CFA Institute Research Challenge

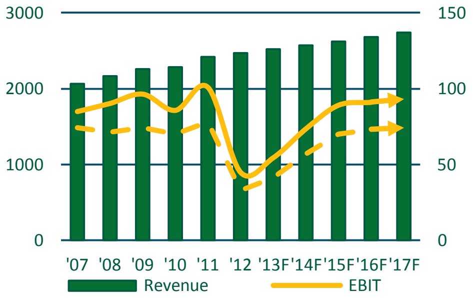
Hosted by CFA Society Netherlands

Team - Erasmus University Rotterdam,
Rotterdam School of Management

Company Name: *Sligro Food Group*
Industry: *Food retail & wholesale*
Ticker: *SLIGR:EN Amsterdam*

- *Recommendation:* ***BUY***
- *Price Target: €24.26*
- *Current Price (12 Jan 2013): €21.76*
- *Discount: 11.48%*

Date: *17th January 2013*



Source(s): Company's statements, team analysis

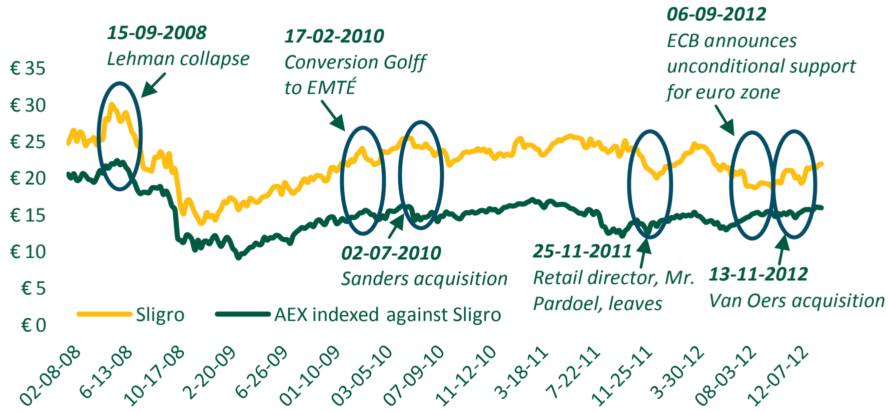
Key statistics

52-week range	€18.48 - €24.85
Avg. daily volume (3 months)	€28.67
Market Value (M)	€967.9
Enterprise Value (B)	€1.1
Shares outstanding (m)	44.3
Div. Yield	4.8%
Float	49.7%
Institutional holding	32.2%
Top 10 inst. Holders	27.4%
Analyst coverage	7 analysts
Target Price	€20.8
LT growth rate	0%
Avg. Rating	Hold

Source(s): FactSet Database

Sligro Food Group: A Stock to Sink Your Teeth In

- ***The analysis reveals a recipe for success:*** The buy recommendation for Sligro stems from various valuation techniques (DCF Gordon Growth, DCF Exit Multiple Method, trading- and transaction comps), which have been weighted according to their relevance. This comes down to a target price of **€24.26**, indicating that the share trades at a ~10% discount.
- ***Sound financial position with ample potential:*** A balanced customer and product mix, combined with a strong purchasing position has led to a healthy EBIT margin of 6.10% in its food services segment. The underperforming food retail segment has value embedded in strategic options, such as expansion or divestment. Given the strong cash-generating capacity of both segments, Sligro is able to maintain a high dividend pay-out (targeting 50%) in cash and a financially-sound balance sheet. Moreover, due to the company's conservative financing strategy, there is still ample potential to lever up in order to finance growth.

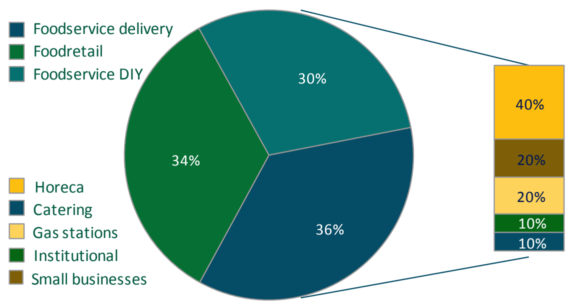


Source(s): FactSet Database, team analysis

- ***This is how the cookie crumbles:*** The recommendation is backed by (i) Sligro's strong market position in its flagship foodservice division, with an EBIT margin of ~6% compared to the 0.72% - 3% range for its peers. The leading position in the market was further strengthened recently, by means of the van Oers acquisition. Furthermore, the outlook for the sales drivers (CCI, and GDP) are also positive, (ii) the attractive and stable dividend yield of 4.8%, (iii) growth opportunities in geographical areas (e.g. in the 'Randstad'[2] or international expansion) and demographic segments; the increasing number of senior citizens may provide fruitful areas for growth in the institutional foodservice market.

- ***The outlook:*** The food service division is expected to enjoy a revenue growth rate of ~2.5%, whilst the food retail division is estimated at a more conservative growth rate of approximately ~1.4%.

- ***'If you can't stand the heat…' - Key risks for Sligro:*** Since Sligro has made significant investments in food retail, real estate price volatility, a potential failure to successfully convert the acquired stores or a drop in real estate prices may lead to large impairments/write-offs on the balance sheet. Other risks are potential IT-failures, which may have detrimental effects to Sligro's centralized distribution system. Prolonged macro-economic woes, combined with changing consumer preferences (e.g. downtrading) could potentially have an impact on Sligro's foodservice revenues.



Sligro's revenue split. *Foodservice revenues (DIY & delivery) are further split up in 5 different customer segments. Note: DIY stands for Do-It-Yourself, and represents the cash-and-carry locations of Sligro. Horeca stands for hotels, restaurants, and cafés. Source(s): Company's statements*

In a Nutshell - Investment Summary

- ***BUY - This is how the cookie crumbles:*** After a thorough competitive analysis and weighting (according to relevance) of the DCF Gordon Growth Method, DCF Exit multiple Method, Transaction- and Trading comparables, a target price of €24.26 has been established for Sligro. Thus, the stock is undervalued by ~10%, which is why a BUY is recommended. The valuation technique has also been subjected to 'what-if' checks by conducting a sensitivity analysis, a Monte Carlo analysis (which showed limited downside and strong upside potential), and a bottom-up revenue forecast to evaluate Sligro's capacity for growth. Moreover, the resulting BUY recommendation is backed by (i) Sligro's strong market position in its flagship food service division, with an EBIT margin of ~6% compared to the 0.72% - 3% range for its peers.
- ***The Sligro recipe:*** The food service business appears to be influenced by GDP growth and consumer confidence (see Section II.1.1.B, Figure II.4, and Figure A.1). However, even in a recession, groceries still have to be done. The food retail business therefore serves as somewhat of a natural hedge during periods of economic uncertainty. Sligro group has a cash- adjusted beta of a mere 0.66. This indicates the low volatility of the stock. The consistent business mix between the two segments has led to stable sales growth and a low-risk profile.
- ***Strong cash generating capacity offers attractive dividend yield:*** Sligro has a strong cash generating capacity in both business segments and relies on internal cash to finance its activities. The CFO in 2011 stood at €123 million, which enables them to continuously maintain a high dividend pay-out ratio (targeting 50%). The company is less dependent on external financing, and displays a healthy 18% debt/total assets ratio and a 22x EBITDA interest coverage ratio. Its sound financials allow Sligro to lever up or access the equity capital markets to finance growth.
- ***Food for thought:*** There are some strategic trends which may either pose a threat (e.g. larger store size, urbanization, and rising food prices) or present opportunities (rise of online shopping and an increase in single-person households). Sligro has already shown to be aware of the strategic dynamics of the industry by making the move into e-commerce retailing, thereby utilizing their competitive advantage in distribution and DIY. Sligro has also made headway into the MRE[1], catering to the single-person household segment. However, they have left some opportunities unseized by not entering into the geographical 'Randstad'[2] market, where we see growth potential for the food retail division.
- ***Sligro's bread and butter:*** The food service division makes the stock attractive, with its position as market leader in an attractive industry (see section II.1.2.D.), the recent *van Oers* acquisition has further strengthened this position. Their EBIT margins of ~6% are approximately twice that of the best performing peer (Lekkerland). On the downside, there is the more fragmented and competitive food retail market, in which Sligro significantly lags behind its peers in terms of margins (1.5% below their worst performing peer; PLUS). The analysis also indicates that they lack economies of scale. Interestingly, a counterfactual analysis turns back the clock and shows that Sligro would have been better off focusing solely on food services as opposed to their expansion into food retail in 2001. This would have yielded a share price of €29.37; almost 35% higher than what it is today (see Figure D.15). Nevertheless, there is still ample opportunity for growth in this division, due to (i) M&A potential (e.g. Nettorama), (ii) organic growth (e.g. Randstad), and (iii) strategic synergies in future e-commerce activities such as click-and-collect, where the distribution network and knowledge of DIY-systems gleaned by the food service division is applied to food retail. The market also sees value in growth opportunities as ~7% of enterprise value is still unaccounted for when capitalizing current FCF (see Section III.5).
- ***The ingredients of the forecast:*** The forecasted period (2012/2013-2017) is estimated to have a revenue CAGR of 1.76%. Whilst this may seem like a modest growth rate, we expect the EBITDA to have a CAGR of 8.43%. The forecast is based on both a macro-economic, as well as an econometric approach (see Section IV and Appendix C). Moreover, economies of scale are important in this industry and although the acquisition of *van Oers* may bring about higher (integration) costs in earlier years, it is expected to have a positive impact starting in 2014. Additionally, the economic recovery will be a driver for the increase in profitability in the near future as well.
- ***Investment risks:*** Significant investments made in real estate for food retail has led to an exposure to volatility in real estate prices, and a potential failure to successfully convert the acquired stores. The distance from the consumer to the food service division partly mitigates some risks. However, the centralized distribution system may make the foodservice division vulnerable to IT-failures and prolonged macro-economic woes, combined with changing consumer preferences (e.g. downtrading) could have detrimental effects on Sligro's food service revenues.
- ***Strong corporate governance:*** Family controlled Sligro can be characterized as having a high % inside-ownership, in addition to 6 block holders. These attributes align managerial interests with those of the shareholders, ensuring good corporate governance. Furthermore, Sligro abides by the Dutch corporate governance code ('Tabaksblat').

I Here's the Dish - Business Description

- ***Sligro Food Group N.V.,*** headquartered in Veghel (NL), consists of food retail (EMTÉ) and foodservice divisions selling directly and indirectly to the entire Dutch food and beverages market, a market estimated to be worth €56bn, according to FSIN. The Group also operates their own in-house production facilities and works together with its partners for specialised convenience products (e.g. fish, bakery). See appendix E for an overview of Sligro's corporate governance and CSR policies.
- ***The food service division*** is Sligro's flagship, which currently consists of 46 cash-and-carry wholesale outlets in the Netherlands and ten Sligro delivery-service wholesale outlets, offering ~60,000 products. The Sligro format occupies a mid-segment position vis-à-vis prices. The product range, designed for the professional user includes long-life and short-life perishables, frozen foods, wines and spirits and food-related non-food items. The company's customer base can roughly be split up in five categories, namely 1) Horeca (hospitality sector), 2) leisure, 3) patrol outlets, 4) large-scale users, and 5) institutional market (e.g. schools). Other non-core operations are franchising activities such as snack bar concept "Big Snack".
- ***The food retail division*** consists of 131 full-service EMTÉ supermarkets, of which 30 are operated by independent retailers. The EMTÉ supermarkets are mainly located in the southeast of the Netherlands. Its objective is regional market leadership. The emphasis is on fresh products, a friendly ambiance and low prices. They acquired supermarkets under two formats, Sanders and Golff. In 2010, Sanders supermarkets were acquired while the Golff supermarkets not suited to the Emté format were disposed of. Sligro is a member of the Superunie purchasing cooperative. This cooperative represents 15 independent retail formats in the Netherlands. The members of Superunie have 2,000 supermarkets and a joint purchasing share of 30%

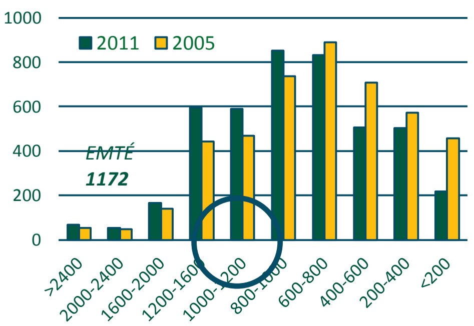


Figure II.1
Small stores are being displaced by large stores. *Number of stores (x-axis) per size segment (y-axis) in 2005 and 2011. Source(s): Locatus, HBD*

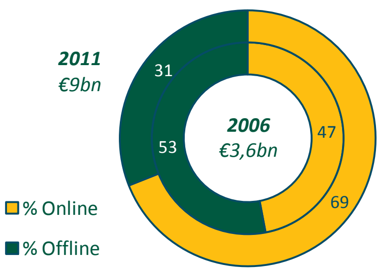


Figure II.2
% of consumers shopping online is growing*. Inner [outer] ring = 2006 [2011]. Source(s): CBS, Thuiswinkel Market Monitor*

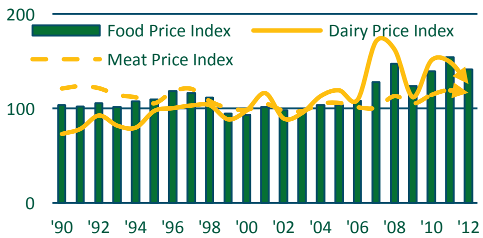


Figure II.3
Food prices are on the rise. *Source(s): Food and Agriculture Organization (FAO)*

II What's Cooking? - Strategy Analysis

1 - Industry Analysis

1.1 Industry Trends

1.1.A - Foodretail: Industry Trends

- ***Putting the 'Super' in Supermarket:*** Traditional mom and pop stores are quickly giving ground to larger chain stores, with only slightly less than half (47.6%) of the smallest stores that existed in 2005 still being open in 2011.[3] Furthermore, the number of stores larger (smaller) than 1000sqm saw a 28.2% (-13.6%) increase during the period 2005 - 2011. This indicates that incumbent rivalry and pricing pressure leads to i) continual shake-out of smaller stores and ii) continual search for scale economies. Since Sligro solely operates small stores (avg. of 1172 in 2011[4]), this trend certainly heralds a change in its strategic landscape.
- ***High growth in niche market of online shopping:*** Web-based shopping has already gained a firm foothold in many industries and has thereby often made incumbent brick-and-mortar business models obsolete (e.g. Netflix vs Blockbuster). Although we have yet to see a sustainable and profitable business model for web-based food retailing (Ahold's web-based operations are currently loss-making), with limited growth opportunities in the brick-and-mortar segment, we expect web-based business models to be a key avenue for growth in the future. With ~7 in 10 Dutch consumers aged 16-75 already shopping online for various products (vs European average of 4 in 10)[5], it comes as no surprise that ING Equity Research estimates that within 10 years, store-based sales for food retail will see a drop of 20%[6]. We view this as an opportunity for Sligro, since they are well-positioned to capture growth in this segment with its knowledge of optimal distribution and DIY-systems.
- ***Rising food prices:*** The nominal FAO food price index has more than doubled, and the real index has shown a 50% growth in the past decade[7], with the short-term outlook for prices of key crops (i.e. cereals, wheat, dairy) remaining negative. Rising food prices will affect food service revenues, but higher margins on these products will provide flexibility. Food retail products, however, have much lower margins (see section III.2) and the ability to pass these price increases on to the consumer depends, among other things, on how the market leader, Ahold, deals with this issue (i.e. use its bargaining power to pass price increases onto suppliers/customers or start price war)

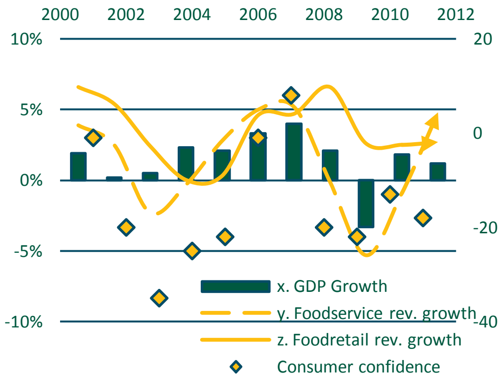


Figure II.4

Foodservice revenues are influenced by the business cycle and consumer confidence. *GDP, food service- and retail revenue growth on left axis. Consumer confidence (normalized for seasonal effects) on the right Source(s): CBS, CBL, team analysis*

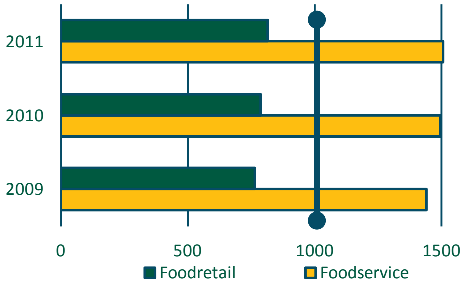


Figure II.5

The foodservice industry is moderately concentrated as opposed to the foodretail industry which is still fragmented. *Herfindahl index for food-service and retail. Source(s): CBS, team analysis*

	Foodservice		Foodretail
Sligro	***19%***	*AH*	*34%*
Lekkerland	*15%*	*Jumbo*	*22%*
Deli-XL	*11%*	*Aldi*	*8%*
Metro	*9%*	*Lidl*	*7%*
De Kweker	*4%*	*Plus*	*6%*
Kruidenier	*4%*	*Detail*	*4%*
Hanos	*3%*	*Coop*	*3%*
Breweries	*13%*	***EMTÉ***	***3%***
Other	*22%*	*Other*	*13%*

Figure II.6

Marketshares by sales for foodservice and foodretail market for Sligro and its main competitors. *Source(s):Foodservice Monitor Jaarrapport 2011, Nielsen*

Urbanisation: With EM-TE stores being mainly located in rural areas, Sligro is more vulnerable to the current trend of urbanization (migration from rural areas to city centres) than many of its competitors are. With a growth rate of 0.67% of urban population vs. a nationwide growth rate of 0.45%,[8] future growth potential lies in urban areas. Especially since it is often the younger generations that migrate towards larger cities to pursue education or employment. Since Sligro is not active in urban areas, the company foregoes the opportunity to build brand equity among the younger generations.

1.1.B - Foodservice: Industry Trends

- ***Foodservice: Cyclicality is the Name of the Game:*** As consumers face less disposable income and more uncertainty during economic downturns, the willingness to make use of food service offerings declines, as evidenced by its correlation with the Dutch GDP growth; a steep 82% (see also appendix A.1). The consumer confidence indicator also shows that, as consumers become less optimistic, they spend less on food service. This is not as pronounced for food retail, since consumers continue to buy necessities.
- ***Individualization and increase in single-person households:*** ~4 in 10 households currently consist of only one person and this number is expected to increase.[9] The strong increase in single-person households will cause more people to make use of food service products, especially convenience ones, such as take-out. In addition, there is a large growth in single-person households consisting of elderly persons, which is likely to drive growth in the institutional Foodservice market; another potential growth market for Sligro.

1.2) Industry potential

1.2.A - Industry Concentration

In order to assess the amount of concentration in each division, the Herfindahl-Hirschman Index was computed.[10] A score below 1,000, indicates that there is no concentration, whereas up until 1,800 it indicates moderate concentration (see also appendix A.2, A.3, and A.4). Figure II.5 shows that the food retail industry is not concentrated, as there are several players holding a sizeable share of the market. The food service industry, however, is moderately concentrated. Furthermore, over time both industries have become increasingly more concentrated, which is a trend that we expect to continue into the future.

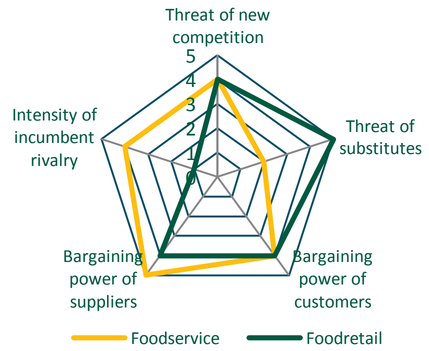
1.2.B - Industry Landscape

- ***Foodservice:*** Sligro is the market leader in the food services sector, with a market share of ~21% (after acquiring *van Oers*). Their main competitors are Lekkerland, Deli XL and Metro. In terms of food sales, Sligro outperforms Metro in the cash-and-carry market and Deli XL in the delivery-services market. Due to Sligro's diversified product- and customer mix, they have achieved a relatively stable CAGR of 3.9% over the past five years in food services, whilst the growth rate of its competitors was more volatile. Furthermore, benefiting from its strong market position and utilizing its efficiency IT and distribution systems, they is able to consistently generate a superior EBIT margin of ~6% (vs EBIT of 0.7% - 3.0% for its main competitors).
- ***Foodretail:*** Sligro has a market share of 2.8% in foodretail, significantly lagging behind its main competitors Albert Heijn, Jumbo and Plus. While the primary focus of its competitors is mainly retail, Sligro can benefit from its strong position in food services by applying knowledge gained through the wholesale activities, to the retail activities. Cost-sharing activities such as IT, logistics and distribution are also appealing. The membership of Superunie purchasing organisation enables it to negotiate highly competitive purchasing terms. However, the company still lacks some economies of scale (e.g. marketing efficiency is lower). This is evidenced by the historical 5-year average EBIT margin of 1% for Sligro, as compared to the 2.41% and 6.75% average EBIT margin earned by Jumbo and Ahold, respectively, during the same period. Their competitors are all located in major cities, whereas Sligro's strategy was

__Figure II.7__

Foodretail faces heavy incumbent rivalry but also has strong bargaining power and little threat of substitutes. Foodservice has a high threat of substitutes.

5=low and 1=high (i.e. the larger the area, the more attractive the industry. Source(s): Team analysis



to avoid direct competition by positioning the stores in regions of low population density. Sligro's sales per sqm were the lowest among its peer group with around €6,000 per sqm vs €8,500 for Jumbo and €11,870 for Ahold.

1.2.C - Foodretail: Competitiveness

Although the food retail industry scores well on most factors in Porter's 5 forces (e.g. customers have limited options to procure their food and beverages outside the this industry and are therefore relatively price-insensitive), the profit potential as a whole is limited due to the high intensity of incumbent rivalry; the most important factor. With large investments in real estate and distribution networks, many food retail players have large sunk costs, and are therefore less likely to exit the industry. This, in addition to high advertising expenses, low margins, and low growth, leads to a limited profit potential for the industry (see also appendix A.5).

1.2.D - Foodservice: Competitiveness

The food service industry experiences less intense incumbent rivalry, this is because the industry is still growing and competitors do not have to use large marketing expenditures to steal customers away from each other. Coupled with the strong bargaining position vis-à-vis customers as well as suppliers, the food service industry has considerable profit potential. However, whereas customers such as restaurants have almost no substitute options, the end-consumer does have viable substitute options for food service; cooking at home. Especially in economic downturns, consumers will become more price-sensitive and they will be more likely to substitute food service products for food retail, which has not been uncommon in the last few years.

2) Competitive and corporate strategy analysis

2.1 Positioning of Sligro's divisions within their respective industry

2.1.A - Foodretail: Industry Positioning

Within the Dutch food retail industry there are players that employ a clear generic strategy. Examples are cost leaders Aldi and Lidl, or differentiator Ahold with their Albert Heijn brand. However, most players straddle the middle as they struggle between offering quality products and services and dealing with the intense price competition from the larger players. In our view, Sligro's food retail division EMTÉ is one of the many players that is at risk of being stuck in the middle. As their logo *'fresh, affordable, and friendly'* indicates, it is currently not clearly positioned as either a differentiator or a cost leader (see Figure II.8). Although Sligro has been able to avoid direct competition to some extent, by operating in geographical niche markets, a clear competitive strategy needs to be outlined if management wants to successfully grow EMTE.

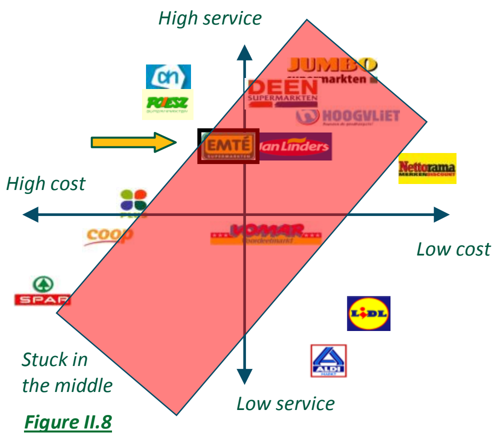


__Figure II.8__

Unclear positioning of EMTÉ leads to risk of being stuck in the middle. *Red rectangle indicates unclear positioning. Source(s): Radar Consumer Survey, team analysis*

2.1.B - Foodservice: Industry Positioning

Sligro is market leader in the food service segment and only has a few main competitors. In order to differentiate, they have focused on quality and on offering a wide selection of fresh products (Sligro holds a minority stake in several fresh produce manufacturers, such as the country's largest fresh fish supplier Smit Vis). Although their quantity of products (~60,000) is similar to its industry peers (which ranges from 50,000 to 70,000), their food service division has been able to utilize their bargaining power to offer products at competitive prices. This, whilst also offering high quality products and services. As a result, similar to their other division, Sligro is in the midsegment vis-a-vis price, as opposed to competitor Metro. The latter focuses more on low-cost, or competitor Kweker, which focuses on high-price, high-quality.

2.2 Strategic outlook for the divisions

2.2.A - Foodretail: Strategic Outlook

Management's aim is to grow the market share for food retail to become one of the top three players.[11] This will certainly increase efficiencies in terms of economies of scale and scope (see section III.2), we question whether a focus on growth, rather than profitability, is the right thing to do. Notwithstanding our

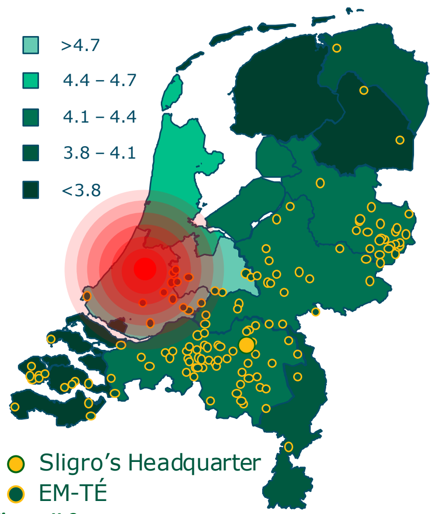


__Figure II.9__

There are still opportunities for foodretail in some geographical markets.

Number of inhabitants per square meter of foodretail space for each province (nationwide average is 4.15). The lighter the area, the more opportunity for growth. The red area indicates the 'Randstad', which is geographically the segment where we see the most potential for growth opportunities. Source(s): CBS, HBD, team analysis

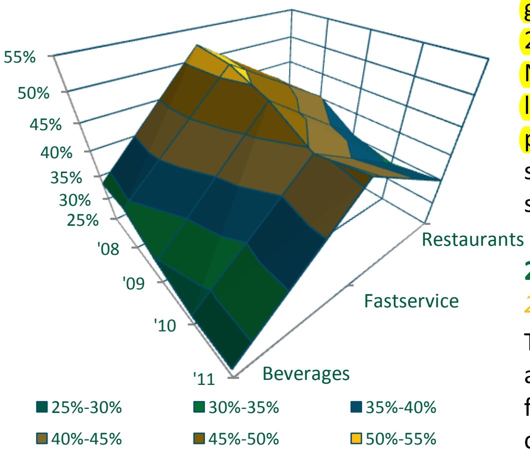


__Figure II.10__

2011 marks a turnaround for foodservice, with an increased number of customers making use of foodservice products.

% of people visiting foodservice outlets. Source(s): Foodstep, team analysis

scepticism, we do see some growth potential. For example, we believe cash-rich Sligro is in a good position to take advantage of future M&A opportunities, because other players, such as market leader Ahold (~33% market share) is unlikely to gain approval for any acquisitions due to antitrust concerns. Moreover, Jumbo recently entered into a large deal and is therefore unlikely to enter into any major new deals in the near future. Furthermore, there are still some potential targets such as Nettorama; a discounter operating 29 stores in the same geographical region as Sligro. Additionally, growth could come from entering new markets, such as the Randstad' conurbation, where they are not active yet due to managements' concerns about a higher rate of theft and less available retail locations. However, our view on this issue differs. As can be seen from Figure II.9, the number of inhabitants per square meter of food retail space for each province is highest in the Randstad area with around 5 (against a nationwide average of around 4).[12] Although it is true that the real estate prices are also higher, we see that as an opportunity for Sligro to gain experience in operating high-cost/high-turnover-per-sqm stores, which can then be applied to all stores to increase efficiency. Finally, we see great potential in the introduction of a 'click-and-collect' system, announced by CEO Koen Slippens. This will make full use of Sligro's core competencies in logistics, distributions and operating DIY stores, gained from their food service division, whilst it avoids having to operate retail stores.

2.2.B - Foodservice: Strategic Outlook

As a result of the economic recession, food service growth has not been at its full potential. However, 2011 marked the turnaround for the food service industry with a positive revenue growth of ~5%[13] and an increased number of visitors (see Figure II.11). Since the revenues in this industry are highly correlated with economic growth, and with a forecast for GDP growth in the Netherlands of +1.5% p.a. until 2017[14], we expect to see a healthy growth in this division in the future. Nevertheless, several years of shrinking disposable income for consumers will leave its mark, as we expect down trading to continue and consumers being more price-sensitive. As such, we expect more growth potential in the low- and mid-segment of food service products (e.g. take-out) and low-price restaurants dishes such as pasta. See Figure A.7 in the appendix for a SWOT-analysis for Sligro.

2.3 Risk Analysis

2.3.A - Foodretail: Risks

The food retail industry is one of the least risky vis-a-vis consumer habits, but it is also one of the most competitive industries. This means that risks mostly originate from industry dynamics such as 1) consolidation through M&A, 2) increased competition from new entrants (e.g., Belgian retailer Colruyt has not been able to obtain a permit from the government to enter the Dutch market), 3) and price wars initiated by market leaders to put pressure on smaller players such as EMTÉ. On the supply side there is a major risk in 4) the inability to control costs when input prices rise (only 1 in 10 retailers responded that they focused on reducing COGS when cutting costs in an E&Y report[15]). This recently occurred with crop prices, when the market leader decides to start a price war, as opposed to passing price increases onto consumers. There are also risks unique to Sligro, such as 5) the potential failure to successfully convert all the acquired stores and reach target efficiency in those stores. Secondly, there is the risk of 6) cannibalization through the multi-channel approach that Sligro's management maintains. That is, the more successful the retail stores are doing, the less likely are people to make use of food service offerings such as restaurants; they will cook at home instead. This will partly undermine the wholesale activities of Sligro. Additionally, with the recent announcement of e-commerce retail activities, the brick-and-mortar retail activities may face channel competition from online shopping. Moreover, since Sligro made large investments in real estate when they entered the retail segment, there is a risk of 7) write-offs on the balance sheet as a result of volatility in the real estate

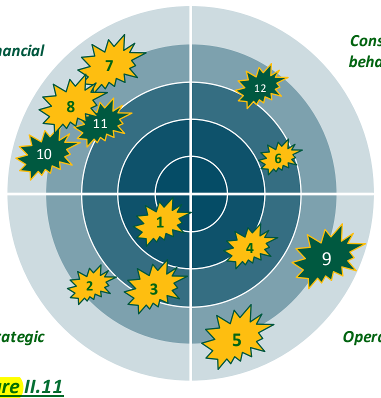


Figure II.11

Risk Radar: High impact risks have small probability of occurring and vice versa.

Risks to Foodretail (yellow) and Foodservice (green), where size indicates impact and the proximity to centre indicates higher probability of occurring. Numbers refer to the risks that are indicated in the main text with numbers. Source(s): team analysis

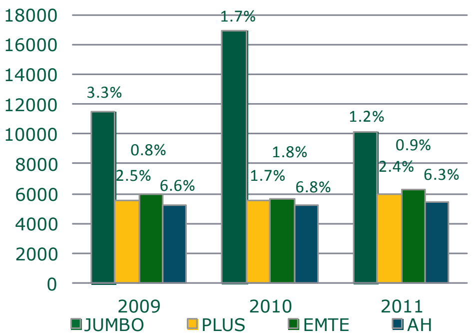


Figure III.1

Sales per store in € (left axis) and margins for Sligro's foodretail division and its main competitors.

Source: company's financial statement, team analysis

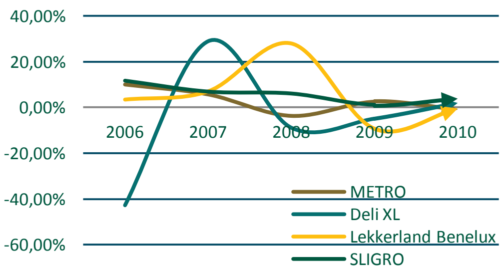


Figure III.2

Sales growth for Sligro's foodservice division and its major competitors

Source: company's financial statement, team analysis

market. Finally, the goodwill paid for acquisitions makes up around 15% of total assets, so there could be a risk of 8) impairments if Sligro turns out to have overpaid for the acquisitions.

2.3.B - Foodservice: Risks

Although Sligro's comfortable market position in the food service market and its distance from the consumer may make some risks less pronounced, there are still some issues which may pose a danger to their wholesale activities. For example, 9) since Sligro makes use of a single central warehouse and distribution centre, any major supply disruptions or IT-failures will have considerable detrimental effects. Another risk is 10) another increase in tax rates by the government, since foodservice revenues are highly affected by the amount of disposable income consumers have. A related risk is that of 11) a prolonged recession, as we have shown in section 1.1.B. and Figure II.4, food service revenues are highly correlated with GDP growth and consumer confidence. A result of the recent recession has been a change in consumer habits, such as downtrading and all-you-can-eat became more commonplace as well. There is a risk that 12) even after a full economic recovery, consumers will have become used to lower prices and bargain deals. This could potentially affect Sligro's margins.

2.3.C - Group Level: Risks

Sligro, as a food wholesaler and retailer is especially vulnerable to food safety issues. However, the company abides by strict internal and external regulations regarding food safety. Major food-borne diseases such as salmonella have been declining in Europe over the past years[16]. Therefore, we view this risk as minimal. The credit risks are limited as well, considering that retail works on a cash basis and the food service only supplies a small part of products without advance payment. In addition, the division has many, relatively, small customers to diversify away idiosyncratic credit risk.

There are also very limited currency risks, since Sligro operates mainly in the Eurozone and because any currency rate changes can be quickly incorporated into the selling prices. Besides that, Sligro's exposure to the US dollar (as a result of goods purchased) is completely hedged[17].

Since the group has a policy of making a large[18] acquisition every one or two years[19], there are some risks associated with overpayment or inability to successfully integrate the acquired company. However, this risk is somewhat mitigated by Sligro's experience and track record in M&A.

The government could potentially introduce regulations that introduce a deposit on currently non-returnable cans/bottles in order to combat the environmental damage of throwing them out instead of recycling. This could potentially depress sales for the beverages products.

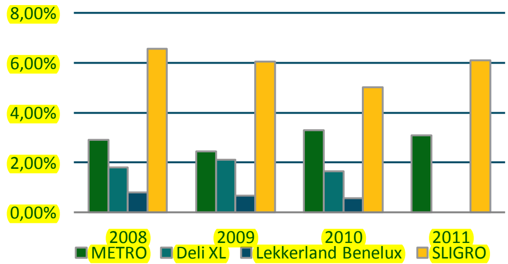
III Counting Beans - Financial Analysis

1. Sales

- ***Sales grew slightly below the targeted growth*** due to a lack of large acquisitions. Sligro achieved a CAGR of 3.6% in sales over the trailing five years and maintained a revenue mix of 1:2 between the food retail segment and food services segment. The counter-cyclical growth pattern in the food retail market can hedge the market shrinkage in food services, and contribute to a stable sales growth at the group level.

➢ ***Well-diversified clients and product portfolio*** leads to stable sales growth in the food services. With a 3.9% CAGR from 2008-2012, the foodservice division outperformed its peers by nearly 3 percentage points[20]. Although this market was negatively impacted by the decrease in outdoor food consumption (e.g. bar, restaurant), Sligro can be more resilient than its competitors due to a good mix of customers & products. The acquisition of *van Oers* will further expand its market share to 21%, and is expected to add to sales.

Figure III.3
EBIT margins for Sligro's foodservice division and its major competitors
Source: company's financial statement, team analysis



➢ ***Modest growth rate in food retail*** was due to less promotional efforts and the reduced number of stores. Sligro grew conservatively with a CAGR of 3.1% (Like-for-Like growth rate of 4.5% on average), which was modest compared to the expansion of its main competitors. The number of stores decreased from 147 to 131 over the same period due to network optimization. Although Sligro's €6.01 million sales/1000 m2 is the lowest among the peer group (as a result of the geographic positioning of its stores in regions of low population-density), sales/1000 m2 grew by nearly 10% due to improved network integration and stores optimization. Despite the increased promotional efforts (re-formatting of stores) and advertising, we believe the growth rate in this segment will be in line with the market (not outperform) due to its small share, lower customer volume, and the mature market conditions.

➢ **Management's growth objective of 10% is optimistic:** Given the primary focus on the saturated Dutch food sector and the gloomy consumer confidence (demonstrated by a record low CCI of -39% at end-2012). The low CCI negatively impacts the sales outlook for Sligro in the food services segment, which largely depends on outdoor food consumption (which fell by 1.1% in 2012). This was demonstrated in section 1.1.B and Figure II.4 to be dependent on consumer confidence. Thus, we expect both the retail and food services segment to have modest organic revenue growth prospects.

2. Profitability

➢ ***The operating margin has been stable around 4% over the past 5 years***: EBIT margin stood at 4.18% in 2011, inched up from 3.75% due to strong performance in food services and lower operating cost (in depreciation). However, the retail business had an EBIT margin of 0.85% in 2011 (averaging 0.93% from 2008-2011), far behind the 6.10% (averaging 5.93%) EBIT margin of the food service division. Due to this gap in operating margin, the RONC[21] for foodservice in 2011 was 22.84%, while this was only 3.17% for food retail. This reflects the difference in Sligro's competitive position in each segment.

➢ ***The foodservice division is consistently the dominant earnings contributor***, representing more than 90% of the net income. As a market leader in the food services segments and diversified customer & product portfolio, Sligro's profitability continuously outperformed its peers. Its EBIT margin stood at 6.1% at the end of 2011 (up from 5.02% in 2010), significantly higher than its peers' average. We believe the integration with *van Oers* into Sligro's current services and changes in distribution channel will impact its profitability in 2014, but can strengthen its market position and improve its margin after a successful integration.

➢ ***Sligro lacks economies of scale for its retail business,*** which is necessary in competing in a cost-sensitive market such as food retail. 2011 saw a decrease in EBIT margin from 1.79% in 2010 to 0.85%, as a result of the non-recurring expenses incurred in the full conversion of 20 Sander stores (estimated at several million euros) and roughly €7mln amortization cost on properties acquired. This division continuously underperformed its larger peers such as Albert Heijn, Jumbo and Plus. After Jumbo's acquisition of C1000, the Dutch food retail sector has become more consolidated, whilst Sligro has a meagre market share of 2.8%. Due to the economic recession, we expect higher cost of sales as price competition intensifies, which will add increasing pressure on margins. We therefore believe Sligro's operating margin is not likely to increase until 2014, given the intense competition, weak consumer confidence and its small market share in retail.

3. Cash Flow Analysis

➢ ***Sligro has a strong cash-generating capacity*** from its operations (CFO €123 million in 2011) which has been steadily increasing by 10% y.o.y over the past five years, outpacing its revenue growth. It mainly relied on stable CFO (cash flow from operations/sales ratio roughly 5%) to finance its activities. Capital expenditures consumed most of CFO (roughly 44% on average) over the past 4 years; while the company gradually increased its dividend payout ratio to 49% in 2011 (slightly below the announced 50% policy). External financing was mainly used for large acquisitions, funded by the capital market rather than bank debt (€140 million facility, roughly 50% committed) due to its easier access. As of end-2011, the company has a total outstanding debt of € 168 million with remaining terms of 3, 6 and 9 years respectively. The CFO was highly sufficient to repay interest and other short-term financial obligations. We believe the company has managed its cash flow in line with the overall business nature. We believe Sligro's CFO growth is likely to be on a par with its revenue increase in 2013.

4. Balance Sheet

- ***Sligro's financial position is healthy and offers financial flexibility***. The debt/total assets ratio stood at roughly 18%, while EBITDA coverage was 22x at the end-2011. We assume the current leverage level will remain stable in the near future. However, the current debt level allows Sligro to lever up for large acquisitions.
- ***The balance sheet shows ample potential to further improve its operations*.** Sligro has been managing its working capital position cautiously, evidenced by a steady increase in working capital/total assets (21.7% at end-2011 vs. 6.6% at end-2007). However, we believe Sligro can improve its efficiency. Compared with the peer group, its 32 days cash conversion cycle[22] was relative long. Zooming in, especially the higher inventory level stood out, as evidenced by the 32 days inventory on hand. Another notable difference is that Sligro used fewer lease contracts, and real estate property accounted for a relatively sizable proportion of its balance sheet (nearly 27%). Due to the high(er) days inventory on hand and large property ownership, the asset turnover is somewhat sluggish compared to its peers in both retail and food services.

5. Current Value versus Growth Opportunities

As was argued in section II.2.3, there are some growth options, which is why a cross-check is conducted on the market's opinion. Indeed, capitalizing current FCF (Net Income) by WACC (Cost of equity) and dividing by EV, we obtain a proxy for the value of growth opportunities (see Figure B.1 and B.2) of 7.25% (7.5%) as a % of EV.

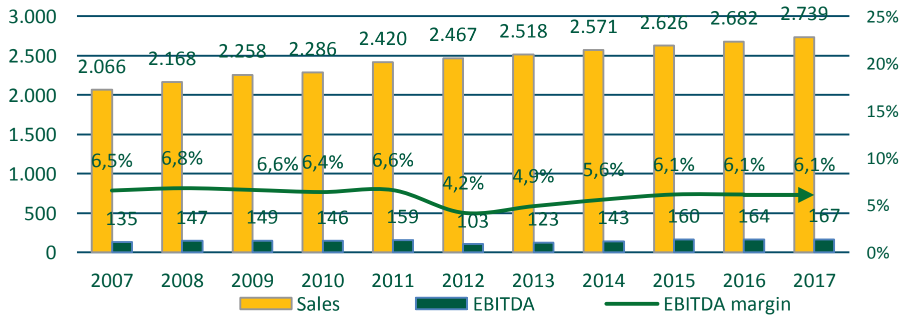
IV The Bread and Butter - Financial Forecast

1. Forecast

The explicit forecasting period is set at 5 years, since Sligro can be categorized as a stable company, growing at a rate close to GDP. The stable situation of the company also resulted in most of the inputs being linked to sales.

- ***Sales:*** The forecast estimate for the revenues is based on same-store sales[23]. Thus, no future store openings are accounted for within the next five years, since it is assumed that Sligro will focus on the more profitable food services business. Both an economic- and econometric analysis (ARMA model) is conducted in order to most accurately forecast the sales figures (see appendix C). Due to the slow economic recovery, the growth rate for the food service business was set at ~2.5%. For food retail this was estimated to be a mere ~1.4%, due to the weak(er) market position and the increasing competition (see II.1.2.A). Thus, the overall revenues for the company in its entirety are estimated to gradually increase to an overall growth rate of 2.13%.[24]

Figure IV.1 Overview Forecast figures in millions of Euros
Source(s): team analysis, Sligro annual report



- ***Costs & Margins:*** The recent acquisition of *van Oers* will bring about integration costs before it can bring about economies of scale. As mentioned previously, the latter is not expected untill 2014. Thus, SG&A is expected to increases from 6.6% to 7.5% before it drops back to 7.3% from 2014 onwards. Due to high food prices that are not all passed on to consumers[25], COGS will slightly increase from the current 87% before it drops to 86.7% of sales at a later stage. In line with the costs, the EBITDA margin is expected to drop in 2012[26], after which it gradually recovers to remain at 6.1% from 2015 onwards.
- ***Capex & Depreciation:*** In line with management's target of 2%, the capital expenditure remains stable[27]. It is set at a 5-year average of 2.5% for the forecasted period. Depreciation is currently 2.23% and gradually converges with capex in later years, in order to achieve a steady state.
- ***Terminal value assumption*:** The terminal value was estimated by means of the Gordon Growth Model, with a perpetuity growth rate set at 2%[28]. Due to the great impact of the terminal value on the target price, another method was used as a sanity check; the exit multiple method. The LTM EBITDA multiple of Sligro amounts to 7.6x, which is applied to the EBITDA in the final year. After computing the terminal value with both methods, the implied perpetuity growth rate can be backed out from the multiple method and vice versa. This ensures that the terminal value is estimated in a more robust and reliable manner.

V Bringing Home the Bacon - Valuation

1. Football Field of Valuation

In order to establish a football field of valuation, several perspectives were analyzed; Discounted cash flow model (Gordon Growth and Exit Multiple Method), Trading- and Transaction comparables. Based on these valuation methods, a possible range was established (see also figure appendix D.11 for the weighting scheme).

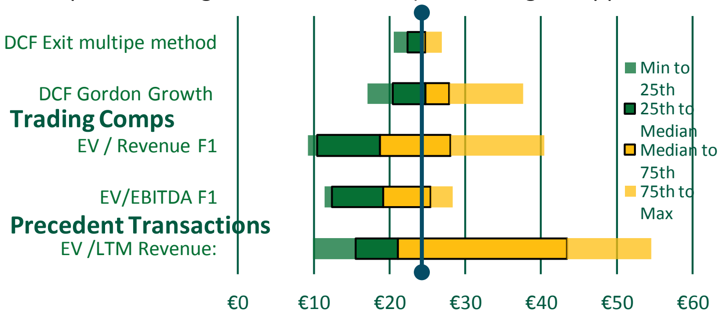


Figure V.2
Valuation Football field indicates a target price of ~€24.
Source(s): Team analysis, Merger Market, Company Annual Reports

- ***Discounted Cash Flow Model:*** The intrinsic value of Sligro is equal to the forecasted FCFs, discounted by the WACC of 6.45%.[29] Using the Gordon Growth model, the base price came out to about €24.77, which indicates a discount to the market of 13.8%[30]. The pessimistic scenario[31] indicates a price of €20.45, whilst the optimistic scenario[32] indicates a price of €27.89 (see also appendix D.9 and D.10).When the terminal value is estimated by means of the LTM EBITDA multiple of 7.6x, the base price comes out to €24.30, indicating an 11.7% discount. This is relatively close to the DCF estimate.
- ***Trading Comparables:*** Comparable assets trade at comparable prices. However, a lower weighting was attributed to the transaction comparables, since the closest competitors for Sligro are private companies. Based on listed food retailers, the trading range comes out to a median share price range of €11.1 - €24.33.[33]
- ***Precedent Transaction Analysis:*** In addition to trading comps, transaction comps are also analyzed as a sanity check. A list of comparable acquisitions is collected from the past 3 years and the deal multiple (EV/REV) is applied to Sligro's 2012 revenues.[34] The transaction comps establish a median share price of €21.1.
- ***Target Price:*** The valuation models are weighted according to their relevance. The widely used Gordon Growth DCF is attributed a weighting of 80% and the less widely used Exit Multiple Method a 10% weight[35]. The trading- and transaction comps account for 5% each due to the lack of comparable peers (different business mix or size). Subsequently, a target price of €24.26 is derived. This is approximately an 11.48% discount to the market.[36]

2. WACC

The Capital Asset Pricing Model (CAPM) is used in calculating the Weighted Average Cost of Capital, where the levered beta for Sligro is estimated by using a regression model of excess returns against the MSCI world index returns, and adjusted for the cash holdings (since cash has a beta of zero). The market risk premium is set to 5.5%[37], whilst the risk free rate is set to 3.18% (see Figure D.12 and D.13 in the appendix). The final WACC comes down to 6.45%.

3. Contingency Analyses

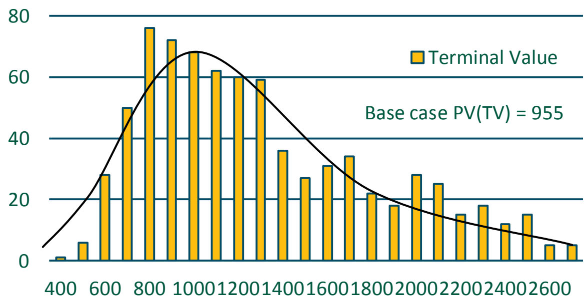


Figure V.3
Monte Carlo analysis on terminal value, where terminal growth rate is varied based on a bootstrapping method used on GDP growth rate
Frequency (left axis) of Terminal values (right axis).
Source(s): CBS, team analysis

3.1 Bootstrapping: Monte Carlo Analysis

Since the future value makes up a large part of any company's value, we have looked at what the risk to Sligro's value is by if the TV growth rate turns out to be lower/higher. This was done by analyzing 25 years of historical data taken from CBS. This data was winsorized for quarterly economic growth and the mean and standard deviation were computed (Figure D.14 in the appendix shows that the economic growth is approximately normally distributed). This, in order to find out what the range of terminal values would be in a Monte Carlo simulation using 1000 trials. We believe that our base case of 2% (yielding a PV(TV) of 955) is reasonable, given that the mean in the historical data set and in our Monte Carlo simulation were 2.24% and 2.17% respectively. The end result was that the terminal values were positively skewed. However, although most values were between 600 and 1400, the likelihood that it dropped below 600 was negligibly small, while the likelihood that it would end up doubling (i.e. >1900) was still around 13%.

3.2 Bad apple or an acquired taste? Counter-factual Analysis

What if Sligro never ventured into food retail? By investing their food retail acquisition money in a broad food distributor index, we have answered this question. Interestingly, the results indicate that Sligro indeed took a wrong turn by entering this market, judging from the higher ~€29 (~35% difference) share price (see Figure D.15 for details).

3.3 Bottom-up revenue forecast

A bottom-up revenue forecast using operational sales drivers indicate that Sligro indeed has the capacity to grow at the rate our econometric analysis indicates (see Figure D.17).

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CFA Institute

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Appendices

Appendix A - Strategy

A.1. Correlation Foodservice revenue with GDP

Figure A.1
Foodservice revenues are correlated with GDP growth
Source(s): CBS, CBL, team analysis

	Foodservice revenue growth	GDP revenue growth
1998	0.064	0.038
1999	0.073	0.046
2000	0.066	0.04
2001	0.039	0.019
2002	0.025	0.002
2003	-0.023	0.005
2004	-0.003	0.023
2005	0.028	0.021
2006	0.05	0.033
2007	0.052	0.04
2008	-0.001	0.021
2009	-0.053	-0.033
2010	-0.009	0.018
2011	0.048	0.012
Correlation	***82.29%***	

A.2. Herfindahl-Hirschman Index

The "other" share has been neglected since the total number of food service companies in the Netherlands amount to 8315 (CBS, 2012), resulting in a small market share each which does not affect the HHI index much. By the same line of thought, the *various breweries* also have not been taken into account. Looking at the HHI index for food services, it indicates that the food service market is not concentrated, with a HHI index of below 1000. However, the past three years it has slightly increased. Thus, the concentration is increasing.

Figure A.2
Herfindahl-Hirschman Index table for Foodretail
Source(s): team analysis

	2009	2010	2011
Albert Heijn	32.8	33.6	33.5
C1000	11.7	11.5	12.1
Super de Boer	6.5	5.5	-
Jumbo	4.9	5.5	7.4
Superunie (total)	29.6	29.6	29.2
Coop	2.4	2.5	2.6
Deen	1.9	2	2
Detailconsult	-	4.2	3.9
Em-Té	1.8	1.9	-
Golff	0.8	0.6	-
Hoogvliet	1.9	2	2
Jan Linders	1	1	1
Plus	6	6	5.9
Poiesz	0.9	1	1
Spar	2.3	2.2	2.2
Vomar	1.7	1.7	1.6
Sanders	0.3	0.3	-
Aldi	8.3	7.9	7.9
Lidl	5.4	5.6	6.7
Others	0.8	0.8	10.6
HHI-index	***1,440***	***1,497***	***1,505***

Figure A.3
Herfindahl-Hirschman Index table for Foodservice
**=Excluded. Source(s): team analysis*

	2009	2010	2011
Sligro	17.4	18.2	18.7
Lekkerland	14.8	14.5	14.7
Deli-XL	10.9	11	11.2
Metro	8.8	8.9	9
De Kweker/Vroegop	3.7	3.8	3.7
Kruidenier	4.4	4.4	3.9
Hanos/ISPC	3.5	3.4	3.4
Other	21.9*	21.7*	22.3*
Various Breweries	14.6*	14.1*	13.1*
HHI index	***763***	***787***	***813***

A.3. Porter's 5 Forces Model for Foodretail and Foodservice Industry

Figure A.4
Porter's 5 forces model for foodretail and foodservice industry
The sign in brackets indicates whether a factor is positive (+) or negative (-). The number given to each of the five forces can range from 1 (high) to 5 (low). Source(s): team analysis

	Foodservice Industry		Foodretail Industry	
Threat of new entrants	*Entry barriers (+)* *High Profitability (-)*	*4*	*Web based shopping (-)* *Brand equity (+)* *Distribution network (+)*	*4*
Threat of substitutes	*Ease of substitution (-)* *Low switching costs (-)*	*2*	*Limited number of substitutes (+)*	*5*
Bargaining power of customers	*Low buyer concentration relative to industry (+)* *Price sensitive (-)*	*4*	*Price insensitive (+)* *Low buyer concentration relative to industry (+)*	*4*
Bargaining power of suppliers	*High industry concentration relative to suppliers (+)* *Suppliers products are commodities (+)*	*5*	*High industry concentration relative to suppliers (+)*	*4*
Intensity of incumbent rivalry	*High growth (+)* *Low advertising expenses (+)*	*4*	*High advertising expenses (-)* *Sunk costs (-)* *Low growth (-)*	*1*

A.4. Analysis - Sligro's Value Chain

A.6.1.Description of value chain activities

Primary activities

Figure A.5 **Analysis of Sligro's value chain.** *Source(s): team analysis*

- ***Inbound logistics:*** Sligro is the only player in the market that has one central distribution centre, handling both wholesale as well as retail products. Ordering by customers can be done by telephone or by using the internet application Slimis. The order-picking process is done efficiently by using 2,500 warehousing trucks.
- ***Operations:*** The main warehouse and distribution centre in Veghel includes facilities to store products that need to be chilled or frozen. Via its proprietary IT-system, the products are arranged into packages ready to be shipped to a regional warehouse or food store. Additionally, Sligro has various in-house facilities for specialised convenience products, fish-preparation, patisserie, meat-processing, and delicacy items. The in-house facilities add value to the business by enabling to maintain quality and freshness standards. They also enable Sligro to control environmental friendly production. Recently, the CEO announced plans for e-commerce operations for the foodretail business unit, these activities are still in the beginning phase but we expect this to be an important part of operations in the future. Other non-core operations include the franchises that Sligro operates such as 'Big Snack', a local snack bar concept.
- ***Outbound logistics:*** Logistics are 100% outsourced by Sligro. Long-term contracts are employed with various logistics companies in order to assure a high quality standard.
- ***Marketing and sales:*** Foodservice publishes a promotional flyer every three weeks, while Emté supermarkets publish a flyer each week. Additionally, temporary price reductions are aimed at increasing direct sales volumes. Overall, Sligro does not have a distinctive promotional programs, also the intensity lacks behind competitors.
- ***Services:*** Emté services: Recipes, photo pies, child promotions, dry cleaner, child magazine (Tsjakka!), new loyalty program for customers. Sligro wholesale outlets: Recipes, cooking techniques, payment methods, product guarantees

Support activities

- ***Firm infrastructure:*** Sligro Food Group has a widespread network of delivery-service centres (11) and cash-and-carry locations (45). Activities involving customers and related logistics are all decentralized, while facilitative functions have been centralized and are managed from the head office in Veghel. All delivery-service centres are organized in the same manner, this enables the centres to take-over activities in emergencies. Logistics at Van Hoeckel will be integrated into Sligro's in 2012. Food retail includes 130 Emté supermarkets, mainly located in the south of the Netherlands. Self-scanners have been introduced at the supermarkets in order to expand customer service. However, customer still pay at a cashier, this enables the company to stay in contact with its customers.
- ***Human resource management:*** Sligro emphasises a distinctive approach towards professionalization. This translates into tailor-made training courses, consolidation courses and internships. Continuous learning and development, or 'lifetime learning', is an integral part of competence development for Sligro Food Group staff, including truck drivers. The Human Resource department has been centralized. Each department has a Head of HR who reports to the Group Director of Human Resources. Specialists assist the HR departments to deal with health and safety, compensation and other benefits. Also, the introduction of Emplaza, e-HRM software, enables a renewed focus on assisting management with management development, absenteeism and performance appraisal. In 2009, Sligro started using new software for their recruitment and selection activities. This resulted in less reliance on printed media and more recruitment activities via the internet.
- ***Technology development:*** A very important aspect of the foodservice sector is errorless on-time delivery. An important competitive advantage for Sligro is the in-house development of IT-systems, focused on making the order-picking processes more efficient. The IT department consists of around 70 FTE (85 people), of which 40-50 people are developing and maintain the current software. Sligro has developed its own IT-system and software in order to achieve operating excellence. Dispatch scanning through cross-docking systems result in considerable fewer errors while the PaperLess Order Picking project (called mobile PLOP) has been implemented to enable a highly efficient order assembly. In addition, dynamic route planning reduced costs while GPS-tracking systems ensure on-time delivery. Furthermore, the e-commerce application Slimis is used by 15,000 customers to place their orders. Sligro implemented various automation processes such as the automation of the invoicing processes which especially adds value at foodservice. Institutional organizations and restaurants are offered great service by efficient invoicing. In 2010, Sligro implemented the E-HRM system Emplaza. This system enables the Human Resource Department to improve the management of the organization, the quality of information and will make processes and procedures more efficient.
- ***Procurement:*** Procurement is essential for Sligro, as their aim is to offer high-quality, fresh products at competitive prices. In order to be assured of sufficient purchasing power in the market, food retail purchases are handled by the Superunie co-operative purchasing organisation, which has a 30% share of the Dutch supermarket

sector. As one of the largest players in the foodservice market, Sligro Food Group handles its own purchasing for the foodservice activities – worldwide and, where possible, direct from the source.

A.6.2 Order-processing

- **Process**: When an order has been received it will be allocated to a designated centre. At the delivery centre the order will go through the order assembly department, cross-dock zone and will be delivered to the customer. At the Fresh Partners the order will go through production and will then be delivered at the designated delivery service centre. The fresh products will then go through the cross-deck zone and will be delivered together with all other products. At the self-service outlet the orders are assembled and send by overnight transportation to the delivery-service centre. The order will go through the cross-dock zone and will be delivered to the customer with all other products.

Figure A.6
Flowchart of Sligro's order fulfilment.
Source(s): Company's annual reports

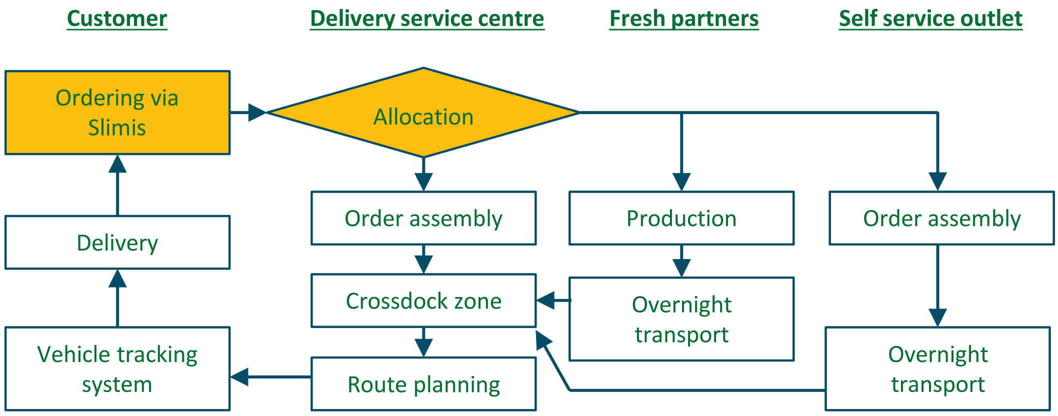


Figure A.7
Sligro's value chain.
Source(s): team analysis

	Positive	**Negative**
Internal	**Strengths** - *Sligro is in the food business: Food will always be a basic need* - *Diversified business:* - *Successful proprietary IT-system* - *Strong cash-generating capacity and sound financial position*	**Weaknesses** - *No economies of scale/ scope in food retail* - *Centralized distribution system makes Sligro vulnerable to system failures* - *In food retail Sligro is a market follower, no control over the market*
External	**Opportunities** - *Sustainability trend: Extend and focus on* - *Individualization trend: Extend single meals and focus on fresh products from Sligro's Fresh-Partners.* - *Market consolidation: M&A opportunities may exist both for food retail as well as foodservices.*	**Threats** - *Food prices are volatile and unpredictable.* - *Internationalization of food sector* - *Location of Emté supermarkets in rural areas.* - *Market consolidation: Especially Emté supermarkets may be seen as a potential acquisition candidate* - *High exposure to real estate price volatility*

Appendix B - Financial Analysis

Figure B.1
FCF/WACC. Current Value versus growth opportunities.
Current value = Enterprise value - (FCF/WACC). Growth opportunities = Enterprise value - current value
Source(s): FactSet, team analysis

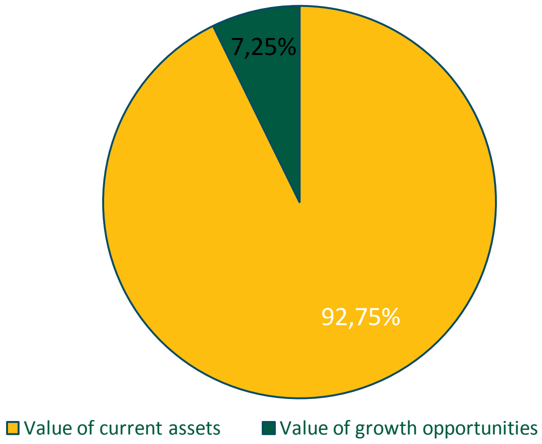
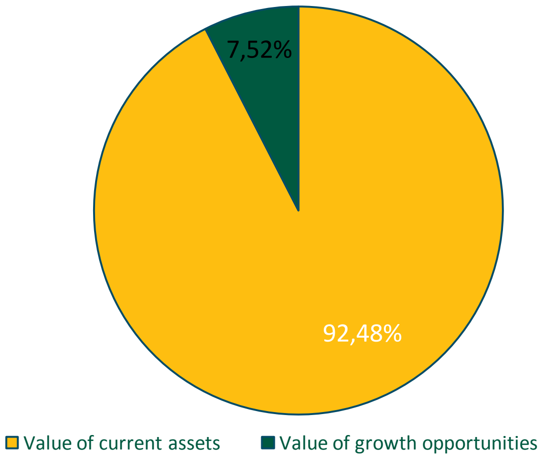


Figure B.2
Net Income / Cost of equity. Current Value versus growth opportunities.
Current value = Enterprise value - (NI/Cost of Equity) Growth opportunities = Enterprise value - current value
Source(s): FactSet, team analysis



Appendix C - Forecasting

C.1. General approach to forecasting revenues

As previously described, Sligro's business consists of two main pillars; Food Service and Food Retail. There has been a clear upward trend in both of these pillars. As discussed, the 5-year CAGR in revenue amounts to 3.89% for food services and 3.11% for food retail.

Figure C.1
Revenue development
Source(s): Company's annual reports

Attempting to forecast these trends for another five years *(2013-2017)* was done in the following steps;

- **Estimate a regression** of macro-economic indicators to analyze the impact on both the food retail and food service business. Economic analysis aids in translating the current and upcoming trends to revenue growth estimates.
- **Check the data** for stationarity and forecast the time-series trend by means of an autoregressive moving average (ARMA) model.
- **Estimate how much revenue growth** can be attributed to Sligro.
- **Compare the output** of the economic analysis and econometric analysis
- **Translate** estimates into revenue numbers for Sligro for the coming five years

In order to grasp the underlying drivers of these different segments, a time-series regression *(Newey-West robust errors)* was estimated for each pillar. The regressions are based on monthly (N=134) CBS data, and quarterly data, such as GDP, was transformed by means of cubic-spline interpolation.

C.2. Forecasting Foodretail revenue

Firstly, the supermarket revenue growth in the Netherlands was analyzed. As can be seen in Figure II.4 in the main text and Figure D.2 below, both the consumer confidence as well as the inflation are significant drivers. The strong impact of inflation is no surprise, since this drives up food prices. Consumer confidence has a somewhat weaker influence, since grocery shopping is not that dependent on the state of the economy as compared to the restaurant business (linked to food services).

Figure C.2
Regression output Foodretail
** = regression with Newey-West robust standard error.*
Source(s): CBS, Team analysis

Y= Supermarket revenue growth*	**Coefficient**	**Newey-West Std. Err.**	**t**	**P>|t|**	**[95% Conf. Interval]**	
Constant	0.8243233	0.7203184	1.14	0.255	-0.6006383	2.249285
Consumer Confidence	0.0634955	0.0192177	3.30	0.001	0.0254782	0.1015128
Inflation	1.548886	0.302841	5.11	0.000	0.9497939	2.147977

In estimating the revenue growth in the years 2013-2017, the following trends need to be considered.

- **As a result of high unemployment and low GDP growth rates**, the inflation is expected to decrease in the near future. However, if food prices decrease again the volume of sales might increase and thus the final figure (Price * Volume) will remain relatively constant.

- **The economy is recovering very slowly**, in terms of consumer confidence, and there will still be a high amount of uncertainty in the coming years.[38]
- **The competitive position of the retail business** is not clearly positioned and the industry has become increasingly more competitive (see section II.1.2.A)
- **Sligro's supermarket chain has launched a national campaign** on Jan 15th this year in an effort to make the leap to becoming a more national supermarket (as opposed to regional)
- **Ahold is leader of the pack** and is stealing away market share from competitors by staying on top of the digital trends.

Thus, taking the trends into consideration, the growth in this segment will be declining in the near future. In 2012, the growth amounted to about 2.7%, which is expected to decline gradually to about 2%, due to the highly competitive landscape and the pressure on margins.

C.3. Forecasting Food service revenue

As to the food service business, the revenue growth in the wholesale (food) sector in the Netherlands was analyzed. In addition to consumer confidence, the GDP clearly does matter. If the economy is doing extremely well, this is accompanied by an increase in dining out. Thus, the food service business is clearly more sensitive to the state of the economy than the food retail business.

***Figure C.3* Regression output foodservice**

** = regression with Newey-West robust standard error.*

Source(s): CBS, Team analysis

Y= Wholesale revenue growth* (Food)	Coefficient	Newey-West Std. Err.	t	P>|t|	[95% Conf. Interval]	
Constant	-16.32753	8.536946	-1.91	0.060	-33.33033	0.6752705
Consumer Confidence	0.1364337	0.0237729	5.74	0.000	0.0890859	0.1837816
GDP	0.0001497	0.0000593	2.52	0.014	0.0000315	0.0002679

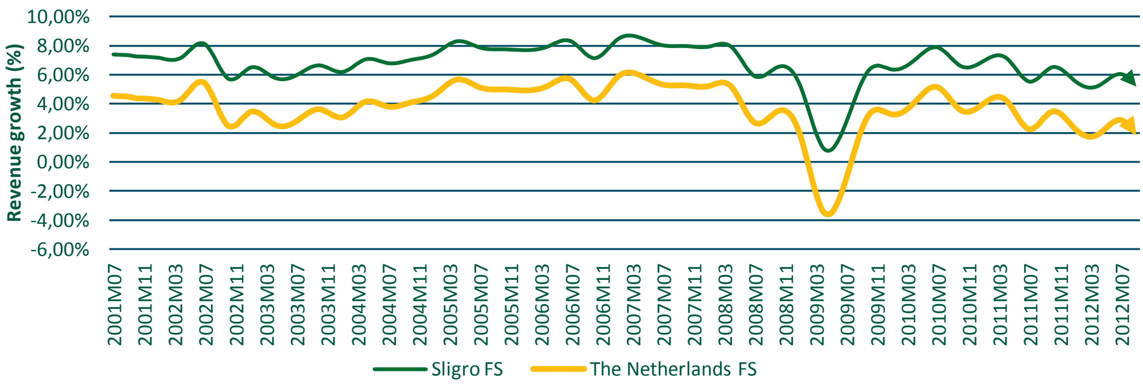
The outlook for the food service business in 2013-2017 is an upward figure, due to the following trends.

- **GDP growth will be recovering slowly,** although consumer confidence will remain relatively low in the coming years. Growth for the 2013-2017 period is estimated to be about 1.5%.[13]
- **Strong competitive position as a market leader**. They have been growing faster than the average growth of food wholesale business in the Netherlands (see Figure C.4).
- **There are future growth opportunities**, as the recent acquisition of van Oers indicates.

Although the 1.6% growth in 2012 was slightly disappointing, the trends mentioned above indicate that revenue growth outlook is more optimistic. As the economy is recovering slowly, this will trigger revenue growth in the food service business upward. Therefore, the growth is expected to gradually increase to about 2.5%. This is somewhat of a conservative estimate (compared to the 5 year CAGR of 3.89%) due to the high level of uncertainty with respect to the macro-economic situation and the effect this has on consumer confidence.

***Figure C.4* Revenue development Sligro foodservice division.(%)** *growth as compared to same month in preceding year*

Source(s): CBS, company's annual reports



C.4. Econometric analysis

In addition to the macro-economic forecast, an econometric forecasting method was used as well for comparison purposes and robustness.[39] This consists of the following steps:

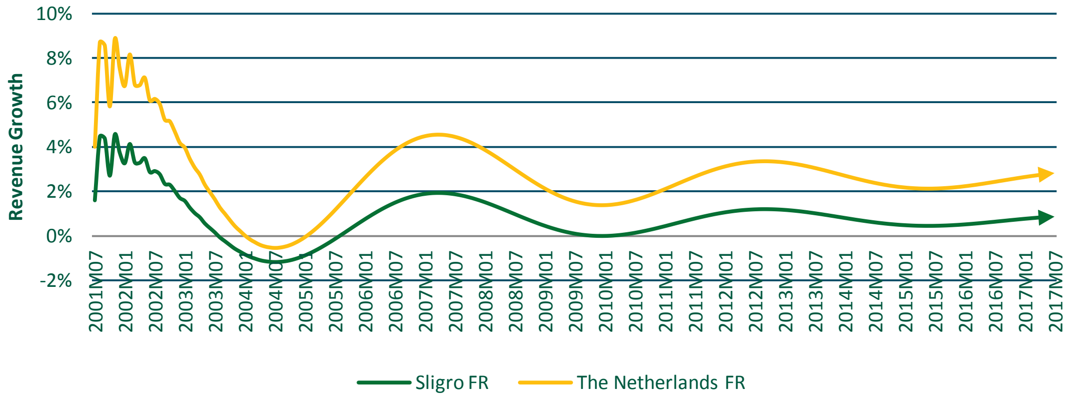
- **Check the data for stationarity** with the Augmented Dickey Fuller (ADF) test
- **Choose an Autoregressive Moving Average Model (ARMA)**, based on the lowest AIKAKE information criteria.

➢ **Determine what part of the revenue growth** in the Netherlands will be captured by Sligro

C.4.1 Food Retail

Since the supermarket revenue growth is stationary (no unit root detected with the augmented dickey fuller test), the data can be forecasted. After choosing the best fit ARMA model[40], another regression was estimated to allocate part of the supermarket revenue growth in the Netherlands to Sligro. As can be seen below, the resulting (econometric) forecast indicates that this growth will be fluctuating from approximately 1.2% in 2013 to a slower 0.5% in 2014 and finally 0.9% in 2017.

***Figure C.5* Econometric forecast**
Source(s): Team analysis



C.4.2 Food services

The food service (wholesale) revenue development variable is subject to a unit root, which is persistent in the *difference* in growth as well. Using this time series to estimate an ARMA model would result in an inaccurate forecast.

C.5. Concluding forecast

Concluding it can be said that the different forecasting methods yield different results for the food retail business (see Figure C.6). The econometric forecast predicts that the food retail business will not grow by more than 1%. Therefore, an average was taken of the 2 forecasting methods in order to set the final growth rate.

***Figure C.6* Concluding forecast numbers**
**=Weighted by the amount of revenue from each business segment.*
Source(s): Team analysis

Estimate Rev. growth 2013-2017	**Macroeconomic**	**Econometric**
Foodretail	~2%	~0.75%
Foodservice	~2.5%	-
Business as a whole*	~2.67%	-
	Foodservice	**Foodretail**
Estimated growth rate	2.5%	1.375%
Business as a whole*	**2.13%**	

Appendix D - Valuation

Figure D.1
Underlying DCF calculation based on forecasted figures and a WACC of 6.45%.
Source(s): Team analysis

	2012	2013	2014	2015	2016	2017	TV
EBITDA	102.93	122.67	143.28	160.4	163.8	167.3	167.3
FCF	13.39	22.33	33.04	54.6	55.08	57	57
Period	0	1	2	3	4	5	5
WACC	6.45%	6.45%	6.45%	6.45%	6.45%	6.45%	6.45%
Discount factor	1	0.94	0.88	0.83	0.78	0.73	0.73
NPV(FCF)	13.4	21.0	29.2	45.3	43.4	41.7	
Sum of NPV	***193.9***						

Figure D.2
Terminal Value computation.
Two Different methods for robustness purposes.
Source(s): Team analysis

TV Method 1 - Gordon Growth	**TV Method 2 - Exit Multiple**
Perpetuity growth rate 2%	Exit EBITDA multiple 7.6x
Implied EBITDA multiple 7.81x	Implied perpetuity growth rate 1.91%
PV Terminal Value 955	PV Terminal value 935
Operating Value 1,149.4	Operating Value 1,128.8
+ Cash +56	+ Cash +56
+Non-operating assets +67	+Non-operating assets +67
Enterprise Value ***1,272.8***	**Enterprise Value** ***1,252.2***
- Debt and provisions -177	- Debt and provisions -177
Market Cap ***1096.1***	**Market Cap** ***1,075.6***
Share price ***24.77***	**Share price** ***24.30***
Discount to Market ***13.8%***	**Discount to market** ***11.7%***

Figure D.3
Trading comparables computation.
All figures in million Euros
**Tesco and Casino have been excluded due to dissimilar size and growth prospects.*
Source(s): Team

	EV*	EV/Revenue	LTM EBITDA	EV/EBITDA	EV/EBIT
Ahold	17,463	0.51	7.79	7.45	11.80
Carefour	14,672	0.18	3.91	3.75	6.70
Casino*	16,832	0.33	5.99	4.91	7.08
Colruyt	5,915	0.69	8.62	8.25	11.43
Delhaize	5,740	0.25	4.12	4.00	7.38
Metro	12,098	0.18	3.68	3.60	5.87
Sainsbury	10,441	0.43	7.75	7.41	12.09
Tesco*	44,748	0.65	8.83	8.55	27.75
Sligro	1,090	0.43	7.64	7.18	11.23

Figure D.4
Trading comparables computation.
The trading range of Sligro's peers.
Source(s): Team analysis

	Peer Trading range			
High	0.51	7.79	7.45	12.09
Mean	0.31	5.54	5.19	8.49
Median	0.29	5.06	4.45	7.23
Low	0.18	3.68	3.60	5.87

Figure D.5
Trading comparables computation
Source(s): Team analysis, Company annual reports

	Sligro EV Estimates Based on Peer Trading range			
High	1,299	1,112	1,131	1,173
Mean	797	791	787	824
Median	732	722	676	702
Low	456	524	546	570

Figure D.6
Comparable Sligro Acquistions
All figures in million EUR
Source(s): Company's financial statements, team analysis, Merger Market

Date	Target	Activity	Country	Bidder	Seller	EV	EV/REV
30/11/2012	Real SB-Warenhouse GmbH	owns and operates grocery stores and hypermarkets	Germany	Groupe Auchan SA (subsidiary of Metro AG)	Real SB-Warenhouse GmbH	1100	0.4x
10/9/2012	EKO holding SA	Operations of hypermarket chain & supermarkets	Poland	Advent international	2 private investors	102	0.3x
26/4/2012	Jumbo Supermarkten B.V. (82)	Operating chain of supermarkets	NL	Royal Ahold N.V.	Jumbo Supermarkten B.V	290	0.4x
11/10/2012	Caprabo S.A. (16%)	Owner & Operator of discount food retail stores	Spain	Sociedad Cooperativa limitada de (?)	Botet Family	200	0.8x
30/5/2012	Makro Self Service ltd	Chain of supermarkets/grocery stores	UK	Booker Group Plc	Metro AG	175	0.2x
12/12/2011	Guyenne et Gascogne	Wholesale stores to commercial customers	France	Carrefour S.A.	Guyenne et Gascogne	494	0.9x
24/11/2012	C1000 B.V.	Food retail group supplying groceries and providing services to supermarket chains	NL	Jumbo Supermarkten B.V	CVC Capital Partners ltd	900	0.3x
1/3/2011	Distribuidara Internatiocional de Alimentation SA	Supermarket group	Spain	Carrefour S.A.	Carrefour S.A	2,904	NA
26/5/2010	Netto Food store ltd	Discount supermarket chain	UK	ASDA Group ltd.	Supermarked A/S	919	1.0x
18/9/2009	Super de Boer N.V	Chain of supermarkets	NL	Jumbo Supermarkten B.V	Casino Guichard Perrachon	634	0.4x
Median	***0.4x***						
Sligro's revenues 2012	***2,467***						
Sligro EV 2012 Median	***987***						

Figure D.7
Sligro's Balance Sheet
**forecasted items. Only sales figures are known.*
Source(s): Company's financial statements, team analysis

	2007	2008	2009	2010	2011	2012F*	2013F	2014F	2015F	2016F	2017F
Cash & Cash Equivalents	17	23	25	67	56	41	42	42	43	44	45
Receivables	116	124	112	110	119	122	128	134	136	139	142
Inventories	187	200	189	195	197	237	245	257	262	268	274
Other Current Assets	7	2	3	12	8	7	7	7	7	8	8
Total Current Assets	327	349	329	384	380	406	421	440	450	459	469
Long term investments	71	67	69	65	67	73	75	76	78	79	81
Net PPE	279	283	284	305	307	316	316	316	316	316	316
Other Non-Current	181	176	170	183	177	196	200	204	209	213	218
Total Non-Current Assets	531	526	523	553	551	585	591	596	602	608	615
Total Assets	***858***	***875***	***852***	***937***	***931***	***991***	***1,012***	***1,037***	***1,052***	***1,068***	***1,084***
Short term liabilities	74	53	28	53	0	0	0	0	0	0	0
Other Current liabilities	82	79	73	71	71	74	76	77	79	80	82
Accounts Payable	114	129	110	107	107	145	148	151	154	157	161
Total Current Liabilities	**271**	**261**	**210**	**232**	**178**	**219**	**223**	**228**	**233**	**238**	**243**
Long term Liabilities	184	154	128	173	174	149	118	94	65	26	37
Other	29	34	31	32	39	39	39	39	39	39	39
Total Non-Current Liabilities	**213**	**188**	**160**	**206**	**212**	**188**	**157**	**132**	**103**	**64**	**75**
Total Liabilities	**483**	**449**	**370**	**437**	**391**	**406**	**380**	**360**	**336**	**302**	**318**
Shareholder's equity & paid up capital	301	355	408	500	541	541	541	541	541	541	541
Retained earnings	74	71	74	0	0	44	91	136	175	225	225
Total Equity	**375**	**426**	**482**	**500**	**541**	**584**	**632**	**676**	**716**	**766**	**766**
Total Liabilities & Shareholders' equity	***858***	***875***	***852***	***937***	***931***	***991***	***1,012***	***1,037***	***1,052***	***1,068***	***1,084***

Figure D.7
Sligro's Common-size Balance Sheet
**forecasted items, only sales figures are known.*
Source(s): Company's financial statements, team analysis

	2007	2008	2009	2010	2011	2012F*	2013F	2014F	2015F	2016F	2017F
Cash & Cash Equivalents	1.9%	2.7%	2.9%	7.2%	6.1%	4.1%	4.1%	4.1%	4.1%	4.2%	4.2%
Receivables	13.5%	14.2%	13.1%	11.7%	12.7%	12.3%	12.6%	12.9%	13.0%	13.1%	13.1%
Inventories	21.8%	22.8%	22.2%	20.8%	21.2%	23.9%	24.2%	24.8%	24.9%	25.1%	25.3%
Other Current Assets	0.9%	0.2%	0.4%	1.3%	0.8%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%
Total Current Assets	38.1%	39.9%	38.6%	41.0%	40.8%	41.0%	41.6%	42.5%	42.7%	43.0%	43.3%
Long term investments	8.3%	7.6%	8.1%	7.0%	7.2%	7.4%	7.4%	7.3%	7.4%	7.4%	7.5%
Net PPE	32.5%	32.3%	33.4%	32.5%	33.0%	31.9%	31.2%	30.5%	30.0%	29.6%	29.2%
Other Non-Current	21.1%	20.2%	19.9%	19.6%	19.0%	19.8%	19.8%	19.7%	19.8%	20.0%	20.1%
Total Non-Current Assets	61.9%	60.1%	61.4%	59.0%	59.2%	59.0%	58.4%	57.5%	57.3%	57.0%	56.7%
Total Assets	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***
Short term liabilities	8.7%	6.1%	3.3%	5.7%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other Current liabilities	9.5%	9.1%	8.5%	7.6%	7.7%	7.5%	7.5%	7.4%	7.5%	7.5%	7.6%
Accounts Payable	13.3%	14.7%	12.9%	11.4%	11.5%	14.6%	14.6%	14.5%	14.6%	14.7%	14.8%
Total Current Liabilities	31.5%	29.8%	24.7%	24.7%	19.1%	22.1%	22.1%	22.0%	22.1%	22.3%	22.4%
Long term Liabilities	21.4%	17.6%	15.1%	18.5%	18.6%	15.0%	11.6%	9.0%	6.2%	2.4%	3.4%
Other	3.4%	3.9%	3.7%	3.5%	4.2%	3.9%	3.8%	3.7%	3.7%	3.6%	3.6%
Total Non-Current Liabilities	24.8%	21.5%	18.7%	21.9%	22.8%	18.9%	15.5%	12.8%	9.8%	6.0%	7.0%
Total Liabilities	56.3%	51.3%	43.4%	46.6%	41.9%	41.0%	37.5%	34.8%	32.0%	28.3%	29.4%
Shareholder's equity & paid up capital	35.0%	40.5%	47.9%	53.4%	58.1%	54.6%	53.4%	52.1%	51.4%	50.6%	49.9%
Retained earnings	8.6%	8.2%	8.7%	0.0%	0.0%	4.4%	9.0%	13.1%	16.6%	21.1%	20.8%
Total Equity	43.7%	48.7%	56.6%	53.4%	58.1%	59.0%	62.5%	65.2%	68.0%	71.7%	70.6%
Total Liabilities & Shareholder's equity	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***	***100%***

Figure D.8
Sligro's Income statement.
**=only sales figures have been published, no other items are known at the time of writing.*
Source(s): Company's financial statements, team analysis

	A 2007	A 2008	A 2009	A 2010	A 2011	A/F* 2012	F 2013	F 2014	F 2015	F 2016	F 2017
Revenue	2,066	2,168	2,258	2,286	2,420	2,467	2,518	2,571	2,626	2,682	2,739
COGS	(1,791)	(1,873)	(1,955)	(1,989)	(2,105)	(2,182)	(2,210)	(2,244)	(2,278)	(2,326)	(2,376)
Depreciation	(39)	(48)	(51)	(55)	(54)	(54)	(64)	(66)	(67)	(68)	(70)
Gross Profit	**235**	**247**	**252**	**243**	**261**	**230**	**244**	**262**	**282**	**288**	**294**
SG&A	(150)	(156)	(155)	(157)	(160)	(186)	(189)	(188)	(192)	(196)	(201)
Other operating expense	0	0	0	(0.3)	0	0	0	0	0	0	0
EBIT	**85**	**90**	**97**	**86**	**101**	**45**	**54**	**74**	**89**	**91**	**93**
Interest expense	(12)	(12)	(6)	(5)	(7)	(6)	(5)	(4)	(3)	(1)	(2)
Other non-operating income	13	14	8	5	6	6	6	6	6	6	6
Unusual expense (income)	(10)	0	(0)	(0)	2	**0**	**0**	**0**	**0**	**0**	**0**
Earnings Before Taxes	**96**	**92**	**98**	**86**	**98**	**45**	**56**	**76**	**93**	**96**	**98**
Tax expense	(22)	(21)	(24)	(21)	(25)	(12)	(14)	(19)	(22)	(23)	(23)
Equity in Earnings of Affiliates	0	0	0	5	5	0	0	0	0	0	0
Net Income	***74***	***71***	***74***	***70***	***78***	***33***	***41***	***57***	***70***	***73***	***74***

Figure D.8
Sligro's Common-size Income statement.
**= 2012 numbers are partially forecasted due to incomplete numbers*
Source(s): Company's financial statements, team analysis

	A 2007	A 2008	A 2009	A 2010	A 2011	A/F* 2012	F 2013	F 2014	F 2015	F 2016	F 2017
Revenue	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
COGS	-86.7%	-86.4%	-86.6%	-87.0%	-87.0%	-88.5%	-87.8%	-87.3%	-86.7%	-86.7%	-86.7%
Depreciation	-1.9%	-2.2%	-2.2%	-2.4%	-2.2%	-2.2%	-2.5%	-2.5%	-2.5%	-2.5%	-2.5%
Gross Profit	**11.4%**	**11.4%**	**11.2%**	**10.6%**	**10.8%**	**9.3%**	**9.7%**	**10.2%**	**10.7%**	**10.7%**	**10.7%**
SG&A	-7.3%	-7.2%	-6.9%	-6.9%	-6.6%	-7.5%	-7.5%	-7.3%	-7.3%	-7.3%	-7.3%
Other operating expense	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
EBIT	**4.12%**	**4.17%**	**4.28%**	**3.75%**	**4.18%**	**1.81%**	**2.16%**	**2.86%**	**3.40%**	**3.40%**	**3.40%**
Interest expense	-0.58%	-0.56%	-0.28%	-0.21%	-0.29%	-0.25%	-0.19%	-0.15%	-0.10%	-0.04%	-0.06%
Other non-operating income	0.62%	0.66%	0.34%	0.23%	0.23%	0.24%	0.24%	0.23%	0.23%	0.22%	0.22%
Unusual expense (income)	0.62%	0.66%	0.34%	0.23%	0.23%	0.24%	0.24%	0.23%	0.23%	0.22%	0.22%
Earnings Before Taxes	**4.65%**	**4.26%**	**4.34%**	**3.77%**	**4.05%**	**1.81%**	**2.21%**	**2.94%**	**3.52%**	**3.58%**	**3.56%**
Tax expense	-1.06%	-0.97%	-1.04%	-0.94%	-1.03%	-0.47%	-0.56%	-0.73%	-0.85%	-0.85%	-0.85%
Equity in Earnings of Affiliates	0.00%	0.00%	0.00%	0.24%	0.21%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Net Income	**3.59%**	**3.29%**	**3.29%**	**3.07%**	**3.23%**	**1.33%**	**1.65%**	**2.22%**	**2.67%**	**2.73%**	**2.71%**

Figure D.9
Implied Share price sensitivity (Gordon Growth Model).
*WACC is given in the first column and the perpetuity growth rate in the first row. Base case is indicated with *. Source(s): Team analysis*

	1%	**1.5%**	**2%**	**2.5%**
7.74%	€ 17.13	€ 18.39	€ 19.88	€ 21.67
6.74%	€ 20.63	€ 22.49	€ 24.77*	€ 27.62
5.74%	€ 25.72	€ 28.68	€ 32.50	€ 37.62
	Min € 17.13	***25th € 20.44***	***75th €27.89***	***Max € 37.62***

Figure D.10
Implied Share price sensitivity (Exit multiple).
*WACC is given in the first column and the Exit multiple is given in the first row. Base case is indicated with *. Source(s): Team analysis*

	6.64x	**7.14x**	**7.64x**	**8.14x**
7.45%	€ 20.58	€ 21.90	€ 23.22	€ 24.54
6.45%	€ 21.54	€ 22.92	€ 24.30*	€ 25.69
5.45%	€ 22.56	€ 24.00	€ 25.45	€ 26.90
	Min € 20.58	***25th € 26.90***	***75th € 24.77***	***Max € 26.90***

Figure D.11
Weighting of valuation methods yields a price range of €19.99 - €28.23. Overview table of valuation methods and corresponding weights.
Source(s): Team analysis

Method	**Weighting**
Transaction comps	5%
Trading comps EBITDA	5%
DCF Gordon growth	80%
DCF Exit multiple	10%
Min (pessimistic)	***€19.99***
Median (base)	***€24.26***
Max (optimistic)	***€28.23***

The Capital Asset Pricing Model (CAPM) is used in calculating the Weighted Average Cost of Capital (WACC):

Figure D.12 **Overview Cost of Capital calculation.** *Source(s): Damodaran, company's statements, ECB, team analysis*

Cost of Equity = Risk free rate + Beta * Market risk premium= 3.55% + 0.66*5.5% = 7.14%
WACC = (1- effective tax rate)* Debt/EV* Cost of Debt + Equity/EV*Cost of Equity
WACC = (100-23.98%)*18.47%*4.17% + (1-18.47%)*7.14% = 6.45%

The following assumptions were used

- ***Total Debt/EV, Tax rate and Cost of Debt*** are assumed to stay constant at the historic 5-year average
- ***Market risk premium:*** Set to a widely used and accepted 5.5%[41].
- ***Risk free rate:*** Given the AAA sovereign rating of the Netherlands and the Dutch focus of Sligro, we used Netherlands 10-years bond yield as risk free rate. Due to European sovereign debt crisis, Netherlands 10 years bond yield is exceptionally low. Therefore, we normalized risk free rate by averaging the trailing 10 years annual yield data to adjust for the impact of business cycle fluctuations and the financial crisis. The risk free rate is 3.18% for our model.
- ***Levered beta:*** We have estimated the levered beta for Sligro by using the following regression model:

$$R_p - R_f = \alpha + \beta(R_m - R_f)$$

Where,

R_p = Sligro's returns,
R_f = The returns on a 10-year Dutch government bond, and
R_m = Returns on the MSCI world index

Returns are calculated as (closing price$_{t+1}$-closing price$_t$)/closing price$_t$).The regression yielded a beta of 0.636, which we have adjusted for the cash holding for Sligro (since cash has a beta of zero and artificially lowers the overall beta) by dividing it by (1-(cash/firm value)) to end up with a beta of 0.66.

Figure D.13 **Regression plot of Sligro's returns against the MSCI world index returns.** *Sources(s): ECB, Factset, Team analysis*

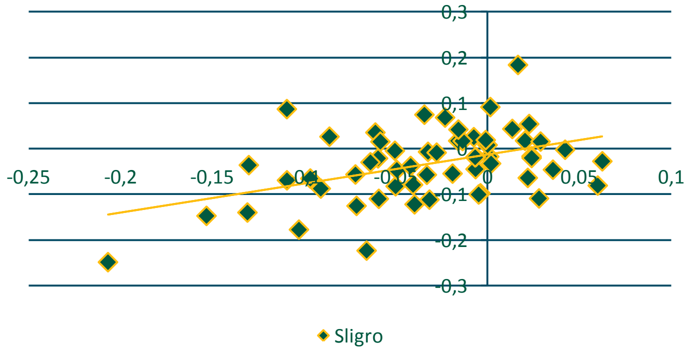
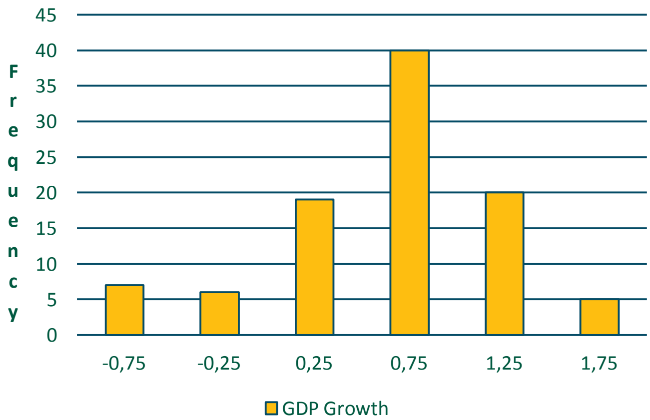


Figure D.14 **Historical quarterly GDP growth is approximately normally distributed.** *Frequency of Historical GDP growth. Source(s): CBS, Team analysis*



Counterfactual Analysis

- ***If I could turn back time:*** Now that the Sligro business has been thoroughly analyzed, it is time to ask the dooming "What if" question. As has been discussed, the retail segment seems to lag behind the wholesale business significantly. Would Sligro have been better off without it? In order to answer this question, the clock is turned back. When did Sligro take this turn into food retail and what acquisitions have been made along the way?[42]
  - In Jan-2001, Sligro ventured into food retail with its acquisition of Prisma Food Retail, which had 441m turnover. Grocery stores were trading at EV/REV of 0.56x[43] . The assumed deal value is therefore 246.96m
  - Acquisition of EM-TE Supermarkten on 16-Apr-2002 for 30.82m.
  - Acquisition of J.Smit Vishandel on 11-Jun-2002. At this time, grocery stores were trading at EV/REV of 0.54x[44]. The revenues of J. Smit Vishandel were 27m at that time; the deal value is estimated at 14.58m
  - Acquisition of 223 Edah stores on 29-May-2006 for 282.21m
  - Acquisition of Sanvier on 02-July-2010for 62.3 m
- ***What could have been:*** The money invested in the retail business could have been spend on food services instead. This increased focus on their core business could have lead to a much higher value of the Sligro business today. In order to proxy for this different path, a broad (worldwide) food distributor index is chosen with 47 constituents[45]. Subsequently, it is assumed that the estimated (undisclosed) deal values are also sales prices. Hence, no additional premium is added. Finally, this retail acquisition money (as listed above) is invested in the food distributor index from the announcement date onwards. Thus, this capital flows from passing up retail opportunities, into the food distributor index.

- ***Food retail; past expiration date?*** As can be seen in figure x, the food service business by itself has an EV of ~523m. This was derived by applying an EV/REV multiple of 0.32x, as given by Damodaran[46]. In order to derive the market cap from this figure, the same numbers were used as in the DCF (w.r.t cash, debt). However, in addition to that, there is a chunk of cash (~830m) obtained from passing up food retail opportunities and investing it in the broad based food distributor index instead. Concluding, it can be said that the 29.34EUR is indeed more appealing than the target price of €24.26, based on the business mix of food- services and retail. Unfortunately, it seems that Sligro did take a wrong turn along the way somewhere in 2001.

Figure D.15
Counterfactual analysis
Source(s): FactSet, team analysis

Counterfactuals	
Food Service Revenues 2012	1,634.72
EV/Rev 2012	0.32x
Enterprise value	***523.11***
PLUS LT investments	67.10
PLUS Existing Cash	56.4
PLUS Cash from FS index	830
Less Debt/provisions	177
Market Cap	***1,299.72***
Shares outstanding	44.3
Implied share price	***€29.34***

Bottom-up Revenue Forecast

In order to check whether our econometric forecast was not too optimistic and whether Sligro would be able to grow at a rate projected by our analysis, we have made a bottom-up revenue forecast based on operational drivers.

We have forecast the revenue from food retail, foodservice DIY, and foodservice delivery separately using the following formulae:

Revenue food retail = Current store revenue + New store revenue growth:

*Current store revenue = average revenue per sqm * sqm per store * number of current stores*

*New store revenue = average revenue per sqm * sqm per store * new store openings*

Revenue food DIY = Current location revenue + New location revenue growth:

Current location revenue$_t$ *= number of DIY locations*$_t$ ** avg revenue per location*$_{t-1}$ ** (1+g)*^{t}

New location revenue = new locations$_t$ ** avg revenue per location*$_{t-1}$ ** (1+g)*^{t}

Revenue food Delivery = Current location revenue + New location revenue growth:

Current location revenue$_t$ *= number of delivery locations*$_t$ ** avg revenue per location*$_{t-1}$ ** (1+g)*^{t}

New location revenue = new locations$_t$ ** avg revenue per location*$_{t-1}$ ** (1+g)*^{t}

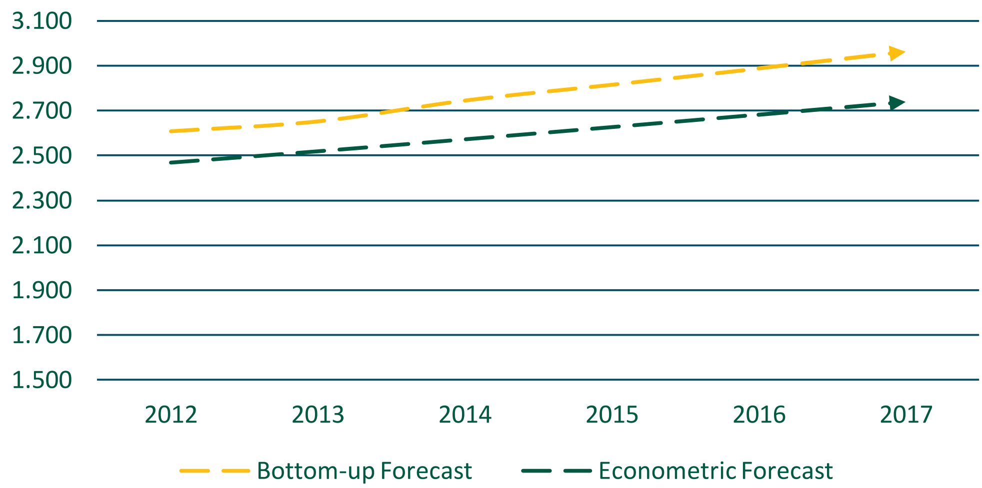
The following assumptions are used:

- ***Additions DIY locations:*** Sligro has plans to add 3 more DIY locations over the upcoming years.[47] We therefore assume that every year there will be one new location added. Historical figures support this assumption, as over the past 4 years 3 locations have been added (only in 2010 was there no addition).
- ***Growth rate in DIY revenue per location:*** We assume that Sligro maintains its competitiveness and let the price for DIY products increases with inflation (~2%)
- ***Average revenue per delivery location:*** We calculated the average revenue per delivery location by dividing the delivery revenue by the number of locations over the past 3 years and taken the average. We end up with an avg of €83.5m, which is similar to the range that managent indicates of €75 to €150m per delivery centre is €100m.[48] Since Sligro has many small locations and a few large ones, the average falls at the lower end of the range given by management.
- ***Average revenue per DIY location:*** Similar to avg rev per delivery location we have divided the delivery revenue by the number of locations over the past 3 years and taken the average.
- ***Additions DIY locations:*** The number of delivery locations has gone up from 7 in 2007 to 10 in 2010, we therefore conservatively estimate one new addition every two years
- ***Growth rate in delivery revenue per location:*** We assume the price increase for delivery products grow slightly above the rate of inflation but still above the growth rate in DIY, since Sligro can command a premium for the convenience of delivery products and services offered

Figure D.16 **Bottom-up revenue forecast summary table**
Source(s): Team analysis

	Bottom-up revenue forecast					
Year	2012	2013	2014	2015	2016	2017
Sligro Food Group Revenue (€m)	***2608.91***	***2652.90***	***2745.76***	***2816.25***	***2888.49***	***2962.51***
Total foodservice revenue (€m)	***€ 1,674.99***	***€ 1,712.98***	***€ 1,751.85***	***€ 1,791.60***	***€ 1,832.27***	***€ 1,873.88***
DIY revenue (€m)	*€ 776.62*	*€ 792.15*	*€ 807.99*	*€ 824.15*	*€ 840.64*	*€ 857.45*
Like-for-like revenue (€m)	€ 760.09	€ 775.30	€ 790.80	€ 806.62	€ 822.75	€ 839.21
New location revenue (€m)	€ 16.52	€ 16.85	€ 17.19	€ 17.54	€ 17.89	€ 18.24
Delivery revenue (€m)	*€ 898.37*	*€ 920.83*	*€ 943.85*	*€ 967.45*	*€ 991.64*	*€ 1,016.43*
Like-for-like revenue (€m)	€ 855.59	€ 876.98	€ 898.91	€ 921.38	€ 944.41	€ 968.02
New location revenue (€m)	€ 42.78	€ 43.85	€ 44.95	€ 46.07	€ 47.22	€ 48.40
Total Food retail revenue (€m)	***€ 933.92***	***€ 939.92***	***€ 993.91***	***€ 1.024.65***	***€ 1.056.21***	***€ 1.088.63***
Other revenue (€m)	*€ 145.00*	*€ 100.00*	*€ 102.00*	*€ 104.04*	*€ 106.12*	*€ 108.24*
Total operating revenue (€m)	*€ 788.92*	*€ 839.92*	*€ 891.91*	*€ 920.61*	*€ 950.09*	*€ 980.39*
Same-store revenue (€m)	*€ 781.21*	*€ 831.80*	*€ 883.40*	*€ 911.92*	*€ 941.23*	*€ 971.35*
avg rev per sqm	€ 5,487.27	€ 5,771.41	€ 6,055.56	€ 6,176.67	€ 6,300.20	€ 6,426.20
sqm per store	1171.75	1171.75	1171.75	1171.75	1171.75	1171.75
# of current stores	121.50	123.00	124.50	126.00	127.50	129.00
New-store revenue (€m)	*€ 7.72*	*€ 8.12*	*€ 8.51*	*€ 8.68*	*€ 8.86*	*€ 9.04*
avg rev per sqm	€ 4,389.81	€ 4,617.13	€ 4,844.44	€ 4,941.33	€ 5,040.16	€ 5,140.96
sqm per store	1171.75	1171.75	1171.75	1171.75	1171.75	1171.75
New stores added	1.5	1.5	1.5	1.5	1.5	1.5
	Econometric revenue forecast					
Year	2012	2013	2014	2015	2016	2017
Sligro Food Group Revenue (€m)	***2467.00***	***2517.57***	***2571.20***	***2625.96***	***2681.90***	***2739.02***

Figure D.17
Comparison Econometric forecast with bottom-up revenue forecast shows that the econometric sales forecast is within Sligro's growth capacity
Sales forecast (€bn) using econometric method and bottom-up method.
Source(s): Team analysis



Appendix E - Corporate Governance, Ethics & Corporate Social Responsibility

Remuneration of the executive and supervisory board is in line with the ethical standards of the Netherlands, the Tabaksblat code (see also Figure E.3). A profit-sharing scheme for employees is in place based on profit as a percentage of sales. The total amount is converted in shares. At the moment 1,614,000 shares are held by employees, of which 250,000 (or ~15%) belong to members of the executive board. CSR is very much a priority for Sligro (see also Figure E.5). One of their CSR policies entails the introduction of 'Eerlijk and Heerlijk' ('honest and delicious') as house brand which is based on four concepts namely: organic, fairtrade, sustainable and local to meet customers' demands for fair trade and sustainable products. In addition, several initiatives such as sustainable veal, label rouge (quality chicken), eel, and sustainably-produced cocoa have been introduced into their product range. Sligro also has become a license holder for the Fairtrade/Max Havelaar in 2009, which enables them to make their own choices with regard to their sustainability framework rather than being dependent on suppliers

Figure E.1 **Composition Supervisory board per 31-12-2011**
Source(s): Company's annual report

A. Nühn (1953) Supervisory Director, President	➢ Supervisory Director of Macintosh Retail Group N.V., Stern Groep N.V., Leaf International, Anglovaal Industries, Heiploeg, Plukon Royale and member of the Board of Trustees of WWF-Netherlands (World Wide Fund for Nature) and the OLVG hospital in Amsterdam. ➢ Appointed in 2009 until 2013 and eligible for reappointment. ➢ Annual remuneration: €40k
Th.A.J. Burmanje (1954) Supervisory Director	➢ Chair of the Dutch Land Registry Board. Member of the Supervisory Board of Deltares and a Governor of the Netherlands School of Public Administration. Supervisory Director of ARN B.V., Weurt, and chair of the Supervisory Board of Canissius Wilhelmina hospital. ➢ Appointed in 2008 until 2012. In 2012 reappointed until 2016. ➢ Annual remuneration: €32k
B.E. Karis (1958) Supervisory Director	➢ Chairman of the Executive Board of Zeeman Textielsupers ➢ ppointed in 2012 until 2016 and eligible for reappointment. ➢ Annual remuneration: €32k
R.R. Latenstein van Voorst (1964) Supervisory Director	➢ Chairman of the Executive Board of SNS Reaal N.V. Board member of the Oranje Fund, VNO-NCW (Confederation of Netherlands Industry and Employers), the Dutch Association of Insurers, board member of Stichting Weet Wat Je Besteedt and member of Bank council DNB ➢ Appointed in 2008 until 2012. In 2012 reappointed until 2016 ➢ Annual remuneration: €32k

Figure E.2

Composition Executive Board per 31-12-2011

Source(s): Company's annual report

K.M. Slippens (1967) Chairman	➢ Date of joining the company: 29 July 1998 ➢ Present position held since: 21 September 2008 ➢ Background: degree in business economics
H.L. van Rozendaal (1956) Finance	➢ Date of joining the company: 1 May 1991 ➢ Present position held since: 1 May 1991 ➢ Background: chartered accountant
W.J.P. Strijbosch (1968) Foodservice	➢ Date of joining the company: 1 June 2011 ➢ Present position held since: 1 June 2011 ➢ Background: degree in business administration
G.J.C.M. van der Veeken (1961) Company secretary	➢ Date of joining the company: 1 March 2005 ➢ Present position held since: 1 March 2005 ➢ Background: degree in Dutch and tax law

Figure E.3

Remuneration Executive board per 31-12-2011 (€000).

Source(s): Company's annual report

	K.M. Slippens	***J.H.F. Pardoel***	***H.L. van Rozendaal***	***J.H. Peterse***	***Total***
Fixed salary	344	305	305	50	1,004
Short-term bonus	94	83	83	0	260
Long-term bonus	94	83	83	0	260
Pension contribution	79	80	95	13	267
Value of options	46	46	46	0	138
Total	657	597	612	63	1,929

Figure E.4

Bonus policy.

Source(s): Company's annual report

Bonuses

The short-term bonus, 50% of total bonus, is determined by the extent the budget has been achieved. If less than 90% of the target has been achieved no bonus will be paid out. Achieving the budget will lead to a short-term bonus of 15% of the fixed salary. This bonus will increase with the extend to which the budget has been exceeded. The long-term bonus is determined by goals relating to business milestones. In 2011, the integration of Sander stores, the Gretaer Amsterdam project, commissioning of the new delivery service centre in Enschede and achieving suitable progress with the CSR program were all important whether or not a bonus was paid. This part of the bonus is also capped at 15% of the fixed salary. Because this part related to the long-term bonus, it needs to be used to purchase Sligro Food Group shares, these need to be held at least 4 years. In 2011, 90% of the bonus target level was paid out, in comparison to 55% in 2010.

Figure E.5

Overview of Sligro's CSR spearhead projects.

Source(s): Company's annual report

CSR spear-head projects

- *Affiliation with BSCI (Business Social Compliance Initiative)*
- *Covered freezers in supermarkets and cash-and-carry stores*
- *Video conferencing*
- *New transport technologies*
- *Piloting alternative fuels*
- *Projects for a sustainable primary sector*
- *Eerlijk & Heerlijk*
- *Heat-recovery trial project*
- *Energy saving at frozen-food distribution centres*
- *High-frequency lighting at distribution centres*
- *Support of voluntary projects by Sligro food group staff*

Figure E.6
Overview of Sligro's shareholders showing a significant holding (~34%) for the founder/management family Slippens.
Source(s): FactSet

Shareholders	% of total shares
Stichting Administratiekantoor Slippens	33.95%
Darlin N.V.	6.12%
ING Groep N.V.	5.43%
Stichting Administratiekantoor Arkelhave B.V.	5.06%
FMR LLC	5.03%
Boron Investments N.V.	5.02%
Belegging- en Exploitatiemaatschappij De Engh B.V.	5.01%

Endnotes

[1] MRE = Meal, Ready-to-eat
[2] The Randstad area is a densely-populated geographic conurbation covering the four major cities in the Netherlands.
[3] Source: Locatus/HBD,
[4] Source: Company's annual statements and team analysis
[5] Source: Eurostat
[6] Source: ING Equity Research, '*European Retail - The more clicks, the fewer bricks*', October 2011
[7] Source: FAO.org
[8] Source: CBS
[9] Source: CBS
[10] The formula for the Herfindahl-Hirschman Index is as follows: $HHI = s1\hat{}2 + s2\hat{}2 + s3\hat{}2 + \ldots + sn\hat{}2$
[11] Source: Food Magazine (6-12-2012)
[12] Source: CBS, HBD
[13] Source: CBS
[14] Source: CPB
[15] Source: Ernst & Young, Top 10 risks and opportunities retail
[16] Source: European Food Safety Authority, 'EFSA and ECDC zoonoses report: Salmonella in humans continues to decrease, Campylobacter increasing' March 2012
[17] Source: Company's annual report 2011
[18] Meaning an increase in sales of at least 5%
[19] Source: Company's annual report 2011
[20] Source: Foodservice Monitor Report 2011
[21] RONC is calculated as: EBIT/[(Net Operating Capital Employed $_{t-1}$ + Net Operating Capital Employed$_t$)/2]
[22] Cash Conversion Cycle is calculated as: Days of Inventory Outstanding (DIO) + Days of Sales Outstanding (DSO) –Days of Payable Outstanding (DPO)
[23] Source: Sligro Annual Report 2012
[24] See calculations in appendix
[25] See preceding analysis
[26] Although sales figures are published, full results are not at the date this report was written. 2012 is therefore both actual/forecasted
[27] Source: Sligro Annual Report 2011
[28] The European Commision (2012) states that ECB has a target of maintaining low inflation, slightly below 2%. According to the OECD (2012) in their report on long-term global growth prospects**,** the 2011-2060 economic growth hovers slightly above 2%.
[29] See calculations in Appendix
[30] As compared to the market value at 1/12/2013
[31] Please refer to the sensitivity table. By varying the WACC and perpetuity growth rate, a range of possible values was achieved. The 25th quartile rather than the lowest was taken for the pessimistic scenario. For the optimistic scenario, the 75th quartile was taken. This because a more narrow (and likely) range was established after cross-checking with the other valuation methods.
[32] Sales gradually revert back to 5 year CAGR of 3.6% for overall firm whilst margins slightly improve due to scale efficiencies
[33] See Appendix
[34] EV/REV is chosen since other multiples suffered from a lack of data. Moreover, revenue multiples are less subject to accounting distortions, making it more comparable across companies. Listed food retailers are not 100% comparable due to differences in business mix (more retail).
[35] The Exit Multiple Method is often a sanity check on Gordon Growth. See Hitchner, J.R., 2011. Financial Valuation: Applications and Models, John Wiley & Sons.
[36] As compared to the market value at 1/12/2013
[37] Source: Aguirreamalloa, J. & Avendaño, L.C., 2011. US Market Risk Premium Used in 2011 by Professors, Analysts and Companies: A Survey with 5.731 Answers. SSRN Electronic Journal.
[38] Source: Rijksoverheid, 2012
[39] Source: Massimiliano Marcellino, T.C., A comparison of time series models for forecasting GDP growth and inflation.

[40] Supermarketgrowth = 2.60560659667 + [AR(1)=0.922454121336,AR(2)=0.403837135621,AR(3)=0.294202992703,AR(4)=-0.645688286411,MA(1)=-.32783811346,MA(2)=-0.232007820745,MA(3)=0.470134892111,MA(4)=0.0899312315407]

[41] Source: Aguirreamalloa, J. & Avendaño, L.C., 2011. US Market Risk Premium Used in 2011 by Professors, Analysts and Companies: A Survey with 5.731 Answers. SSRN Electronic Journal.

[42] Only pure food retail acquisitions were used in the counter factual analysis

[43] Source: Damodaran (2001)

[44] Source: Damodaran (2002)

[45] Due to a lack of broad based European food distributor indices, the FDSAGG World / Food Distributors is used.

[46] Based on 15 food distributor companies, 2012 data

[47] Source: Annual report 2011, p. 28

[48] Source: Annual report 2011, p. 34