EDISON

SandpiperCI

An island of opportunity

Initiation of coverage

Retail

SandpiperCI is the leading Channel Island retailer, primarily operating franchise stores and a number of its own food convenience stores. It operates a high-quality portfolio of brands covering food, clothing and specialist products. Sandpiper has been able to leverage its long relationships with major retailers to open their brands in Gibraltar and, more recently, in the Isle of Man. It also owns a high-quality freehold property portfolio that was independently valued at £60m 12m ago. We believe the current share price offers a good entry point, with significant upside to our fair value of 130p.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
01/19	189.1	3.8	3.04	1.00	26.3	1.3
01/20	188.5	4.5	3.56	2.30	22.4	2.9
01/21e	195.2	5.4	4.33	3.00	18.5	3.8
01/22e	202.2	5.1	4.10	3.10	19.5	3.9

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Strong track record

Sandpiper can trace back operation of the M&S franchise in Jersey to 1967 and it has developed close and long-lasting relationships with all its franchisors. It is a dependable operator and upholds the franchisor's brand values, while the tax differential between the Channel Islands and the rest of the UK allows it to arbitrage the additional logistics and employment costs. Over the last three years, Sandpiper has witnessed revenue CAGR of 6.6% and trading EBITDA CAGR of 16.7%.

Expansion opportunities

Sandpiper has been able to leverage its relationships with its franchise partners to open their brands in additional geographies: initially Gibraltar and more recently the Isle of Man. There are some opportunities for in-fill across existing geographies, but we believe that more significant long-term opportunities lie in developing into new territories and an expansion into an adjacent segment such as hospitality. However, this is unlikely to occur in the short term given the ongoing pandemic, which caused the acquisition of a Channel Island-based hospitality business to fall through in January 2020.

Valuation: Fair value of 130p

We value Sandpiper primarily on a DCF basis. Our model assumes medium-term sales growth of 3.5%, 1.5% terminal growth rate and broadly flat margins. At a WACC of 8.1%, this results in a fair value of 130p. Our medium-term sales growth of 3.5% reflects consensus RPI forecasts of c 3% and modest space growth, as Sandpiper expands across its existing geographies. While there are not many direct peers, Sandpiper trades on a CY21 P/E of 19.4x and EV/EBITDA of 8.5x, a 48% premium and 3% discount respectively to a peer group of food retailers and franchisors. We believe a premium is warranted given Sandpiper's significant freehold property, and its attractive and well-underpinned dividend yield (3.9% in 2021, which rises to 4.75% for Channel Island investors due to tax credits).

15 January 2021

Price	**80p**
Market cap	**£80m**

Net debt (£m) at 1 August 2020	19.0
Shares in issue	100m
Free float	100%
Code	SANDPI
Primary exchange	TISE
Secondary exchange	N/A

Share price performance

Business description

SandpiperCI operates a high-quality portfolio of retail brands covering food, clothing and specialist products. It primarily operates franchise stores but also a number of its own food convenience stores. It is the leading Channel Islands retailer and is also present in Gibraltar and the Isle of Man.

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FY21 results	May 2021

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Edison profile page

SandpiperCI is a research client of Edison Investment Research Limited

Investment summary

Company description: The leading Channel Island retailer

Sandpiper is the largest food retailer in the Channel Islands and operates franchise stores for Wm Morrison, Iceland, M&S Jersey and its own chain of convenience stores, fuel forecourts and off-licenses. Its non-food retail business covers franchises for food, non-food and specialist brand retail. Examples include Hotel Chocolat, Card Factory and iQ, the Apple Authorised Premium Reseller. Sandpiper has also been able to leverage its long relationships with major retailers to open their brands in Gibraltar and, more recently, in the Isle of Man. It owns a portfolio of commercial and residential freehold assets in prime locations. This underpins the valuation, renders the cashflow more stable and acts as an effective barrier to entry for any competition.

The company has long-term and successful relationships with its franchise partners, which has led to franchises mostly being renewed. The strategy consists of filling in ‘white spaces’ by introducing target brands to existing territories and leveraging its existing relationships with franchisors to enter new territories. Management has also stated its intention to selectively add to its freehold portfolio to secure strategic locations and acquire businesses that operate in adjacent sectors in the Channel Islands (ie hospitality) to broaden its appeal and complement the retail operations, although we believe this is unlikely in the short term given the ongoing pandemic and unpredictable restrictions on the hospitality segment.

Financials

Sandpiper posted sales CAGR of 6.6% between 2017 and 2020, with trading EBITDA CAGR of 16.7% during the same period. During this time, the company has expanded geographically into the Isle of Man and has worked to fill in some of its ‘white spaces’ across its portfolio. The 58,000 sq ft Liberty Wharf shopping centre was acquired in a prime location in Jersey and was refurbished. We expect the pace of expansion to slow down and forecast sales CAGR of 3.6% between 2020 and 2023e, with trading EBITDA CAGR of 3.2%. Sandpiper’s exposure predominantly to food retail has resulted in a strong performance during the COVID-19 pandemic: while the non-food retail operations have suffered due to a reduction in footfall in town centres and temporary store closures, the food retail side has witnessed a material acceleration as consumers had more meals at home. Overall revenues in H121 were up 6%, with trading EBITDA up 7%.

Valuation: Fair value of 130p

We value Sandpiper primarily on a DCF basis. Our model assumes medium-term sales growth of 3.5%, 1.5% terminal growth rate and broadly flat margins. This results in a fair value of 130p. We also look at peer group analysis. Although there are not many direct peers, Sandpiper trades on a CY21 P/E of 19.4x and EV/EBITDA of 8.5x, a 48% premium and 3% discount respectively to a peer group of food retailers and franchisors. We believe a premium is warranted given Sandpiper’s significant freehold property, and its attractive and well-underpinned dividend yield (3.9% in 2021).

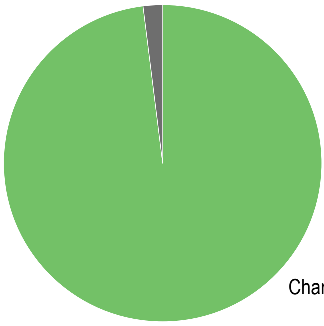
Sensitivities

Retail is a discretionary consumer category and therefore the key sensitivity is macroeconomic in nature. GDP and population growth are good predictors of discretionary consumer spend. Raw material cost increases and FX are also a risk to the sector as a whole. In Sandpiper’s case, there is also the risk it loses its franchise partners over the long term, either due to a deterioration in the relationship, or the franchisors ceasing trading or choosing to exit franchise partnerships.

Company description: Leading Channel Island retailer

Sandpiper is the leading Channel Island retailer, with a high-quality portfolio of brands covering food, clothing and specialist products. Sandpiper is the largest food retailer in the Channel Islands and operates franchise stores for Wm Morrison, Iceland, M&S Jersey and its own chain of convenience stores, fuel forecourts and off-licenses. Its non-food retail business in the Channel Islands consists of a portfolio of high-quality UK brands covering food, non-food and specialist brand retail, operating under franchise or as an authorised reseller. Examples include Hotel Chocolat, Card Factory and iQ, the Apple Authorised Premium Reseller. Sandpiper owns the freehold at a number of retail locations. It has also been able to leverage its long relationships with major retailers to open their brands in Gibraltar and, more recently, in the Isle of Man.

Exhibit 1: FY20 turnover by country of destination (£000)



Source: Company data

A brief history

Sandpiper was formed in 2007 from the buyout of CI Traders, which itself was formed in 2002 but had roots in Channel Island retailing dating back to the 1800s. Following its formation in 2007, Sandpiper signed a number of new franchises such as Costa Coffee, Iceland and Hotel Chocolat and streamlined the business by selling non-core operations including a bottler, a hotel and a wholesale drinks operation. In February 2016, Sandpiper was bought by a consortium of Channel Islands-based investors together with the management team, and was subsequently listed on TISE in 2019.

A high-quality portfolio of brands

Sandpiper is the leading Channel Island retailer, with a high-quality portfolio of brands. The business is divided into three areas:

- **Channel Islands food retail:** the largest food retailer in the Channel Islands, operating franchises for Wm Morrison, Iceland, M&S Jersey and its own chain of smaller convenience stores, fuel forecourts and off-licences.
- **Channel Islands non-food retail:** a portfolio of high-quality brands covering food service, non-food and specialist brand retail. These are principally operated under franchise and include Hotel Chocolat, Costa Coffee, Burger King, Card Factory, Crew and Matalan. In addition, iQ operates as the Apple Authorised Premium Reseller.
- **Non-Channel Islands retail:** this leverages Sandpiper's existing long-standing relationships with franchisors to bring their brands to Gibraltar and more recently the Isle of Man.

Exhibit 2: Sandpiper business structure

Source: Company data

Channel Islands food retail

Channel Islands food retail consists of 47 mixed-format food retail operations, including convenience stores, fuel forecourts and off-licenses, in prime locations. The core long-term franchises are with Morrisons and Iceland, which cover both Jersey and Guernsey and Alderney, and with M&S, which is in Jersey only. The retail formats are clearly segmented, thus covering the full range of customers from value to premium, and the franchise brands also fit into this strategy, for example with Iceland at the value end of food retailing, Morrisons in the middle tier and M&S at the premium end. Checkers Express is Sandpiper's own brand of convenience stores, some of which have forecourts. Wine Warehouse is an alcohol retail sub-brand, and operates across a number of stores.

Channel Islands non-food retail and food service

Channel Islands non-food retail and food service consists of a portfolio of three clothing brands, operated under franchise in two stores each, hence six stores in total: M&S (clothing and general merchandise), Matalan and Crew. Sandpiper operated George stores under franchise until 2020, but Asda George made the decision to pull out of all franchises, hence these stores were franchised to Matalan instead.

In addition, five specialist retail brands operate in 15 stores under either exclusive franchise or as an authorised reseller, with nine of these dedicated to food service, as detailed below.

Exhibit 3: Number of non-food retail and food service stores by geography

Brand	Channel Islands	Gibraltar	Isle of Man
Costa Coffee	8	4	
Burger King	1		
Hotel Chocolat	2	1	
iQ, Apple Authorised Premium Reseller	2		1
Card Factory	2	1	1

Source: Company data

Geographical overview

We provide a summary overview of the territories in which Sandpiper operates in Exhibit 4.

Exhibit 4: Economic overview of key geographies

	Population (000)	GDP ($bn)	Key industries
Jersey	108	6.63	International financial services, legal services, construction, retail, agriculture, tourism, telecoms
Guernsey & Alderney	63	4.42	Financial services including insurance, tourism, manufacturing, horticulture
Gibraltar	34	2.04	Tourism, online gambling, financial services, bunkering
Isle of Man	86	7.43	Insurance, online gambling, information and communications technology, offshore banking

Source: Statistics Jersey, Guernsey Annual GVA, United Nations Statistics, IMF

Franchise retailing

A franchise is the right or licence granted by a company (the franchisor) to an individual or business (the franchisee) to market and/or trade products and services in a specific area or territory, for a defined time. The franchisee must usually comply with rules and guidelines regarding the business, to maintain brand consistency. Typically, an initial franchise fee is payable to the franchisor, together with regular royalties. The franchisor usually provides support with things such as staff training and marketing and branding assistance.

There are two main ways to run and operate a franchise business:

- A franchise fee, which is typically charged as a royalty on sales. There may be a separate flat fee as well, but the bulk of the amount payable to the franchisor is calculated as a percentage of sales. There may be some overriders or ratchets whereby the royalty diminishes if certain milestones are passed and there may be a marketing retainer included in the agreement.
- A ‘cost-plus’ model. Rather than a royalty on sales, the franchise fee is paid via the cost of goods sold. The franchisor will charge the franchisee for the products or services sold, and under this model the franchisor effectively recovers the franchise fee in this manner. It is a much more complex model, especially in the retail segment, where prices of goods are changing frequently and the mix of goods cannot be predicted with certainty. When products are promoted, typically both the franchisor and franchisee contribute to the promotional cost. Again, there can be overriders/ratchet mechanisms to encourage surpassing a certain level of sales.

The key consideration for a franchisor looking for a partner tends to be reliability: as discussed above, the franchisee must maintain brand consistency, but an unreliable franchisee can cause lasting damage to the brand well beyond its own territory.

Sandpiper operates a mixture of the models detailed above, depending on the franchisor. Products are sourced from franchisors, but pricing is mostly set by the franchisee.

Franchise retailing in British territories

Channel Islands

The Channel Islands present a unique proposition in terms of franchise retailing, with shoppers eager to access the same brands as the UK high street. Logistics and distribution costs are higher than in the UK as most goods are brought to the islands by boat and labour costs tend to be higher than average. There is, however, a VAT/tax differential compared to the UK. The VAT differential does not apply to all food items, as food staples are not subject to VAT in the UK. That said, average food prices are higher on the Channel Islands, as most goods and produce incur higher distribution costs. We illustrate a basic non-food example in Exhibit 5, and we note that while goods in Jersey are subject to a 5% Goods Sales Tax, Guernsey has no such tax.

Exhibit 5: Illustration of tax differentials on non-food items

	Mainland UK	Jersey	Guernsey/ Gibraltar	Isle of Man
Item cost ex tax (£)	100	100	100	100
VAT/GST (%)	20%	5%	0%	20%
VAT/GST (£)	20	5	0	20
Item cost incl tax (£)	120	105	100	120
Arbitrage headroom for logistics cost if prices kept in line with mainland UK (£)		15	20	0

Source: Edison Investment Research

Isle of Man

The Isle of Man does not present the same VAT/tax differential as the Channel Islands, and hence pricing reflects the increased cost of distribution. There is an incumbent operator in the food retail space, and hence Sandpiper sees more scope for expansion in the non-food retail segment.

Gibraltar

Gibraltar – like Guernsey – has no GST, and hence there is a tax differential versus the UK mainland. Distribution costs, however, are significantly higher given the distance from the UK. Pricing therefore reflects this and Sandpiper's business model is to leverage its long-standing relationships with its retail partners to bring their brands to a new market.

Property portfolio

Sandpiper's portfolio of stores consists of some locations that are leased, and some that are owned. Sandpiper owns a selection of freehold properties in prime locations. The property has been independently valued at £60m by Cushman & Wakefield and CBRE in January 2020, and forms a significant barrier to entry. Part of the company's strategy is to selectively add retail freeholds as high-quality locations become available.

In the Channel Islands, Sandpiper owns the freehold for eight Morrisons stores, one Iceland store, two Checkers Express stores and a Le Cocq store. In addition, among other property, it also owns the Liberty Wharf shopping centre in Jersey, Nelson House in Guernsey, its own headquarters and over 50 residential flats in Jersey and Guernsey associated with the food retail stores. The latter generate £0.7m of annual income.

Exhibit 6: Freehold portfolio

Jersey	Guernsey & Alderney
Food retail	
Morrisons x5	Morrisons x3
Checkers Express	Iceland
	Checkers Express
	Le Cocq
Other	
Traders House: Sandpiper HQ and 50k sq ft warehouse let to Bidvest on LT lease	Over 50 residential flats associated with the food retail stores
Liberty Wharf shopping centre	Nelson House (Admiral Park)
35 King Street, St Helier	

Source: Company data

The Liberty Wharf shopping centre was acquired by Sandpiper in 2018. It is a 58,000 sq ft covered shopping centre set in a historic building, which is next to the new International Finance Centre, and a three-minute walk from the main shopping artery in St Helier, King Street. Current tenants include Marks & Spencer Simply Food, Costa Coffee, Matalan, several independent local retailers, a bar and restaurant and a new 7600 sq ft gym. Sandpiper acquired and redeveloped the shopping centre, upgrading a neglected asset. Ownership of the freehold allows management to control the tenant mix: for example, the introduction of iQ, the Apple Authorised Premium Reseller to the anchor unit in autumn 2019 has driven an over 20% increment in footfall to the shopping centre.

Growth opportunities

As detailed above, Sandpiper has a mix of food and non-food franchise retail operations and operates a small number of its own convenience stores, fuel forecourts and off-licences. It operates across the Channel Islands, the Isle of Man and Gibraltar and has close and long-term relationships with its franchisors. Sandpiper management knows the markets in which it operates and can leverage its relationships with the franchisors to expand its presence. We illustrate the white spaces in Exhibit 7. We recognise that some white spaces are unlikely to be available, for example Marks & Spencer has a different long-term franchisee in Guernsey, is a loyal franchise partner and hence is unlikely to switch unless there are unforeseen problems with its current partner. Expansion into food retail on the Isle of Man is also unlikely as there is an incumbent and competent food retail operator. Additional brand franchises remain a possibility, although Sandpiper understandably carefully selects its partners. It shies away from high fashion brands as it looks to secure long term agreements, and not all brands are available for franchise.

In addition to filling in white spaces across its existing geographies, there is the potential to bring existing franchises to new territories, or to take these over if they become available. During 2020, Sandpiper opened its first stores in the Isle of Man and now operates both Card Factory and iQ in that territory. We would expect further geographical expansion to be opportunistic.

The other opportunity for meaningful expansion is to enter an adjacent category, such as the leisure and hospitality segment. In January 2020 Sandpiper announced its intention to acquire The Guernsey Pub Company, which operates its own brewery and a network of 20 pubs and hotels. The acquisition fell through due to the effects of COVID-19. Given the ongoing pandemic, the hospitality segment is not immediately attractive, but we believe the company remains interested in expanding into this space over the longer term.

Exhibit 7: Sandpiper presence by geography

	Jersey	Guernsey & Alderney	Isle of Man	Gibraltar
Franchises				
M&S Food	✓	✗	✗	✗
Iceland	✓	✓		✗
Morrisons	✓	✓		✗
M&S non-food	✓	✗	✗	✗
Crew clothing	✓	✓		✗
Costa Coffee	✓	✓	✗	✓
Matalan	✓	✓		✗
Burger King	✓	✓		✗
Hotel Chocolat	✓	✓		✓
Card Factory	✓	✓	✓	✓
iQ	✓	✓	✓	✗
Own stores				
Checkers Express	✓	✓		✗
Wine Warehouse	✓	✓		✗
Le Cocq's Stores	✗	✓	✗	✗

Source: Company data, Edison Investment Research. Note: Crosses denote areas where the franchise is operated by another franchisee or where the franchisor is not interested in expansion.

COVID-19

As all retail operators, Sandpiper had to adapt to the COVID-19 pandemic. Trading has been strong in the food segment and across all fascias since the start of the pandemic as consumers have more meals at home, while the non-food portfolio has felt the effect of partial closures and reduced town centre footfall as more people work from home. Trading EBITDA in H121 was ahead of the prior year by 7% on the back of a 6% increase in revenues, demonstrating the resilience of the business. (Adjusted trading EBITDA (more recently termed 'trading EBITDA') is defined by the company as EBITDA before any profit or loss on disposal of fixed assets, revaluation of investment property and non-recurring items such as costs associated with converting and rebranding stores.)

Management

Tony O'Neill, Executive Chairman

Tony was previously CEO of the company (since its buyout in August 2007) and moved to the position of Executive Chairman in November 2019. He spent 13 years at Marks & Spencer, rising to a senior executive position. He subsequently worked for Somerfield, where he held a number of board positions, latterly MD of Somerfield Stores. He then moved to private equity, working on several turnarounds.

Tony van der Hoorn, CFO

Tony was appointed CFO in 2019 following his return from New Zealand. He is a qualified chartered accountant and has experience in management consulting. He has held senior financial positions in UK retail such as Littlewoods, Iceland and Sainsbury's, where he served as director of corporate finance. He was also CFO for two of New Zealand's largest retail businesses, Foodstuffs and Farmlands.

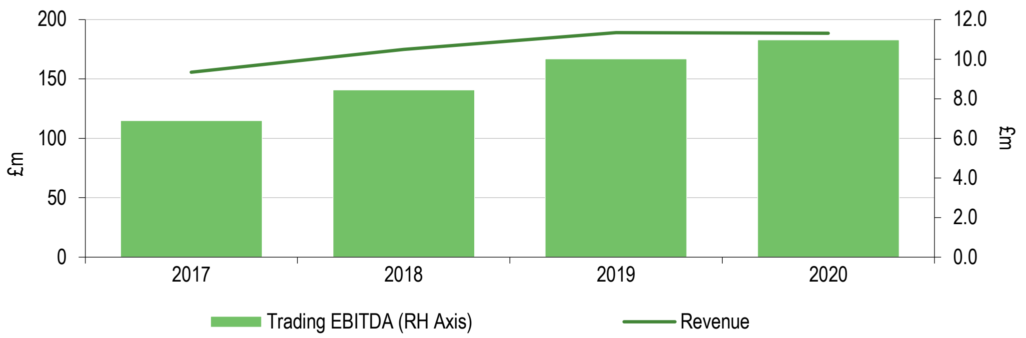
Mike Rutter, Retail MD

Mike was appointed retail managing director for the Channel Islands and Isle of Man in November 2019, having previously held a number of senior executive roles within SandpiperCI over the preceding 12 years, including MD of Marks & Spencer Jersey and MD of the Food Retail division. He previously spent six years at Somerfield holding the positions of supply chain director and business transformation director.

Financials: Strong category growth

We illustrate below Sandpiper's track record in terms of revenue and EBITDA progression. As a reminder, Sandpiper's freehold property portfolio provides a stream of third-party rental income (which was £2.7m in FY20), but also gives long-term security for many of Sandpiper's retail outlets and is a barrier to entry for the competition.

Exhibit 8: Historical revenue and trading EBITDA (£m)

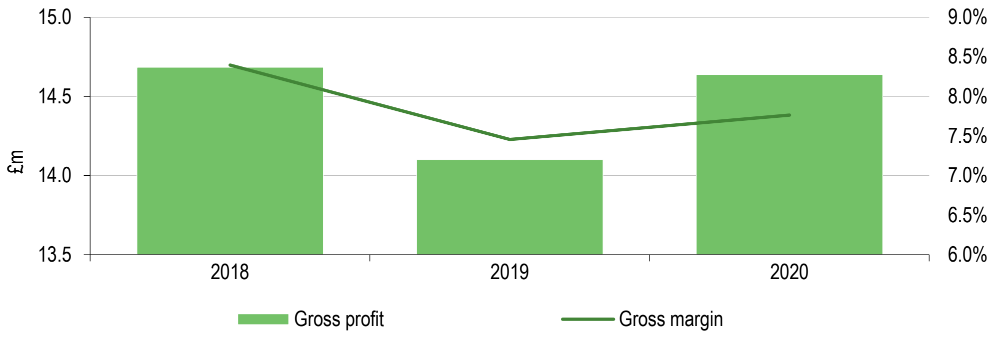


Source: Company data

Sandpiper posted sales CAGR of 6.6% between 2017 and 2020, with adjusted EBITDA CAGR of 16.7% during the same period. During this time, the company expanded geographically into the Isle of Man and worked to fill in some of the 'white spaces' across its portfolio. The 58,000 sq ft Liberty Wharf shopping centre was acquired in a prime location in Jersey and was refurbished. In addition, Nelson House was acquired in Guernsey in March 2019.

In Exhibit 9 we show the gross profit and gross margin progression between 2018 and 2020.

Exhibit 9: Historical gross profit and gross margin



Source: Company data

Forecasts

We detail our key forecast assumptions below:

- In revenue terms, we expect the pace of expansion to slow down and forecast sales CAGR of 3.6% between 2020 and 2023e.
- We expect revenue growth in the medium term of 3.5%, via a combination of price increases broadly in line with RPI and modest ongoing space growth. This compares to 6.6% sales CAGR 2017–2020, although we note there was significant growth in space during the period, with the acquisition of the Liberty Wharf shopping centre. We note consensus forecasts for UK RPI are c 3%, and hence our forecasts assume modest space growth of 0.5% per year.
- From a profitability perspective, we expect gross margins to remain broadly flat as these are generally agreed on with the franchisor as discussed above so are largely outside Sandpiper's control. Sandpiper is a low-cost operator and has optimised its costs, but we believe opportunities for gross margin expansion are limited.
- We forecast adjusted EBITDA CAGR of 3.2% between 2020 and 2023e.

Turning to cash flow, we highlight the following:

- The business runs with negative working capital, as is typical of many retailers, hence an expanding revenue line should lead to a working capital cash inflow, if all else is equal.
- There have been several store refits and refurbishments over the last two years, so management is expecting capital expenditure to fall sharply over the short and medium term. We take a conservative approach and forecast capex at 3% of sales. This compares to 4.5% during FY20 and 1.8% during FY19. Our forecast includes the cost of opening new space We note capex across the UK food retail space tends to run at 3-4% of sales.
- Depreciation is expected to experience an uptick in FY21 as a result of the above-mentioned refurbishments.
- We forecast net debt of £18.9m at end FY21 (vs £19.0m in H121 and £19.1m in FY20), which places the net debt/EBITDA ratio at a comfortable 1.7x. We forecast balance sheet gearing of 30%, EBIT interest cover of 8.1x and EBTIDA interest cover of 14.7x.

Sensitivities

Sandpiper's key sensitivities are:

- GDP and population growth, which are good indicators of discretionary consumer spend.
- Input cost inflation related to the goods it purchases.

- FX, in particular GBP/EUR due to a lot of fresh produce being sourced from the eurozone, but also GBP/USD as some raw material costs in non-food are ultimately dollar denominated. There is no direct translation FX exposure as Sandpiper has exited the (small) Spanish business and all other geographies are GBP denominated.
- Sandpiper acts as the franchisee for some well-known retailers. While measures are in place to protect the franchisor such that the brand messaging is maintained, there is the risk that the brand, its appeal and credibility are affected by factors outside Sandpiper's control, thus rendering the franchise less desirable. There is also the risk that the franchisor may cease trading, or that Sandpiper itself may experience a performance shortfall that breaches the contractual requirements of the franchise agreement.
- Franchise agreements typically last five to 10 years, although often they are renewed. There is the risk that a franchisor decides not to renew the franchise agreement and that Sandpiper cannot then find other parties to take up the space coming available. There are no franchises that are up for review over the next two years, with the first franchise expiry due in 2025. We note that Sandpiper (and its predecessor entities) has not lost any franchises since 2007, with the recent loss of the George franchise being the first one; we understand this was caused by a change in the franchisor's company strategy (it chose to exit franchising) rather than any shortfall in performance by Sandpiper.
- Any change in tax legislation, particularly in the Channel Islands, would affect the company's profitability given the current differential in VAT between the Channel Islands and the rest of the UK.
- Stock liquidity is currently low. While the free float is 100%, 98% of the shares are currently held by Huntress Nominees (which is administered by Ravenscroft), and this represents over 200 nominees, mostly Channel Islands investors.

Valuation

Our primary valuation methodology is DCF, as it effectively captures the potential growth of the business and it can be flexed to illustrate the sensitivity to our assumptions. We outline our key assumptions:

- Revenue growth of 3.5% per year in years three to 10. We note there may be further scope for geographic expansion and a potential move into adjacent segments such as hospitality, but our forecasts do not take these into account as they would most likely require an acquisition.
- We assume EBIT margins remain flat in the medium term: Sandpiper is a low-cost operator and has optimised its costs, but agreements with the franchisors effectively limit the opportunity for meaningful margin expansion.
- An ongoing capex requirement of 3% of revenues. This is at the lower end of the UK retail segment and is again in light of Sandpiper management's focus on cost.
- Capex/depreciation of c 1.1x. Capex/depreciation has been lumpy over the past three years, ranging from 0.7x in FY19 to 1.7x in FY20 as Sandpiper refitted stores and refurbished the Liberty Wharf centre.
- A steady working capital inflow over time as the business grows. Working capital is negative, as is the case for most retail businesses, and hence a growing business will generate more cash.
- Ongoing effective cash tax rate of 25%.
- Terminal growth of 1.5%, in line with our assumptions for the consumer space.
- Our WACC of 8.1% is predicated on a risk-free rate of 2%, an equity risk premium of 5% and a beta of 1.3.
- Net debt of £18.9m at end FY21.

Our DCF valuation with the assumptions detailed above leads to a fair value of 130p. We illustrate how our DCF valuation is sensitive to flexing the cost of capital and terminal growth rate in Exhibit 10, and the terminal growth rate and the terminal EBIT margin in Exhibit 11. Our DCF valuation does not add a standalone value for the property portfolio.

Exhibit 10: DCF sensitivity to WACC and terminal growth rate (p/share)

		Terminal growth				
		0.5%	1.0%	1.5%	2.0%	2.5%
WACC	9.0%	106	110	114	119	125
	8.5%	113	118	123	129	136
	8.0%	122	127	133	140	149
	7.5%	131	138	145	154	164
	7.0%	142	150	159	170	183
	6.5%	155	164	176	190	207
	6.0%	170	182	196	214	237
	5.5%	188	203	222	246	278

Source: Edison Investment Research

Exhibit 11: DCF sensitivity to terminal growth rate and EBIT margin (p/share)

		EBIT margin				
		4.0%	4.5%	5.0%	5.5%	6.0%
Terminal growth	0.0%	102	109	115	122	128
	0.5%	106	113	120	127	134
	1.0%	110	117	125	132	140
	1.5%	114	122	130	139	147
	2.0%	120	128	137	146	155
	2.5%	126	136	145	155	165
	3.0%	134	144	155	166	176

Source: Edison Investment Research

Peer group analysis

Peer group analysis is not straightforward as there are few direct peers. Domino's Pizza and DP Eurasia are also franchisors but in an adjacent category. We include the listed franchisors as peers, although we recognise their business models are slightly different and they benefit from greater scale. McColl's is a convenience store and newsagent operator and Applegreen is a petrol forecourt operator. We illustrate Sandpiper's metrics versus the peer group in Exhibit 12 below.

Exhibit 12: Peer group valuation

		P/E (x)		EV/EBITDA (x)		Dividend yield (%)	
	Market cap (m)	2020e	2021e	2020e	2021e	2020e	2021e
Sainsbury	£5,355.1	15.6	13.2	5.2	5.0	5.3	4.7
Tesco	£23,755.4	18.0	14.3	9.2	8.7	3.4	3.7
Wm Morrison	£4,482.2	17.4	13.7	7.3	6.8	4.6	5.0
Marks & Spencer	£2,608.0	25.7	15.8	6.9	6.4	1.0	2.8
Hotel Chocolat	£465.5	849.9	760.3	42.8	27.6	0.1	0.1
Card Factory	£137.3	26.6	6.7	7.5	7.2	1.2	8.1
McColl's	£30.5	6.0	5.1	7.6	7.4	0.0	0.0
Applegreen	€ 690.7	40.8	17.2	18.2	12.2	0.1	0.3
Domino's Pizza	£1,572.2	20.1	19.0	17.4	16.7	2.8	3.1
DP Eurasia	£64.7	-10.5	-123.4	11.8	8.1	0.0	0.0
Peer group average		**21.3**	**13.1**	**9.9**	**8.8**	**2.3**	**3.5**
Sandpiper	£80.0	18.8	19.4	8.8	8.5	3.7	3.9
Premium/(discount) to peer group		**(11.6%)**	**48.3%**	**(11.1%)**	**(3.2%)**	**59.6%**	**11.4%**

Source: Refinitiv, Edison Investment Research, company data. Note: Priced at 14 January 2021. Average excludes Hotel Chocolat and DP Eurasia. All metrics calendarised to aid comparison.

We exclude Hotel Chocolat and DP Eurasia from our peer group average as their metrics are out of kilter with the rest of the group. Sandpiper trades at a premium to its peers for CY21 on P/E but at a discount on EV/EBITDA. This is justified by its strong property portfolio and an attractive dividend yield, in our view. The current equity market valuation is £80m, or EV of £99m. With a property portfolio valued at £60m, this implies the franchise operations are valued at just £39m. Of course, for full comparison, an operating company stripped of the property would have to bear rental costs instead of depreciation. The dividend is well covered by free cash flow and Channel Island investors further benefit from a 20% tax credit on any dividends paid after December 2020.

Exhibit 13: Financial summary

£'000s	2018	2019	2020	2021e	2022e	2023e
Year end 31 January	FRS 102	FRS 102	FRS 102	FRS 102	FRS 102	FRS 102
INCOME STATEMENT						
Revenue	174,884.0	189,056.0	188,475.0	195,189.0	202,151.5	209,372.7
Cost of Sales	(160,200.0)	(174,956.0)	(173,836.0)	(180,028.5)	(186,450.2)	(193,110.6)
Gross Profit	14,684.0	14,100.0	14,639.0	15,160.5	15,701.3	16,262.1
EBITDA	8,444.0	10,013.0	10,973.0	11,256.7	11,658.2	12,074.7
Normalised operating profit	3,838.0	5,003.0	5,834.0	6,171.2	5,875.8	5,889.9
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	(1,395.0)	4,309.0	(2,390.0)	(1,700.0)	0.0	0.0
Share-based payments	0.0	0.0	0.0	0.0	0.0	0.0
Reported operating profit	2,443.0	9,312.0	3,444.0	4,471.2	5,875.8	5,889.9
Net Interest	(1,306.0)	(1,207.0)	(1,058.0)	(764.5)	(755.5)	(734.0)
Joint ventures & associates (post tax)	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	(257.0)	0.0	0.0	0.0
Profit Before Tax (norm)	2,532.0	3,796.0	4,519.0	5,406.7	5,120.2	5,155.9
Profit Before Tax (reported)	1,137.0	8,105.0	2,129.0	3,706.7	5,120.2	5,155.9
Reported tax	(1,248.0)	(1,348.0)	(1,281.0)	(1,037.9)	(1,382.5)	(1,392.1)
Profit After Tax (norm)	(247.2)	3,036.8	3,563.8	4,325.3	4,096.2	4,124.7
Profit After Tax (reported)	(111.0)	6,757.0	848.0	2,668.8	3,737.8	3,763.8
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)	(247.2)	3,036.8	3,563.8	4,325.3	4,096.2	4,124.7
Net income (reported)	(111.0)	6,757.0	848.0	2,668.8	3,737.8	3,763.8
Basic average number of shares outstanding (m)	100	100	100	100	100	100
EPS - basic normalised (p)	(0.25)	3.04	3.56	4.33	4.10	4.12
EPS - diluted normalised (p)	(0.25)	3.04	3.56	4.33	4.10	4.12
EPS - basic reported (p)	(0.11)	6.76	0.85	2.67	3.74	3.76
Dividend (p)	0.50	1.00	2.30	3.00	3.10	3.20
Revenue growth (%)	12.4	8.1	(-0.3)	3.6	3.6	3.6
Gross Margin (%)	8.4	7.5	7.8	7.8	7.8	7.8
EBITDA Margin (%)	4.8	5.3	5.8	5.8	5.8	5.8
Normalised Operating Margin	2.2	2.6	3.1	3.2	2.9	2.8
BALANCE SHEET						
Fixed Assets	76,015.0	92,809.0	95,748.0	95,542.2	95,824.3	95,920.7
Intangible Assets	27,268.0	26,169.0	24,454.0	22,854.0	21,254.0	19,654.0
Tangible Assets	48,745.0	66,471.0	71,292.0	72,686.2	74,568.3	76,264.7
Investments & other	2.0	169.0	2.0	2.0	2.0	2.0
Current Assets	26,070.0	23,295.0	26,014.0	26,656.9	27,789.4	29,056.0
Stocks	10,203.0	10,447.0	10,505.0	10,801.7	11,187.0	11,586.6
Debtors	4,089.0	5,229.0	5,714.0	5,855.7	6,064.5	6,281.2
Cash & cash equivalents	11,778.0	7,619.0	9,795.0	9,999.5	10,537.8	11,188.2
Other	0.0	0.0	0.0	0.0	0.0	0.0
Current Liabilities	(49,207.0)	(31,127.0)	(33,566.0)	(33,854.3)	(34,631.1)	(35,430.4)
Creditors	(27,856.0)	(29,215.0)	(26,716.0)	(27,004.3)	(27,781.1)	(28,580.4)
Tax and social security	0.0	0.0	0.0	0.0	0.0	0.0
Short term borrowings	(21,351.0)	(1,912.0)	(6,850.0)	(6,850.0)	(6,850.0)	(6,850.0)
Other	0.0	0.0	0.0	0.0	0.0	0.0
Long Term Liabilities	(2,722.0)	(25,047.0)	(24,556.0)	(25,036.0)	(25,036.0)	(25,036.0)
Long term borrowings	(101.0)	(23,367.0)	(22,038.0)	(22,038.0)	(22,038.0)	(22,038.0)
Other long term liabilities	(2,621.0)	(1,680.0)	(2,518.0)	(2,998.0)	(2,998.0)	(2,998.0)
Net Assets	50,156.0	59,930.0	63,640.0	63,308.8	63,946.6	64,510.4
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' equity	50,156.0	59,930.0	63,640.0	63,308.8	63,946.6	64,510.4
CASH FLOW						
Op Cash Flow before WC and tax	8,444.0	10,013.0	10,973.0	11,256.7	11,658.2	12,074.7
Working capital	2,195.0	(1,306.0)	(3,329.0)	(150.1)	182.6	183.0
Exceptional & other	(2,475.0)	(3,849.0)	(3,052.0)	(1,964.5)	(755.5)	(734.0)
Tax	(6.0)	(30.0)	(1,700.0)	(1,037.9)	(1,382.5)	(1,392.1)
Net operating cash flow	8,158.0	4,828.0	2,892.0	8,104.2	9,702.9	10,131.6
Capex	(3,877.0)	(3,458.0)	(8,548.0)	(4,879.7)	(6,064.5)	(6,281.2)
Acquisitions/disposals	(4,212.0)	(10,272.0)	0.0	0.0	0.0	0.0
Net interest	0.0	0.0	0.0	0.0	0.0	0.0
Equity financing	0.0	0.0	2,419.0	0.0	0.0	0.0
Dividends	0.0	0.0	(2,254.0)	(3,000.0)	(3,100.0)	(3,200.0)
Other	4,750.0	4,751.0	7,681.0	0.0	0.0	0.0
Net Cash Flow	4,819.0	(4,151.0)	2,190.0	224.5	538.3	650.4
Opening net debt/(cash)	(7,229.0)	9,694.0	17,680.0	19,113.0	18,888.5	18,350.2
FX	(290.0)	(8.0)	(14.0)	0.0	0.0	0.0
Other non-cash movements	(21,452.0)	(3,827.0)	(3,609.0)	0.0	0.0	0.0
Closing net debt/(cash)	9,694.0	17,680.0	19,113.0	18,888.5	18,350.2	17,699.8

Source: Edison Investment Research, company data

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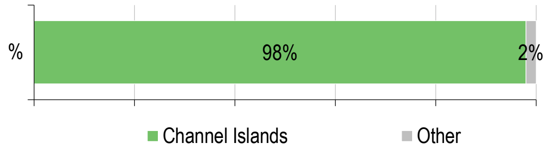
Revenue by geography



Management team

Executive chairman: Tony O'Neill

Tony was previously CEO of the company (since its buyout in August 2007), and moved to the position of executive chairman in November 2019. He spent 13 years at Marks & Spencer, rising to a senior executive position. He subsequently worked for Somerfield, where he held a number of board positions, latterly managing director of Somerfield Stores. He then moved to private equity, working on several turnarounds.

CFO: Tony van der Hoorn

Tony was appointed CFO in 2019 following his return from New Zealand. He is a qualified chartered accountant and has experience in management consulting. He has held senior financial positions in UK retail such as Littlewoods, Iceland and Sainsbury's, where he served as director of corporate finance. He was also CFO for two of New Zealand's largest retail businesses, Foodstuffs and Farmlands.

Retail MD: Mike Rutter

Mike was appointed retail managing director for the Channel Islands and Isle of Man in November 2019, having previously held a number of senior executive roles within SandpiperCI over the preceding 12 years, including MD of Marks & Spencer - Jersey and MD of the Food Retail division. He previously spent six years at Somerfield holding the positions of supply chain director, and business transformation director.

Principal shareholders	(%)
Huntress Nominees	98.2
SBS Nominees	0.9
Pershing Nominees	0.7
The Bank of New York Nominees	0.1

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