Companhia Brasileira de Distribuicao

Elevator Pitch

An $860m company selling below half of working capital[1] sat on $675m cash soon to spin-off an asset worth over $1bn.

Introduction

Companhia Brasileira de Distribuicao (CBD) was founded in São Paulo in 1948. CBD is a holding company comprising of: (a) Grupo Pão de Açúcar (GPA) – the 2nd largest retailer in Latin America; (b) Exito[2] – a leader in food retail with over 600 stores across Argentina, Colombia, and Uruguay; (c) Cnova – the 3rd largest e-commerce site in France; and (d) hidden assets including 74 Gas Stations and lots of real estate.

Business

CBD has a huge regional presence spanning: 735 stores in Brazil; 492 stores in Colombia; 94 stores in Uruguay; and 33 stores in Argentina. The primary component – that is, the part of the business that will remain once the restructuring has taken place – is GPA. GPA has over 700 high-end grocery stores in Brazil. Ratings agencies believe – despite an interim downgrade – that CBD will continue to be a relevant player in Brazilian food retailing given its strong and consolidated brands, diversified formats, and a good reputation in the middle- and high-income segment. Moreover, CBD expects to open 250 to 300 stores from 2023 to 2025, most of which in the proximity store format, which has been registering better performance. GPA's businesses span: brick and mortar stores; specialized businesses; commercial galleries; E-commerce; exclusive brand products; loyalty; and B2B.

Exito Business

Exito is the #1 multi-format food retailer in Colombia and Uruguay with 603 grocery stores across Argentina, Colombia, and Uruguay. Exito operates: 210 Hypermarkets; 104 Supermarkets; 42 Cash & Carry stores and plans to add 25 Cash & Carry stores per year going forward. Exito has 43% market share in Uruguay; 28% market share in Colombia; and 9% market share in Argentina. Between Q4 2021 → Q3 2022 each geography represented 17%, 75% and 8% in Sales/EBITDA, respectively. On top of this, Exito owns: (a) Puntos Colombia – a customer loyalty monetization program in Colombia in partnership with Bancolombia with 6.2m active clients with 35m customers registers; (b) a 51% stake in Fondo Immobiliario Colombia's (FIC1) 18 assets making up 40% of 'other revenue' and 13% recurring EBITDA (60% margin) worth $1/3m[3]; and (c) a credit card and receivables business.

Exito Spin-Off

CBD plans to spin-off Exito because its parent company, Casino (Casino Guichard-Perrachon SA), needs to monetize its assets to reduce debt. Ratings companies have identified that Casino's debt is causing them to downgrade anything it touches e.g., CBD, Exito, Cnova etc. As such, not only will this extremely value-accretive spin-off generate an abundance of value to CBD shareholders; the effect will be two-fold given that ratings companies ought to look more favourably upon CBD because of its parent companies' debt reduction. Moreover, the spin-off will increase company liquidity as the float increases further driving business value. This spin-off is due to take place in the first half of 2023 which – due to a few non-concerning delays – is likely to culminate in June.

Cnova

GPA owns 34.2% (117m shares) of Cnova which operates Cdiscount – France's 3rd largest e-commerce site.

Hidden Assets

CBD has access to assets hiding in plain sight as well as assets you must dig a little deeper to find. This comprises 74 gas stations, 758,000 sqm GLA (34 assets) with 75% via Viva Malls SPV.

Why does this opportunity exist?

1) Disappointing Q4 results due to inflationary pressures and non-recurring charges (tax and employment provisions).[4]

2) Latin American businesses in Argentina, Brazil, Colombia, and Uruguay can be easily passed over due to geographic risks. Moreover, the Brazilian market as a whole – of which CBD trades most like – has been weak as of late.

3) CBD announced it was unable to file its annual report (31-Dec-22) due to the Exito segregation resulting in a 5%+ decline in share price.
    a. *"The Company is still reviewing the financial information of Éxito, including Éxito's management's assessment of internal control over financial reporting."*

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[1] Total Current Assets ($5.4bn) – Total Current Liabilities ($3.2bn) ≈ $2.2bn
[2] Grupo Exito - *Almacenes Exito SA*
[3] Total valuation worth COP$2.7bn @ 1.5x book value ~ $300k.
[4] @ClarkSquareCapital – Twitter

4) Parent Company Debt

a. In Q4, 2022 S&P downgraded CBD due entirely because of its parent company's rating. The Casino group showed poor operating cash flows and significant debt maturities (€3bn in the next two years).

i. S&P suggest Casino has valuable assets that they could monetize. As such, this downgrade is parent-company specific thus Casino have found themselves in a sticky situation of which all assets required to dispose aren't done so due to wants, but rather needs.

5) Weaking Business Profile

a. In Q1, 2023 Fitch Ratings downgraded CBD due to its weakening business profile because of the Exito separation which will result in a material loss of scale and geographic diversification. Moreover, Fitch suggested CBD needs to monetize its operation and strengthen its cash generation.

i. This, however, is not a concern for pre-separation shareholders who will keep this 'weakening' business whilst holding 4 shares of the business which is clearly valuable enough to warrant a downgrade.

Valuation

This investment can be analysed using a sum-of-the-parts valuation.
All multiples use JPMorgan comparables with a range of: [lowest]–[median] multiple of the JPM set for conservatism.

Exito

Currently Exito trades publicly with just 3% float. In the following month Exito is due to be fully separated and its float increasing significantly. It currently has a market capitalisation of $1.18bn equating to $0.91 per share. With limited float and little volume, Exito's current market capitalisation may not accurately represent its intrinsic value. Before Exito was absorbed by GPA in 2019 – with greater liquidity – Exito traded at a median EBITDA of 7.0x (2008 to 2019) thus its EV would equate to $2.21bn ($0.91 p/s). LatAm Supermarkets (which comprises both CBD and Exito) trade at a median EV/EVITDA of 5.8x thus using TTM EBITDA of $316m and a 5.8x multiple, Exito's EV would be ~$1.8bn ($1.15 p/s). Should Exito trade at the lowest of its LatAm Supermarket counterparts (3.7x EV/EBITDA) it's EV would equate to $1.2bn ($0.84 per share). I believe Exito could be worth:

25% of current value	based on PE or TBPS	=> $0.91 received
50% of current value	based on adjusted[5] TE	=> $1.80 received
85% of current value	based on EV/Sales or TE	=> $3.03 received
100% of current value	based on BVPS	=> $3.60 received
185% of current value	based on EV/EBITDA	=> $6.81 received

Cnova

GPA owns 117m shares of Cnova which are worth $351m in the market today equating to $1.30 per share for CBD owners.[6] Assuming Cnova trades as an EM supermarket (to be more conservative), Cnova would be worth 0.1 – 0.3x sales. Thus, with $1.8bn in revenues (TTM), Cnova would be worth $180m - $540m. CBD owns approximately 33% of Cnova thus its portion would be worth $60m – $180m ($0.23 - $0.68 per share). Should Cnova be able to command a PS ratio of a DM supermarket (as Casino and Carrefour do), it would trade at 0.1 – 0.6x sales. As such, Cnova would be worth $180 – $1.1bn. As such, CBD's portion would be worth $180 – $360m ($0.68 – $1.35).

Non-Core Assets

Management's expectation of non-core assets is: 1,000 – 1,500m reais. Assuming management are optimistic we can apply the following scenarios: 750 / 1000 / 1250 / 1500 reais => $150m / $200m / $250m / $300m .:. $0.56 / $0.74 / $0.93 / $1.12 for each CBD shareholder.[7]

GPA

Excluding the value of GPA there remains significant upside. That said, using a similar valuation approach to Cnova and Exito, CBD can be valued at: (a) Adjusted Total Equity ~ $2.96; (b) EV/Sales ~ $2.58 to $5.16; (c) EV/EBITDA ~ $3.36 to $5.26; or (d) Tangible Book Value ~ $6.71 with conservative estimates[8]. Thus, the results of the sum of the parts can be seen as:

	GPA*	+ Exito	+ Cnova	+ Non-Core Assets	- Taxes	- Net Debt	= IV[9]	[ROI]
LO	*$2.58*	*$0.91*	*$0.00*	*$0.56*	*$0.74*	*$1.60*	*$1.90*	*- 40%*
LQ	*$3.36*	*$1.80*	*$0.23*	*$0.74*	*$0.74*	*$1.60*	*$3.98*	*+ 25%*
UQ	*$5.16*	*$3.60*	*$0.68*	*$0.93*	*$0.74*	*$1.60*	*$8.03*	*+ 152%*
HI	*$6.71*	*$6.81*	*$1.35*	*$1.12*	*$0.74*	*$1.60*	*$13.65*	*+ 328%*

*GPA could be worth 87% of market value and all other elements at their lower quartile value and one could still breakeven.

[5] Adjusted Total Equity ~ C,CE,MS + 0.75*Receivables + 0.50*Inventories + 0.75*OCA + PP&E + Other LT Assets – Total Liabilities.
[6] Cnova MC = $1,036m thus GPA's 117m of 345.21m CSO ~ $351m thus with 269.98m CSO, Cnova is worth $1.30 to CBD shareholders.
[7] CBD's 51% JV stake of private real estate [Findo Immobiliario Colombia – FIC1] valued at ~ $300m which equates to this higher valuation.
[8] TTM Sales of $2.3bn [0.3 – 0.6x] and TTM EBITDA of $245m [3.7 – 5.8x].
[9] Taxes and Net Debt assumptions taken from clarksquarecap.

Catalysts

1) Exito Spin-off
    a. Completed in the next month whereby Exito will become part of indices and international ETFS etc.

2) Sale of non-core assets
    a. Half of the $250m is expected to be realised in the next 6 months.

3) Ratings Agency Improvements
    a. CBD's rating is heavily dependent upon Casino's financial position. Given that Casino group is incentivized to dispose of assets, a successful disposal will see S&P Global raising CBD's rating in the next 12 months.

4) Greater liquidity
    a. As Exito's float goes from 3.5% to over 50% this may cause Exito to revert to its pre-GPA valuation multiples.
    b. Exito may also become more investable for international and local Colombian pension funds.
    c. Colombian pension funds will finally have an ability to purchase Exito shares.

5) Reduced Macroeconomic Headwinds
    a. Inflation and interest rates ought to decline making operations more profitable and enabling a multiple re-rating as cash flows increase due to interest expenses declining.

6) Strategic Push[10]
    a. Stores are now open later (10pm) and delivery is available over the weekend.
    b. De-leveraging will lead to free cash flow improvements (lowered interest expense).
    c. 8-9% target for adjusted EBITDA from 7-8% currently .:. even with the 'BS earnings' part, uptick ought to have a positive impact generally.
        i. Driven by: (a) commercial margins[11] – supplier negotiations and a push to perishables; (b) breakage[12] – review of supply flow and in-store operations; and (c) expenses[13] – SG&A readjustment, new technology, zero-based budgeting, and dilution by expansion.
    d. Digital
        i. In the last 12 months, GPA's app has been simplified, upgraded, and includes more discounts resulting in digital sales growing 15% and, as food delivery leaders in Brazil, aim to take online sales from 10% of revenues to 20% by 2024.
    e. Expansion
        i. GPA will focus on their Minuto Pão de Açúcar banner in anticipation of the densification of São Paulo and surrounding regions. Opening 78 stores in 2022 brought in R$1.2bn in incremental sales. In the next three years they expect to open 300 stores in 'proximity' format exploiting their Pão de Açúcar and Minuto brands as they are more profitable brands with a focus on perishables which are more profitable. GPA's projects are currently reported with full costs despite immature stores therefore as they mature upside ought to reveal itself.
        ii. Proximity stores tend to have lower CapEx and higher density producing greater returns on incremental capital. Assuming 250 stores contributing R$12m each with 3% margins trading at 5x EBIT would represent $0.33/share.[14] With GPA selling at $3.19 today this represents 10% of its current share price.

7) GPA Labs
    a. 135 active contracts with startups such as: (a) B4Waste – partnered with a startup to sell near-expired produce which is showing 'highly promising results'; (b) Digital Sommelier – BeeID's product to find out which wine pairs best with the occasion; and (c) Mission e Anthor currently active in 164 stores – outsourcing of shelf stackers and pickers resulting in increased capacity and sales.

Risks

1. Exito's limited float may disguise true value.
2. Brazilian retail/professionals may have a negative view on Colombian assets / exposure.
3. Uncertain geopolitical context and the current volatile markets have not favoured asset disposals.
4. Macroeconomic uncertainty due to a high correlation with commodity prices and exorbitant interest rates.
5. The S&P downgrade follows recent lower-than-expected group results and a tough retailing environment in France.
6. Approximately $500m of Casino groups de-leveraging process will possibly be raised through selling of CBD/Exito thus will depress the share price post-spin somewhat thus will culminate in an Exito sell off.

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[10] fb3d562b-cb5a-399e-2026-cc52e822e809 (mziq.com)
[11] 780 suppliers already renegotiated. 113 stores renovated with a further potential of 70.
[12] Variable renumeration on breakage (incentives); half new ops team and security implemented.
[13] Personnel expenses down 20%; Self-checkout from up 50% since 2021; Plan to add 300 new supermarket and proximity stores: 110 in 2023; 117 in 2024.
[14] ClarkSquareCap VIC write up