

Kingfisher: Store Visits Confirm French Crisis

SHORT @ £3.29

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Kingfisher – [View All Notes and Models](#)

Recommendation: **Short (No Change)**

Price: £3.29	Market Cap: £7.3bn	Ticker: KGF LN
3m Average Daily Volume (USD): \$36m	2 Year Price Target: £2.10	Forecast Return: 36%
Valuation Metric: FY'20 PE undiscounted	Current Multiple: 16x	Target Multiple: 10x

Investment Thesis

- **French business is struggling.** Store visits show that Castorama and Brico Depot stores are quieter and more difficult to shop in than larger rival Leroy Merlin.
- **Price survey suggests discounter Action undercuts Castorama by 33%.**
- **Profits for French business expected to fall by nearly 50% over next three years.**
- **Combined with weak B&Q business, overall net income expected to fall from £584m in FY'17 to £440m in FY'20.**
- **Reducing price target from £2.25 to £2.10, providing 36% downside.**

Problems in France

We have previously highlighted Kingfisher's problems in France [here](#), [here](#) and [here](#) and Q1'17 results there were dreadful. Like for likes were down 4.3% at Castorama and 6.8% at Brico Depot, an appalling result when compared to the Banque de France data which showed a 1% decline in the overall French DIY market.

We visited stores around Lille on 25th and 26th May 2017 – two warm and sunny days in early summer - to test our thesis that there are fundamental weaknesses in the French business, rather than just a one-off bad period. In our [video](#) last week we highlighted our main findings which we give more detail on [here](#).

The stores visited were Castorama Lille Helleness, Castorama Bondues, Castorama Englos, Brico Depot Lille, Leroy Merlin Villeneuve d'Ascq, Leroy Merlin Lesquin and Action, Lille South.

Overall, Kingfisher stores were quieter than rival Leroy Merlin. Signage was poor, particularly in Castorama and it was extremely difficult to find anything. Stores were in much better shape than B&Q in the UK, however do not provide as good a shopping experience as Leroy Merlin.

We have downgraded our French estimates and now expect the French business to see profits contract by nearly 50% over the next three years. We reduce our price target from £2.25 to £2.10 and reiterate our Short recommendation with 36% downside.

Store Visits

We made the following general observations, and these are highlighted with our selection of photos from the trip.

- **Castorama stores were tidy and more up to date in terms of décor than B&Q in the UK.** Lighting was good and the aisles were wide and easy to navigate. Displays were generally tidily arranged. The whole Castorama estate was refurbished in recent years so perhaps this is not a surprise.
- **Both Castorama and Brico Depot stores were quiet, whereas Leroy Merlin was extremely busy.** The Leroy Merlin car park was almost completely full whereas the Castorama stores were all half empty. Brico Depot was particularly quiet. Tills at Leroy Merlin had queues that were three to four people long.

Exhibit 1: Leroy Merlin, Villeneuve d'Ascq, Lille. Full Car Park, Clear Signage, Packed with Customers



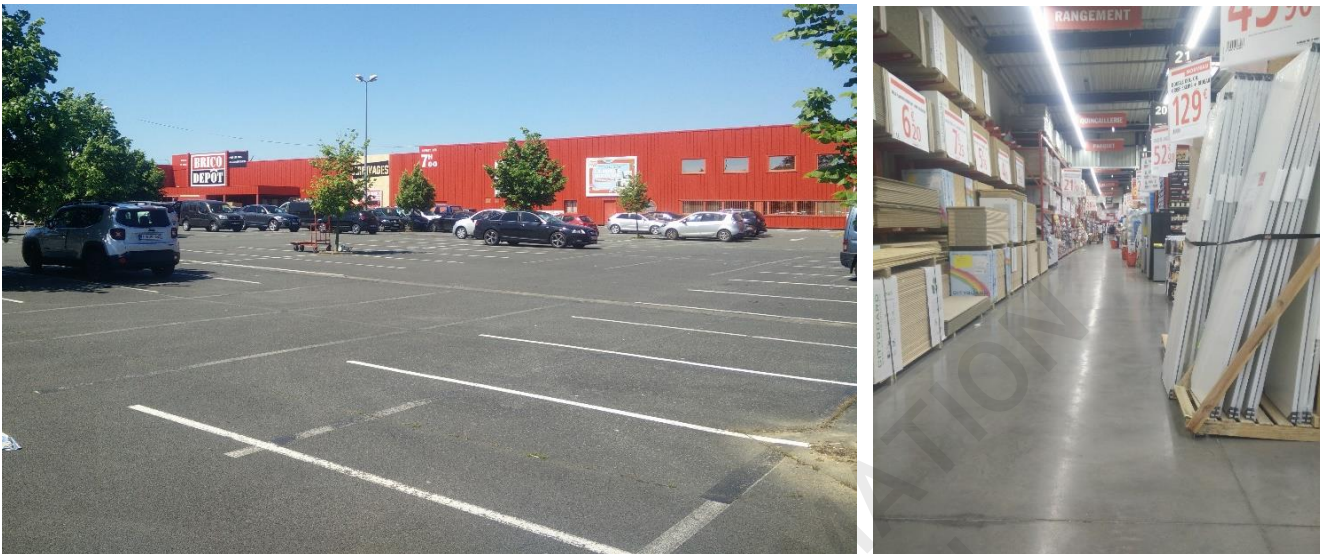
Source: The Analyst Lens

Exhibit 2: Castorama Hellennes, Lille. Quiet Checkouts. Confusing Signage



Source: The Analyst Lens

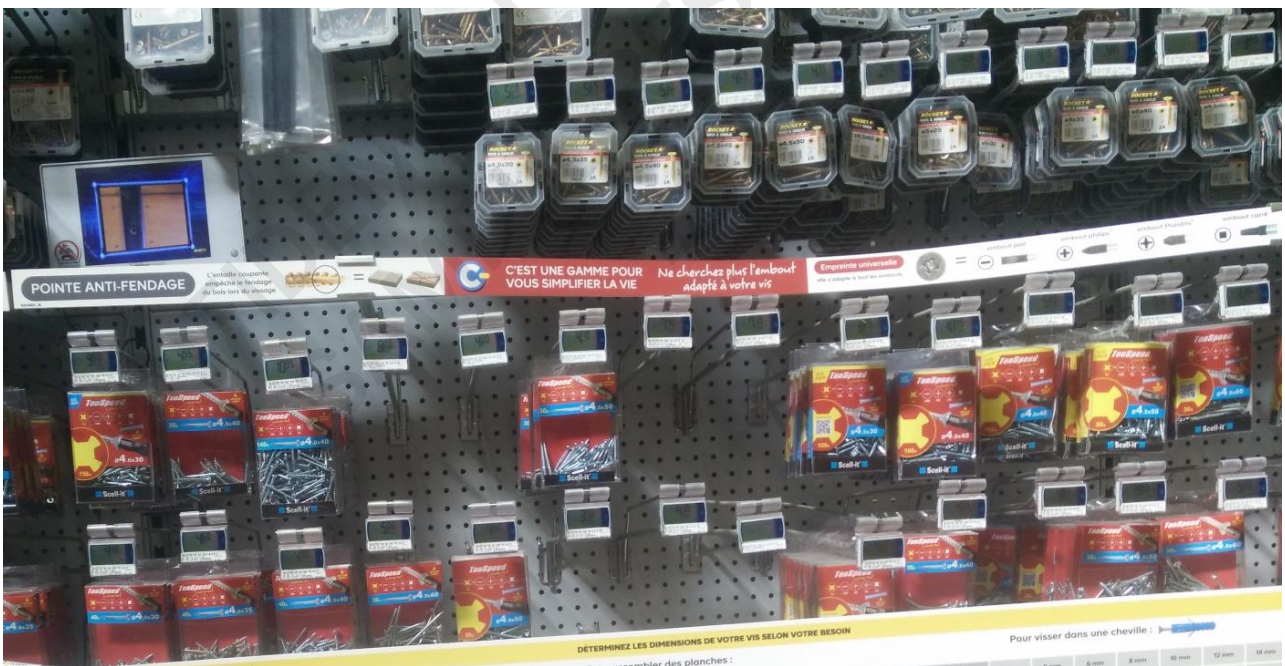
Exhibit 3: Brico Depot Lille – Quiet Car Park & Store



Source: The Analyst Lens

- Despite being more modernised than B&Q, Castorama in particular did suffer from the B&Q problem of being difficult to find things. Store signage was often non-existent and competed for attention with more distinctive signs for product offers hanging from the ceiling. Meanwhile Leroy Merlin was easy to navigate with clear signage at the end of each aisle.

Exhibit 4: Castorama – Can You Read These Prices?!



Source: The Analyst Lens

- In Castorama, pricing for individual items is put on small digital displays which are incredibly difficult to see and it is difficult to relate a particular display to each particular item. Some items have no prices shown at all. Leroy Merlin pricing was much clearer.
- Most items in Castorama and Brico Depot had a reasonable amount of stock displayed, with little evidence of gross overstocking. However we did observe a small proportion of out of stock items. Leroy Merlin appeared to have very few items out of stock.

Exhibit 5: Castorama – Spot the Random Coathangers



Source: The Analyst Lens

- Random coat hangers were found at various places in the store. We struggled to see why they were actually there.
- Service levels in the stores appeared good with countless store assistants in Castorama, Brico Depot and Leroy Merlin. This is very different from B&Q in the UK where assistants are difficult to find.
- Across the store, Leroy Merlin appeared to have more extensive product ranges across all categories than either Castorama or Brico Depot.
- Castorama and Brico Depot websites are difficult to use. The search functions are particularly awkward and we see some items entered twice.
- Batteries and light bulbs in Castorama and Brico Depot were of the same brands as those found in B&Q (these were the first “unified categories”) although the pack sizes did vary between them. **For Varta branded batteries, B&Q was on average 22% cheaper than Castorama for identical items** and it is this price differential that may indicate why margins are higher in France than in the UK. B&Q has so far faced more competition from discounters and online in the UK than the French business, hence Kingfisher UK gross margins were down by a total of 190 b.p. over the last three years compared to France where they were up 20 b.p. over the same period. We expect Kingfisher will need to cut pricing in France to respond to the increased price pressure.

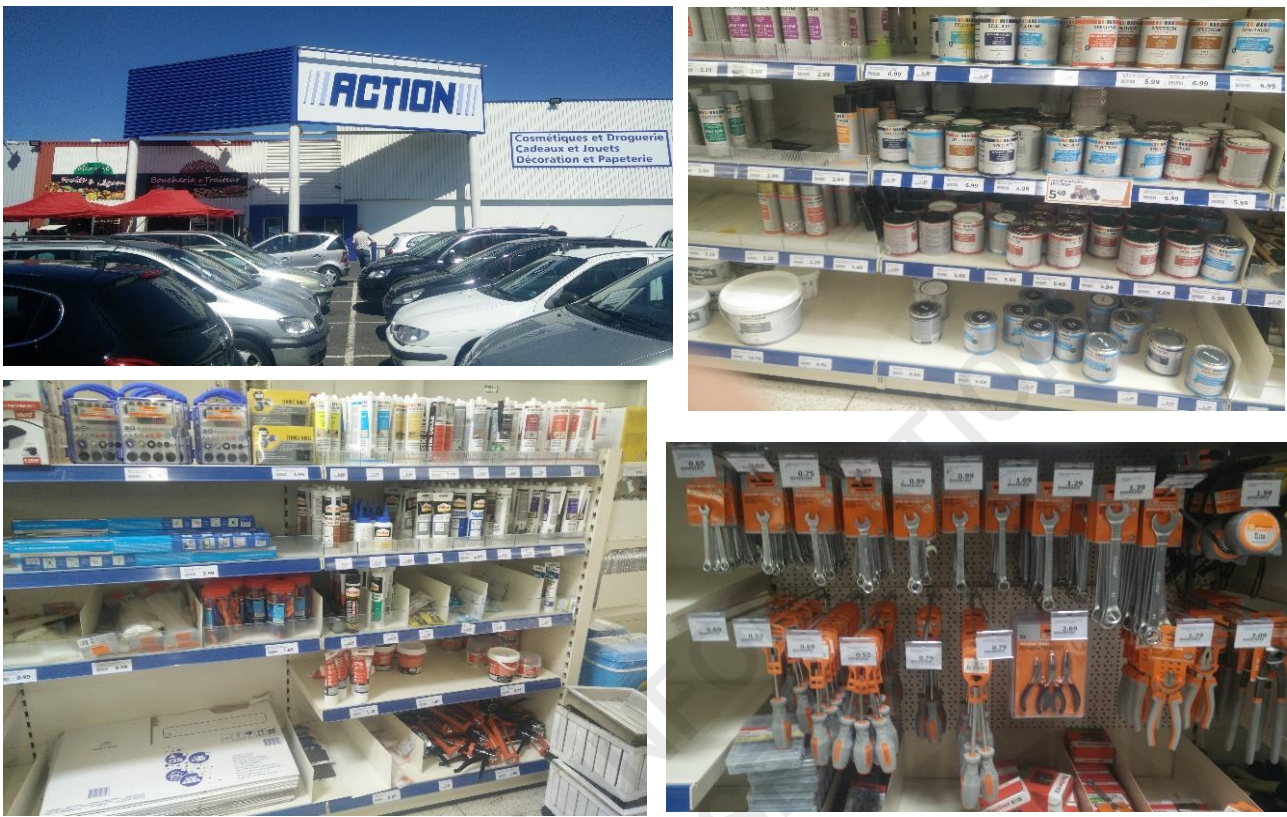
Exhibit 6: Varta AA Batteries on offer at Castorama and Leroy Merlin Websites

Variation of AA Battery	Castorama	Leroy Merlin
AA - 4	€ 4.99	€ 4.99
AA - 4 + 1		5
AA - 6	6.99	
AA - 6	6.99	
AA - 6 + 2 gratis	6.99	
AA - 8	8.99	
AA - 8 + 4 gratis	8.99	
AA - 12 + 4 gratis	13.99	
AA - 12 + 4 gratis	13.99	
AA - 14 + 6 gratis	17.99	
AA - 20	17.99	
AA - 24	14.00	
AA Max Tech - 4		5.80
AA Max Tech LR 6 - 4	5.99	
AA Max Tech LR6 - 4 + 2 gratuit		5.80
AA Max Tech LR 6 - 5 + 3 gratis	6.99	
AA Max Tech LR 6 - 8	10.99	
AA Max Tech LR6 - 8 + 4 gratis	5.99	
AA Long Life - 2		7.60
AA Long Life - 4	14.9	14.90
AA Long Life Extra LR6 - 16		
AA rechargeable 900 maH - 4		15.90
AA rechargeable 2100 maH - 6		24.90
AA rechargeable 2100 maH - 4		
AA rechargeable 2400 maH - 4		
AA rechargeable 2600 maH - 4		22.95
AA Professional Lithium - 2		7.90
AA Professional Lithium - 4		12.35

Source: Castorama and Leroy Merlin Websites, 2 June 2017

- For Varta batteries, prices were identical at Castorama compared to Leroy Merlin. Castorama have more SKU's than Leroy Merlin, and the websites show 40 and 35 SKU's respectively. However many of the different SKU's of Castorama are just different pack sizes of the same type of AA battery. **Leroy Merlin actually have a better range than** Castorama and have Varta Professional batteries (much more powerful than the standard) which Castorama do not have. Leroy Merlin also have AA rechargeable batteries separately available but we could not find these on the Castorama website.
- Overall Leroy Merlin and Castorama are similarly priced, but Leroy Merlin has a bigger product range and stores that are easier to navigate. More customers in the store was clear evidence of which company people prefer to shop in. Leroy Merlin of course have the advantage that they are headquartered in France, therefore we would expect them to be stronger in their home market than Kingfisher who are UK listed.

Exhibit 7: Action, Rue Clemenceau, Lille. Packed Car Park & Cheap DIY Products In Store



Source: The Analyst Lens

Exhibit 8: Products Available in Action, Rue Clemenceau, Lille vs Castorama Website

Product	Action	Castorama	Discount
	€	€	
20m hose reel	29.95	49.95	-40%
20cm plant pot	2.29	1.20	91%
Reclining garden chair	17.95	19.95	-10%
Lawn food, 5kg	3.89	15.90	-76%
Interior plant food, 1L	0.99	3.80	-74%
Secateurs, 12cm	2.69	1.90	42%
Gardening gloves	0.99	2.50	-60%
Garden saw - cordless	34.99	69.99	-50%
Hand saw	2.99	3.65	-18%
Palm electric sander	19.95	39.99	-50%
Electric drill 12V	29.95	15.99	87%
Universal silicone, 310ml	1.99	2.45	-19%
Silicone holder	2.99	2.80	7%
Wood glue, 250g	1.97	2.60	-24%
Paint roller, 25cm	1.49	3.95	-62%
Masking tape, 40m x 25mm	1.29	3.95	-67%
Extension lead, 15m, 4 sockets	15.95	17.90	-11%
Total	172.31	258.47	33%

Source: Action, Rue Clemenceau, Lille, Castorama website. Cheapest Items Chosen Where Choice Available

- In addition to other DIY chains, there is growing price competition from discounters such as Action plus online operators such as Amazon. The Lille branch of Action had a reasonable selection of basic DIY items, including paint, hand tools and light bulbs and critically were undercutting the cheapest available products at Castorama by 33% on average. The biggest differences were for lawn and interior plant food where the Action products were one quarter the price at Castorama.

So customers who are price sensitive choose a discounter or online, whereas those wanting a premium shopping experience with the biggest range and the most well laid out stores go to Leroy Merlin. Castorama and Brico Depot have nothing unique for customers. We here have only looked at Leroy Merlin but the French DIY market has many other competitors, for example Mr Bricolage and Bricorama, so if Kingfisher is slipping behind on its offer then it will continue to lose market share as we have seen in Q1'17.

France Estimates & Impact on Valuation

Exhibit 9: France Estimates

	FY'15	FY'16	FY'17	Old			New		
				FY'18e	FY'19e	FY'20e	FY'18e	FY'19e	FY'20e
Castorama	€m	€m	€m	€m	€m	€m	€m	€m	€m
Stores	103	102	102						
Revenue	2291	2076	2308	2368	2309	2251	2356	2285	2216
% Change	-7.3%	-9.3%	11.2%	2.6%	-2.5%	-2.5%	2.1%	-3.0%	-3.0%
% Change CC	-1.7%	0.1%	-2.4%	-2.5%	-2.5%	-2.5%	-3.0%	-3.0%	-3.0%
LFL	-1.4%	-0.2%	-3.0%						
Brico Depot									
Stores	114	118	119						
Revenue	1841	1710	1946	2048	2048	2048	1986	1927	1869
% Change	-5.8%	-7.2%	13.8%	5.2%	0.0%	0.0%	2.1%	-3.0%	-3.0%
% Change CC	-0.1%	2.5%	-0.1%	0.0%	0.0%	0.0%	-3.0%	-3.0%	-3.0%
LFL	-3.2%	-0.5%	-2.3%						
Total									
Revenue	4132	3786	4254	4415	4356	4298	4342	4211	4085
% Change	-6.6%	-8.4%	12.4%	4.0%	-3.0%	-3.0%	4.0%	-3.0%	-3.0%
% Change CC	-1.0%	1.2%	-1.4%						
LFL	-2.3%	-0.4%	-2.7%						
Retail EBIT	349	311	353	318	261	215	304	232	184
Margin	8.4%	8.2%	8.3%	7.2%	6.0%	5.0%	7.0%	5.5%	4.5%

Source: The Analyst Estimates

We were previously negative on France, expecting sales reductions in Castorama and an overall fall in margin from 8.3% in FY'17 to 5.0% in FY'20. In light of the negative findings from our French store visits and the Q1'18 results, we adjust our estimates for the French segment down further, with FY'20 EBIT estimates reduced by 15%. That means we expect French profits to fall by nearly 50% between FY'17 and FY'20.

As part of these assumptions, French gross margin in FY'17 is assumed to be in line with the group at 37%. We see that dropping to 35% by FY'20 as price cuts are implemented. With revenues at constant currency falling by 3% p.a. and operating costs flat. This results in operating profits falling from £353m to just under half.

Our total Kingfisher net income estimate is reduced from £463m to £440m and valuing on 10x FY'20 earnings our price target is reduced from £2.25 to £2.10. This gives 36% downside from today.

Conclusion

Kingfisher's French business provides an inferior shopping experience to larger rival Leroy Merlin and customers agree, with Leroy Merlin stores being considerably busier on our visits. Meanwhile discounters and online continue to undercut on price.

We therefore reiterate our Short recommendation with a lower £2.10 price target, providing 36% downside from today.

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