Q20). In such an environment, PCO's highly cost-effective business model and "price leadership" strategy should boost the Company's market share. Simultaneously, PCO's strategy does not allow it to lead in passing on cost increases in retail prices and it will wait for other major players to act first, which might potentially weaken the gross margin temporarily.

PEPCO vs Sinsay. LPP is significantly accelerating the expansion of its lowest-priced brand, Sinsay (average offline purchase PLN ~60 vs Pepco Polska PLN ~45), particularly in the CIS and CEE regions, except Poland (2x y/y increase in retail space in '21 vs +47% y/y in Poland, including a 17% y/y rise in the average store size to 670 sqm). In our opinion, LPP and PEPCO are not direct competitors: (1) the offer of both companies does not overlap significantly (in PEPCO, textiles are dominated by children and baby clothes, and ~40% of the offer is homeware), (2) the price range in Sinsay is much wider than in PEPCO, and LPP will probably attempt to build LFL by adding higher price points, without, of course, cannibalising its other brands.

3Q20/21 estimates. #Revenue. Q3 sales results were 5% above our expectations (mainly higher sales per store in both formats). **#GM.** Q3 foot traffic reduced the mark-down, in our view. We expect the GM to improve q/q both at PEPCO and Poundland Group, although it will stay below the level of the seasonally most important Q1 (blended 43% vs 43.2% in Q1). **#EBITDA.** We should see a positive effect of the operating leverage across retail, and even more so in the case of PCO owing to its B&M only model. Consequently, we expect EUR ~160m of adj. EBITDA and EUR ~75m of EBIT. At the same time, the reported results will be dragged by debt refinancing costs and part of the IPO costs (we estimate them at EUR ~30m in total). **#ND.** The trading update also highlighted an EUR 87m q/q fall in net debt, particularly in view of the expected Q3 increase in CAPEX, which we associate with the cash conversion cycle improving.

Medium-term outlook: the MB is much more optimistic about expanding. Our forecasts assume an annual roll-out of ~460 new stores over the next five years (CAGR 11%, +60% vs '20), revenue CAGR at 13% supported by the 5.5% average LFL at PEPCO and 2.5% at Poundland Group, plus the 2pp EBITDA margin increase in '25 vs '19, driven by restructuring measures introduced at Poundland Group, the effects of which have already become apparent this year. At the same time, our forecast of the chain growing by 2.3k stores across all banners by '25 is conservative given the 8k new stores identified by the MB in current and priority markets in the long term. Nevertheless, the chain's expansion directions outlined by the MB largely stretch outside its current comfort zone as they target new markets, WE in particular. Action is also interested in some of them, starting its expansion in Italy and planning to enter the Spanish market in 2022 ([3i presentation](#)).

Valuation/TP. We used two approaches in our valuation: the income-based approach (DCF, PLN 56 per share) and the multiples approach (EV/EBITDA, EV/EBIT and P/E, PLN 49 per share), where the peer group consisted of foreign companies considered "variety discounters" and Polish retailers with exposure to the VFM and FMCG segments. The 12M target price of PLN 62 is 100% based on DCF.

Buy
(Initiation)

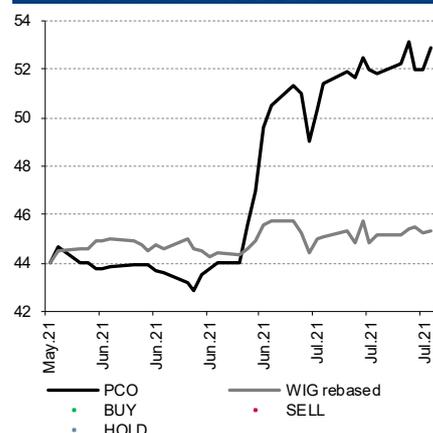
Target Price: 62 PLN
(issued 20/07/2021)

Upside: 17%

FACT SHEET

| | | | |
|---------------------|------------|----|----|
| Ticker | PCO | | |
| Sector | Retail | | |
| Price (PLN) | 52,90 | | |
| 52wk Range (PLN) | 42 / 53,83 | | |
| Number of share (m) | 575,0 | | |
| Market Cap (mPLN) | 30 418 | | |
| Free-float | 20% | | |
| Avg Vol 3M (mPLN) | - | | |
| Price performance | 1M | 3M | 1Y |
| | 20,8% | - | - |

RELATIVE SHARE PRICE PERFORMANCE



Recommendation history

| Date | Price |
|------|-------|
|------|-------|

Shareholders

| Shareholder | Share |
|----------------------|-------|
| Pepco Holdco Limited | 73,4% |
| Andy Bond | 0,6% |
| Sean Cardinaal | 0,2% |
| Mark Elliott | 0,1% |

Important dates

| | |
|---------------------|------------|
| 2021 Trading update | 14.10.2021 |
| 2021 Prelim results | 14.12.2021 |
| 1Q22 Trading update | 13.01.2022 |
| 2021 Annual results | 27.01.2022 |

Analyst

| | |
|--------------------------|---|
| Grzegorz Kujawski | +48 (22) 433 83 69 grzegorz.kujawski@trigon.pl |
| David Sharma | +48 (22) 433 83 49 david.sharma@trigon.pl |

| EURm | 2019 | 2020 | 2021E | 2022E | 2023E | 2024E |
|------------------------|-------|-------|-------|-------|-------|-------|
| Revenue | 3 415 | 3 518 | 4 182 | 4 702 | 5 344 | 6 017 |
| EBITDA | 333 | 502 | 648 | 758 | 889 | 1 024 |
| Adjusted EBITDA* | 333 | 229 | 422 | 507 | 613 | 720 |
| EBIT | 258 | 120 | 314 | 369 | 464 | 556 |
| Adjusted Net Profit** | 151 | 31 | 180 | 239 | 314 | 386 |
| Adjusted P/E (x) | 44,4 | 214,6 | 37,2 | 28,0 | 21,3 | 17,4 |
| EV/EBITDA (x) | 21,5 | 15,8 | 12,4 | 10,6 | 9,0 | 7,8 |
| Adjusted EV/EBITDA (x) | 21,5 | 30,7 | 16,6 | 13,6 | 11,1 | 9,2 |
| P/BV (x) | 8,4 | 8,9 | 7,0 | 5,9 | 4,9 | 4,1 |
| DY (%) | 0,0% | 0,0% | 0,0% | 1,3% | 1,8% | 2,3% |

Source: Pepco Group Financial Statements, Trigon, *adjusted for one-offs and pre-IFRS 16, **net profit in FY21 adjusted for interest expense refinancing at-IPO effect (according to our assumptions ca. EUR 40 m per year)

Trigon Dom Maklerski S.A.

Plac Unii, Budynek B, ul. Puławska 2

02-566 Warszawa

T: +48 22 330 11 11 | F: +48 22 330 11 12

<http://www.trigon.pl> | E: repcja@trigon.pl

Research:

Grzegorz Kujawski, Head of Research

Consumer, Financials

Maciej Marcinowski, Deputy Head of Research

Strategy, Banks, Financials

Kacper Koproń

Video Games, TMT

Katarzyna Kosiorek

Biotechnology

Michał Kozak

Oil&Gas, Chemicals, Utilities

Dominik Niszc

TMT, IT

Łukasz Rudnik

Industry, Metal&Mining

David Sharma

Construction, Developers, Real Estate

Sales:

Paweł Szczepański, Head of Sales

Paweł Czupryński

Sebastian Kosakowski

Michał Sopiński

Hubert Kwiecień

Disclaimer

General information

The Document has been prepared by Trigon Dom Maklerski S.A. (the "Brokerage House"), for remuneration, on behalf of Warsaw Stock Exchange S.A. (the "WSE"), based on agreement for the provision of services for the preparation of analytical reports (the "Agreement"), which is supervised by the Polish Financial Supervision Authority.

In the first place, the Document is addressed to selected clients of the Brokerage House who use its services in the area of research and recommendations. It may, however, be distributed to a wider public from the date specified therein (by posting it on the Brokerage House website, providing it to entities that may quote it in media, in whole or in parts as they see fit, or otherwise) as a recommendation within the meaning of the Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC Text with EEA relevance ("Regulation").

Definitions

capitalisation – market price multiplied by the number of a company's shares
 free float (%) – a percentage of a company's shares held by shareholders with less than 5% shareholding reduced by treasury shares held by the company
 min/max 52 wks – minimum/maximum share price within the last 52 weeks
 average turnover – average volume of share trading within the last month

EBIT – operating profit
 EBITDA – operating profit increased by depreciation and amortisation
 adjusted profit – net profit adjusted for one-off items
 CF – cash flow
 capex – sum of investment expenditures on fixed assets

ROA – rate of return on assets
 ROE – rate of return on equity
 gross profit margin – a ratio of gross profit to net revenue
 EBITDA margin – a ratio of sum of operating profit and depreciation/amortisation to net revenue
 EBIT margin – a ratio of operating profit to net revenue
 net margin – a ratio of net profit to net revenue

EPS – earnings per share
 DPS – dividends per share
 P/E – a ratio of market price to earnings per share
 P/BV – a ratio of market price to book value per share
 EV/EBITDA – a company's EV to EBITDA ratio
 EV – sum of a company's current capitalisation and net debt
 DY – dividend yield, dividend paid to share price ratio
 ISSUER – PEPCO GROUP N.V.

Recommendations of the Brokerage House

BUY – we expect that the rate of return on an investment will be at least 10%
 NEUTRAL – we expect the price of an investment to be relatively stable, optionally it will increase no greater than 10%
 SELL – we expect that an investment will make a loss greater than 0%
 Recommendation prepared by: Grzegorz Kujawski, David Sharma

Recommendations are valid for a period of 12 months from the date of issuance (the date specified at the beginning of the document) or until the price target of the financial instrument is achieved. The Brokerage House may update its recommendation at any time, depending on current market conditions or assessment of persons preparing the recommendation.

Short-term recommendations (particularly those designated as speculative) may be valid for a shorter period of time. Short-term recommendations designated as speculative involve a higher investment risk.

Valuation methods used

The Brokerage House customarily applies two methods – discounted cash flow (DCF) and multiples methods (a comparison of a company's trading multiples with the metrics of comparable companies). Alternatively, a discounted dividend model may also be used. The key disadvantage of methods based on discounted cash flows is high sensitivity to adopted assumptions, whereas their advantage is a lack of relation to a company's current market price. On the other hand, the main disadvantage of the multiples method is a risk that at a given point in time the market prices of comparable companies might not reflect their true value, whereas its advantage lies in the fact that it shows a company's market value obtained based on the market values of comparable companies.

As basis valuation methodology and the adopted assumptions used to assess the financial instrument or issuer or to determine the target price of the financial instrument was adopted DCF.

The valuation, valuation methodology or adopted assumptions did not change from the date of preparation and the first dissemination of the Document.

The Document was not presented to the issuer and then changed. The document did not change from the date of its preparation and the first dissemination.

Detailed information on the valuation or methodology and assumptions, as well as information on previous recommendations on the Issuer's financial instruments, published in the last 12 months prior to the date of this recommendation, is available on the website of Brokerage House www.trigon.pl.

Legal disclaimers, disclaimers related to risks

In the opinion of the Brokerage House, the Document has been prepared objective, with due care and attention and with the avoidance of potential conflicts of interest. The Brokerage House bears no responsibility for any inaccuracies, incompleteness or inconsistency with the facts in the Document. In particular, the Brokerage House bears no responsibility for any damage suffered as a result of investment decisions made on the basis of information contained in the Document.

The Document does not take into account the individual needs and circumstances of any investor nor is it an indication that any investment is suitable for a given investor. Accordingly, the conclusions drawn based on the Document may prove inappropriate for a given investor.

The Brokerage House bears no responsibility for the way in which the information contained in the Document is used. Historical data presented in the Document relate to the past and past performance is no guarantee of similar results in the future. The information relating to the future may prove wrong, as it expresses opinions of persons representing the entity described or represents independent assessment of the Brokerage House.

The information and opinions contained in the Document are not intended to be the sole basis upon which decisions are made. It is therefore advisable for the recipient(s) to make its/their own judgment and assessment of the information, consider information other than that presented in the Document, verify the presented information themselves, assess the risks related to decision-making based on the Document, and consider consulting an independent analyst, investment advisor or other persons with relevant expertise.

Unless specifically stated, the information contained in the Document should not be treated as authorized or approved by the entity described therein. The conclusions and opinions expressed in the Document are conclusions and opinions of the Brokerage House.

There are no conflicts of interest between the Brokerage House and/or persons taking part in the preparation of the Document or having access to the Document before its publication (employees, service providers and other associated persons) and the Issuer. As of the date of preparation of the Document, the Brokerage House hold shares in the Issuer, subject to the following information.

There are no persons among those who took part in the preparation of the Document, or those who did not take part in its preparation but had or could have had access to the Document, who would hold shares in the Issuer representing 5% or more of its share capital or financial instruments whose value is materially linked to the value of financial instruments issued by the Issuer. The Brokerage House has not received any dividend from the Issuer in the last 12 months. No members of the governing bodies of the Issuer or their relatives are members of the governing bodies of Trigon Dom Maklerski S.A. None of the persons engaged in the preparation of the Document serves in the governing bodies of the Issuer, holds a managerial position in, or is a close person of any member of the governing bodies of the Issuer. Moreover, none of those persons or their relatives is a party to any agreement with the Issuer that would be executed on terms and conditions other than those of other agreements executed by the Issuer and customers.

Between The Brokerage House and / or participating in the preparation of this Document or having access to the Document prior to its publication: employees, contractors and other services related parties and the Issuer there is no conflict of interest. At the date of preparation of the Document The Brokerage House does not hold shares of the Issuer. As of the date on which this Document is prepared The Brokerage House performs orders to buy or sell financial instruments in its own name but on behalf of the Issuer for the purposes of performance of tasks connected with market maker services or buying or selling financial instruments on its own account for the purposes of performing the investment underwriting agreement or service underwriting agreement.

The Brokerage House act as a market maker. Remuneration for persons participating in drawing up this Document is not directly based on financial results achieved by the Brokerage House in connection with transactions in Issuer financial instruments performed by the Brokerage House. Among those who participated in preparation of this Document, as well as those who did not participate in its preparation, but had or could have had access to the Document, there are not people who hold shares of the Issuer in the amount of at least 5% of the share capital or hold other financial instruments whose value is essentially linked to the value of financial instruments issued by the Issuer. The Brokerage House in the past 12 months has not received from the Issuer dividend. Directors of the Issuer or their relatives are not directors of The Brokerage House. None of the persons involved in the preparation of this Document, does not take a management position or is close to the members of governing bodies of Issuer and none of these persons, as well as their relatives are not part of any agreement with the Issuer, which would be concluded on different terms than other agreements entered into by the Issuer and consumers.

There are no other circumstances as regards potential conflict of interest which could be the subject to disclosure on the ground of the regulation on the recommendation.

Additionally, at any time The Brokerage House can perform a function of mandatary or mandatary in relation to more than one party, perform long or short stock, perform transactions on its own account or on the client's account regarding financial instruments issued by the Issuer. In the future The Brokerage House is likely to have investment connections within the framework of fiduciary activity as well as other connections with the parties other than the Issuer or Issuer's shareholders.

The Brokerage House manages its actual and potential conflicts of interest by means of measures provided for in the Regulation on Recommendations and by implementing the Brokerage House's general policy for the management of conflicts of interest. In the Brokerage House's opinion, the Document has been prepared in a manner eliminating the effect of any potential conflicts of interest.

The Brokerage House employees participating in the preparing this Document: i) do not receive remuneration directly related to transactions related to the services of the Brokerage House specified in Sections A and B of Annex I to Directive 2014/65 / EU or any other type of transaction that is carried out by the Brokerage House or any other person legal being part of the same capital group as the Brokerage House, nor with fees for such transactions that are received by the Brokerage House or any other legal entity that is part of the same group as the Brokerage House, ii) do not receive or buy shares of the Issuer before the public offer.

Detailed information about the conflict of interest management policy can be found at www.trigon.pl.

The Brokerage House pays careful attention to numerous risks related to investments in financial instruments. Investing in financial instruments carries a high degree of risk of losing some or all funds invested.

The date presented on the first page of the Document is a date of its preparation and delivery to the recipients. Trigon Dom Maklerski S.A. is the owner of the trademarks, service marks and logo presented in the Document. The GPW owns copyrights to the Document and the content of the Document. The Brokerage House based on the Agreement is authorized to redistribute the Document to its clients. Any publication, dissemination, copying, use or provision of the Document (or any part thereof) to any third party in any manner other than its legally sanctioned use, requires the consent of the WSE.

Due to certain legal limitations, the Document may not be directly or indirectly presented, made available or issued in jurisdictions where its dissemination may be subject to local legal limitations. Persons presenting or disseminating the Document are obligated to be familiar with and observe such limitations. It is assumed that each person (organisational entity) who receives, accepts or consents to receive the Document, by doing so:

- accepts every reservation mentioned above;
- confirms that he/she has read the Trigon Dom Maklerski S.A. Terms and Conditions of research and recommendations (available on websites: www.doakcji.trigon.pl, www.trigon.pl, referred to as the "Terms & Conditions") and accepts them;
- gives his/her consent to be provided with a one-time service of research and recommendation provision by the Brokerage House through receiving access to the Document. The provision is covered by the Terms & Conditions together with reservations contained in and related to the Document. Additionally, (1) the service is limited to free of charge provision of the Document and use of the Document by the addressee, (2) the service is valid only for the time of using the Document by the addressee.

The Document is not an offer within the meaning of Art. 66 of the Polish Civil Code, nor is the basis for entering into any other agreement or creating any other obligation.

Date of preparation: 20 July 2021

Date of first distribution: 20 July 2021 08:00