August 31, 2010

ACTION

Buy

Ocado Group PLC (OCDO.L)

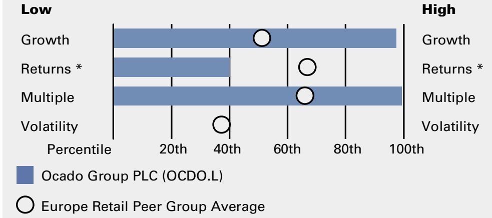
Return Potential: 39%

Delivering groceries and growth. Initiating as Buy

Source of opportunity

We initiate on Ocado with a Buy rating and a 6-month price target of 200p, implying 39% potential upside. In our view, Ocado's differentiated business model (proprietary centralised, semi-automated distribution and delivery network) results in a superior customer offering relative to other online grocers in the UK (e.g. more flexible delivery slots, higher order accuracy), hence, the company is well placed to benefit from the structural shift towards online grocery. We expect the UK online grocery market to more than double over the next five years, from c.£3 bn in 2009 to over £7 bn in 2014 and Ocado's sales to grow at a 26% CAGR over the same period.

Investment Profile



* Returns = Return on Capital. For a complete description of the investment profile measures please refer to the disclosure section of this document.

Catalyst

The company will release its 3Q2010 (June-August) trading statement on September 7. We expect this to be solid and provide evidence of continued sales momentum over the period. In 1H2010, Ocado reported gross revenue growth of 30% to £246 mn. 1H EBITDA was £8 mn, implying a margin of 3.5% on net sales (FY2009: 2.3%) and reflecting the operational leverage in the business. Any updates on the company's capacity expansion plans would also, we believe, help the market understand the progress at which Ocado is investing for future growth.

Valuation

Our 6-month DCF-based price target is 200p. We believe Ocado's closest listed peers are the internet retailers (e.g. Amazon, ASOS and YOOX), and the UK grocery retailers. Although Ocado competes with Tesco, Sainsbury's et al, we view its growth rate and business model as being closer to that of its internet peers. Our price target implies a CY2011E EV/sales ratio of 1.6x, a c.25% discount to ASOS and Yoox at our price targets.

Key risks

Loss of key supplier relationships; increasing competition from established and new online grocers; operational/execution risk (for expansion plans).

INVESTMENT LIST MEMBERSHIP

Pan-Europe Buy List

Coverage View: Neutral

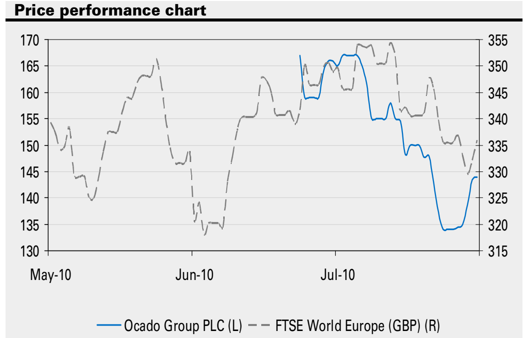
United Kingdom

Retail

Key data	Current
Price (p)	144
6 month price target (p)	200
Upside/(downside) (%)	39
Market cap (£ mn)	749.8
Enterprise value (£ mn)	585.3

	11/09	11/10E	11/11E	11/12E
Revenue (£ mn)	402.0	522.6	679.4	849.3
EBIT (£ mn)	(13.4)	2.4	23.3	41.0
EPS (p)	(5.83)	(1.61)	3.25	6.96
EV/EBITDA (X)	NM	24.3	17.4	11.3
P/E (X)	NM	NM	44.3	20.7
Dividend yield (%)	NM	0.0	0.0	0.0
FCF yield (%)	NM	(6.9)	(15.3)	(0.9)
CROCI (%)	3.7	9.6	13.8	16.2
CROCI/WACC (X)	--	--	--	--
EV/GCI (X)	NM	2.4	2.0	1.7

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	--	--	--
Rel. to FTSE World Europe (GBP)	--	--	--

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 8/27/2010 close.

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Ocado Group PLC: Summary Financials

Profit model (£ mn)	11/09	11/10E	11/11E	11/12E
Total revenue	402.0	522.6	679.4	849.3
Operating costs	(392.8)	(498.6)	(633.1)	(777.9)
R&D	0.0	0.0	0.0	0.0
Lease payments	0.0	0.0	0.0	0.0
Other operating profit/(expense)	0.0	0.0	0.0	0.0
EBITDA	**9.2**	**24.1**	**46.3**	**71.4**
Depreciation & amortisation	(22.6)	(21.7)	(23.0)	(30.4)
EBIT	**(13.4)**	**2.4**	**23.3**	**41.0**
Net interest income/(expense)	(11.1)	(9.5)	(6.3)	(4.8)
Associates	0.0	0.0	0.0	0.0
Profit/(loss) on disposals	0.0	0.0	0.0	0.0
Others (recurring)	(1.1)	0.0	0.0	0.0
Pretax profits	**(25.6)**	**(7.1)**	**16.9**	**36.3**
Income tax	2.3	0.0	0.0	0.0
Tax rate (%)	9.0	0.0	0.0	0.0
Minorities	0.0	0.0	0.0	0.0
Preferred dividends	0.0	0.0	0.0	0.0
Net income (pre-exceptionals)	**(23.3)**	**(7.1)**	**16.9**	**36.3**
Other non-recurring items post tax	0.0	0.0	0.0	0.0
Net income	**(23.3)**	**(7.1)**	**16.9**	**36.3**
EPS (underlying) (p)	**(6.08)**	**(1.61)**	**3.25**	**6.96**
EPS (basic, reported) (p)	(6.08)	(1.61)	3.25	6.96
Weighted shares outstanding (mn)	383.4	445.1	520.7	520.7
Common dividends declared	0.0	0.0	0.0	0.0
DPS (p)	0.00	0.00	0.00	0.00
Dividend payout ratio (%)	0.0	0.0	0.0	0.0
Dividend cover (X)	NM	NM	NM	NM

Growth & margins (%)	11/09	11/10E	11/11E	11/12E
Revenue growth	25.1	30.0	30.0	25.0
EBITDA growth	315.5	162.5	92.4	54.2
EBIT growth	37.5	117.8	871.9	76.2
Net income growth	30.0	69.3	337.0	114.1
EPS growth	37.8	73.6	302.6	114.1
DPS growth	--	--	--	--
EBITDA margin	2.3	4.6	6.8	8.4
EBIT margin	(3.3)	0.5	3.4	4.8

Cash flow statement (£ mn)	11/09	11/10E	11/11E	11/12E
Net income	(23.3)	(7.1)	16.9	36.3
D&A add-back (incl. ESO)	22.6	21.7	23.0	30.4
Minority interest add-back	0.0	0.0	0.0	0.0
Net (inc)/dec working capital	5.1	5.7	7.4	8.1
Other operating cash flow	(0.3)	0.0	0.0	0.0
Cash flow from operations	**4.1**	**20.2**	**47.4**	**74.7**
Capital expenditures	(19.6)	(57.6)	(158.0)	(78.4)
Acquisitions	0.0	0.0	0.0	0.0
Divestitures	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
Cash flow from investing	**(19.6)**	**(57.6)**	**(158.0)**	**(78.4)**
Dividends paid (common & pref)	0.0	0.0	0.0	0.0
Inc/(dec) in debt	(1.5)	(31.8)	(28.4)	0.0
Other financing cash flows	24.2	200.0	0.0	0.0
Cash flow from financing	**22.7**	**168.2**	**(28.4)**	**0.0**
Total cash flow	**7.2**	**130.9**	**(139.0)**	**(3.7)**
Capex/D&A (%)	86.7	265.6	686.1	257.9
Reinvestment rate (%)	NM	396.3	395.3	117.6
Cash flow cover of dividends (X)	NM	NM	NM	NM
Free cash flow cover of dividends (X)	NM	NM	NM	NM

Balance sheet (£ mn)	11/09	11/10E	11/11E	11/12E
Cash & equivalents	13.0	143.9	4.9	1.2
Accounts receivable	5.7	7.4	9.6	12.1
Inventory	9.2	12.0	15.5	19.3
Other current assets	0.0	0.0	0.0	0.0
Total current assets	**27.9**	**163.3**	**30.1**	**32.6**
Net PP&E	96.9	132.8	267.8	315.8
Net intangibles	0.0	0.0	0.0	0.0
Total investments	11.7	11.7	11.7	11.7
Other long-term assets	0.0	0.0	0.0	0.0
Total assets	**136.6**	**307.9**	**309.6**	**360.1**
Accounts payable	33.8	44.0	57.2	71.5
Short-term debt	31.8	0.0	0.0	0.0
Other current liabilities	11.7	11.7	11.7	11.7
Total current liabilities	**77.3**	**55.7**	**68.9**	**83.2**
Long-term debt	88.3	88.3	59.9	59.9
Other long-term liabilities	3.1	3.1	3.1	3.1
Total long-term liabilities	**91.4**	**91.4**	**63.0**	**63.0**
Total liabilities	**168.8**	**147.1**	**131.9**	**146.2**
Preferred shares	**0.0**	**0.0**	**0.0**	**0.0**
Total common equity	**(32.2)**	**160.7**	**177.6**	**213.9**
Minority interest	**0.0**	**0.0**	**0.0**	**0.0**
Total liabilities & equity	**136.6**	**307.9**	**309.6**	**360.1**
Capitalised leases	0.0	0.0	0.0	0.0
Capital employed	**87.9**	**249.0**	**237.5**	**273.8**
Adj for unfunded pensions & GW	0.0	0.0	0.0	0.0
Adj capital employed	**87.9**	**249.0**	**237.5**	**273.8**
Gross cash invested	**194.1**	**246.0**	**396.5**	**466.8**

Ratios	11/09	11/10E	11/11E	11/12E
CROCI (%)	3.7	9.6	13.8	16.2
CROCI/WACC (X)	--	--	--	--
ROIC (%)	(14.4)	1.1	7.0	11.8
ROIC/WACC (X)	--	--	--	--
ROA (%)	(17.8)	(3.2)	5.5	10.8
WACC (%)	--	--	--	--
Inventory days	8.4	8.4	8.3	8.3
Asset turnover (X)	4.1	3.9	2.5	2.7
Net debt/equity (%)	(333.0)	(34.6)	30.9	27.4
EBITDA interest cover (X)	0.8	2.5	7.3	15.0

Valuation	11/09	11/10E	11/11E	11/12E
EV/sales (X)	NM	1.1	1.2	1.0
EV/EBITDAR (X)	NM	24.3	17.4	11.3
EV/EBITDA (X)	NM	24.3	17.4	11.3
EV/EBIT (X)	NM	244.3	34.6	19.7
P/E (X)	NM	NM	44.3	20.7
Dividend yield (%)	NM	0.0	0.0	0.0
FCF yield (%)	NM	(6.9)	(15.3)	(0.9)
EV/GCI (X)	NM	2.4	2.0	1.7
EV/adj. capital employed (X)	NM	5.6	3.5	3.0
Price/book (X)	NM	4.7	4.2	3.5

Note: Ratios are adjusted for leases where appropriate. Only separately disclosed where significant and ongoing.

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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All prices in the body of this note are based on the close of August 27, 2010.

Investment view: Setting the standard for online grocery

We initiate coverage on Ocado with a Buy rating and 6-month price target of 200p. Ocado is the largest pure internet grocer in the world. It is growing rapidly, with a scalable business model based on proprietary technology, which we believe can ultimately deliver superior returns to store-based peers. Near term, the company continues to invest in expansion. However, having moved into profit, we believe future growth will drive rapidly improving returns over the next five years.

Unlike many other items offered for sale over the internet, groceries are not a discretionary purchase. Hence, Ocado is not trying to persuade customers to make incremental purchases, but instead is competing for a share of grocery spend. This leads to lower marketing spend than that of other internet retailers, and significant repeat business.

Ocado: Offering a unique proposition

Ocado has developed an online grocery proposition, which, in the terminology of our US internet research team's "dotCommerce report" (*dotCommerce: Online shifts apparel's center of gravity*", published May 24, 2010) is a disruptive offering. While the main bricks and mortar grocers have significant online operations, we view these as essentially defensive, having an inherently higher cost structure.

For Ocado, unique and proprietary warehouse and routing software provide a strong competitive advantage which, we believe, will become more apparent with scale. Ultimately, we believe Ocado could enjoy higher margins than existing grocery retailers, reflecting its absence of store costs and regional distribution centres.

A partnership with Waitrose, recently extended until at least March 2017, provides Ocado with quality products which appeal to its core A and B social groups. Economies of scale between the two bring gains to both parties, and we believe that the offerings are seen by many consumers as complementary rather than competitive.

We believe that the management team is stable and entrepreneurial. The average tenure of the 11 senior management team members is eight years, and seven of the 11 have been at the company since its trading launch in 2002.

We believe online grocery is a growing market

Euromonitor estimates that UK internet retailing was worth £19.6 bn in 2009, up 15.7% on the prior year. This compared to 1.6% growth for the total UK retailing market. Euromonitor expects UK internet retailing to grow to £37.4 bn by 2014, a CAGR of 13.8%, compared to a CAGR of 2.1% for total UK retailing. These forecasts are in real terms, and therefore growth for both could be 2%-3% higher, reflecting inflation.

Tesco estimates online grocery was a £3 bn market in the UK in 2009. This represented only 2% of total spend on groceries, though on Euromonitor data, grocery is still the largest online product category. Nonetheless, at 2% the penetration rate is much lower than for many other goods. Hence, while Euromonitor forecasts that online grocery shopping will grow at the c.15% it expects for general online retailing in the medium term, there is scope for this figure to be greater in our view.

Our 6-month price target of 200p implies 39% potential upside

Our DCF-based 6-month price target is 200p. We believe Ocado's closest listed peers are the internet retailers (e.g. Amazon, ASOS and YOOX), and the UK grocery retailers (e.g. Tesco). Although Ocado competes with Tesco, Sainsbury's et al, we view its growth rate and business model as being closer to that of its internet peers.

Our price target implies a CY2011E EV/sales ratio of 1.6x, representing approximately a 25% discount to online retail peers Yoox and ASOS, at our target prices for these stocks. Our 26% forecast sales CAGR (FY2009-14E) for Ocado compares to our high 20%-30% forecasts for Amazon, YOOX and ASOS over the next five years. In contrast, our Retail research team forecasts UK sales growth for Tesco and Sainsbury's of 5%-5.5% pa on average over the same period.

Financials: A high-growth company

Ocado reported positive EBITDA in FY2008 and we believe will achieve a positive EBIT in FY2010E. As such, we believe the business is at a tipping point, where continued growth should bring rapidly increasing returns. We forecast a sales CAGR of 26% over the next five years, which should drive an EBITDA CAGR of 67%, reaching an EBITDA margin of 9.4% in FY2014 (from 2.3% in 2009).

Our profit forecasts are very sensitive to sales growth (sensitivities to different growth parameters are shown in Exhibits 41 and 46). On our base case estimates, Ocado would account for just 0.7% of UK grocery spend in FY2014E (versus 0.3% in 2009) and active customers would represent 2.1% of UK households in FY2014E (versus 0.85% in 2009).

We expect near-term capex to remain significant as the company automates more slow moving items, enabling it to expand its product range into a long tail, and starts development of the second Customer Fulfillment Centre (CFC2). As the Ocado brand is now well established and synonymous with online groceries for many consumers, marketing spend is focused on targeted customer initiatives. We believe this, and the consumers' need for groceries, means Ocado enjoys lower customer acquisition costs than many other internet retailers.

Risks to our view and price target

A key risk to our price target and investment view for Ocado is the potential for increased competition from existing grocery chains, via the increased effectiveness and attractiveness of their online offerings. This could lead to a slower rate of growth and thus lower profitability than we forecast. Any change in consumer preferences that were to discourage buying groceries online would also lead to a smaller market. We believe that there is execution risk associated with the build up and expansion of Ocado's customer fulfillment centre (CFC).

Potential loss of suppliers is also a key risk. Ocado sources the majority (c.80% by value) of its products directly or indirectly through its sourcing and branding arrangement with Waitrose. While increasingly many products are sourced directly from major consumer product companies and other suppliers, part of its "quality food" image (a strong part of the Ocado brand) comes from its association with Waitrose. Any termination of the arrangement with Waitrose would therefore have a negative impact on brand image with some customers.

The companies have agreed a new ten-year contract, which runs until at least March 2017. In terms of prospects for future renewals, we believe that Waitrose also benefits from increased economies of scale in purchasing (while we estimate Ocado's sales are only 10% of Waitrose's own total, Ocado's high growth drives bonus payments from suppliers).

Online retailing continues to gain market share

The UK has one of the largest online retail markets in Western Europe. This reflects a number of factors including: relatively high broadband penetration, early start-up of many sites, payment infrastructure and widespread use of credit cards. In our view, online grocery retailing is gaining increased acceptance among shoppers in the UK, as demonstrated by the very strong growth reported by Ocado and its competitors. In addition, mobile devices are becoming an increasingly important commerce channel in their own right, and a complementary channel to the internet.

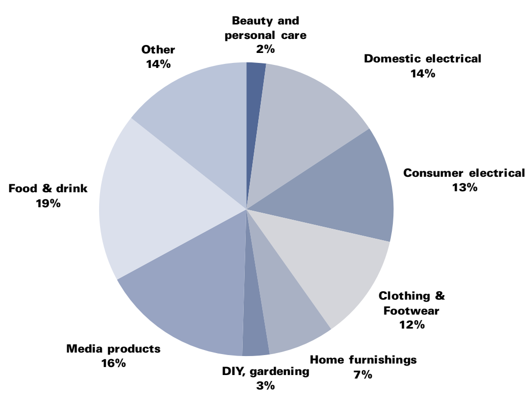
In our view, factors encouraging people to shop online and driving migration away from offline retail include: time saving, avoiding queues, the ease of finding and comparing products and prices, and the possibility of arranging flexible delivery times and payment methods. Based on Tesco data, around 60% of the UK's adult population has shopped online, in line with broadband penetration rates.

Online spending is increasing, particularly for groceries

Increasing internet use (resulting from rising broadband penetration, more online offerings and new secure online payment methods) is driving rapid growth in online retailing. According to Euromonitor, online retailing in the UK grew at a compound annual rate of 23% through 2004-2009. According to ONS data, online retailing accounted for 6.5% of total retail sales in 2009.

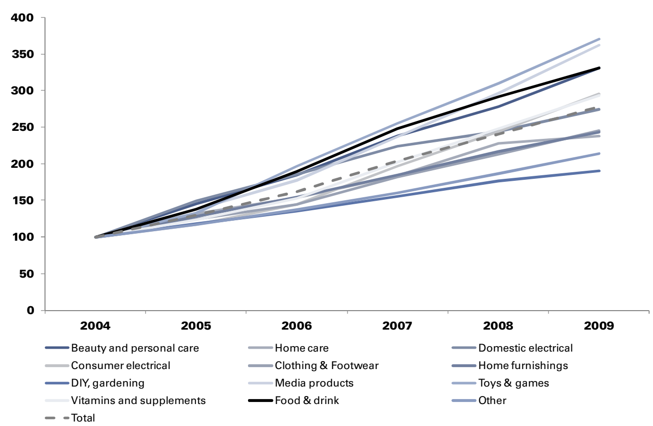
Looking out to 2014, Euromonitor expects a real sales CAGR of 13.8%, which, assuming annual RPI of 3%, could equate to nominal growth of up to 16.8% (though not all products are affected equally by inflation). This would imply internet retail sales rising to 11%-12% of total UK retail sales.

Exhibit 1: Food and drink already largest online market
UK online retail sales split by product category, 2009



Source: Euromonitor.

Exhibit 2: Grocery is one of the faster-growing areas
UK online retail sales by product category (2004-2009; by value, indexed)



Source: Euromonitor.

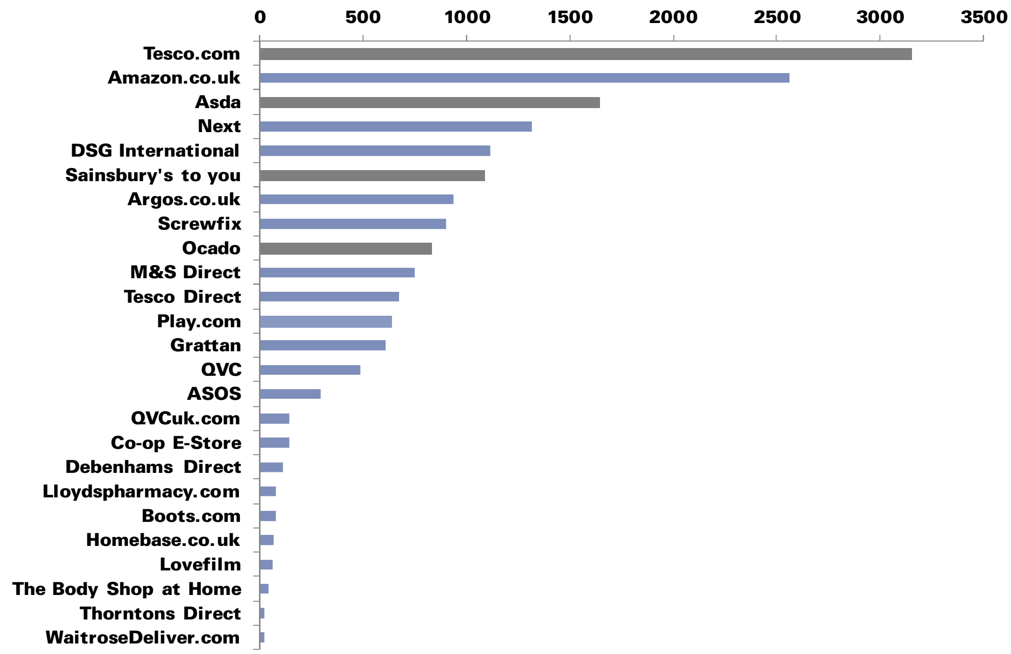
While online penetration of grocery sales remains very low, groceries are increasingly becoming an important part of the total online retail market in the UK. Indeed, with such categories accounting for just under half of total retail sales (Euromonitor data), this is still the largest single category of online sales (£3 bn, according to Tesco).

Furthermore, UK internet grocery sales grew faster than the market through 2004-2009 (Exhibit 2), outstripped only by media products (unsurprisingly boosted by downloads), and toys and games (a much smaller category).

Tesco the largest online retailer in the UK

The largest internet retailers in the UK are a mix of pure-plays and the online offerings of traditional bricks and mortar retailers (Exhibit 3): the largest online retailer is also the largest offline retailer (Tesco); however, the second-largest is Amazon.co.uk.

Exhibit 3: Food is already a major part of UK e-commerce
E-commerce sales by retailer, UK 2010E (US$ mn, shaded in grey are food)



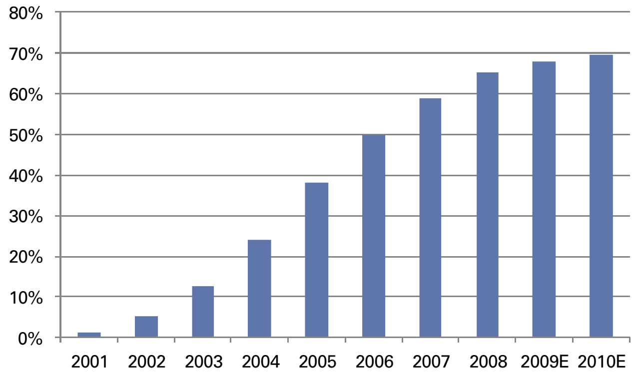
Source: Planet Retail, Euromonitor. Ocado and ASOS (UK only) are Goldman Sachs Research estimates.

As grocers account for 44% of total UK retail spend, unsurprisingly many feature among the larger online retailers.

Rising broadband penetration is a key driver of online retail growth

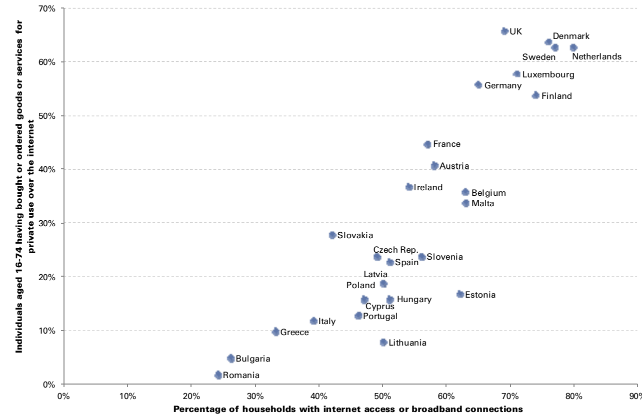
We believe rising broadband penetration in the UK is a key driver of growth in the online retail market. Broadband penetration rates vary significantly by country, and we believe this partly explains the different development rates of countries' online retail markets. In the UK, where broadband penetration is approaching 70% of households (Exhibit 4), we believe the consumer is expanding its range of online purchases rapidly, particularly into new areas including groceries.

Exhibit 4: Broadband penetration in the UK has been rising significantly over time
UK broadband penetration: % of households, 2000-10E



Source: Telecom companies data (2000-2008), Goldman Sachs Research estimates.

Exhibit 5: Propensity to purchase online highly correlated with broadband penetration rates across the EU27
Broadband penetration and internet purchase by country in the EU27 (2009)

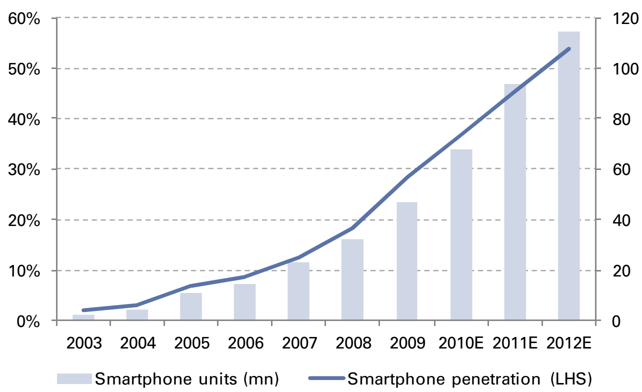


Source: Eurostat, Goldman Sachs Research.

Mobile is also becoming an increasingly important channel

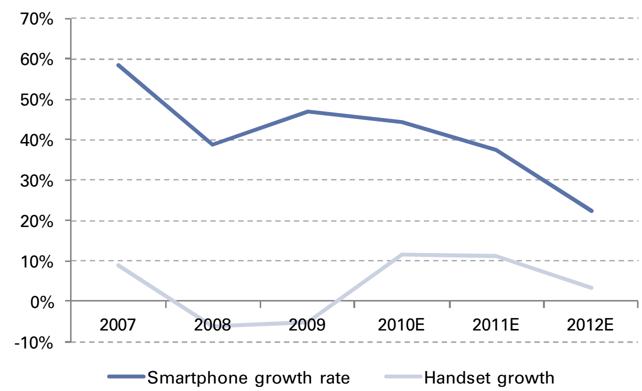
In addition to broadband access to the internet, we believe a small, yet rapidly growing customer group is shopping online via mobile devices (also known as m-commerce). We believe m-commerce is becoming increasingly important in its own right, and also as a complementary channel to the internet. In our view, it is important for companies that are performing well in the internet space to expand their offering into the mobile channel to ensure they maintain their lead.

Exhibit 6: We expect smartphone penetration to reach 54% by 2012E in Western Europe
Smartphone penetration rate and smartphone units (mn) in Western Europe



Source: Company data, Gartner, IDC, and Goldman Sachs Research estimates (2010-2012).

Exhibit 7: We forecast a 3-year (2009-12E) smartphone CAGR of 34%, compared to a CAGR of 9% for the total handset market in Western Europe
Smartphone and handset growth rates in Western Europe



Source: Company data, Gartner, IDC, and Goldman Sachs Research estimates (2010-2012).

Using mobile phones, particularly smartphones, consumers can purchase / access many goods and services (banking products for paying bills, products for buying groceries etc.). Several consumer-facing companies (e.g. Unibet, bwin, IG Group, SeLoger, Rightmove and Domino's Pizza) have recently noted the increased use of mobile devices.

Ocado launched an iPhone application in July 2009. In April 2010, c.6% of its orders were made or edited via the iPhone. The company launched an Android application in April 2010, equipped with voice recognition and a barcode scanner, and is currently developing an application for the iPad.

As broadband penetration has driven internet retail, we expect rising smartphone penetration to drive m-commerce. Our European Telecoms research team forecasts that smartphone penetration will increase to 54% of users in Western Europe by 2012, from 28% in 2009, with the total number of smartphones exceeding 114 mn. We would expect increased acceptance of ordering through smartphone applications to drive new/increased use of e-commerce.

The UK online grocery market could be worth £7 bn by 2014E

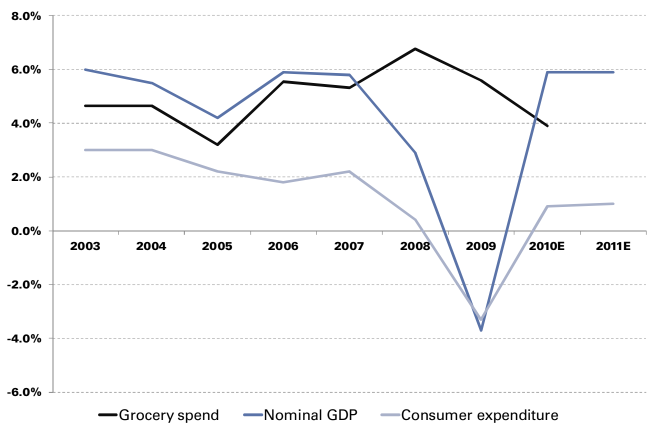
Based on Euromonitor forecasts, we expect the online grocery market in the UK to more than double over the next five years, from c.£3 bn in 2009 to over £7 bn in 2014. We also believe there is scope for UK online grocery to continue to grow beyond 2014, as the percentage of grocery spend being transacted online implied by the above forecast would be only c.4% of the total.

Grocery spending growing at a premium to real GDP

Grocery spending in the UK has grown more closely in line with nominal GDP than consumer expenditure over the last eight years; we would expect it to continue to do so in the future. The UK supermarkets' ability to pass through higher costs (Exhibit 9) leads us to believe that grocery sales are relatively protected from inflation.

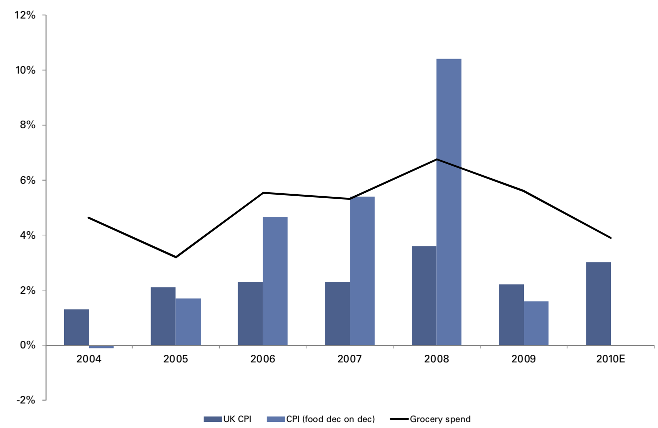
Indeed, an analysis of UK grocery spend and inflation shows that food price inflation supported grocery spend in 2006-08, real spending declining in 2008 before recovering in 2009. Year-to-date data for 2010 indicates spending again increasing in real terms (up 3.9% vs. food CPI up 3.4%).

Exhibit 8: Grocery spend trends with nominal GDP
UK grocery spending vs. nominal GDP and consumer expenditure (annual change)



Source: ONS, TNS, Goldman Sachs ECS Research estimates.

Exhibit 9: Grocery spend grew in real terms in 2009
UK sales of grocery stores compared to UK CPI and Food price inflation



Source: ONS, TNS, Goldman Sachs ECS Research estimates.

Although the major UK supermarket chains have been expanding their non-food ranges (UK Competition Commission data and more recent information from Tesco), we believe that Tesco, the largest grocer in the UK and probably one of the most advanced grocers in terms of diversification, has increased its proportion of non-food sales by only 1%-2% over the last four years.

Our economists forecast a recovery in the UK economy in 2010 and 2011, with nominal GDP growth of 5.9% in both years and nominal consumer expenditure forecast to grow 4.8% and 4.1% respectively. In addition, we forecast retail sales volumes yoy growth to increase from 3.9% in 1Q2010 to 7.6% in 4Q2010.

Grocers have pricing power, hence inflation is passed through

After peaking at 5.1% in 2Q2010, our economists expect UK inflation (RPI) to decline to 3.8% in 4Q2010, and increase to an annual rate of 4.0% in 2011.

Food prices are a more volatile part of the UK price indices, with crop sizes and changes in exchange rates affecting prices from year to year. Furthermore, the oligopolistic nature of UK food retailing (the top four supermarket chains have a 62% share of UK grocery sales, including Tesco with c.27% alone), means price increases are passed through to consumers, as are other cost increases. As a result, while food prices represent only 10.4% of the UK CPI for 2010 grocery prices have usually kept up with or exceeded general CPI.

Our Retail research team has observed improving food inflation trends across Europe, including the UK, since the beginning of the year (see *Inflation trends improving in 2Q; commodity prices support our optimistic view* of August 20, 2011). Recent commodity price moves also suggest support for a continued rise in food inflation in 2011.

We view the re-emergence of food inflation as a positive for the grocery sector as a whole as price increases are passed on to the consumer.

UK online grocery penetration could still be only in its infancy

While our Retail research team forecasts a UK grocery market sales CAGR of 3% to 2014, we believe the online market is likely to grow by at least 15% pa over the same period.

The migration of shopping from offline to online seems to have varied mostly according to product type. In 2009, 12% of consumer electronics sales were made online in the UK (source: Euromonitor). In the same year, c.7% of total apparel sales were made via the internet in the UK (source: ASOS). In the US, the figures were 14% and 9% respectively, (source: Goldman Sachs Research, Forrester Research).

According to Tesco (in November 2009), c.2% of total UK groceries sales (worth c.£3 bn) were made online in the UK in 2009. Assuming online grocery spend increases at the nominal rate of 15%-16% pa from 2009-14 that Euromonitor forecasts for total online retailing (not unreasonable in our view considering 44% of retail spend in the UK is on groceries), we calculate that by 2014, c.4% of UK groceries will be bought online. If this figure were 5%, the online grocery market would be £8.8 bn.

Indeed, based on Euromonitor forecasts and company comments, and assuming a 2% annual inflation rate for grocery products, we believe the online UK grocery market could be worth £7 bn by 2014E. As Euromonitor expects the online grocery market to grow only 3% in real terms in 2014 (after 14%-15% pa in the prior four years), we believe that this figure could be conservative.

Longer term, we see potential for UK online grocery sales to reach 10% of total retail sales (or more), implying a market in 2025 of around £24 bn.

Exhibit 10: Only 22% of those who shopped online in 2009 bought food or groceries
Type of products bought by UK adults who shopped online in 2007 and 2009

Product type	2007	2009
Films, music	51%	50%
Clothes, sports goods	38%	49%
Household goods (e.g. furniture, toys, etc)	39%	47%
Holiday accommodation (hotel, etc)	NA	42%
Books, magazines, newspapers or e-learning material	35%	41%
Other travel arrangements (transport tickets, car hire, etc)	NA	40%
Event tickets	33%	37%
Electronic equipment	20%	28%
Food or groceries	**20%**	**22%**
Shares, insurances or financial services	9%	17%

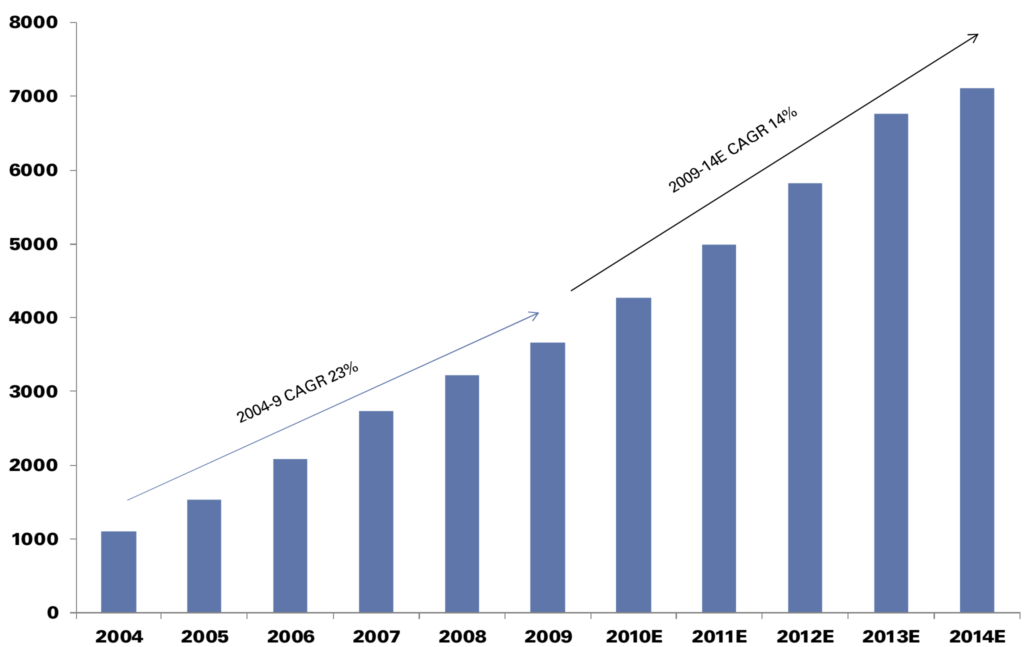
Source: ONS, Goldman Sachs Research.

In the US, our Retail research analysts have identified 7% penetration as the tipping point for internet purchases, the point at which online spend's share of the product total accelerates (see, "*dotCommerce: Online shifts apparel's center of gravity*", published May 24, 2010).

Homogenous products were the pioneers of internet shopping

Sales of broadly homogenous products (e.g. consumer electronics, books, music and DVDs) over the internet began relatively early in the evolution of online retail. In our view, this was because of the ease of comparison of such products (e.g. a 40" LCD flat-screen Samsung television is identical whether purchased from Amazon or Play.com, excluding any differences in after-sales service) and the limited need for physical contact with the product prior to purchase. The homogenous nature of these products generally results in higher online penetration rates.

Exhibit 11: We estimate the UK online grocery market could be worth over £7 bn in 2014
UK online grocery market size estimate (£ bn assuming 2% annual inflation in forecasts)



Source: Euromonitor, Goldman Sachs Research estimates.

Less homogenous products (apparel is a key example; a red dress by one designer is not the same as a red dress by another) that require relatively more physical contact before purchase (for example, to try the item for size and feel) appear to have experienced a later pick-up in internet sales. As a result, ultimately we expect these types of products to have lower online penetration rates than homogenous goods. Nonetheless, clothing and footwear have a penetration rate of 7% in the UK, compared to the estimated 2% currently achieved by grocery products.

In our view, groceries fall into both categories: some products are relatively homogenous (e.g. daily staples such as milk, eggs, bread, or general branded goods such as Heinz' baked beans and Coca-Cola) and some relatively heterogeneous, possibly requiring physical inspection before purchase (e.g. certain cuts of steak).

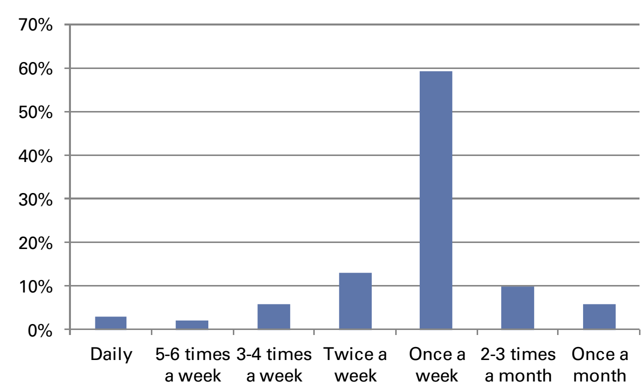
Therefore, while product heterogeneity could ultimately result in the penetration rate of overall online grocery sales being lower than that of relatively homogenous products, we believe there remains scope for the penetration rate to increase significantly from the current 2% to (eventually) a double-digit level. This should lead to continued strong growth in online grocery in our view. In particular, once customers have successfully bought relatively more heterogeneous products online, we believe their willingness to purchase such products over the internet will accelerate. This has been seen in apparel and is the tipping point referred to by the US internet analysts.

Grocery shopping is largely functional

We believe the majority of grocery shopping is functional; an individual enters a shop with a list of regular grocery items, most of them relatively homogenous and/or familiar. In our view, this is the major potential growth driver of online grocery penetration; the regularity of this type of shopping can be readily shifted to an easily scheduled programme online.

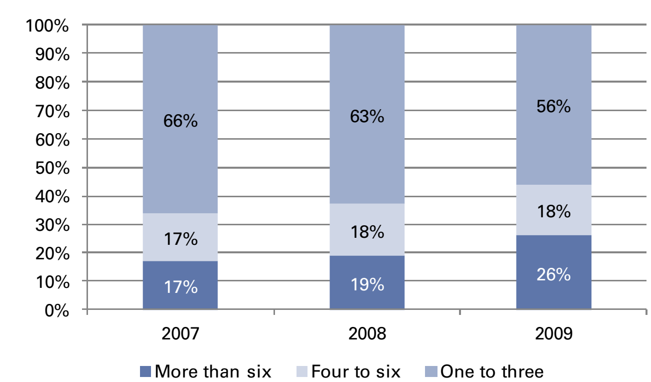
While people living near supermarkets or using a supermarket's town-centre car park for other errands and shopping are likely to continue to use stores, we view the convenience of a weekly/monthly shop delivery as increasingly attractive, particularly to time-constrained consumers. We believe the propensity to buy groceries online is correlated with family size: it is likely much easier to have groceries delivered than take (often unwilling) children to a supermarket. Furthermore, such consumers may often have larger average baskets.

Exhibit 12: A majority of grocery shopping is conducted once a week
Shopping frequency



Source: UK Competition Commission.

Exhibit 13: Ocado has been steadily increasing shop frequency in the past three years
Shopping frequency for active customers at year end in the previous 12 weeks



Source: Company data.

However, some individuals consider grocery shopping an enjoyable/leisurely activity, providing an opportunity to explore different food types and experience the sights and smells of the products. In our view, while these 'leisure' grocery shoppers are a minority, we believe ongoing technological advances and structural social changes could drive these shoppers towards online grocery shopping, as has been the case in online apparel. The frequency with which consumers use Ocado for their shopping has increased over the last two years (Exhibit 13). We believe this demonstrates that Ocado is gaining a bigger share of the customers' total grocery spend. This trend was accelerated by the introduction of the Ocado delivery pass which involves a fixed annual payment for delivery (on orders over £40) regardless of how many orders are made.

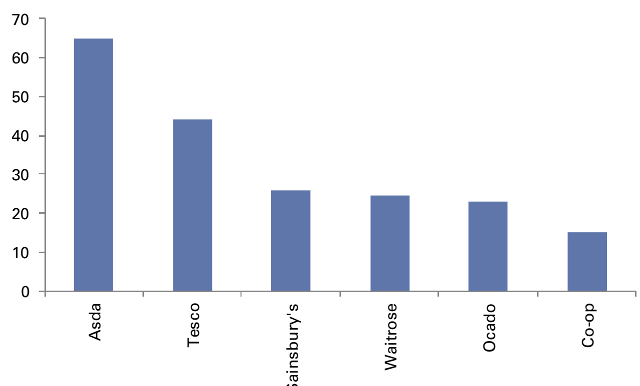
Technological advances and ongoing structural social changes to drive penetration rate

In our view, a good first online shopping experience (helped by technology advances), combined with ongoing structural social change (where buying groceries online becomes the social norm) will allow online grocery sales to grow at least as fast as the overall UK online retail market. Technological advances (e.g. faster internet download speeds enabling a richer graphic and browsing experience) have enhanced the online shopping experience for heterogeneous products such as apparel, and we believe this is also applicable to groceries. According to the UK Competition Commission, while the proportion of total pre-planned purchases shoppers are making is declining (as shoppers visit grocery retailers looking for 'meal solutions' rather than shopping for individual items), the proportion of total pre-planned purchases is still a majority of the total.

In this regard, the range of products available is important. Typically, consumers prefer to buy all their groceries in one place: in the event they need to go elsewhere for key products, they might choose to take their entire shop to save time. To grow its customer base further, Ocado is therefore aiming to significantly widen its range; its central fulfillment centre can stock more items than any one supermarket in the UK, and thus can offer more choice of specialist foods. Currently, it has a range of over 20,000 store keeping units (SKUs), more than any individual Waitrose supermarket (though less than many Tesco and Asda stores; Exhibit 14), and management intends to double this over the next few years. To put this in perspective, in 2006 Ocado had only 11,000 SKUs.

Exhibit 14: We believe there is still scope for Ocado to increase its product range

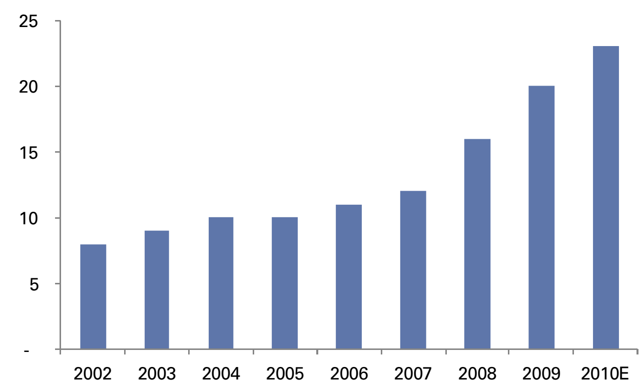
Product range (000s SKUs) of supermarkets in the UK



Source: Company data, UK Competition Commission.

Exhibit 15: Ocado expects to reach 23,000 SKUs by the end of FY2010

Ocado's product range over time (000s SKU)



Source: Company data.

Ocado's unique proposition

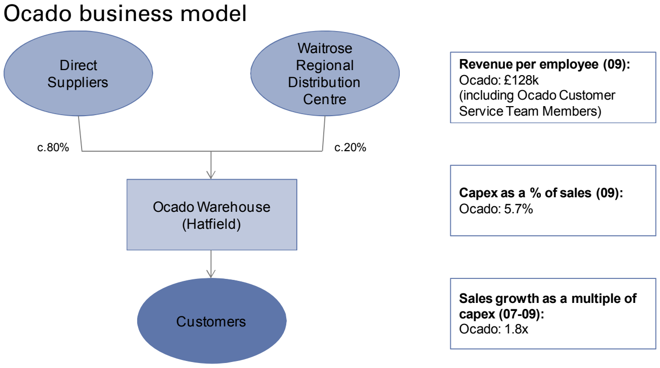
With a cost-effective business model, unique proprietary technology and a strong and growing product offering, we believe Ocado is strategically well positioned within the online grocery market. This, together with an extension of its offering across the UK, should in our view enable the company to continue to gain share and thus grow faster than the market as a whole.

Our US Internet research team discussed the disruptive effect of online retailing in "*dotCommerce: The Great Disruption*". We believe that Ocado is one of these disruptive forces, with a business model that is focused on optimizing the power of the internet, rather than being an online offering like that of a traditional store.

Transforming the grocery distribution model

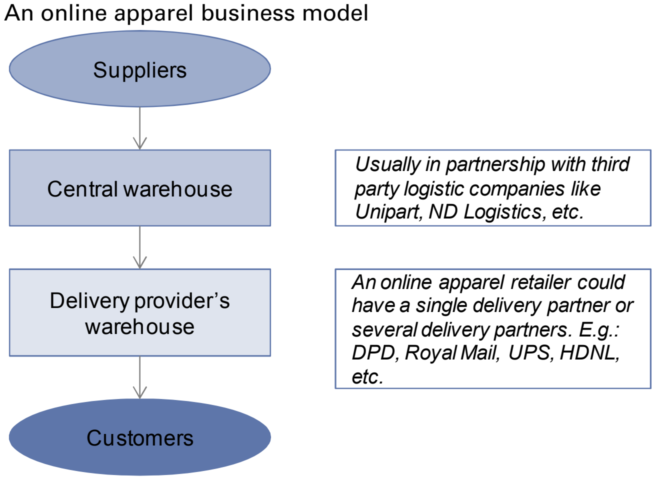
Ocado's business model is fundamentally different from other online grocery providers. Being based around a central, semi-automated warehouse, it is similar to that of pure-play online retailers such as Amazon, ASOS and YOOX. Its land-based competitors' online offerings currently pick in-store, and thus have an extra cost layer, having delivered the groceries to the store shelves.

Exhibit 16: In our view, Ocado's business model is similar to other pure-play online retailers
Ocado business model



Source: Company data.

Exhibit 17: We believe pure-play online retailers typically operate a centralized warehouse distribution model
An online apparel business model



Source: Goldman Sachs Research.

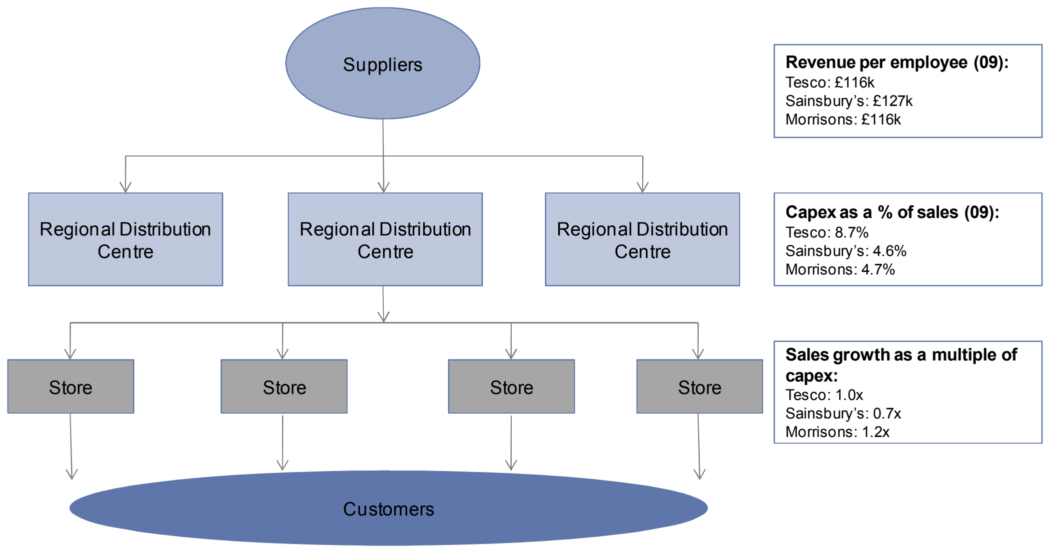
For many online retailers, marketing (or customer acquisition) becomes a major cost (generically 8% of sales as estimated in the "dotCommerce" report). Ocado has 700 mobile billboards (its vans) and a brand in the UK which is already synonymous with online groceries. Hence, we believe its ongoing marketing expense will be only around 2.5% of gross sales (including vouchers). This can be targeted at customers as a result of the considerable information Ocado has about the shopping habits of all visitors to its sites.

However, Ocado differs from other online retailers such as Amazon or ASOS by making deliveries in-house. Hence, it controls this vital interface with the customer. Although this partly reflects the need to deliver groceries (i.e. perishable goods) to the consumer, rather than posting them through a letterbox, it also enables Ocado to offer more convenient delivery slots and deal with refunds and any other issues in a prompt and efficient manner.

Other online grocery offerings pick in-store

Tesco and the other grocery chains which offer an online service also deliver in their own vans. However, they have a very different business model, based around their existing infrastructure. As shown in Exhibit 18, this creates an extra leg in the distribution chain. This is one reason Ocado is able to offer fresher produce, which it believes will become an increasing competitive advantage as consumers become more aware of it.

Exhibit 18: Other online grocers have an extra step in the chain
Store picked model for grocery (both in-store and online)



Source: Company data.

To date, Ocado's competitors have followed a different model for their online businesses, using in-store pickers to fulfill orders for a given locality. Tesco and Asda have set up "dark-stores", effectively stores/warehouses exclusively for fulfilling internet orders in areas of high demand. Based on company comments, GS food retail analysts believe Tesco currently has two in operation, with as many as a further 10 planned. According to Planet Retail, Asda has one in operation with others possible.

"Dark stores" located on industrial sites enable a more automated approach to fulfilling internet orders: pickers do not get in the way of, or are themselves not delayed by, in-store customers. Furthermore, they can allow retailers to expand their operations in areas of high demand, but where planning permission for another conventional supermarket may prove difficult. However, we believe they require significant volume to make them economically viable.

Tesco trials drive-through services and Amazon UK launches grocery offering

We note that Tesco has recently begun trialing drive through services at its Tesco Extra store in Baldock, Hertfordshire (*The Guardian*, August 22, 2010). This would allow customers to place their order online and drive to their local store for collection within a two-hour slot. A flat £2 charge will apply instead of the sliding scale of home delivery charges, which begin at £3.

In our view, this drive-through service leverages Tesco's existing store network in providing additional flexibility for online customers. Given the early stage of trials, we do not currently view this development as a significant incremental challenge to Ocado, which offers relatively more flexible delivery options compared to Tesco (see Exhibit 32).

Amazon UK launched its grocery offering in July (*BBC*, July 7, 2010). Whilst the company is one of the larger online retailers in the UK (Exhibit 10), especially in books and media, we do not view its current offering in the UK grocery market as a meaningful competitive threat to Ocado, as it is geared more towards bulk buying and longer life items and less towards the weekly grocery shop. For example, fresh milk is not available and only four bread loafs and seven bread roll options (mainly specialty) are available, a limited stock of other fresh and chilled items (through Banana King) and only a narrow/ specialist selection of household items, such as bin bags and washing up liquid, are available for bulk purchase.

In addition, fulfillment for certain items rests with the third-party seller and the customer's shopping basket is currently not aggregated by Amazon and centrally fulfilled. This entails multiple deliveries (with wide estimated windows, sometimes running into several days) and high overall delivery charges relative to Ocado or a supermarket's online offer.

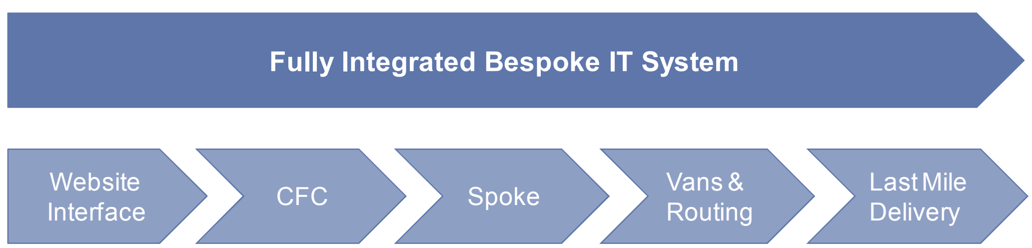
On the other hand, while Amazon Fresh in the US has a broader offer than its UK counterpart, it is currently only available in selected neighbourhoods in the Seattle area. Amazon Fresh offers around 60,000 SKUs, including fresh produce such as bakery, meat and seafood. Delivery options are also more in keeping with the products sold, for example one hour window day time attended, pre-dawn doorstep and daytime doorstep delivery options.

While we believe these recent launches are unlikely to pose a meaningful competitive threat to Ocado in the short term, we continue to monitor the development in Ocado's competitive environment.

Proprietary technology is at the core of Ocado's operations

Ocado's entire business is controlled by proprietary software which provides complete visibility over each item of grocery from order to delivery. The code-writing for the IT system is divided between c.160 in-house IT professionals.

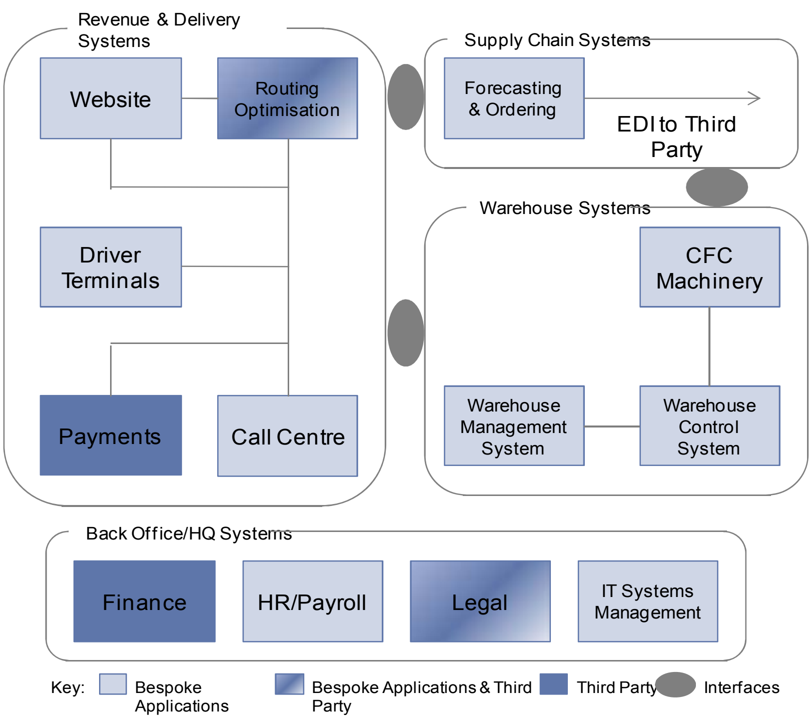
Exhibit 19: Ocado's entire business model is controlled by in-house proprietary software, making it difficult to replicate



Source: Company data.

Small incremental updates are introduced on a regular basis, which reduce the risks of problems (the system can be easily switched back to the previous version).

Exhibit 20: The majority of Ocado's systems are proprietary
Overview of Ocado's key business applications



System	Description
Website	• Website for customers to place orders
Route Optimisation	• Optimises delivery schedule to provide confirmed hourly order slots & optimised drop density
Driver Terminals	• Provides delivery information & satellite navigation for the CSTMs
Payments	• A secure credit card payment system
Call Centre	• Extension to Website to support call centre activity
Forecasting & Ordering	• Stock control system to calculate replenishment levels
Warehouse Management System (WMS)	• Supports inbound, picking & outbound processes, including the allocation of stock to orders
Warehouse Control System (WCS) & CFC Machinery	• Interfaces between the WMS & the CFC machinery by providing local instructions to control the movement of each tote around the CFC
Back Office/HQ	• Packaged finance application • System for self service HR functionality

Source: Company data.

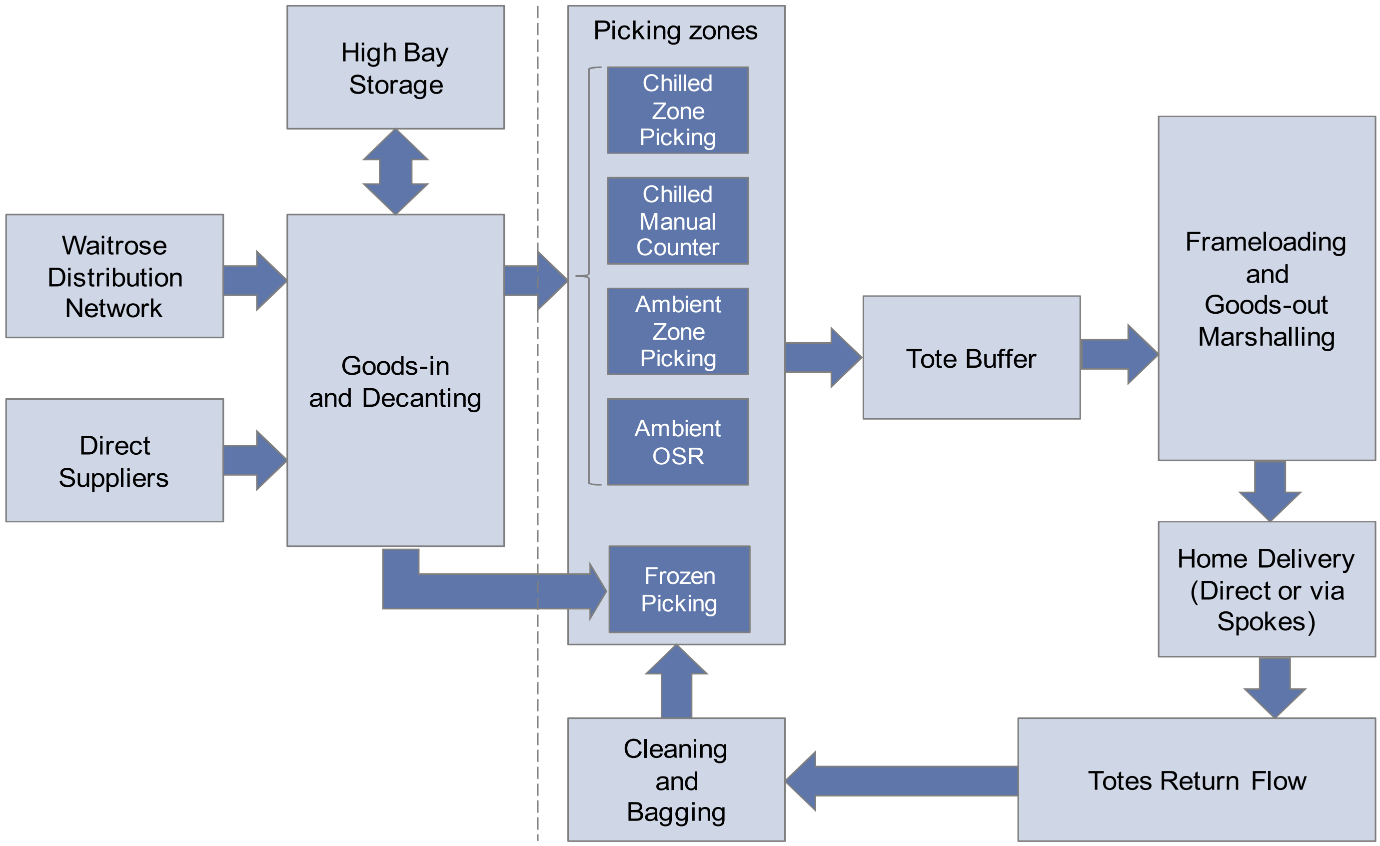
Ocado's 295,000 square feet customer fulfillment centre (CFC) in Hatfield is highly customized following several years of iterations with purpose-built machinery (e.g. order, storage and retrieval) for slower moving ambient products, and bespoke code. Hence, we believe the CFC's functionality cannot be replicated with current 'off-the-shelf' solutions. To demonstrate the efficiency that this brings, Ocado indicates that its most advanced semi-automated systems can pick c.600 items per hour on average, whereas manual trolley loading (common for in-store picking) can only achieve 100-120 items per hour, on average.

CFC is a significant barrier to entry

While it is not impossible for competitors (both existing and potential) to replicate Ocado's business model, we believe to do so would take considerable time and investment. Furthermore, Ocado's system has been refined by eight years of operation.

We believe that years of experience operating the CFC, as well as the algorithms that control the movement of goods around its warehouse, are key to the efficiency of the operation of Ocado's CFC. These would be difficult to replicate in a system written from scratch for a potential competitor, and therefore even expensive efforts to duplicate Ocado's operation would, in our view, not necessarily produce something as efficient or effective. We believe this is a major barrier to entry. Indeed, Sainsbury's tried to build automated fulfillment centres (working with Accenture), but had to write down £340 mn of redundant IT developments, automated equipment in the new fulfillment centres and stock loss from changes in operations in October 2004. The company could not make the process work economically.

Exhibit 21: Ocado's CFC is currently running at an effective capacity of 105,000 orders per week, with a potential estimated maximum capacity of 180,000 orders per week
Overview of how the CFC operates



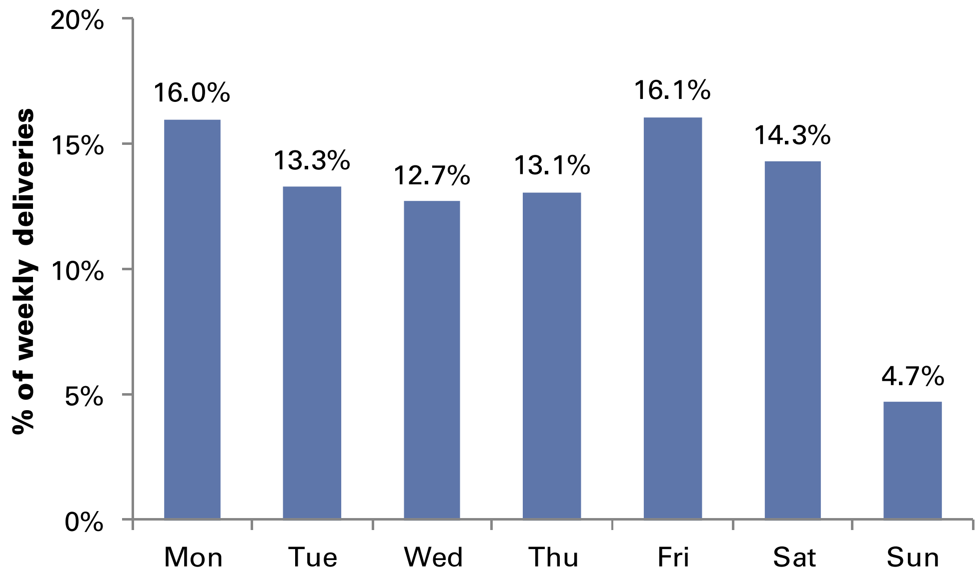
Source: Company data.

More importantly, development and improvement in logistics and delivery networks is vital for the success of online grocery, as we believe the level of service demanded by customers for groceries ordered online is significantly higher than for other products (e.g. books, consumer electronics, apparel). This is not unsurprising as groceries are effectively a necessity and mostly perishable, requiring the customer to be present during delivery.

Capacity can be raised to 180,000 orders per week

The most orders processed in a single week to date in the CFC is 100,633 in May 2010, with the highest daily output achieved being 18,800 orders. Approximately £80 mn of capex is required to extend the CFC's capacity to an average 180,000 orders per week according to the company.

Exhibit 22: Nearly a third of Ocado's weekly deliveries occur on Monday and Friday
Weekly delivery profile, based on average weekly orders over December 2009 – February 2010, excluding weeks including a bank holiday



Source: Company data.

Ocado operates a fleet of 56 LGV tractors and 91 LGC trailers. Each trailer holds 7.5 routes and allows a mix of ambient and chilled product transportation to the spokes. The total capacity of the existing seven-spoke network is c.130,000 orders per week and limited capital expenditure (<£1 mn) is required to increase the capacity to over 150,000 orders per week.

For door-to-door delivery, Ocado has a fleet of more than 700 vans that have been semi-customised to its requirement. The internal layout of the van provides easy access to grocery totes (e.g. loading the van according to the totes that contain the groceries for the first customer in the front access).

Exhibit 23: Ocado has a network of seven storage and distribution facilities (spokes), allowing it to achieve 66% coverage of UK households from a single CFC in Hatfield
Ocado's spokes coverage

Source: Company data.

Ocado is constantly innovating to maintain a competitive edge

In our view, Ocado has used technology to improve its service offering and enhance the online grocery shopping experience. Examples of innovation introduced by Ocado range from relatively straightforward initiatives, such as…

- recipes,
- detailed product information,
- product ratings,
- Ocado Delivery Pass (similar to Amazon Prime), and
- Ocado Reserved (allows customers to reserve a weekly delivery slot);

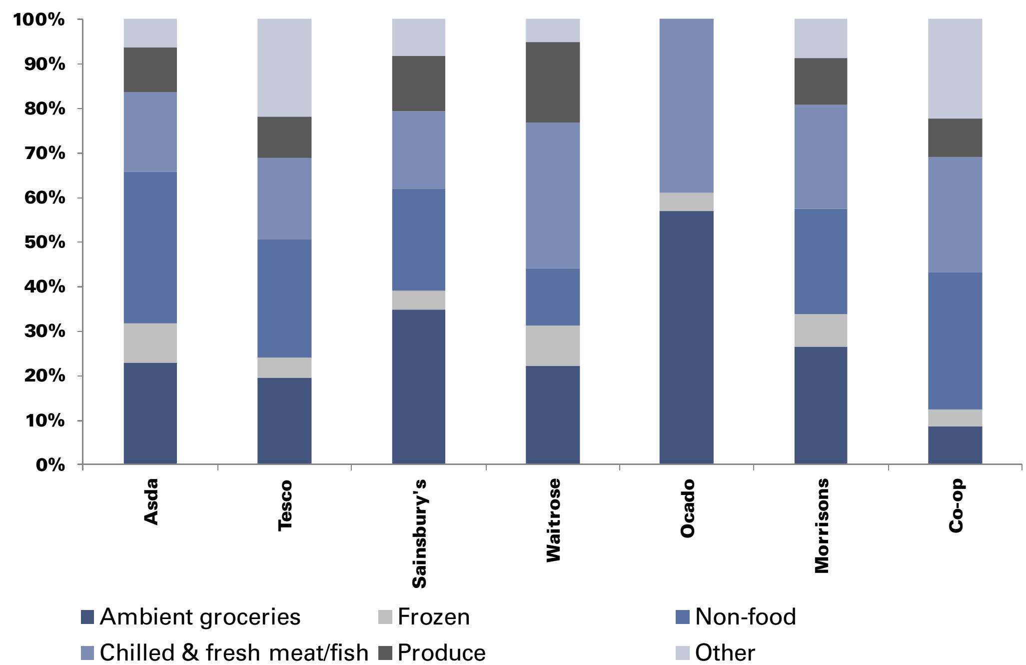
…to more sophisticated initiatives, including:

- software-recommended products such as "Your Instant Shop" (creates a suggested order based on shopping history and is connected with the Ocado Reserved service to completely automate the weekly shop),
- "Did you forget?" (recommends items previously purchased but not included in the current order), and
- "You might like" (recommendations based on items ordered by customers who order similar items).

One factor making some shoppers reluctant to buy groceries online is a fear they will receive poor-quality produce, perhaps close to the sell by date. Ocado's shorter distribution chain, as well as its ability to trace every product through its system, enables it to reduce this risk. Indeed, Ocado ships more fresh produce as a proportion of its sales than any of the other major UK grocers.

Although the data is relatively old, Exhibit 24 shows the breakdown (ex-petrol) of sales by food type between the major UK grocers. Waitrose has the highest share of produce, a factor that is replicated by Ocado, (albeit Ocado's profile is for FY09).

Exhibit 24: Product mix varies by grocer
Breakdown of grocery sales by type, major grocers (2006 data, 2009 for Ocado, though breakdown not as precise)



Source: UK Competition Commission, "2007 groceries investigation report, provisional findings", Company data.

Fresher produce is just one area in which Ocado seeks to provide a superior offering. The company also seeks to provide a better service proposition. A number of the ways in which this can be done are shown in Exhibit 25.

Exhibit 25: In our view, the level of service offered by Ocado is higher than that of online retailers in other product segments in the UK

Comparison of service level offered by various online retailers operating in the UK, August 2010

Company	Minimum spend per order	Delivery charges (range)	Delivery options available	Free delivery threshold	Free returns?	In-store pick up available?
Ocado	£40	£0 - £6.99	06:00 to 23:30, available everyday, within one hour slots	May offer free delivery for orders over £75 on quieter slots	Yes - Customer Service Team Managers handle refunds directly at delivery. Customer is billed after delivery.	NA
ASOS	None	£0 - £7.95	Super Saver (within 6 working days) Standard (within 3 working days) Next day (order by 7pm weekday/2pm Sunday) Nominated day (choose up to 7 days in advance) Same day (order by 2pm midweek/12pm weekend)	Super saver - no threshold Standard - over £75 Next day - over £100	Yes	NA
YOOX	None	£5.00 - £32	Standard (4 - 6 days) Express (2 - 3 days) Next day Saturday morning	NA	Yes	NA
Tesco Direct	None	£5 - £19	Small items: Next day 2hr delivery slots Saturday Large items: 5-10 days Large kitchen appliances: 2-3 days	NA	Yes	Yes - only in stores with Tesco Direct desk
Amazon.co.uk	None	£0 - £14.99	First class (1-2 days) Super Saver (3-6 days) One-day delivery Express delivery (same day if possible) Expedited delivery (1-3 days) Evening delivery (same day - providing order within deadline specified) Scheduled delivery	Depends on item purchasing	Yes	NA
Play.com	None	Free	3-5 working days	None	Yes	NA
Marks & Spencer (non-food)	None	£0 - £5.99	Standard: Clothing/homeware: up to 5 working days Flowers: with 3 working days Large appliances : 3 - 7 working days Rapid/Saturday delivery (large appliances): within 2 working days Made to measure shirts: within 21 days	Only on furniture / large technology items or if spend £150 or more	Yes	Yes
Next	None	£3.95 - £19.99	Next day delivery Free store delivery	In-store only	Yes - only in-store or for Next Directory Account customers	Yes
Argos	None	£5.95 - £19.99	Standard (any weekday of your choice - dates indicated on purchase Next day (if ordered before 1pm) Saturday delivery (7am - 3pm) Courier (within 5 working days) Express delivery (2-3 days -on selected products only)	NA	Yes (within 30 days)	Yes
John Lewis	None	£0 - £19.95	Standard - within 5 working days Next working day (order by 7pm day prior) Named day delivery Express delivery	Over £30	Yes - only in-store	Yes
Topshop	None	£0 - £7.50	Standard: 2 - 3 working days Next day Nominated day	Over £100	Yes	No
HMV	None	£0 - £6.60	Standard: 2-5 working days Express delivery: usually 24hrs	None	Only for incorrect or faulty items	No
Littlewoods	None	£0 - £6.95	Standard: within 48 hrs Next day Specified day Saturday delivery	None	Yes	NA
Homebase	None	£5.95 - £8.95	Smaller items: 48 hours or on specified date Next day order before 1pm Saturday Bigger items: 7-28 days	NA	Yes	Yes
Boots.com	None	£0 - £12.99	Standard (within 4 working days) Named day Next day (order before 2.30pm) Saturday (delivered between 7am - 1pm) Heavy items (within 5 working days) Super heavy items (within 5 working days)	Over £40	Yes	Yes

Source: Goldman Sachs Research.

Furthermore, we believe the level of service offered by Ocado is higher than that of other online retailers in other product segments in the UK (e.g. specific hourly delivery slots compared to delivery slots over working days), which, in our view reflects a barrier to entry to the online grocery market.

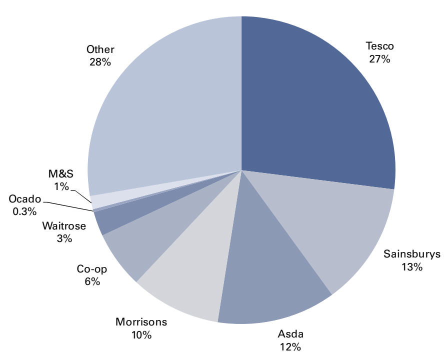
Exhibit 26: Ocado is the online pure-play online grocer in the UK
Competition overview of UK online grocery retailers

	Ocado	Tesco	Sainsbury's	ASDA	Waitrose
History	• Started operations in 2002 • Only dedicated online player with a central warehouse and Spokes • Heavy investment in IP	• Tesco.com launched in 2000 • Growth through store based delivery – low expansion costs • Sizable non-food offering since 2006 (Tesco Direct)	• First UK grocer to offer online delivery through its wine direct service launched in 1995 • Online push de-emphasised in 2004-05 • Head of online business appointed in 2007 & non-food launched in 2009	• Owned by Walmart • Initially went online in 1998 • Publicly announced significant online expansion in 2006 • Increasing focus on non-food (Asda Direct)	• First went online in 2000 • Supply agreement with Ocado
Online Net Sales (£m)	402 (FYE Nov-2009)	c. 1,700 (Total online less non-food FYE Feb-2010)	c.520 (FYE Mar-2010)	c.500 (Rolling 52 week sales) As of Apr-2010	Not publicly disclosed
Implied Market Share	13%	54%	17%	16%	n/a
Coverage	66%	99%	90%	97%	40%

Source: Company data.

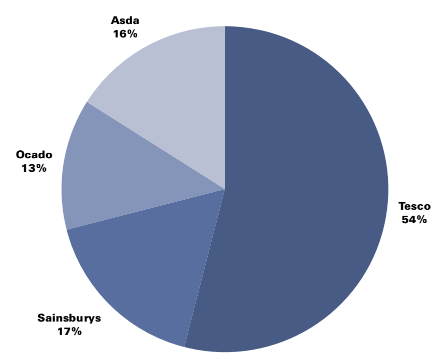
While Ocado is a small player in terms of the total UK grocery market, it is a major player in terms of online groceries.

Exhibit 27: Tesco is the largest grocer…
UK grocery market shares (2009)



Source: Euromonitor.

Exhibit 28: …and dominates the online market
Online grocery shares (last fiscal year, Waitrose excluded as data not available)



Source: Ocado from company data.

Tesco's strong position is driven by its number of stores (2,507 outlets versus 872 for its nearest rival, Sainsbury's) and perceived position as price leader on many lines (through greater buying power).

Competitive position enhanced by accuracy of offering

In our view, Ocado's business model creates structural and cost advantages versus its land-based grocery competitors. As a result, Ocado has been able to progressively address key barriers to customers buying groceries online by improving its product offering and service level:

- A very high level of product availability: 95% of products are available for next day delivery, almost full availability for deliveries one week forward (in this regard, Sainsbury's recently commented that its online business had availability just above 97%, but that it is unlikely to achieve close to 99% availability under a store-pick model in a cost-effective manner (source: 1Q2011 IMS analyst conference call, June 16, 2010);
- Greater order accuracy and low product substitution compared to its competitors;
- On-time delivery and flexible hourly slots available: 97.6% of orders were delivered on time or early during the week ending May 16, 2010;
- Higher product quality and freshness: Ocado is the only UK grocer to guarantee 'use by' dates which are visible on its website;
- User-friendly website with unique functionality: According to management, the "Your Instant Shop" feature currently has c.65% accuracy in predicting an order (based on product and quantity ordered) and management has indicated that it is aiming for 90% accuracy in the future. In addition, the company estimates that the "Did you forget?" feature adds c.1.5% of sales.

Exhibit 29: Ocado has the widest range of delivery slots
Market positioning of UK online grocery retailers

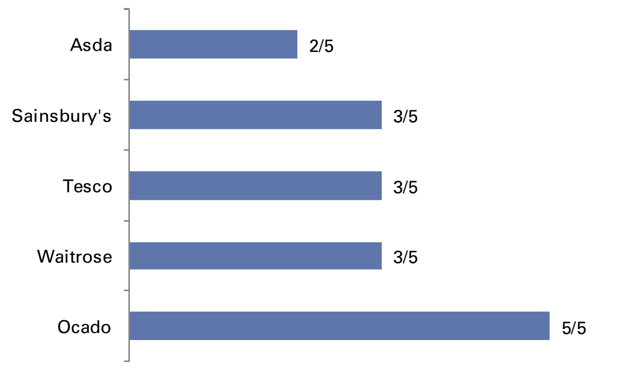
	Ocado	Tesco	Sainsbury's	ASDA	Waitrose
Industry Perception	Premium / Green	Mass Market	Mass Market	Value Orientated	Premium
Business model	Online only (1 CFC, 7 Spokes)	Store Picking (c.300 stores; 2 online-only stores)	Store Picking (c.170 stores)	Store Picking (c.170 stores; 1 online only store)	Store Picking (c.130 stores)
Minimum Spend per Order	£40	None	None	£25	£50
Delivery charge	£0 to £6.49 depending on slot & order size	£3 - £6 depending on slot	£100 for free delivery (Tues, Wed & Thu) £3.50 for orders between £40-£100 £6 for orders under £40	£3.50 - £5.50 depending on slot	Free delivery
Delivery Times	06:00 to 23:30	09:00 to 23:00	10:00 to 22:00	10:00 to 22:00	09:00 to 22:00
Delivery Slot	One hour	Two hours	One hour	Two hours	Two hours (6 slots) One hour (2 slots)
No. of Delivery Slots Per Day	27 daily (except Sunday) – every half an hour	13 (Mon-Fri), 10 (Sat) & 4 (Sun) – every hour	12 (Mon-Fri), 11 (Sat) & 6 (Sun) – every hour	12 daily – every hour	8 (may vary by location) daily

Note that analysis of spend, delivery times and slots based on a sample London postcode and may vary by geography.

Source: Company data.

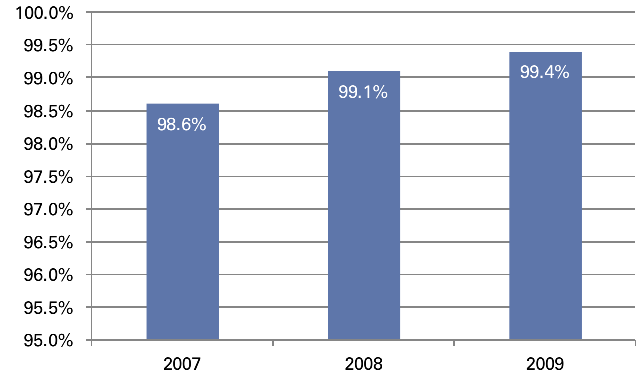
A comparison of the online grocery offerings of the major retailers by consumer magazine Which? (June 2009) showed Ocado performing strongly in many categories including: product offering (quality and freshness), price (value for money) and in all aspects of customer service (accuracy and availability, delivery service and user-friendly interface).

Exhibit 30: Ocado scores best for accuracy compared to other major online grocers
Customer accuracy rating



Source: Which? June 2009.

Exhibit 31: Ocado's order accuracy is improving over time
% of items delivered exactly as ordered (without any missing items or alternative items)



Source: Company data.

Medium-term geographical and product expansion opportunities

We see clear scope for Ocado to leverage its fulfillment infrastructure and distribution network by extending its product offering to the non-food segment. This could include small-sized non-food categories, which would be 'natural' cross-sell opportunities to existing grocery customers (e.g. baby, kitchenware, health and beauty, and toys and gifts). As shown in Exhibit 29, Ocado currently offers more flexible customer service than online retailers in other product categories.

While currently Ocado has no near-term plans to expand outside the UK, we believe there are opportunities for the company to expand into other countries, replicating its existing business model in countries which could be well-suited to online grocery (e.g. France).

This could involve Ocado providing infrastructure and online grocery know-how, along with its proprietary technology, and a domestic grocery retail partner providing local market knowledge and sourcing relationships.

Ocado management has indicated that it does not anticipate purely licensing its technology and infrastructure know-how to grocery retailers in other countries. In our view, this is sensible: while technology licensing would reduce Ocado's operational risk, it could result in lower potential returns to Ocado in the medium-to-longer term.

Ocado is broadening its appeal to a wider audience

Ocado's customer base is predominantly from the A and B social groups. We believe that these groups food shop at Waitrose and M&S food (among others), and value quality as much as price. However, as part of its expansion plans, Ocado is keen to attract customers that are more price sensitive.

Waitrose occupies a premium segment within the UK grocery market. Consequently, as Ocado sources its food through Waitrose some consumers consider Ocado by association "expensive". Ocado has sought to address this with a "Tesco price match" promotion on branded products stocked by both retailers (launched in March 2008). The price match currently covers c.7,000 branded products, thus making Ocado cheaper than Waitrose on some items.

In its 2006 report, the UK Competition Commission suggested that consumers are price sensitive and will switch between stores in their area that are perceived to offer value for money. Ocado has addressed this with its "Tesco price match" on branded goods.

While it does not necessarily need to gain significant customers in the C1/C2 social groups to grow, we believe that success here would increase Ocado's rate of growth. These groups are more price-sensitive and are typically Tesco customers (according to the UK Competition Commission report).

In Exhibit 32 we show a basket of 49 items typically included in a four-person family shop (this being a key internet shopping group) to compare prices between the online grocers.

While the basket costs most from Ocado (approximately 8% more than the average), we believe this mainly reflects its market position as a premium grocery retailer (like Waitrose), offering better quality non-branded products. As expected, most of the branded products are "price matched" with Tesco, while other products (mostly fresh products) are about 12% more expensive than the group average.

Exhibit 32: The average shopping basket cost approximately £91 from the four major UK online grocery stores

Sample price comparative basket. Prices were as of appropriate websites on August 26, 2010

Sample Shopping List: Mid-Range Product Offering

Category	Item	Quantity	TESCO	ASDA	SAINSBURY'S	OCADO
Fresh produce	Bread	Loaf medium wholemeal	£0.74	£0.74	£0.74	£0.74
	Milk	4 pints semi-skimmed	£1.53	£1.25	£1.53	£1.53
	Eggs	6 free-range medium	£1.46	£1.46	£0.97	£1.46
	Butter	250g unsalted dairy butter	£1.15	£1.14	£1.15	£0.98
	Cheese	500g cheddar	£3.85	£3.00	£3.09	£3.97
	Yogurts	8 pack Activia	£2.85	£2.84	£2.95	£2.85
	Orange juice	1 litre	£1.50	£1.00	£1.52	£1.59
	Apples	6 pack Royal Gala	£1.60	£1.17	£2.00	£1.99
	Bananas	6 loose	£0.78	£1.37	£0.66	£1.13
	Carrots	500g	£0.65	£0.40	£0.48	£0.45
	Potatoes	2.5kg King Edward	£1.87	£1.87	£1.87	£2.19
	Onions	3 pack	£1.00	£1.07	£1.00	£0.55
	Lettuce	300g iceberg	£1.00	£1.00	£1.00	£1.19
	Cucumber	Whole	£0.70	£0.70	£0.70	£0.75
	Tomatoes	6 pack	£0.88	£0.88	£0.95	£0.95
	Peppers	3 pack mixed	£1.38	£1.00	£1.64	£1.99
	Chicken	Whole medium	£3.64	£3.87	£4.67	£5.35
	Mince	500g beef	£2.00	£1.64	£2.20	£1.99
	Salmon fillets	2 pack 300g	£4.00	£3.58	£4.00	£4.99
	Bacon	16 rashers smoked	£3.50	£3.84	£4.00	£4.98
	Sausages	8 pack pork	£0.97	£0.97	£0.97	£0.97
Frozen items	Pizza	Deep crust cheese feast	£1.50	£1.17	£1.00	£2.89
	Ice-cream	2 litres vanilla	£1.20	£1.06	£1.07	£1.14
	Frozen peas	900g Bird's Eye garden peas	£1.64	£1.64	£1.64	£1.64
Cupboard items	Chopped tomatoes	400g tin	£0.58	£0.55	£0.59	£0.59
	Mayonnaise	500ml	£0.98	£0.98	£0.99	£1.04
	Jam	454g strawberry	£0.75	£0.98	£0.98	£1.49
	Pasta sauce	500g tomato	£0.75	£0.92	£1.00	£0.99
	Baked beans	4-pack Heinz	£2.16	£2.16	£2.16	£2.16
	Olive oil	500ml	£2.18	£1.98	£2.18	£1.95
	Spaghetti	500g	£0.75	£0.75	£0.70	£0.55
	Basmati rice	1kg	£1.47	£1.63	£1.68	£2.89
	Cornflakes	750g own brand	£1.18	£1.18	£1.59	£1.20
	Weetabix	24 pack	£1.98	£1.98	£1.78	£1.98
	Milk chocolate digestives	300g	£0.74	£0.77	£1.05	£0.99
	Milk chocolate	230g Dairy Milk	£1.58	£1.58	£1.79	£1.58
	Crisps	6 bag 25g Walkers Classic Variety	£1.48	£1.38	£1.39	£1.38
Drinks	Tea bags	80 bag PG Tips	£2.18	£2.18	£2.18	£2.18
	Coke	2 litres Coca-Cola	£1.66	£1.66	£1.69	£1.66
	Bottle of wine	Casillero del Diablo Cabernet Sauvignon	£5.00	£6.97	£4.65	£6.99
Household items	Washing up liquid	650ml Fairy Original	£1.40	£1.00	£1.40	£1.40
	Bin liners	40 pedal bin liners	£1.50	£1.50	£1.53	£1.76
	Washing powder	24 tablets Persil Non-Bio	£5.85	£5.86	£5.85	£5.85
	Toilet paper	4 pack white	£1.90	£1.78	£1.90	£1.97
	Antibacterial surface cleaner	500ml Dettol	£2.00	£2.00	£2.25	£2.00
	Nappies	27 pack Pampers New Born	£3.74	£3.00	£3.75	£3.74
	Rusks	150g Heinz Farley's Original	£1.29	£1.28	£1.00	£1.29
	Shower gel	250ml Radox Relax	£1.70	£1.68	£1.70	£1.00
	Toothpaste	100ml Colgate Total	£2.20	£1.94	£2.00	£2.20
TOTAL			**£88.39**	**£86.35**	**£89.58**	**£99.09**

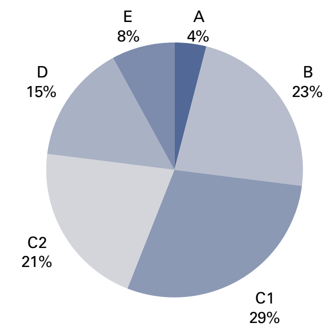
Source: Compiled by Goldman Sachs Research and company data.

The Ocado customer today

Currently, the majority of Ocado's customers are from households with income above £40,000 pa. In our view this is unsurprising, as the relatively more affluent are more likely to be early adopters of internet shopping and have the ability to spend more and indulge.

However, based on ONS data we calculate that the average income of the C1 social group is £47,000 and that of the C2 group is £34,000. Therefore, even if it were confined to only people within the A, B, C1 and C2 social groups, Ocado's potential customer base would cover three-quarters of total UK households.

Exhibit 33: 27% of UK households is in the A and B categories; 50% in C1 and C2
Breakdown of UK adults by social category



A: Higher managerial, administrative or professional.

B: Intermediate managerial, administrative or professional

C1: Supervisory or clerical and junior managerial, administrative or professional

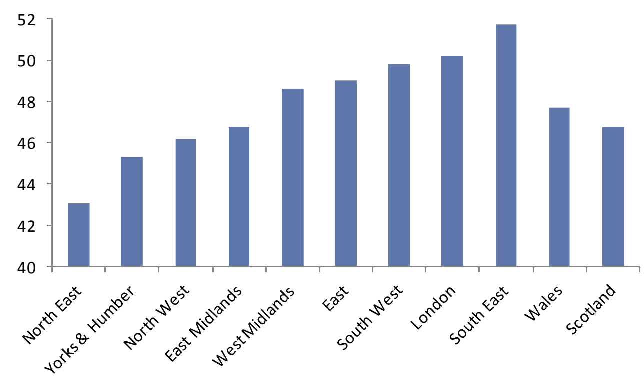
C2: Skilled manual workers

D: Semi and unskilled manual workers

E: Casual or lowest grade workers, pensioners and others who depend on the welfare state for their income

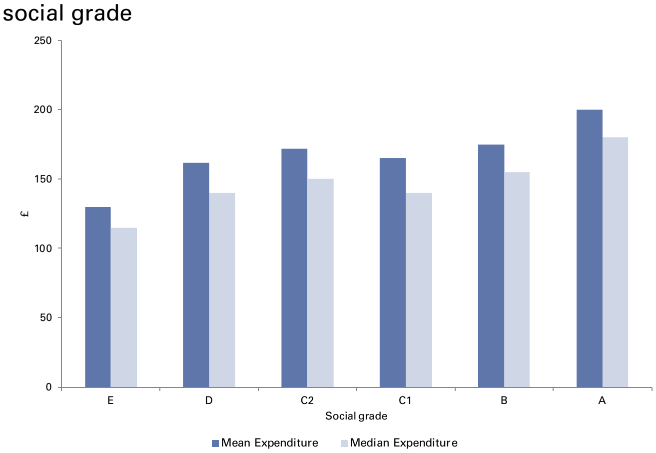
Source: NRS.

Exhibit 34: Food expenditure varies by region
Average weekly food expenditure per household by region in the UK, 2006-2008, (£)



Source: ONS.

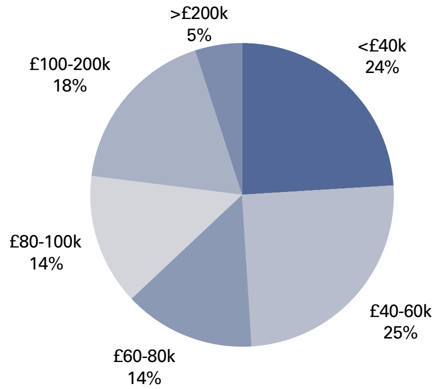
Exhibit 35: ... and by social grade
Average shopping expenditure over a four-week period, by social grade



Source: UK Competition Commission.

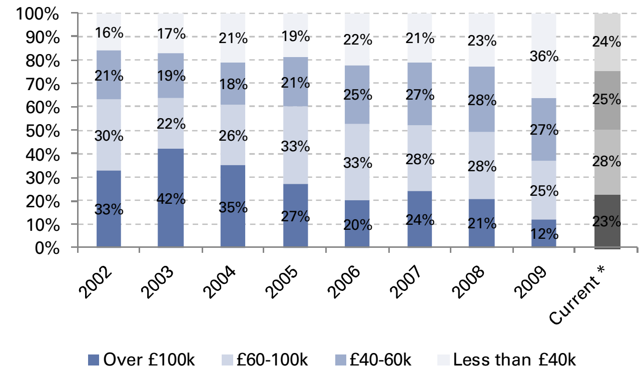
Ocado believes that it has significant scope to grow by attracting a broader demographic of customer. The C1 and C2 social group triple the available market size, compared to the A and B social groups alone (though incremental basket sizes may be smaller with less well-off customers). Note that the A and B social categories include just over a quarter of the total UK households.

Exhibit 36: 76% of Ocado customers have household income above £40,000, as the relatively more affluent are more likely to be early adopters of internet shopping
Ocado customers by household income



Source: Company data.

Exhibit 37: Since introducing the 'Tesco price match' in March 2008, the proportion of new customers from household incomes below £40,000 has increased to 36% in 2009 from 23% in 2008
Current household income by year of first order with Ocado



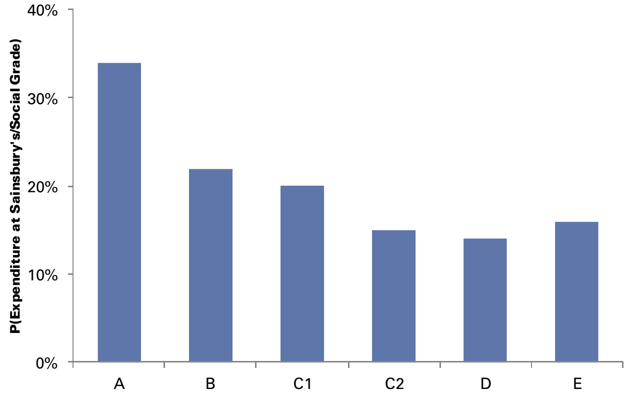
* Current Ocado customers by household income

Source: Company data.

According to Ocado, the majority of its new customers are from Tesco and Sainsbury's. As such, we believe the appeal of Ocado extends beyond Waitrose customers and there is scope for Ocado to increase its online market share. In our view, Ocado is already a relatively well-known brand in the UK grocery market. However, according to management, only c.20% of its first-time shoppers become long-term active customers. Ocado management identifies the two main issues contributing to the loss of the remaining 80% as perceived high(er) pricing – addressed through the Tesco price match – and range, which was until recently more limited than many supermarkets.

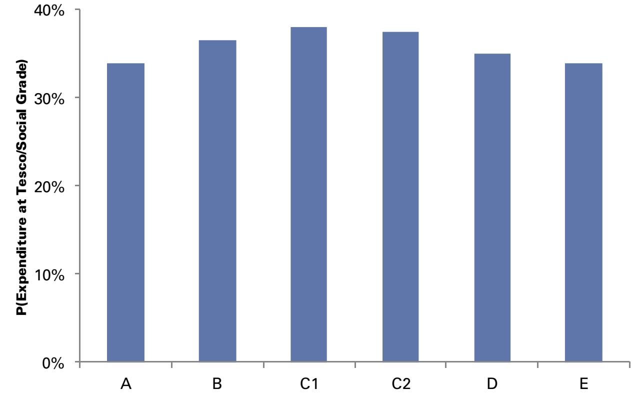
According to Ocado management, new investment in automated facilities for slower-moving items should enable a substantial expansion of the range, from 20,000 to c.40,000 items over several years. We believe that this will enable Ocado to retain a higher proportion of customers going forward, as many more complete shops can be executed in the one place. Indeed, as it effectively has only one "store", we believe Ocado should, in the long run, be able to offer a wider range than any other single store, as it achieves scale on a long-tail that geographically restricted supermarkets cannot.

Exhibit 38: Sainsbury's shoppers are most likely to fall into social category A
Probability that groceries are bought at Sainsbury's, conditional on social category



Source: UK Competition Commission.

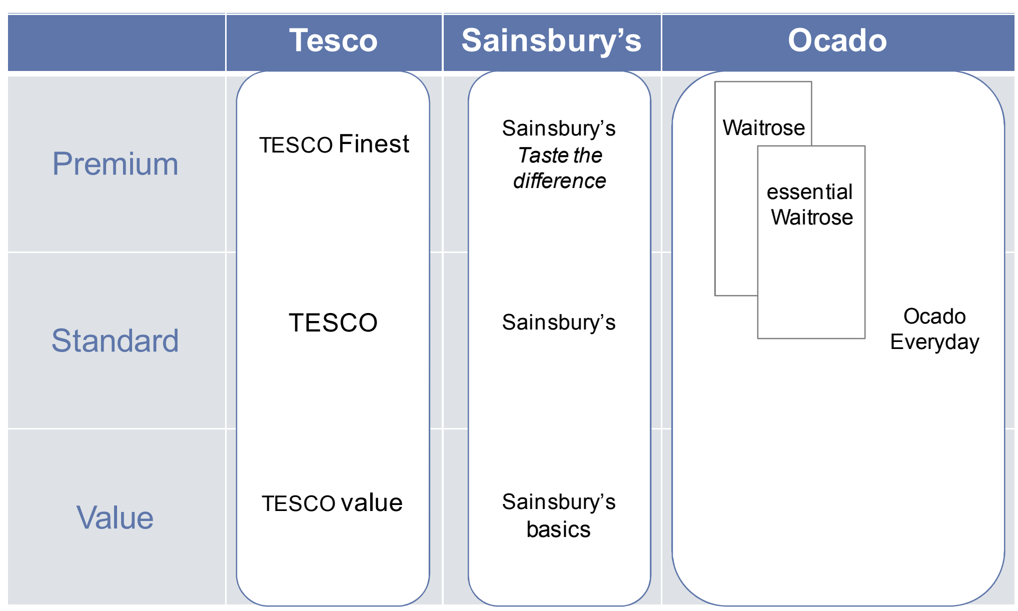
Exhibit 39: While broadly, Tesco shoppers are equally likely to come from all social categories
Probability that groceries bought at Tesco, conditional on social category



Source: UK Competition Commission.

Ocado has also been developing its own-label products at value prices to widen its price range and broaden its appeal to new customers. While this initiative is only beginning, Ocado management has indicated that it aims to have 250-300 own-label products by the end of the year.

Exhibit 40: 41% of orders include at least one own-label item; 61% of first time orders contain at least one own-label item, based on average over 4-week period to May 3, 2010
Market positioning for Ocado, Tesco and Sainsbury's own-label products



Source: Company data.

Risks to our view

We believe key risks for Ocado include the loss of its key supplier relationships, increasing competition from established and new online grocers, damage to the company's sole CFC, execution risk, and changes in consumer preferences.

Loss of supplier relationships

Ocado sources the majority (c.80% by value) of its products directly or indirectly through its sourcing and branding arrangement with Waitrose. While increasingly many products are sourced directly from major consumer product companies and other suppliers, part of its "quality food" image (a strong part of the Ocado brand) comes from its association with Waitrose. Any termination of the arrangement with Waitrose could therefore have a negative impact on brand image with some customers.

The companies have agreed a new ten-year contract, which runs until at least March 2017. In terms of prospects for future renewals, we believe that Waitrose also benefits from increased economies of scale in purchasing (while we estimate Ocado's sales are only 10% of Waitrose's own total, Ocado's high growth drives bonus payments from suppliers).

Increasing or more effective competition

As we expect the online grocery market in the UK to grow faster than the overall market, more aggressive competition from land-based grocery retailers (e.g. Tesco, Sainsbury's, Asda, Morrisons) in the online space could adversely impact Ocado's online market share.

In our view, as Ocado has a very differentiated and proprietary business model compared with the online strategy of land-based retailers (mostly pick in-store), it benefits from structural advantages. This is already reflected in its higher online market share compared to other grocers.

Ocado is set to face increased competition from 2011 from Waitrose Deliver (within the M25). We note that Ocado already competes with Waitrose Deliver outside the M25 and in several areas within the M25, and we see no evidence of an adverse impact on growth rates, which we believe is partly due to the different customer proposition offered by both companies.

Damage to the CFC

Currently, Ocado has only one CFC that fills all of its customer orders, although another one is planned. Natural or man-made disasters impacting the CFC could have a substantial negative impact on operations, revenues, and potentially, customer satisfaction and loyalty. Ocado has attempted to mitigate some of the associated financial risk through the purchase of insurance, but we believe if customers became used to using alternative online providers, it might prove expensive/difficult to rebuild growth momentum when the CFC was back in operation.

Execution risk

We forecast Ocado will more than double its revenue over the next five years, supported by significant growth in customer numbers, geographic expansion in the UK, and the construction of at least one more CFC. Future revenue and earnings growth depends significantly on management's ability to execute on these expansion plans.

Ocado's growth ambitions rely, in our view, partly on increased penetration outside the A and B social categories. Failure to achieve this, or only doing so with a basket size that generates minimal profit, would have a negative effect on our forecasts.

Ocado prides itself on having a superior offering (as measured by customer satisfaction) to that of other companies offering online groceries. Any deterioration in its offering, or an improvement in those of its peers, which reduced the perceived "premium service" could be negative for Ocado's sales and profits growth.

Change in consumer preferences

A significant and unexpected change in consumer shopping behaviour and preferences could limit future growth. Although we view it as unlikely, a trend away from internet shopping towards more store visits would be negative for online retailers including Ocado.

Financials: Poised for profitability

As a pure internet-based grocery retailer, we view Ocado as a high-growth company. We forecast compound EBITDA growth of 67% over the next five years (FY2009-FY2014) driven by sales growth of 26% and an expansion in EBITDA margin from 2.3% in FY2009 to 9.4% in FY2014E.

We expect a sales CAGR of 26% as online grocery penetration reaches c.4% by 2014E

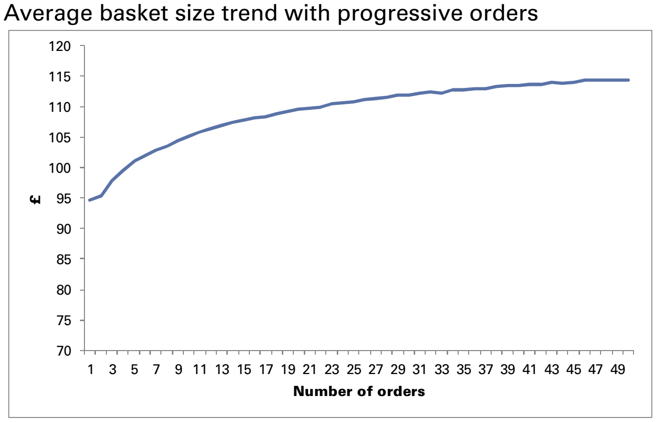
Ocado's growth is a function of customer numbers and value per shop. To some extent there is a trade-off between the two as marginal or new customers may (at least initially) have lower basket sizes. Furthermore, the introduction of the Ocado Delivery Pass in April 2008 led to many customers making more frequent, but smaller shops. Nonetheless, Ocado was able to increase its share of those customers' grocery purchases. The historical trends in both metrics are shown in Exhibits 43 and 44.

The company believes that as customers get used to its service, it gains a higher share of their total grocery expenditure. Thus, the underlying basket size ought to grow as the business ages (helped as well by food inflation). Although the average basket size was flat yoy in FY2009 at £116, this was due to the introduction of the Ocado Delivery Pass; the underlying basket size did increase in FY2009. In FY2010 to date, the company has continued to experience an increase in its underlying basket size, among both subscribers and non-subscribers to the Delivery Pass. Furthermore, in so far as the company is able to further extend its customer base into lower income groups, this may mitigate the growth in average basket size.

Our forecasts assume only a 0.7% share of the grocery market in 2014

In our model, we assume a flat nominal basket size. While this may be conservative given 2% food price inflation, it reflects the expansion of the customer base into the C1 category and the increased popularity of the delivery pass. However, we assume growth in the number of active customers from 220,000 at the end of FY2009 to 545,500 by the end of FY2014. The other key variable is shopping frequency (measured per twelve-week period) which we forecast rising from 4.1 times (or once every three weeks) in FY2009 to 5.3 times (or just under once per fortnight) by FY2014. As these are key assumptions in our model, we show also show the sensitivity of our order growth forecasts to changes to them.

Exhibit 41: Basket size grows with initial orders and then plateaus as customer becomes more frequent
Average basket size trend with progressive orders



Source: Company data.

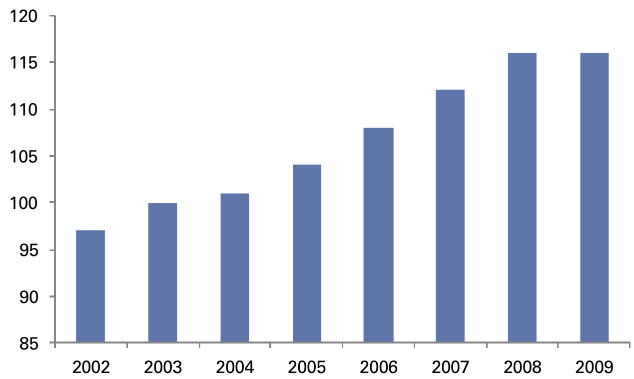
Exhibit 42: Customer growth a key variable
Sensitivity of average weekly order growth (FY2010E-14E) to number of average active customer and order frequency

Order growth 2010E-14E						
Active customer growth	Order frequency 2%	3%	4%	5%	6%	7%
5%	7%	8%	9%	10%	11%	12%
10%	12%	13%	14%	16%	17%	18%
15%	17%	18%	20%	21%	22%	23%
20%	22%	24%	25%	26%	27%	28%
25%	28%	29%	30%	31%	33%	34%
30%	33%	34%	35%	37%	38%	39%

Source: Company data, Goldman Sachs Research estimates.

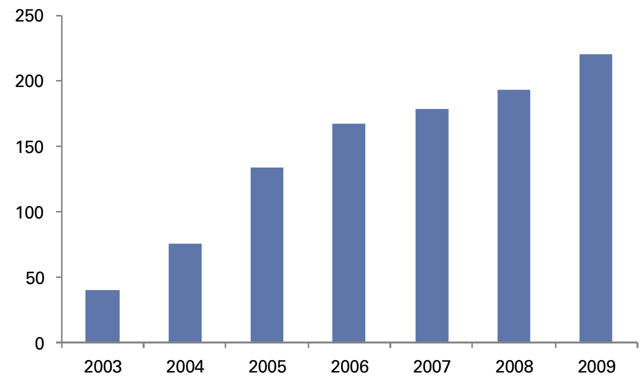
We assume a c.20% FY2009-14E CAGR in customers and a c.5% CAGR in order frequency in our base forecasts. To put our forecast of customer numbers in perspective, 545,500 active customers in FY2014E would represent 2.1% of UK households and 3.8% of households in social groups A, B and C1.

Exhibit 43: Average basket size has been increasing on an underlying basis
Average basket size (£)



Source: Company data.

Exhibit 44: Customer numbers still rising
Number of active customers at fiscal year end (000s, defined as having shopped in previous 12 weeks)



Source: Company data.

We believe Ocado can grow its customer numbers in three different ways:

- **Geographic and product range expansion:** e.g. the addition of the second CFC, addition of a central London spoke in 2010 and a Bristol spoke in early 2011.
- **Return of lapsed customers:** increased product range and targeted offers;
- **Superior offering:** gain customers that currently use other online grocers through targeted campaigns and more delivery flexibility.

Furthermore, we believe that penetration of existing delivery areas is helped when neighbours see Ocado vans active in their area. Ocado has reported that it is still seeing double-digit growth in the majority of its most penetrated post codes. For example, in a Kent postcode sector where Ocado's penetration was 7.7% in 2009 (vs. 2.1% in total coverage area), the number of customer orders rose 34% yoy in FY2009, although the scale of the increase was also boosted by introduction of the Delivery Pass.

Exhibit 45: Ocado is still seeing strong double-digit growth in areas where it first started trading...
Average weekly penetration, % used Ocado in FY2009 and FY2009 order growth in selected areas in London

Postcode Sector	Av. Weekly Penetration (2010 YTD)	% Used Ocado in FY09	Order Growth (FY08-FY09)
London Area 1	8.5%	26.8%	23%
London Area 2	7.7%	26.8%	19%
London Area 3	7.0%	23.0%	30%
London Area 4	6.9%	22.8%	19%
London Area 5	6.2%	22.3%	15%
London Area 6	5.6%	17.6%	20%
London Area 7	5.6%	17.8%	22%
London Area 8	5.3%	19.8%	28%

Source: Company data.

Exhibit 46: ...and is experiencing significant growth in areas where it recently started servicing.
Average weekly penetration, % used Ocado in FY2009 and FY2009 order growth in selected areas in new areas

Location of Postcode Sector	Average Penetration on weekly basis	% used Ocado in FY09	Order Growth (FY08-FY09)
Surrey	2.2%	6.6%	50%
Kent	2.1%	7.7%	34%
West Midlands	1.7%	6.0%	23%
Leicestershire	1.4%	5.2%	49%
North Yorkshire	1.0%	3.0%	284%
Suffolk	0.7%	4.0%	97%
Cheshire	0.8%	3.6%	24%
Milton Keynes	0.8%	3.6%	67%
Wiltshire	0.6%	3.1%	26%
West Yorkshire	0.5%	2.5%	150%

Source: Company data.

We forecast margin expansion driven by operational leverage and increasing productivity

We expect gross margin to remain broadly flat throughout the forecast period, as the underlying cost of goods sold is variable (with the exception of the sourcing fee to Waitrose that was recently renegotiated and is largely fixed).

Ocado had an operating cost base (excluding COGS, D&A and the sourcing fee to Waitrose) of c.£116 mn in FY2009 and we estimate that c.30% of these costs are fixed (the fixed cost component of the CFC and administrative costs), providing scope for significant operational leverage in the future.

Margin expansion very geared to sales growth

Our FY2014 sales forecast represents 0.7% of our UK grocery spend estimate in that year. However, it is possible that sales growth, for various reasons, could be less than we forecast. As Ocado is a highly operationally geared business, this would have a significant impact on margin progression.

In Exhibit 47, we show the sensitivity of our profit forecasts to different four-year (FY2010E-14E) sales CAGR assumptions. In this sensitivity analysis, we assume FY2010 sales growth of 30%, the rate reported in the first 12-week and 24-week periods of FY2010. Our base forecasts imply a FY2010-14E sales CAGR of 25% and our sensitivity analysis includes this scenario (2009-14E CAGR is 26%, FY2010-14E is 25%). Our analysis assumes that for sales CAGRs of 5%, 10%, 15%, 20% and 30%, the annual sales growth is the same each year.

Exhibit 47: Margins are sensitive to sales growth
Progression of EBITDA and EBITDA margins at different sales growth rates between 2010E-14E (£ mn)

4 -year Sales CAGR (FY2010E-14E)		2010E	2011E	2012E	2013E	2014E
30%	EBITDA	24.1	46.3	76.2	99.7	151.5
	margin	*4.6%*	*6.8%*	*8.6%*	*8.7%*	*10.1%*
25%	EBITDA	24.1	46.3	71.4	87.2	119.1
	Margin	*4.6%*	*6.8%*	*8.4%*	*8.2%*	*9.4%*
20%	EBITDA	24.1	38.6	56.4	61.9	87.3
	Margin	*4.6%*	*6.1%*	*7.5%*	*6.9%*	*8.1%*
15%	EBITDA	24.1	34.4	46.7	60.6	60.4
	Margin	*4.6%*	*5.7%*	*6.8%*	*7.6%*	*6.6%*
10%	EBITDA	24.1	30.4	37.4	45.4	54.2
	Margin	*4.6%*	*5.3%*	*5.9%*	*6.5%*	*7.1%*
5%	EBITDA	24.1	26.4	28.8	31.4	34.1
	Margin	*4.6%*	*4.8%*	*5.0%*	*5.2%*	*5.4%*

Source: Company data, Goldman Sachs Research estimates.

In the event of a sales CAGR of 10% or below, we would not expect CFC2 to be built within the forecast period.

Assuming the current CFC operates at full effective capacity of 180,000 orders per week, Ocado's EBITDA margin could increase from 2% in FY2009 to over 12%. We estimate that the increase of c.1,000 bp in margin would be driven equally by efficiency gains and economies of scale (leveraging the fixed cost base).

We forecast Ocado's EBITDA margin will increase from 2.3% in FY2009 to 9.4% in FY2014, resulting in a gross profit drop-through of c.40%. It is implicit in our assumption that Ocado, like most high-growth internet retailers, reinvests any gains from economies of scale and efficiency into improving its product offering and services, which we believe is sensible given its attractive medium-term growth potential.

Exhibit 48: At full capacity, the current CFC in Hatfield would have long-term EBITDA margin potential of c.12%, from efficiency gains and economies of scale

Long-term margin evolution for Ocado, assuming only one CFC operating at full capacity of 180,000 orders per week

	£ mn / % of gross sales		Full capacity potential	Cost classification	Details / Comments
	FY08	FY09			
Average orders per week (000)	57	71	180		The CFC is currently operating at effective capacity of c.105,000 orders per week.
Gross sales	**341**	**427**	**1083**		
Gross profit	**103** *30.2%*	**123** *28.8%*	**311** *28.8%*	Variable	
Other income	**2** *0.6%*	**3** *0.6%*	**7** *0.6%*	Variable	
Total CFC Costs (excluding depreciation)	**-36** *-10.5%*	**-40** *-9.4%*	**-57** *-5.3%*		•Labour costs per order are inversely correlated to productivity, measured by units of processed per labour hour ("UPH") –Labour costs represent c.57% of total CFC costs (exc. depreciation) –Management have a long term target of increasing UPH from 124 (09) to 180 –If achieved that would correspond to a 31% decrease in labour costs per order •Remainder (43%) are fixed costs – will benefit directly from scale •Assuming average orders increased to 180k per week & Ocado reached its long term UPH productivity target, the above would mathematically imply an incremental EBITDA margin of 4.1% (CFC1 only)
Fixed CFC Costs		*-17* *-4.0%*	*-17* *-1.6%*	*Fixed*	
Labour CFC Costs		*-23* *-5.3%*	*-40* *-3.7%*	*Semi-variable*	
Trunking & Delivery Costs (excluding depreciation)	**-44** *-13.0%*	**-51** *-12.0%*	**-90** *-8.3%*	Semi-variable	•Trunking & delivery costs per order are inversely correlated to the number of orders delivered per van per week ("DWW"). –Management have a long term target of increasing DWW from 121 (09) to 175 –If achieved that would correspond to a 31% reduction in delivery costs per order •Assuming average orders increased to 180k per week & Ocado reached its long term DWW efficiency target, the above would mathematically imply an incremental EBITDA margin of 3.7% (CFC1 only)
Administrative Expenses (excluding depreciation)	**-16** *4.7%*	**-18** *-4.2%*	**-18** *-1.7%*	Fixed	•Administrative expenses (predominantly central costs & marketing) are predominantly fixed costs •Absolute amount should not increase materially with sales •Assuming average orders increased to 180k per week & administrative expenses remain at c.£18mn per year the increased scale on these fixed costs would mathematically imply an incremental EBITDA margin of 2.5% (CFC1 only)
Marketing Expenses	-4 *-1.2%*	**-4** *-1.0%*	**-11** *-1.0%*	Variable	
Other Costs (call centre & payment processing, net of impairment)	**-3** *-0.9%*	**-3** *-0.7%*	**-8** *-0.7%*	Variable	
EBITDA	**2** *0.6%*	**9** *2.1%*	**134** *12.4%*		

Source: Company data, Goldman Sachs Research estimates.

Exhibit 49: We forecast FY2009-2014 sales and EBITDA CAGRs of 26% and 67% respectively
Profit and loss (£ mn, November year-end)

Profit and Loss	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Gross sales	**291.4**	**341.0**	**427.3**	**555.5**	**722.1**	**902.7**	**1,128.3**	**1,354.0**
Net sales	**272.9**	**321.3**	**402.0**	**522.6**	**679.4**	**849.3**	**1,061.6**	**1,273.9**
COGS	(184.9)	(218.5)	(279.2)	(362.4)	(469.4)	(585.4)	(730.4)	(875.3)
Gross profit	**88.0**	**102.8**	**122.8**	**160.2**	**210.0**	**263.9**	**331.2**	**398.6**
As a % of gross sales	*30.2%*	*30.1%*	*28.7%*	*28.8%*	*29.1%*	*29.2%*	*29.4%*	*29.4%*
Other income	**0.6**	**1.8**	**2.6**	**3.6**	**4.7**	**5.9**	**7.4**	**8.9**
CFC costs (excluding D&A)	(34)	(36)	(40)	(46)	(54)	(63)	(84)	(96)
Trunking and delivery costs (excluding D&A)	(40)	(44)	(51)	(65)	(83)	(102)	(125)	(147)
Other costs	(3)	(3)	(4)	(4)	(4)	(4)	(6)	(7)
Total distribution costs	**(77)**	**(83)**	**(95)**	**(115)**	**(142)**	**(169)**	**(216)**	**(249)**
As a % of gross sales	*26.5%*	*24.4%*	*22.1%*	*20.8%*	*19.6%*	*18.7%*	*19.1%*	*18.4%*
Indirect employment costs	(12)	(14)	(17)	(19)	(19)	(20)	(24)	(25)
Marketing costs (excluding vouchers)	(7)	(4)	(4)	(6)	(7)	(9)	(11)	(14)
Other administrative costs	(2)	(2)	(1)	(0)	(0)	(0)	(1)	(1)
Total administrative costs	**(21)**	**(19)**	**(22)**	**(25)**	**(27)**	**(29)**	**(36)**	**(39)**
As a % of gross sales	*7.1%*	*5.6%*	*5.1%*	*4.4%*	*3.7%*	*3.2%*	*3.2%*	*2.9%*
EBITDA	**(9.5)**	**2.2**	**9.2**	**24.1**	**46.3**	**71.4**	**87.2**	**119.1**
EBITDA margin	*-3.5%*	*0.7%*	*2.3%*	*4.6%*	*6.8%*	*8.4%*	*8.2%*	*9.4%*
As a % of gross sales	*-3.3%*	*0.6%*	*2.1%*	*4.3%*	*6.4%*	*7.9%*	*7.7%*	*8.8%*
CFC D&A	(13)	(14)	(11)	(10)	(11)	(18)	(23)	(23)
Trunking D&A	(3)	(4)	(4)	(4)	(4)	(4)	(5)	(5)
Admin D&A	(4)	(6)	(7)	(8)	(8)	(8)	(10)	(10)
Total D&A	**(20)**	**(24)**	**(23)**	**(22)**	**(23)**	**(30)**	**(37)**	**(38)**
As a % of gross sales	*6.9%*	*7.0%*	*5.3%*	*3.9%*	*3.2%*	*3.4%*	*3.3%*	*2.8%*
EBIT	**(29.5)**	**(21.5)**	**(13.4)**	**2.4**	**23.3**	**41.0**	**50.0**	**81.6**
EBIT margin	*-10.8%*	*-6.7%*	*-3.3%*	*0.5%*	*3.4%*	*4.8%*	*4.7%*	*6.4%*
As a % of gross sales	*-10.1%*	*-6.3%*	*-3.1%*	*0.4%*	*3.2%*	*4.5%*	*4.4%*	*6.0%*
Interest income	0.8	0.1	0.0	0.1	0.7	0.0	0.0	0.3
Interest expense	(10.9)	(11.8)	(11.1)	(9.6)	(7.1)	(4.8)	(4.8)	(4.8)
Others non-operating items	(0.6)	(0.1)	(1.1)	-	-	-	-	-
EBT	**(40.2)**	**(33.3)**	**(25.6)**	**(7.1)**	**16.9**	**36.3**	**45.2**	**77.1**
As a % of sales	*-14.7%*	*-10.4%*	*-6.4%*	*-1.4%*	*2.5%*	*4.3%*	*4.3%*	*6.1%*
Taxes	-	-	2.3	-	-	-	-	-
Tax rate	*0.0%*	*0.0%*	*9.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Net income	**(40.2)**	**(33.3)**	**(23.3)**	**(7.1)**	**16.9**	**36.3**	**45.2**	**77.1**
Net income margin	*-13.8%*	*-9.8%*	*-5.5%*	*-1.3%*	*2.3%*	*4.0%*	*4.0%*	*5.7%*
EPS	**(11.9)**	**(9.7)**	**(5.8)**	**(1.6)**	**3.3**	**7.0**	**8.7**	**14.8**

Source: Company data (some items have been reclassified in accordance with Goldman Sachs Research format (FY2007-2009), Goldman Sachs Research estimates.

Cash flow

Stepping up capex to fund further expansion and support up to £2 bn of turnover

Ocado has indicated that it seeks to invest c.£80 mn over FY2010 and FY2011 in more automated capacity in the current CFC. This should remove certain bottlenecks and raise total capacity from 105,000 orders per week currently to 180,000 orders per week over the next 18 months. This is peak capacity, which we estimate as running around 20% higher than average capacity.

Furthermore, Ocado is considering building another CFC in the Midlands. A freehold development would, on the company's estimate, cost £210 mn (£90 mn for land, construction of external building and ordinary internal fit-out; £120 mn for material handling equipment) and would be automated at the best level of the Hatfield CFC.

When fully operational, we estimate this would at least double Ocado's total capacity to around 400,000 orders per week, and in our view, would enable the group to achieve c.£2 bn of annual turnover. Ocado's management has indicated that the second CFC would take just over two years to build. We have assumed that Ocado would stagger the expenditure on the material handling equipment; hence, we would expect the second CFC initially to have capacity of 120,000 orders per week.

To support the second CFC, we have also included capex assumptions for van fleet expansion in our forecasts (we assume c.110 new vans pa in FY2010-2012 and c.150 pa in FY2013 and FY2014 when CFC2 is ready) and for two new spokes per annum (we assume at a total annual cost of c.£5 mn). We assume ongoing IT capex increases broadly in line with inflation at c.3%.

Exhibit 50: We forecast total capex of £365 mn over FY2010E-2014E to increase Ocado's capacity to support c.£2 bn of turnover

Capex schedule (£ mn, November year-end)

Capex breakdown	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
CFC	16.3	10.1	4.9	40.0	140.0	60.0	10.0	20.0
Vehicles	3.2	3.4	4.7	3.9	4.0	4.2	5.9	6.1
Spokes	0.1	3.6	5.4	5.0	5.0	5.0	5.0	5.0
IT	5.4	6.6	7.5	7.7	8.0	8.2	8.4	8.7
Other	1.0	1.0	0.5	1.0	1.0	1.0	1.0	1.0
Total	**26.0**	**24.7**	**23.0**	**57.6**	**158.0**	**78.4**	**30.3**	**40.8**

Source: Company data (FY2007-2009), Goldman Sachs Research estimates.

Exhibit 51: Ocado's business model results in a more efficient use of capital relative to other UK land-based supermarkets

Sales growth as a multiple of capex (LFY-2 to LFY and FY1 to FY5) for Ocado, Tesco, Sainsbury's and Morrisons

Company	LFY-2 to LFY	FY1 to FY5
Ocado	**1.8x**	**2.1x**
Tesco	0.8x	1.5x
Sainsbury's	0.9x	1.1x
Morrisons	1.2x	1.2x

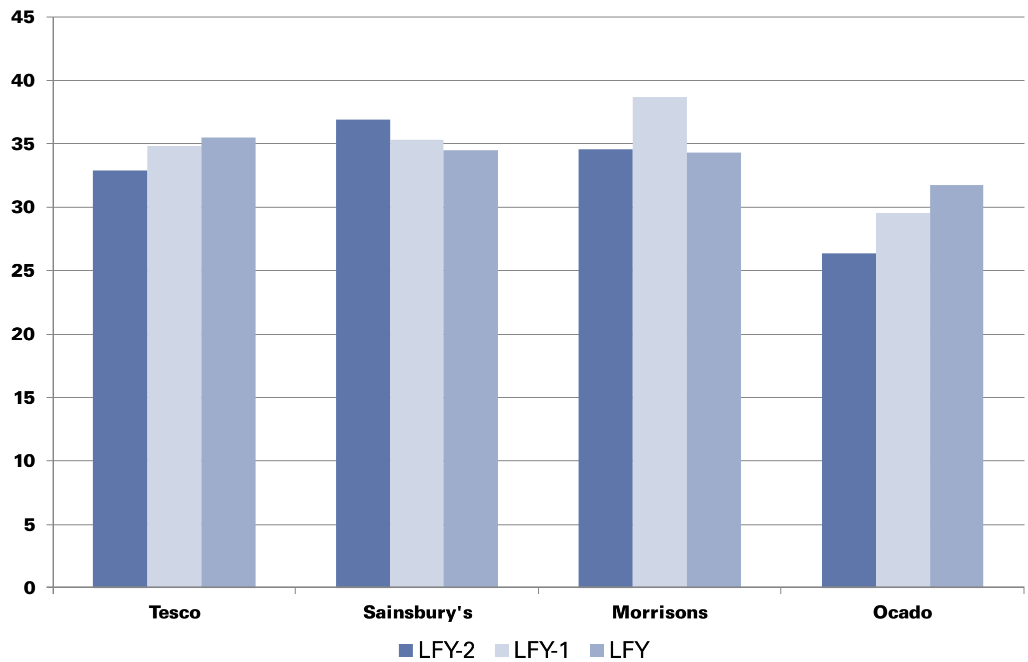
Source: Company data, Goldman Sachs Research estimates.

In our view, while total capex is relatively large as a percentage of sales in certain years in the forecast period (especially FY2010-2012), we believe this is justified: Ocado needs to invest ahead of the sales growth we expect, which is significantly higher than the overall grocery market. However, we continue to believe that Ocado's business model results in a more efficient use of capital, relative to land-based supermarkets, as reflected in its higher sales growth as a multiple of capex over the forecast period (though we note that some of its traditional peers are currently investing heavily in overseas expansion).

Scope for working capital improvement

While Ocado's trade creditor days have been improving in the last three fiscal years, it is still behind its land-based peers. In our view, there is potential for Ocado's trade credit terms to improve as the company reduces its debt.

Exhibit 52: Ocado's trade credit is approaching that of peers
Trade payables (days outstanding), last three fiscal years, £ mn



Source: Company data.

Exhibit 53: We expect Ocado to continue generating positive operating cash flow
Cash flow (£ mn, November year-end)

Cash flow	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Operating profit	(29.5)	(21.5)	(13.4)	2.4	23.3	41.0	50.0	81.6
Depreciation & amortization	20.0	23.7	22.6	21.7	23.0	30.4	37.1	37.6
Receivables, (increase) decrease	1.9	(2.8)	(2.7)	(1.7)	(2.2)	(2.4)	(3.0)	(3.0)
Inventories, (increase) decrease	(1.1)	(0.8)	(0.1)	(2.7)	(3.5)	(3.8)	(4.8)	(4.8)
Payables, (decrease) increase	(9.7)	6.6	10.1	10.2	13.2	14.3	17.9	17.9
Others	0.3	0.1	0.3	-	-	-	-	-
Operating free cash flow	**(18.1)**	**5.3**	**16.8**	**29.8**	**53.7**	**79.5**	**97.2**	**129.2**
Interest paid	(8.1)	(9.0)	(12.7)	(9.6)	(7.1)	(4.8)	(4.8)	(4.8)
Interest received	2.0	0.1	0.0	0.1	0.7	0.0	0.0	0.3
Corporation tax paid	-	-	-	-	-	-	-	-
Cashflow before investing activities	**(24.2)**	**(3.6)**	**4.1**	**20.2**	**47.4**	**74.7**	**92.5**	**124.7**
Sale (purchase) of tangible assets	-	-	-	-	-	-	-	-
Sale (purchase) of intangible & fin assets	0.2	0.0	-	-	-	-	-	-
Property, plant & equipment, net	(22.9)	(19.9)	(19.6)	(57.6)	(158.0)	(78.4)	(30.3)	(40.8)
Cash from investing activities	**(22.7)**	**(19.9)**	**(19.6)**	**(57.6)**	**(158.0)**	**(78.4)**	**(30.3)**	**(40.8)**
Free cash flow	**(47.0)**	**(23.4)**	**(15.5)**	**(37.4)**	**(110.6)**	**(3.7)**	**62.1**	**83.9**
Short-term debt (decrease) increase	-	-	-	(31.8)	-	-	-	-
Long-term debt (decrease) increase	16.6	0.5	(6.5)	-	(28.4)	-	-	-
Dividends	-	-	-	-	-	-	-	-
Share issue / repurchase	30.2	17.9	29.1	200.0	-	-	-	-
Other including fx adjustment	(0.5)	-	-	-	-	-	-	-
Cash from financing activities	**46.3**	**18.4**	**22.7**	**168.2**	**(28.4)**	**-**	**-**	**-**
Cash flow, inclusive of finance	**(0.6)**	**(5.0)**	**7.2**	**130.9**	**(139.0)**	**(3.7)**	**62.1**	**83.9**
Increases (decreases) in cash	**(0.6)**	**(5.0)**	7.2	130.9	(139.0)	(3.7)	62.1	83.9
Liquid funds at start of year	11.5	10.9	5.9	13.0	143.9	4.9	1.2	63.4
Liquid funds at end of year	**10.9**	**5.9**	**13.0**	**143.9**	**4.9**	**1.2**	**63.4**	**147.2**

Source: Company data (some items have been reclassified in accordance with Goldman Sachs Research format (FY2007-2009)), Goldman Sachs Research estimates.

Balance sheet

We expect Ocado to maintain a conservative balance sheet, given the positive operating free cash flow cash generation we forecast. Ocado had net debt of c.£107 mn in November 2009 and total debt of c.£120 mn. The company's total outstanding debt consists of c.£55 mn of bank loans and c.£65 mn of finance leases. In the past three years, Ocado has finance leased almost all of its capex relating to vehicles and significant material handling equipment in the CFC.

Exhibit 54: We forecast consistent net cash by FY2013E
Balance sheet (£ mn, November year-end)

Balance sheet	2007	2008	2009	2010E	2011E	2012E	2013E	2014E
Assets								
Cash & securities	10.9	5.9	13.0	143.9	4.9	1.2	63.4	147.2
Receivables, net	1.1	3.0	5.7	7.4	9.6	12.1	15.1	18.1
Inventories	8.3	9.1	9.2	12.0	15.5	19.3	24.1	28.9
Total current assets	**20.3**	**18.0**	**27.9**	**163.3**	**30.1**	**32.6**	**102.5**	**194.2**
Long term investments & others	8.5	9.4	11.7	11.7	11.7	11.7	11.7	11.7
Property, plant & equipment, net	96.7	97.6	96.9	132.8	267.8	315.8	309.0	312.2
Intangible assets			-	-	-	-	-	-
Total assets	**126**	**125**	**136.6**	**307.9**	**309.6**	**360.1**	**423.2**	**518.2**
Liabilities								
Short-term debt	5.9	39.5	31.8	-	-	-	-	-
Trade payables	20.1	25.9	33.8	44.0	57.2	71.5	89.4	107.2
Other payables	14.2	15.7	14.8	14.8	14.8	14.8	14.8	14.8
Total current liabilities	**40.3**	**81.1**	**80.4**	**58.8**	**72.0**	**86.3**	**104.2**	**122.1**
Long-term debt	129.1	82.1	88.3	88.3	59.9	59.9	59.9	59.9
Pension provisions			-	-	-	-	-	-
Total liabilities	**169.5**	**163.2**	**168.8**	**147.1**	**131.9**	**146.2**	**164.1**	**182.0**
Minority interests	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Undistributable equity	241.1	281.7	310.9	310.9	310.9	310.9	310.9	310.9
Distributable equity	(285.0)	(319.9)	(343.0)	(150.2)	(133.2)	(97.0)	(51.7)	25.4
Total shareholders' equity	**(43.9)**	**(38.2)**	**(32.2)**	**160.7**	**177.6**	**213.9**	**259.1**	**336.3**
Total liabilities & equity	**125.6**	**125.0**	**136.6**	**307.9**	**309.6**	**360.1**	**423.2**	**518.2**

Source: Company data (some items have been reclassified in accordance with Goldman Sachs Research format (FY2007-2009)), Goldman Sachs Research estimates.

We estimate that it will move into a net cash position in the current year, but return to a net debt position as a result of heavy capex in FY2011/2. Subsequently, on our forecasts it becomes consistently cash positive from FY2013.

Valuation: Our 6-month price target of 200p implies 39% upside

As a fast-growing company just breaking into profit, we value Ocado using a DCF model to capture medium and long-term growth potential. Our price target implies a CY2011E EV/sales ratio of 1.6x, representing approximately a 25% discount to online retail peers Yoox and ASOS, at our target prices for these stocks. Although Ocado competes with Tesco, Sainsbury's et al, we view its growth rate and business model as being closer to that of its internet peers.

Our DCF is based on our FY10-15E estimates, a medium-term growth rate of 6% for a further five years to capture the ramp-up of the second distribution centre, and, following this, a terminal growth rate of 2%. However, Ocado's long-term growth could be higher if there is a continual share shift towards online grocery shopping. We expect Ocado's tax losses (£343 mn at the end of FY09) to cover its profitability through the next five years, but expect the company to pay tax at 30% shortly thereafter.

As we expect Ocado to be debt free by the end of this year, and to be highly cash generative once it has spent the bulk of the capex on CFC2, we assume a WACC of 8% (based on UK 10-year government bond yields of 3%; a European equity risk premium of 5% and a beta of 1—reflecting the lower beta of food retailing and the higher beta of internet companies).

Given the differentiated nature of Ocado's business model, we believe there are currently no listed, directly comparable peers for the company. As a result, we have defined the following groups of comparables, each reflecting key aspects of Ocado's business model:

- **US and European internet retailers:** These companies provide goods and services through similar platforms (not auction-based). This group includes Amazon, ASOS, YOOX and Blue Nile. Ocado reported positive EBITDA in FY2008, seven years after starting operation and over the same time-scale as Amazon. We believe Amazon is Ocado's closest publicly traded comparable, reflecting both companies' focus on advanced distribution technology and e commerce platforms.
- **European food retailers:** These peers are also active in the grocery market, with some operating online business units that are broadly comparable to Ocado. This group includes Royal Ahold, Carrefour, Casino, Colruyt, Delhaize, Sainsbury's, Jeronimo Martins, Metro, Morrison and Tesco.
- **Other European internet companies:** We believe that this group of online gaming and real estate advertising companies share an interest in the general 'offline to online' migration trend, in common with Ocado. However, we are cognisant that they have different business models and end markets to Ocado, and face industry-specific issues. This group includes 888, Betsson, bwin, IG Group, PartyGaming, Playtech, Sportingbet and Unibet, Rightmove and SeLoger).

We believe that other internet retailers are the most appropriate comparables for Ocado. While it might be tempting to focus on food retailing peers such as Tesco or Sainsbury's, we view this as analogous to comparing Amazon to WH Smith: the business model and route-to-market are more important than the product sold, in our view. This comparability is borne out by growth rates. Our 26% forecast sales CAGR (FY2009-14) for Ocado compares to our mid 20%- mid 30% forecasts for Amazon, YOOX and ASOS over the next five years. In contrast, we forecast UK sales growth for Tesco and Sainsbury's of 5.2% and 5.6% pa respectively on average over the same period.

Exhibit 55: Comparative multiples of potential peers

Comparative valuation ratios for selected potential peers, based on calendar years

			CY2010E-2012E CAGR			P/E			EV/EBITDA			EV/EBIT			EV/Sales			PEG (2011-13E EPS)		
Company name	Price	Market cap ($ bn)	Sales	EBITDA	EBIT	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E
Ocado Group PLC	**GBp 144**	**$ 1.16**	**27%**	**68%**	**218%**	**NM**	**40.6x**	**20.3x**	**23.3x**	**16.6x**	**11.0x**	**NM**	**32.5x**	**19.2x**	**1.1x**	**1.2x**	**0.9x**	**NM**	**0.7x**	**0.3x**
Morrison (Wm)	GBp 290	$ 11.9	7%	9%	9%	12.7x	11.1x	9.8x	7.0x	6.3x	5.6x	9.6x	8.5x	7.6x	0.5x	0.5x	0.4x	1.3x	1.1x	1.0x
J Sainsbury	GBp 363	$ 9.65	6%	8%	9%	14.9x	13.6x	12.2x	7.6x	7.1x	6.7x	12.9x	12.0x	11.1x	0.4x	0.4x	0.4x	1.8x	1.7x	1.5x
Tesco	GBp 407	$ 49.9	9%	11%	13%	11.8x	10.4x	9.2x	7.9x	6.9x	6.1x	11.1x	9.4x	8.2x	0.7x	0.6x	0.5x	1.0x	0.9x	0.8x
Ahold	€ 9.61	$ 14.4	5%	7%	7%	11.2x	9.2x	8.3x	4.9x	4.0x	3.4x	7.5x	6.1x	5.2x	0.4x	0.3x	0.3x	1.4x	1.1x	1.0x
Carrefour	€ 35.72	$ 32.0	6%	9%	12%	14.9x	11.9x	10.5x	6.6x	5.7x	5.2x	11.1x	9.3x	8.2x	0.4x	0.3x	0.3x	1.4x	1.1x	1.0x
Casino	€ 64.32	$ 9.08	7%	8%	9%	12.4x	10.9x	10.0x	6.3x	5.6x	5.1x	9.6x	8.4x	7.7x	0.4x	0.4x	0.4x	1.6x	1.4x	1.3x
Colruyt	€ 197.45	$ 7.92	8%	8%	9%	17.5x	15.9x	14.7x	9.8x	8.7x	7.9x	12.4x	11.0x	10.0x	0.9x	0.8x	0.7x	2.3x	2.1x	1.9x
Delhaize	€ 53.26	$ 6.76	5%	5%	6%	9.4x	8.5x	8.1x	4.6x	4.2x	3.9x	7.0x	6.4x	6.0x	0.3x	0.3x	0.3x	1.7x	1.6x	1.5x
Jeronimo Martins	€ 8.59	$ 6.86	13%	15%	16%	19.9x	16.0x	13.6x	9.8x	8.2x	7.0x	14.1x	11.7x	9.9x	0.7x	0.6x	0.5x	1.3x	1.0x	0.9x
Metro	€ 40.46	$ 16.8	8%	14%	18%	12.4x	10.1x	8.2x	5.4x	4.7x	4.0x	8.5x	7.2x	5.9x	0.3x	0.3x	0.2x	0.8x	0.7x	0.6x
Simple average: Food retail			**7%**	**9%**	**11%**	**13.7x**	**11.8x**	**10.5x**	**7.0x**	**6.1x**	**5.5x**	**10.4x**	**9.0x**	**8.0x**	**0.5x**	**0.4x**	**0.4x**	**1.5x**	**1.3x**	**1.1x**
Median: Food retail			**7%**	**9%**	**9%**	**12.6x**	**11.0x**	**9.9x**	**6.8x**	**6.0x**	**5.4x**	**10.4x**	**8.9x**	**7.9x**	**0.4x**	**0.4x**	**0.4x**	**1.4x**	**1.1x**	**1.0x**
YOOX	€ 6.45	$ 0.42	29%	35%	36%	32.5x	22.9x	16.9x	15.3x	11.0x	8.6x	17.5x	12.5x	9.5x	1.7x	1.2x	1.0x	0.8x	0.6x	0.4x
ASOS plc	GBp 938	$ 1.07	36%	43%	43%	35.0x	24.7x	17.3x	21.7x	15.0x	10.3x	24.8x	17.4x	11.9x	2.3x	1.7x	1.2x	1.0x	0.7x	0.5x
Amazon.com Inc.	$ 126.64	$ 57.6	26%	28%	35%	36.9x	28.5x	21.2x	21.4x	15.8x	11.0x	31.9x	22.3x	14.7x	1.6x	1.2x	0.8x	1.1x	0.8x	0.6x
Blue Nile, Inc.	$ 43.24	$ 0.63	13%	18%	18%	45.7x	37.2x	30.1x	21.7x	17.3x	13.7x	24.7x	19.8x	15.7x	1.6x	1.4x	1.1x	NM	NM	NM
Simple average: Online retail			**26%**	**31%**	**33%**	**37.5x**	**28.3x**	**21.4x**	**20.0x**	**14.8x**	**10.9x**	**24.7x**	**18.0x**	**13.0x**	**1.8x**	**1.4x**	**1.0x**	**1.0x**	**0.7x**	**0.5x**
Median: Online retail			**28%**	**31%**	**36%**	**36.0x**	**26.6x**	**19.3x**	**21.5x**	**15.4x**	**10.7x**	**24.8x**	**18.6x**	**13.3x**	**1.6x**	**1.3x**	**1.1x**	**1.0x**	**0.7x**	**0.5x**
888 Holdings	GBp 37	$ 0.20	2%	6%	7%	9.3x	9.1x	8.1x	3.7x	4.0x	3.2x	5.2x	5.7x	4.5x	0.4x	0.5x	0.4x	0.9x	0.9x	0.8x
Betsson AB	Skr 91.75	$ 0.42	12%	14%	14%	10.0x	8.6x	7.7x	7.6x	6.4x	5.6x	8.4x	7.2x	6.3x	2.1x	1.8x	1.6x	1.0x	0.9x	0.8x
bwin Interactive Entertainment	€ 37.99	$ 1.73	10%	21%	32%	16.9x	12.4x	10.7x	9.9x	7.2x	6.0x	16.0x	10.3x	8.0x	2.4x	2.0x	1.8x	1.2x	0.9x	0.8x
IG Group Holdings	GBp 523	$ 2.65	14%	14%	15%	15.3x	13.5x	11.8x	9.6x	8.0x	6.7x	10.1x	8.3x	6.9x	5.2x	4.3x	3.7x	1.2x	1.0x	0.9x
PartyGaming plc	GBp 261	$ 1.65	7%	7%	15%	15.6x	14.5x	13.4x	10.9x	9.8x	8.5x	19.9x	16.1x	13.5x	3.0x	2.7x	2.4x	2.2x	2.0x	1.9x
Playtech	GBp 411	$ 1.52	11%	13%	13%	11.6x	10.1x	9.1x	10.8x	8.4x	6.6x	11.1x	8.6x	6.8x	6.0x	4.7x	3.7x	1.2x	1.0x	0.9x
Sportingbet plc	GBp 62	$ 0.48	9%	14%	15%	9.0x	8.1x	6.8x	5.1x	4.3x	3.2x	6.5x	5.4x	4.0x	1.1x	0.9x	0.8x	0.6x	0.6x	0.5x
Unibet Group Plc	Skr 129.75	$ 0.50	10%	12%	12%	9.8x	8.8x	7.8x	6.8x	5.9x	5.0x	8.9x	7.7x	6.5x	1.9x	1.7x	1.4x	0.9x	0.8x	0.7x
Simple average: Online gaming			**9%**	**13%**	**15%**	**12.2x**	**10.7x**	**9.4x**	**8.0x**	**6.7x**	**5.6x**	**10.8x**	**8.7x**	**7.1x**	**2.8x**	**2.3x**	**2.0x**	**1.1x**	**1.0x**	**0.9x**
Median: Online gaming			**10%**	**14%**	**15%**	**10.8x**	**9.6x**	**8.6x**	**8.6x**	**6.8x**	**5.8x**	**9.5x**	**8.0x**	**6.6x**	**2.4x**	**2.0x**	**1.8x**	**1.1x**	**0.9x**	**0.8x**
Rightmove Plc	GBp 619	$ 1.16	12%	16%	16%	17.0x	14.0x	12.5x	11.4x	9.0x	7.6x	11.7x	9.2x	7.8x	7.4x	6.1x	5.2x	1.5x	1.2x	1.1x
SeLoger.com	€ 28.85	$ 0.61	18%	22%	29%	21.0x	15.1x	12.4x	NM	NM	NM	NM	NM	NM	NM	NM	NM	1.1x	0.8x	0.7x
Simple average: Online real estate advertising			**15%**	**19%**	**22%**	**19.0x**	**14.6x**	**12.4x**	**11.4x**	**9.0x**	**7.6x**	**11.7x**	**9.2x**	**7.8x**	**7.4x**	**6.1x**	**5.2x**	**1.3x**	**1.0x**	**0.9x**
Median: Online real estate advertising			**15%**	**19%**	**22%**	**19.0x**	**14.6x**	**12.4x**	**11.4x**	**9.0x**	**7.6x**	**11.7x**	**9.2x**	**7.8x**	**7.4x**	**6.1x**	**5.2x**	**1.3x**	**1.0x**	**0.9x**
Simple average: total			**12%**	**15%**	**17%**	**17.6x**	**14.4x**	**12.1x**	**9.8x**	**8.0x**	**6.6x**	**13.1x**	**10.5x**	**8.5x**	**1.8x**	**1.5x**	**1.3x**	**1.3x**	**1.1x**	**1.0x**
Median: total			**9%**	**13%**	**14%**	**14.9x**	**12.2x**	**10.6x**	**7.9x**	**7.1x**	**6.1x**	**11.1x**	**9.2x**	**7.8x**	**1.1x**	**0.9x**	**0.8x**	**1.2x**	**1.0x**	**0.9x**

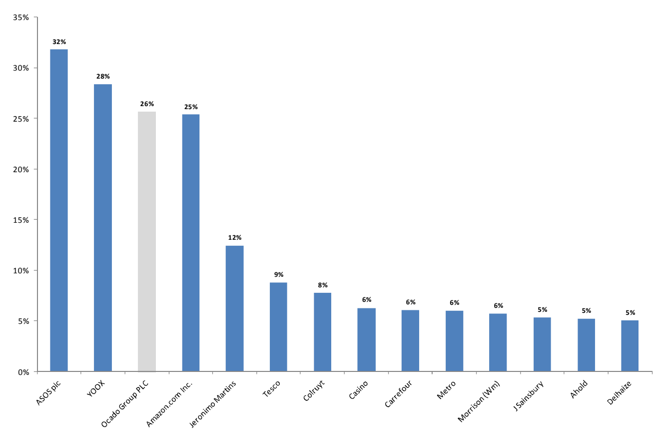
Source: Company data, Goldman Sachs Research estimates.

Growth rate in line with internet retail peers

We forecast that Ocado will report annual average revenue growth of 26% over the next five years and EBITDA growth of 67% (49% between 2010E and 2014E). This is above the average that we forecast for the grocery store and internet retailing peer groups. Below, we set out growth rates for Ocado versus peers based on calendarised earnings.

Exhibit 56: Our forecast of Ocado's revenue growth is in line with its online retail peers and significantly higher than other grocery stores

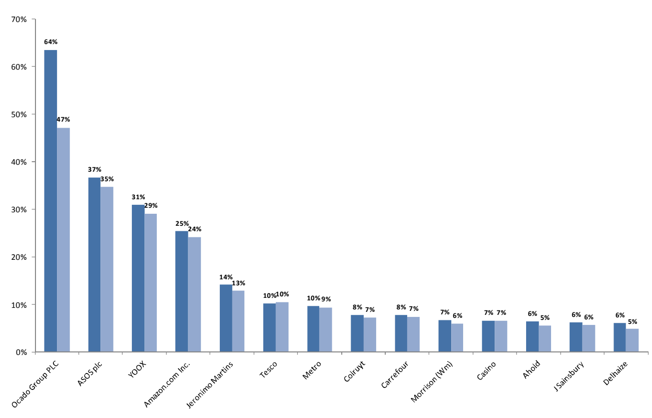
Sales CAGR CY09-2014E



Source: Respective company data, Goldman Sachs Research estimates.

Exhibit 57: EBITDA growth is significantly higher than both online retail and grocery store peers

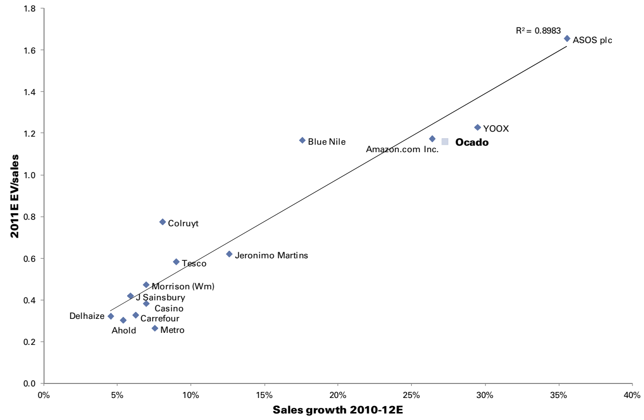
EBITDA CAGR 2009-2014E vs. CY10E-2014E



Source: Respective company data, Goldman Sachs Research estimates.

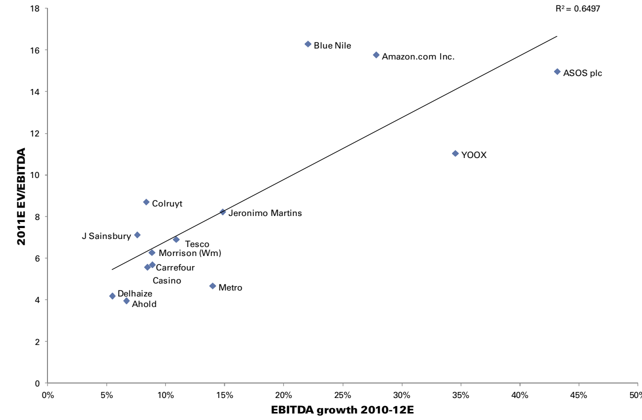
Both sales and EBITDA growth are likely to be major factors driving valuation in our view (Exhibits 58 and 59). Note that our forecasts are for 68% EBITDA growth over the period CY2010-12E, putting Ocado off the scale of Exhibit 59.

Exhibit 58: EV/sales rises with growth
Sales growth CY10-12E versus CY11E EV/sales



Source: Goldman Sachs Research estimates, Quantum database.

Exhibit 59: …as does EV/EBITDA
EBITDA growth CY10-12E versus CY11E EV/EBITDA



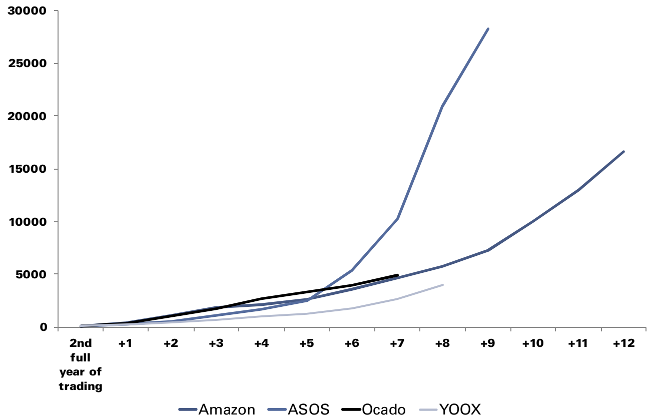
Source: Goldman Sachs Research estimates, Quantum database.

Sales and profit progression similar to that of Amazon

As Ocado has only recently achieved profitability, we believe EV/EBITDA and P/E ratios have less relevance. In this regard, we show the sales and EBITDA margin evolution of ASOS, YOOX and Amazon (Exhibits 59 and 60) to demonstrate Ocado's relative position. ASOS and YOOX have used largely an outsourced model for their warehouses and have limited automation. In contrast, Ocado has a model similar to that of Amazon with a large, wholly-owned semi-automated facility. As a result, capital requirements are greater, but eventual operational gearing should be greater as sales ramp up and capacity is filled.

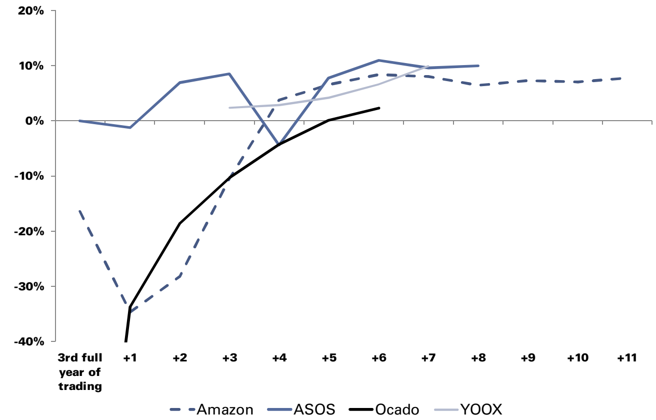
Interestingly, Amazon and Ocado have had a similar sales growth profile after their second full year of trading: both had a sales CAGR of c.74% over the next seven years. Amazon achieved positive EBITDA seven full years after starting operations; Ocado took approximately eight years. We note, however, that Amazon was free cash flow positive from 2002 (seven years after its start), whereas Ocado will only achieve this on our estimates in 2013. Excluding the development of the second CFC, we would expect Ocado to be FCF positive in 2012.

Exhibit 60: Sales growth has been similar to Amazon's
Relative sales growth of Amazon, ASOS, YOOX and Ocado (second full year of trading = 100)



Source: Company data.

Exhibit 61: Timing of move into profit similar to Amazon
EBITDA margin progression of Amazon, YOOX ASOS and Ocado (beginning in third full year of trading)



Source: Company data.

In Exhibits 59 and 60, we show the relative growth rates of various internet retailers and their margin progression. Sales growth and margin are shown from the third full year of trading (as early years all were loss-making) and growth rates are distorted by the zero starting point. YOOX has not disclosed its EBITDA prior to the point at which it became profitable and therefore we only show its EBITDA margin from this point.

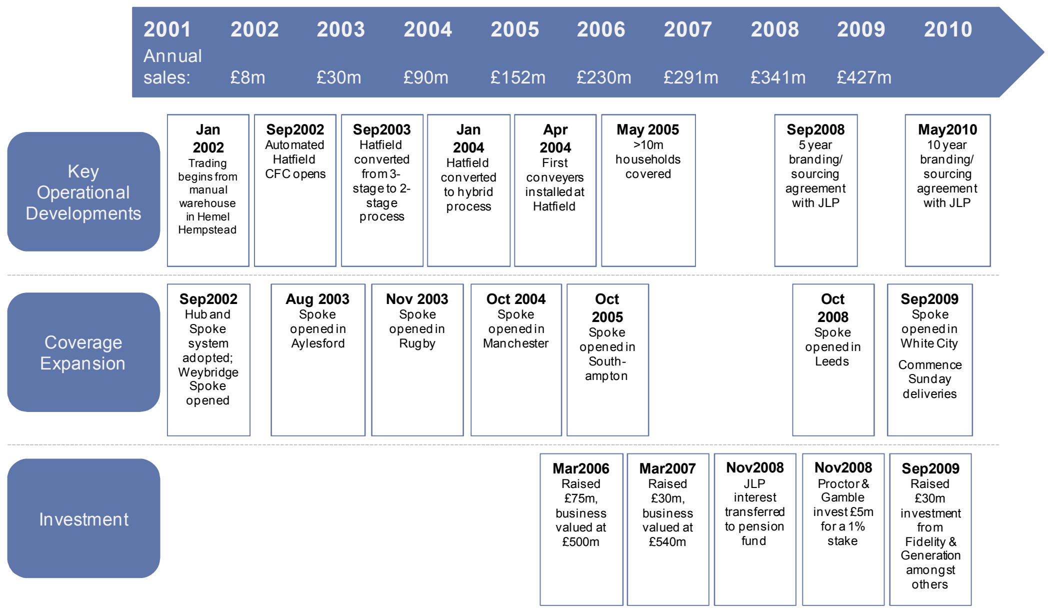
Given their high gross margins and lower capital requirements, both ASOS and YOOX achieved positive profitability sooner than Amazon and Ocado (we note that ASOS's warehouse was badly damaged by a nearby fuel depot explosion in its seventh full year of trading). On our forecasts, we expect Ocado to raise its returns towards the upper end of the range of its internet retailing peers over the next five years.

Company profile: The ‘Amazon’ of online grocery retailing

Ocado was founded in 2000 by Tim Steiner, Jason Gissing and Jonathan Faiman, who believed the internet provided a unique business opportunity. The business began operating in 2002, with the first hub in Hemel Hempstead and first spoke in Weybridge. By the end of 2002, the warehouse operation moved to the current semi-automated facility in Hatfield.

Exhibit 62: Ocado’s key milestones

2001-YTD; business valuations are as implied by the price paid for the relevant stake at that point in time



Source: Company data.

Ocado achieved a five-year gross sales CAGR of 37% in FY2004-2009. In FY2008, the company reported positive EBITDA on £341 mn of gross sales.

Ocado currently has over 1.4 mn registered accounts, 240,000 active customers (defined as a customer who has shopped in the last 12 weeks) and processed over 100,000 orders per week.

Management

Ocado’s founders, Tim Steiner (current CEO); Jason Gissing (Currently Director: People, Culture and Communications) and Jonathan Faiman (who is no longer working in the company) manage the company, alongside most of the other senior management which has been with Ocado for 8-10 years. The CFO, Andrew Bracey, joined in 2009 with a background in investment banking, with a focus on retail.

Reg AC

I, Karen Hooi, CFA, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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The Goldman Sachs Investment Profile provides investment context for a security by comparing key attributes of that security to its peer group and market. The four key attributes depicted are: growth, returns, multiple and volatility. Growth, returns and multiple are indexed based on composites of several methodologies to determine the stocks percentile ranking within the region's coverage universe.

The precise calculation of each metric may vary depending on the fiscal year, industry and region but the standard approach is as follows:

Growth is a composite of next year's estimate over current year's estimate, e.g. EPS, EBITDA, Revenue. **Return** is a year one prospective aggregate of various return on capital measures, e.g. CROCI, ROACE, and ROE. **Multiple** is a composite of one-year forward valuation ratios, e.g. P/E, dividend yield, EV/FCF, EV/EBITDA, EV/DACF, Price/Book. **Volatility** is measured as trailing twelve-month volatility adjusted for dividends.

Quantum

Quantum is Goldman Sachs' proprietary database providing access to detailed financial statement histories, forecasts and ratios. It can be used for in-depth analysis of a single company, or to make comparisons between companies in different sectors and markets.

Disclosures

Coverage group(s) of stocks by primary analyst(s)

Karen Hooi, CFA: Europe-Small & Mid Cap.

Europe-Small & Mid Cap: 888 Holdings, A-TEC Industries AG, Aberdeen Asset Management, Amer Sports, Andritz AG, ASOS plc, Balfour Beatty, Bang & Olufsen, Barco NV, Barratt Developments, Bauer AG, Bellway Plc, Berkeley Group, Betsson AB, Bovis Homes Group, BSS Group, Bucher Industries, Burckhardt Compression Holding AG, bwin Interactive Entertainment, BWT AG, Cardo AB, Carillion, Celesio AG, Cermaq ASA, CFAO SA, Charles Voegele, Charter Plc, Cineworld Group Plc, Close Brothers Group, Club Mediterranee, Computacenter, D S Smith, Danieli, Danieli (Savings), De La Rue Plc, Deutz, Devro Plc., Dignity Plc, Dimension Data, Domino's Pizza, Dufry, eaga plc, EVS Broadcast Equipment, Fluidra SA, Fuchs Petrolub, Game Group, Geberit Holdings, Georg Fischer, GfK SE, Greggs, Groupe Beneteau, Groupe SEB SA, Henderson Group, Hexagon AB, Holidaybreak, Holmen B, Huhtamaki, IG Group Holdings, Indesit Co SpA, Ingenico SA, Intermediate Capital Group, International Personal Finance, Intralot, IPSOS, ITE Group, Jungheinrich, Keller Group, Kier Group, Kingspan Group, KONE Corporation, Konecranes, Kontron AG, Krones AG, Leroy Seafood Group ASA, Loewe Ag, Lottomatica, M-real, Maire Tecnimont, Majestic Wine PLC, Manitou, Marine Harvest, Marshalls Plc, Mayr-Melnhof, Mitie Group Plc, Mondi Group, Mothercare PLC, N Brown Group, Neopost, Norske Skog Industrie, Northgate, Ocado Group PLC, OPAP, Oriola KD, Paddy Power Plc, Palfinger AG, Partners Group, PartyGaming plc, Persimmon, Pfeiffer Vacuum Technology AG, Playtech, Portucel, Praktiker, Promethean World Plc, Provident Financial, Rational AG, Redrow, Restaurant Group PLC, Rexam, Rieter Holding AG, Rightmove Plc, Rotork PLC, Royal Vopak, RPS Group Plc, Rubis, Salmar, SCA (Svenska Cellulosa), Schindler Holding AG, Schoeller-Bleckmann, Schulthess Group, SeLoger.com, SIG, Sika, Smurfit Kappa Group, Société BIC, Soitec, Spectris, Speedy Hire, Sportingbet plc, Stora Enso, Sulzer AG, Séché Environnement, Taylor Wimpey, Ted Baker, Tognum, Tomra Systems, Topps Tiles, Trevi Finanziaria Spa, Ubisoft Entertainment, Unibet Group Plc, United Drug Plc, UPM-Kymmene, Uponor OYJ, Valora Holding AG, Viscofan, Vossloh AG, Wacker Neuson, WAVIN, WH Smith, William Hill, Wincor Nixdorf, WS Atkins, YIT Corporation, YOOX, Zardoya Otis, Zumtobel.

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Goldman Sachs has received compensation for investment banking services in the past 12 months: Ocado Group PLC (144.00p)

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Goldman Sachs Investment Research global coverage universe

	Rating Distribution			Investment Banking Relationships		
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