SUPERMAR, S.A.

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Supermar is a supermarket distribution chain located in the Canary Islands, Spain. After several decades of growth thanks to its successful commercial strategy, Supermar finds itself limited by it geographic limitation as well as increased competition from large hypermarket chains. Its CEO, founder and main shareholder decides to seek further expansion by acquiring another privately owned distribution chain located in the Spanish mainland. The case evidences the inherent challenges of valuing private held firms as well as decision-making in family-owned businesses.

Melissa Gómez looked at her screen and could not help the feeling of excitement as well as responsibility. After earning her MBA three years earlier, it had been a natural transition to go back to the Canary Islands and join SUPERMAR S.A. as its CFO. Her father, Heriberto Gómez, was the founder, General Manager and main shareholder of the family business. Most of the responsibilities that she had encountered in her new management position thus far could be described as the "usual", day-to-day financial management of the company. However, this time, it was different. Mr. Gomez had asked her to prepare a cohesive and well-documented analysis that would help support his new and ambitious expansion strategy for the company, which he hoped to present in the next Board of Directors meeting. Melissa realized that her analysis would have a very important role in the future path that the company would take.

ORIGINS OF THE COMPANY

SUPERMAR was created in the Canary Islands, Spain, at the beginning of the 80s as a small supermarket located in a touristy area of Tenerife. Based on solid management, a large influx of tourists and the higher margins typical of preferred vacation spots, business expanded rapidly during the initial years. Growth was achieved by opening new branches as well as acquisitions of other small supermarket chains on the island. These acquisitions took the shape of mergers where a percentage of SUPERMAR shares were exchanged for the total equity of the target company. This system enabled the creation of a very homogeneous group of shareholders composed of industry professionals.

THE KEY TO SUCCESS

By the mid 1990's, SUPERMAR had become the main supermarket chain on the Canary Islands, with more than sixty establishments, two warehouses and a head office dedicated to purchases. This structure made it possible for SUPERMAR to buy goods at very favorable prices and so offer more value than its competitors, most of which were small chains that did not have more than ten establishments. In the opinion of SUPERMAR owners, the success of the company was based on three characteristics:

The Quality and Proper Management of Perishable Products

Unlike non-perishable products, where price was essential when competing with brands offering similar products, there were hardly any commercial brands for perishable goods. The perceived quality of the product was essential, since it enabled high margins and satisfied, faithful customers. An added benefit was that perishable products had a "dragging" effect that favored the rest of the items in the store. The customer may come to the supermarket attracted by the quality of fish and end up shopping everything else.

There were two factors that made it possible to provide high-quality perishable products:

a.- Quality at origin (when purchased)

b.- Quality in processes, both in the handling and preservation of the product. Here, adequate training of employees plays a key role. A byproduct of this training is that wastage is greatly reduced.

Wide Variety and Very Competitive Prices in Non-Perishable Food Products

The wide range of products was a special asset considering the diverse nationalities of customers that brought with them different tastes and preferences. While offering a wide selection of goods, SUPERMAR also offered low prices for popular items.

Customer Service

SUPERMAR made its best effort to have very satisfied customers. This was achieved by following a policy where:

a.- No product references should be missing in the shelves and these should always be (or at least seem to be) filled with merchandise.

b.- All employees must make special efforts to treat customers well. Thus, cashiers should always welcome and say goodbye to customers with a smile; waiting time in lines should be kept to a minimum; employees from all sections should offer a personalized treatment to customers – very much like traditional street markets-. Complaints should be handled by exchanging products without demanding too many explanations.

STAGNATION

The growth of the 90s continued until the end of 2004, with the company opening more than eighty establishments. From 2005 onwards, growth started to slow down (see Table 1). This trend was caused by two factors:

- Serious competition started to arrive to the Islands from supermarket chains such as Superdiplo, and hypermarkets such as Mercadona, Alcampo, Carrefour, etc. Up to that point, the geographical situation of the Canary Islands had been, to some extent, a barrier for competitors wishing to gain a share of the Islands' market.
- It was difficult to maintain growth by opening new stores on the Islands, since most areas of commercial interest were already properly covered, and new openings translated into a "cannibalization" of revenues among existing stores.

POSSIBLE ALTERNATIVES

Mr. Gómez was worried about the new situation he was facing and realized that he had to act quickly to ensure the survival of his company. He saw three choices:

1.- Continue growing in the Canary Islands at a slow pace, living off SUPERMAR's reputation. The company would ultimately be sold at a discounted price to another large distribution chain in five to seven years. This option seemed inconceivable to Gomez since it would mean allowing the "slow death" of his business.

2.- A second choice was to sell the company now, while its performance was still attractive. Gomez believed that, under this scenario, he would be able to find potential buyers who would purchase the company at a reasonable price.

3.- Even though the immediate sale of the company seemed economically attractive, Mr. Gómez believed that SUPERMAR was sustainable, well managed and with a business structure that could be transferred to other distribution companies located in the Iberian Peninsula. He would not target the same scale as the hypermarkets, but SUPERMAR's experience in the Canary Islands had shown they could compete by targeting specific customer profiles. The difference would be the growth potential that the peninsula offered since there would be no geographic constraints. Therefore, the third alternative was to continue to grow outside the Canary Islands and expand to the mainland.

Of the three possible scenarios, the one that captured the CEO's interest was the third. He did not see himself ready to retire just yet, and felt that the family business still had considerable growth potential.

THE EXPANSION TO THE IBERIAN PENINSULA

The expansion scenario could be implemented using two distinct approaches: either by gradually opening establishments in strategic areas within the Iberian Peninsula, or by buying a pre-existing distribution company with a consolidated network of stores.

Mr. Gómez believed that the first choice was not advisable. He had discussed this possibility with his management team and had concluded that there was no time for a slow expansion. The distribution sector in Spain was in the middle of a feverish process of mergers and acquisitions, leading to a high level of ownership concentration. The only way to be competitive at a national level was to be large and to grow rapidly, and this would only be achieved in the short-term by acquiring an established distribution company.

As an industry expert, Gómez knew there was a relatively high number of distribution companies for sale. There were also active buyers, with large distribution chains playing an important role. The candidate that everyone was looking for had to meet, in his opinion, the following criteria: Distribution Company with revenue of 60 - 180 million Euros, a sound balance sheet, profitable but experiencing falling revenue growth. Preferably, the shareholders of the target would be interested in selling their company due to its inability to be competitive, in the medium term, in a market that was becoming increasingly aggressive with respect to prices and where revenue growth was essential.

However, Mr. Gómez was convinced that a company with this ideal profile would not be affordable, since the asking price would be high due to the demand from other bidders. It would also not be particularly attractive, because of the reduced potential for improvement, and thus growth. Investing in a company that had the same problems as SUPERMAR, i.e., a limited growth potential, was not going to solve the problems but rather make the situation worse. This reasoning convinced him that he should seek to buy a firm in crisis.

At the beginning of 2007 Gomez heard of a company called Supermercados EBROSA, with its registered office in Saragossa. The company was composed of a network of eighty establishments spread throughout the Spanish autonomous regions of Aragón, La Rioja and Navarre. Founded as a family-owned company at the beginning of the 80s, EBROSA had been acquired by a VC (venture capital) group

located in Madrid in 2005. In spite of the change in ownership, the company had experienced a steady slowdown in sales since 2004.

EBROSA seemed to be the acquisition target Gómez had been looking for. After an exploratory conversation with the VC group, they agreed to provide basic information for EBROSA (see Table 2). Mr. Gomez felt very optimistic about reaching an agreement with EBROSA's owners. The VC firm was clearly not generating the high returns expected of venture investments, and the negative trend in EBROSA's profits was having a negative impact on the market value of the VC's own stock. The main challenge was that EBROSA's owners were looking for a cash payment, so the acquisition price would need to be raised in full.

Gomez and Melissa met to discuss the possible cost of acquiring EBROSA. During their discussion, Melissa urged Gomez to commission a report that would analyze the competitive situation in the area as well as the reason for EBROSA's recent negative trend.

As Melissa explained to her father: "crunching the numbers is not a problem, I just feel I need to have enough information to make sure my numbers are meaningful. We know a lot about the islands, but know much less about the competitive landscape in other regions". Paramount in her mind was an expression she had frequently heard as a student…*garbage in, garbage out*. She wanted to avoid making mistakes, especially given the importance of this plan for the future of the Gomez family business.

"I am not totally convinced that we need to pay someone to tell me what I already know", Heriberto Gomez argued. "I have been in this business for 25 years, and made our company grow to a point where the islands are now too small. That should count for something. All business decisions cannot be spreadsheet-based. Sometimes you go with your gut feeling, and I like this plan. After my conversation with the owners, I am very confident that if we offer them an attractive premium above the book value of their equity, which is currently $5,367, they will accept. I believe an offer of $9,000 will move them to sell. Just hire me as the consultant and we will save money".

Melissa was not amused, and she adamantly argued on behalf of her position until Gomez reluctantly agreed to approve the hiring of a consultancy firm to produce the report. Though narrower in scope than she would have liked, she felt lucky to have gotten the approval to commission the analysis.

In addition to general information for EBROSA (see Table 3), the consultant's main findings were:

- There are only two other supermarket chains competing in the area. One of them has a turnover that is quite inferior to that of EBROSA and also shows a negative evolution in terms of margins and turnover. On the other hand, the other competitor, DISA, has a 2007 revenue forecast of 420.7 million euros and seems to have acquired a significant portion of the market share lost by its two competitors. The rest of the market has moved towards large supermarkets chains that have opened new stores in the past few years.
- When comparing EBROSA and DISA:
  - a.- DISA had points of sale that were more attractive and modern facilities, with a slightly larger surface but with somewhat worse locations in the urban area.
  - b.- The product range was similar in both companies, though slightly superior in DISA.
  - c.- The quality of service, measured by waiting times in cashier lines or lack of products in shelves, was again in favor of DISA.
  - d.- At the beginning of 2000, both companies had a similar revenue levels. Both had transitioned from being family businesses to companies acquired by international companies (DISA four years earlier). The better management carried out by DISA, as well as larger and better investments, were the main reasons for this company's favorable standing when compared to its competitors.

FINANCING ALTERNATIVES

The expansion strategy brought the sizeable challenge of financing the cash needed for the acquisition of EBROSA. Melissa discussed several options with Gomez. In the end, it came down to the following:

Equity Financing

The first approach was to try to fund the acquisition through an increase of equity capital. The most direct way would be to reach out to existing shareholders. However, even with their support, there would still be the need for additional equity since only the Gómez family had enough resources to make a substantial equity contribution. A potential solution was to obtain the additional equity from an external investor willing to provide a significant portion of the needed funds. Mr. Gomez had previous business dealings with a financial institution that had expressed interest in becoming one of SUPERMAR's shareholders as a financial investor. The challenge with this proposal was to contemplate the incorporation of a new shareholder that would be in a position to exert ownership influence in SUPERMAR. In any case, the likelihood that the full acquisition price could be financed by equity alone was low, so other sources of funding would still be needed.

Debt Financing

A second approach that offered a potentially higher scale of funding was the use of additional loans. SUPERMAR not only generated positive cash flows, but also had low leverage levels, since Mr. Gomez had never been fond of borrowing except when absolutely necessary. Though the new loans could be collateralized using EBROSA's assets, the borrowing conditions would be attractive given that lenders would be aware that SUPERMAR was behind the transactions. When she was designated as SUPERMAR's CFO, Melissa had at times commented to her father that they were considerably underutilizing their borrowing capabilities. However, there had been no pressing need for funding so the matter had been left alone. Things were different now. The funding requirements would be large, with leverage being the largest source of funding. Melissa knew that leveraged transactions were not uncommon and she had been heartened by her initial conversations with potential lenders since they seemed to be a willing to provide the funding. If they were to take advantage of this initial receptiveness to fund SUPERMAR's expansion, the process needed to get started as soon as possible.

In the end, Melissa felt that the final outcome would be some combination of the two approaches. She decided that it was best to keep all options on the table, and prepare an analysis that could be presented to both current and potential shareholders, as well as lenders.

One concern the CFO had with sourcing the funds through additional borrowing was that this could, due to lender restrictions and self-financing requirements, imply a temporary change (reduction) of the firm's dividend policy. The most recent payout ratio for SUPERMAR was 25% of SUPERMAR's profits, with a growth of at least 1% per year. SUPERMAR's shareholders expected a continuation of this policy, so any proposal would need to address this expectation.

LBO VALUATION AND FINANCING STRUCTURE

The textbook description of a Leveraged Buyout (LBO) typically presents these transactions as large, debt-financed deals that allow financial investors such as private equity firms to take ownership control of a company[1]. If the target company is publicly listed, the outcome of the transaction would be the target firm becoming a privately held enterprise. The expected benefit of the buyout would come in the form of value creation achieved by increasing cash flows, thanks to lower expenditures (investments), cost reduction (layoffs) and the selling of any non-productive or non-core asset. For the private equity investors, the value enhancement is generally captured after five to seven years, when the firm is either taken public, sold to a strategic buyer[2] or sold to another private equity investor. During this window, the acquired firm's leverage is reduced, thus allowing the equity stake to represent a growing portion of total firm value. This capturing of value is the compensation gained by the equity investors of LBO's.

The LBO approach to valuing the target firm generally contrasts to a traditional DCF approach in that the acquirer's main objective is determine whether a specific return (say 30%) can be achieved during the planned investment horizon. Therefore, the analysis becomes a comparison between the acquisition's IRR and the buyer's required return. To calculate the IRR, cash flows are estimated, as well as the exit price at the end of the acquirer's investment horizon. The exit value is calculated using a variety of income

statement multiples. For example, the enterprise value at the time of exit can be estimated assuming 6x EV/EBITDA (Enterprise Value that is assumed to be six times expected EBITDA in the year of exit). As long as the acquisition's IRR satisfies the required return, the deal is considered as acceptable.

Though the description presented above is consistent with a large amount of leveraged transactions, not all of these transactions are large, the buyers need not be financial investors such as private equity firms and the targets are not always publicly listed firms that are to be taken private. Leveraged transactions have been actively used by owners of small and medium-sized firms to fund acquisitions[3]. More recent research[4] also shows that, in contrast to what was generally observed in the past, many LBOs result in greater growth financed by continued leverage financing and investments. In other words, rather than targeting a downsizing in order to improve profitability and facilitate a five to seven-year exit horizon, many LBOs are used to buy growth and continued expansion. In addition, holding periods have become longer. In the 1990s, five to six years was commonly observed as the period during which the LBO Organizational Form (target owned by an LBO fund) was maintained before being sold. In recent years, the holding period is closer to nine years[5].

As its name indicates, leverage is an important component of the financing that takes place in a leveraged transaction. While the types of financing instruments vary widely, three broad types (tranches) of debt are used: Senior, Junior and Mezzanine debt. The intensity of use of each of these sources varies for different regions and within each region, for each industry. For example Mezzanine debt is much more actively used in Europe than in the U.S., while junior (public) debt is floated proportionally more in the U.S. than in Europe. Likewise, industries characterized by few fixed assets will make use of financing instruments that are less dependent on tangible assets for use as collateral (see senior debt section below).

SENIOR DEBT

Senior or secured debt derives its name from the fact that it holds first claim rights over the assets of the company that borrowed the funds, should it go into liquidation. While there are several types of senior debt instruments, most share two basic features: they are private instruments (in contrast to public bonds) and they are priced at a variable rate expressed as a referential rate (for example, EURIBOR[6]) plus a spread. Usually, two common types of senior debt are:

Revolving Credit Facility (Rcf)

Also called "Revolver", this works like a corporate credit card, where the firm uses funds up to its RCF limit. The used funds are charged a variable rate based on a negotiated spread above EURIBOR while the unused portion is charged a fixed fee that compensates the lender for committing to facilitate the funds. The most common use for Revolvers are to finance working capital needs.

Bank Debt

In this form of senior debt, the borrower commits to paying a variable rate over an amortization period that typically spans 5 to 8 years. These "term loans" (TLa or TLb) either fully pay down the loan throughout the amortization period (Term Loan A) or combine smaller payments with the inclusion of a large "bullet" payment at maturity (Term Loan B[7]). These loans can be asset backed (ABLs) , where the collateral used are tangible assets held by the target firm, or cash-flow backed (leveraged loans), where payment capability is the main guarantor, and thus useful for firms that have few tangible assets.

Junior (Subordinated) Debt

This tranche of debt instruments also include a wide variety of arrangements. However, two characteristics are that (1) they have a claim to a firm's assets that is subordinate to that of senior debt holders (but still enjoy priority over equity holders) and (2) pricing comes in the form of a fixed interest rate. Because if the higher risk borne by its holders, the cost of these instruments can be considerably higher than that of the senior tranche. Funding can be provided by private institutions as well as public investors, with maturities that can approach 10 years. For example, high-yield or "junk" bonds are

common components of the junior debt tranche. Typically, junior debt incorporates no amortization throughout the life of the loan, with repayment made in the form of a bullet payment at maturity. Because of the higher cost of these instruments, it is common for firms to pay off this debt when it can be substituted by a lower-cost source. Early payment is thus usually allowed after about half of the instrument's maturity has elapsed.

In some cases, contractual conditions incorporate "cash sweeps", which are mandatory principal repayments as long as cash flow is available after all other payment obligations are made. While junior debt can include cash sweeps, they are typically contingent on senior debt's cash sweeps requirements being met first.

Mezzanine Debt

Another form of subordinated debt is termed *mezzanine* debt because it lies between senior debt and equity in seniority (mezzanine loans are senior only to equity). It is generally used when the amount of leverage financing that is needed exceeds the commitments provided by senior and other junior debt sources, or the amount in excess of senior debt commitments that is required is not large enough to justify the issuance of public junior debt. Sold to investors through private placements that offer floating rates, the payment terms of these instruments are tailored to each transaction but generally take the form of cash payments that may at times be supplemented by a pay-in-kind (PIK) arrangement. The latter form refers to the interest that is due being "paid" by recognizing it as new debt that is added to the outstanding principal. Because of the need to attract private equity investors, mezzanine debt generally contains an "equity kicker" in the form of a warrant, which allows the holder to convert his holding to equity, thus increasing the upside potential of the investment. Generally, these instruments are not callable, so they cannot be paid off prior to maturity.

SHAREHOLDERS MEETING OF 2007

Heriberto Gómez decided to explain the situation in the 2007 General Shareholders Meeting, and thus rally the rest of the shareholders behind his plan. To his surprise, most of the other owners did not agree with the expansion. Borrowing the funds raised concerns about the increase in leverage. Obtaining the funding from a new shareholder was also met with strong reluctance by the current shareholders because of the implied dilution of their ownership stake. The question of how the expansion would affect the sustainability of the current dividend policy also came up in the meeting. In most cases, SUPERMAR shareholders also worked in the company as administrators or sales managers. Their main sources of income were their wages and the dividends that were paid out, the latter accounting for a significant share of their total income.

Gomez responded that they would take a fresh look at the current dividend policy and try very hard to ensure its continuity. In any case, he argued that the increased value of each shareholder's ownership stake under the expansion would very adequately compensate any possible reduction in dividend growth. To the CEO's disappointment, no decision in support of the expansion was made at the meeting. The management team nevertheless offered to provide further details regarding the benefits and costs of the proposed acquisition.

ACQUISITION ANALYSIS

After the shareholder meeting, far from becoming discouraged, Mr. Gomez felt an even greater urgency to prepare and "sell" the advantages of the change to the rest of SUPERMAR's owners. He and Melissa agreed that the proposed acquisition should not be mentioned again until the CFO had completed her analysis. She would make sure her analysis addressed at least three concerns: (1) the impact of the expansion on the wealth of current shareholders, (2) the amount of financing that will be needed, as well as its structure and costs, and (3) the manner in which dividends were going to be affected in the medium- and long-term.

Valuation Inputs

To determine the amount of value that the transaction would create to current shareholders, Melissa planned to make two estimations. First was the determination of EBROSA's stand-alone value. To carry out the stand-alone valuation, she planned to use EBROSA's financial statements, the report they had commissioned from the consultancy firm and additional information she had been able to gather for recent transactions that had taken place in the supermarket sector (Table 4).

The second calculation, an estimate of how much EBROSA would be worth under SUPERMAR's management, was more complicated. She needed to quantify the turnaround effect that her father and the rest of the management team expected to achieve. Instead of focusing on an aggregate value increase based on past acquisitions ("we always double the value of our acquisitions"), Melissa preferred to try to incorporate a detailed discounted cash flow analysis based on how each of the components of value would improve under SUPERMAR's control. She felt this to be a better approach given that this acquisition would be different than the ones previously undertaken by SUPERMAR. The size was larger, and the assets would be managed in a different location. In addition, since the payment would be made in cash, the financing structure would also need to be different than previous acquisitions. The CFO had several meetings with her father and the rest of the management team and asked them to determine how key income statement and balance sheet items for EBROSA would change once acquired by SUPERMAR. The management team had been in place for many years, and they held strong views concerning what makes a commercial model successful. Their conclusions are presented in Table 5.

In addition to EBROSA's future operating performance, Melissa defined a capital expenditure schedule for the next seven years (see Table 6). The schedule included an expansion plan for EBROSA based on the opening of 5 new stores on a yearly basis, together with the renovation and refitting of the existing stores.

For her cost of capital calculations, Melissa decided to incorporate the following considerations:

- Basic cost of capital inputs were collected for both SUPERMAR and EBROSA (Table 7). Though the typical debt to long-term assets ratio (D/(D+E)) for grocery stores was approximately 60%, Melissa felt that the optimal mix should allow some financial flexibility, so she felt that a leverage of 30% was an adequate target for SUPERMAR.
- EBROSA's acquisition was an important step, but it would not be the last one. If successful, SUPERMAR would continue with its expansion process with additional acquisitions. Therefore, any forecast had to incorporate the fact that SUPERMAR's borrowing capability needed to be restored within an eight-year horizon, especially if the financing eventually came in the form of a significant increase in leverage. Because of this, the cost of capital calculations needed to allow variation in debt levels, as leverage was brought back from the starting leveraged transaction to optimal conditions. Melissa collected data for debt ratings and coverage ratio levels (Table 8) and made a plan for the way EBROSA's average debt balance would evolve after being acquired (Table 9).

With this information, the CFO felt she would be able to estimate EBROSA's value so that it could be compared to the offer price currently being considered. Her father wanted to offer $9 million, which was close to a 70% premium above EBROSA's current equity value in books. While she knew that he would not be considering this price if expectations regarding EBROSA's worth under SUPERMAR management didn't considerably exceed this figure, she wanted to be sure. Her training told her that benefits, just as costs, needed to be quantified in order to make decisions. She wanted to quantitatively confirm what her father intuitively believed.

Financing Structure

With an approximate offer price of 9 million euros, Melissa explored her financing options in greater detail. Lenders were willing to fund about 55% of the amount needed. The rest would have to be supplied by additional equity.

The debt financing component would be financed in approximately equal parts in the form of two tranches: senior and junior debt. The senior debt would be paid in 10 years and priced at EURIBOR plus spread, to revised annually. As of the end of 2007 (see Table 10 for historical values), the EURIBOR stood at about 4%. The junior debt tranche would be financed at a fixed rate for 12 years, but subject to refinancing opportunities. Under the assumption of debt renegotiation opportunities, Melissa produced estimates for the average cost of debt (Table 7) they were likely to face after acquisition. To complete her information set, Melissa Gomez also collected SUPERMAR'S financials as well as other industry-related information (see Tables 10 through 13).

THE DECISION

Melissa looked at her computer screen again. *"Why do I feel a knot in my stomach?"* She was very much aware that a mistake in her assessment would have important repercussion on their family business. If she assigned too high a value to EBROSA, they would overestimate the benefits of the acquisition, and would end up shrinking the hard-earned value that her family had created for the last 25 years. If she undervalued the acquisition and so offered too low a price, the deal would not go through and a unique opportunity to expand would be lost, basically condemning the SUPERMAR to either its sale or to a slow decline.

ENDNOTES

1. The degree of involvement of the target firm's management in the funding of the acquisition determines if an LBO is described as a Management Buyout (MBO).
2. Buyer operating in the same industry as the firm being acquired, and thus in a position to derive synergies.
3. See Stancill (1988) "LBOs for Smaller Companies". *Harvard Business Review*
4. Boucly et al. (2011) "Growth LBOs". *Journal of Financial Economics* Vol 102, Issue 2, 432-453 and Cohn et al. (2014), ":The evolution of capital structure and operating performance after leveraged buyout: Evidence from U.S. corporate tax returns". *Journal of Financial Economics* Vol 111, Issue 2, 469-494.
5. Strömberg, Per. "The new demography of private equity." *The global impact of private equity report* (2008): 3-26.
6. Euro Interbank Offered Rate. An average of the rates at which a group of 27 European and international banks are willing to borrow and lend to one another. The EURIBOR is published every day at 11:00 a, central European time, and reflects the average rate after the top and bottom 15% of observations have been eliminated. The LIBOR (London Interbank Offer Rate) is also commonly used as a base rate, however, LIBOR rates exist for various currencies, while the EURIBOR is Euro based. For more information, go to http://www.euribor-rates.eu
7. Other forms of term loans exist, with basically the same seniority as B loans but longer maturities.
8. A relatively conservative increase in sales was expected, since the sector was already mature and new sales meant recovering part of the market share that had been lost to competitors, which meant a slow recovery.
9. Expressed as the book value of long-term debt divided by the sum long-term debt and an estimate of the market value of equity (D/(D+E))
10. Defined as EBIT/Interest expense
11. For 2008 onwards, weights represent market values for D/V and E/V.
12. Euro launched January 1, 1999
13. Nominal share value of 2,404 Euros per share

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APPENDIX

TABLE 1
EVOLUTION OF SUPERMAR SALES, NET PROFITS AND NUMBER OF ESTABLISHMENTS
FIGURES IN EUROS (000'S)

	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**
Sales	16,700	25,841	39,870	53,898	74,571	93,769	109,274	128,470
Growth in sales	-	75.00%	54.30%	35.20%	38.40%	25.70%	16.50%	17.60%
Net Earnings	251	388	638	808	1,268	1,500	1,858	2,312
NE as % Sales	1.50%	1.50%	1.60%	1.50%	1.70%	1.60%	1.70%	1.80%
Nº of Stores	5	8	12	16	21	26	30	35
Sales per store	3,340	3,230	3,323	3,369	3,551	3,606	3,642	3,671

	1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Sales	147,666	165,386	181,925	196,479	212,197	226,350	240,405	253,627
Growth in sales	14.90%	12.50%	12.00%	13.10%	12.60%	12.10%	11.10%	5.50%
Net Earnings	2,510	2,977	3,457	3,733	3,820	4,074	4,327	3,889
NE as % Sales	1.70%	1.80%	1.90%	1.90%	1.80%	1.80%	1.80%	1.50%
Nº of Stores	40	44	50	57	64	73	83	87
Sales per store	3,005	3,071	3,029	3,005	3,017	2,963	2,897	2,915

TABLE 2
P&L AND BALANCE SHEET FOR EBROSA
FIGURES IN EUROS (*000'S*)

	2005	2006	2007
Sales	203,443	195,305	183,099
Cost of Sales	-166,010	-159,369	-149,408
Losses and Wastage	-5,696	-5,469	-5,126
Gross Margin	31,736	30,468	28,564
Payments from suppliers	4,069	3,906	3,663
Other recurring revenues	5,696	5,469	5,126
Gross Margin after payments and other	41,501	39,843	37,353
Adm. and Sales Costs	-36,823	-37,067	-36,986
EBITDA	4,678	2,776	367
Depreciation	-2,043	-1,587	-1,773
Provisions	-361	120	60
Extraordinary Results	301	0	0
EBIT	2,575	1,309	-1,346
Interest Expense	-612	-720	-1130
Earnings Before Taxes	1,963	589	-2,476
Taxes	-691	-207	0
Net Earnings	1,272	382	-4,952

TABLE 2 (CONT)
P&L AND BALANCE SHEET FOR EBROSA
FIGURES IN EUROS (*000'S*)

	2005	2006	2007
Cash in hands	4,207	4,039	3,786
Inventory	5,109	4,772	4,832
Accounts receivable	150	150	150
Current Assets	9,466	8,961	8,768
Land	1,202	1,202	1,202
Building (Reforms)	5,289	5,439	5,445
Machinery	2,885	3,173	3,336
Other tangible assets	1,442	1,641	1,743
Net Intangible assets	721	541	361
Net fixed assets	11,539	11.996	12.087
TOTAL ASSETS	21,005	20.957	20.855

Accounts Payable	7,513	7.591	7.140
Other s/ t liabilities	90	90	114
Provisions	210	90	30
Current Liabilities	7,813	7.771	7.284
Long Term Debt	5,890	5.848	8.204
Shareholder Equity*	4,808	4.808	4.808
Reserves	2,494	2.530	559
Long Term Liabilities	13,192	13.186	13.571
TOTAL LIAB. + EQUITY	21,005	20.957	20.855

* 8,000 shares with a nominal value of 601.01 Euros per Share

TABLE 3
EVOLUTION OF EBROSA SALES, NET PROFITS AND NUMBER OF ESTABLISHMENTS
FIGURES IN EUROS (*000'S*)

	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**
Sales	51,849	63,083	78,637	59,626	109,747	122,709	138,263	144,312	165,051
Growth in sales	-	21.67%	24.66%	-24.18%	84.06%	11.81%	12.68%	4.37%	14.37%
Net Earnings	1,232	1,235	1,238	1,242	1,244	1,247	1,250	1,254	1,257
NE as % Sales	2.38%	1.96%	1.57%	2.08%	1.13%	1.02%	0.90%	0.87%	0.76%
Nº of Stores	21	24	28	32	36	40	45	49	55
Sales per store	2,469	2,628	2,808	1,863	3,049	3,068	3.073	2,945	3,001

	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Sales	174,556	183,199	192,704	199,617	206,530	205,498	203,443	195,305	183,099
Growth in sales	5.76%	4.95%	5.19%	3.59%	3.46%	-0.50%	-1.00%	-4.00%	-6.25%
Net Earnings	1,260	1,263	1,266	1,268	1,270	1,271	1,272	382	-4952
NE as % Sales	0.72%	0.69%	0.66%	0.64%	0.61%	0.62%	0.63%	0.20%	-2.70%
Nº of Stores	58	60	64	68	73	76	79	82	80
Sales per store	3,010	3,053	3,011	2,936	2,829	2,704	2,575	2,382	2,289

TABLE 4
RECENT TRANSACTIONS IN THE SUPERMARKET SEGMENT (*000'S*)

Company	**XXX**	**YYY**	**ZZZ**	**AAA**	**BBB**
Province	La Coruña	Valladolid	Madrid	Barcelona	Salamanca
Enterprise Value paid	70,000	4,000	15,000	19,500	13,500
% of Acquisition	100%	65%	70%	61.50%	100%
Date of Acquisition	2007	2007	2007	2007	2006
Annual Revenues	141,176	15,588	38,100	180,811	102,000

TABLE 5
HISTORICAL AND FORECASTED INCOME STATEMENT COMPONENTS FOR EBROSA
(UNLESS OTHERWISE NOTED, ALL AS % OF REVENUES,
EXCEPT FOR SALES GROWTH)

	2005	2006	2007	***2008***	***2009***	***2010***	***2011***	***2012***	***2013***	***2014***	***2015***
Sales growth[8]		-4%	-6%	3%	3%	4%	4%	4%	4%	4%	4%
Cost of Sales	81.6%	81.6%	81.6%	78.00%	78.00%	77.00%	76.00%	76.00%	76.00%	76.00%	76.00%
Losses and wastage	2.8%	2.8%	2.8%	2.50%	2.50%	2.46%	2.45%	2.40%	2.30%	2.20%	2.20%
Adm. and Sales Costs	18.1%	18.98%	20.2%	18.00%	18.00%	18.00%	18.00%	18.00%	18.00%	18.00%	18.00%
Cash	2.07%	2.07%	2.07%	2.07%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
Inventories (% cost sales)	3.08%	2.99%	3.23%	3.22%	3.21%	3.20%	3.19%	3.18%	3.18%	3.18%	3.18%
Accounts receivable	0.07%	0.08%	0.08%	0.07%	0.07%	0.07%	0.07%	0.07%	0.07%	0.07%	0.07%
Accounts Payable (days)	16.5	17.4	17.4	17.4	22.0	22.0	22.0	22.0	22.0	22.0	22.0
Other s/t liabilities	0.05%	0.06%	0.08%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
Provisions	0.13%	0.06%	0.02%	0.03%	0.03%	0.03%	0.03%	0.03%	0.03%	0.03%	0.03%

* Other Tangible Assets can be assumed to remain constant. Net Intangible Assets increase by the amount of goodwill from the acquisition.

TABLE 6
EXPECTED CAPEX FOR EBROSA AFTER THE MERGER
FIGURES IN EUROS (*000'S*)

NET FIXED ASSETS	2007	***2008***	***2009***	***2010***	***2011***	***2012***	***2013***	***2014***	***2015***
Land	1,202	1,202	1,202	1,202	1,202	1,202	1,202	1,202	1,202
Buildings (improvements)	5,445	6,573	8,085	9,668	11,149	12,496	13,645	14,705	15,682
Machinery	3,336	3,997	4,380	4,626	4,790	4,823	4,719	4,635	4,562
Total	9,983	11,772	13,667	15,497	17,140	18,521	19,567	20,542	21,447
ACCUMULATED DEPRECIATION	**2007**	***2008***	***2009***	***2010***	***2011***	***2012***	***2013***	***2014***	***2015***
Land	0	0	0	0	0	0	0	0	0
Buildings (Improvements)	2,909	2,981	3,169	3,486	3,925	4,478	5,129	5,869	6,692
Machinery	1,653	1,882	2,399	3,103	3,939	4,906	5,910	6,894	7,867
Total	4,562	4,863	5,568	6,588	7,865	9,384	11,038	12,763	14,558

TABLE 7
BASIC COST OF CAPITAL INPUTS FOR SUPERMAR AND EBROSA

	EBROSA	SUPERMAR
Risk-free Rate	4%	
Market Risk Premium	6%	
Tax rate	35%	
Average Target Leverage		30%
Leverage[9] (Dec. 2007)	60%	14%
Equity Beta (Dec. 2007)		1.45
Cost of debt (Dec. 2007)	8%	5%
Cost of Debt (at target Cap Structure)	5%	8%

TABLE 8
RATING, COVERAGE RATIO AND BOND SPREADS

Debt Rating	Interest coverage ratio[10]		Spread	Cost of Debt
	Greater than	Less than		
AAA	15	100	3.00%	7.00%
AA	12	19.999	4.00%	8.00%
A+	9	11.999	5.00%	9.00%
A	8	8.999	6.00%	10.00%
A-	6	7.999	7.00%	11.00%
BBB	4	5.999	9.00%	13.00%
BB	3	3.999	11.00%	15.00%
B	2	2.999	13.00%	17.00%
CCC	1	2.999	15.00%	19.00%
CC	0.5	0.999	17.00%	21.00%
C	0.3	0.499	19.00%	23.00%
D	0.1	0.299	20.00%	24.00%

TABLE 9
EBROSA'S LEVERAGE EVOLUTION AFTER ACQUISITION[11]

	2008	***2009***	***2010***	***2011***	***2012***	***2013***	***2014***	***2015***
Equity	45%	49%	52%	56%	59%	63%	66%	70%
Leverage	55%	51%	48%	44%	41%	37%	34%	30%

TABLE 10
BEGINNING OF YEAR, HISTORICAL 12-MONTH EURIBOR[12] RATES

YEAR	EURIBOR
2007	3.614%
2006	2.361%
2005	2.112%
2004	2.087%
2003	2.908%
2002	3.317%
2001	4.852%
2000	3.100%
1999	3.245%

TABLE 11
PROFIT & LOSS ACCOUNT AND BALANCE SHEET FOR SUPERMAR.
HISTORICAL AND FORECAST.
IN EUROS (*000'S*)

	ACTUAL				FORECAST					
	2004	2005	2006	2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Net Sales	240,405	253,627	263,772	271,688	278,479	282,656	285,481	286,911	288,342	289,784
EBITDA	9,616	9,129	8,703	8,150	7,242	6,502	6,569	6,599	6,629	6,665
Depreciation	2,765	2,885	3,005	3,125	3,125	3,125	3,125	3,125	3,125	3,125
EBIT	6,852	6,225	5,698	5,024	4,117	3,378	3,444	3,474	3,504	3,540
Interest Expense	192	264	313	192	505	529	529	529	520	529
EBT	6,659	5,980	3,585	4,832	3,612	2,849	2,915	2,945	2,975	3,011
Taxes	2,332	2,02	1,887	1,689	1,262	998	1,022	1,028	1,040	1,052
Net Earnings	4,327	3,889	3,504	3,143	2,344	1,851	1,893	1,911	1,935	1,959

	2004	2005	2006	2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Cash	7,693	8,126	8,462	8,715	8,931	9,069	9,159	9,201	9,250	9,298
Inventories	9,040	9,538	9,917	10,217	10,476	10,632	10,734	10,788	10,842	10,896
Accounts Receivable	1,196	1,262	1,316	1,352	1,352	1,352	1,352	1,352	1,352	1,352
Current Assets	17,929	18,920	19,695	20,284	20,759	21,053	21,245	21,341	21,444	21,546
Net Fixed Assets	18,577	20,062	21,462	22,538	22,538	22,538	22,538	22,538	22,538	22,538
Total Assets	36,506	38,982	41,157	42,822	43,297	43,591	43,783	43879	43,982	44,084
Accounts Payable	22,334	23,566	24,509	25,243	25,874	26,264	26,523	26,655	26,793	26,925
Other current liabilities	150	150	150	150	150	150	150	150	150	150
Current liabilities	22,484	23,716	24,659	25,393	26,024	26,414	26,673	26,805	26,943	27,075
Long Term Debt	2,915	2,170	2,104	2,404	2,248	2,152	2,085	2,049	2,014	1,984
Capital	9,316	10,217	10,818	10,818	10,818	10,818	10,818	10,818	10,818	10,818
Reserves	1,791	2,879	3,576	4,207	4,207	4,207	4,207	4,207	4,207	4,207
Total Equity[13]	11,107	13,096	14,394	15,025	15,025	15,025	15,025	15,025	15,025	15,025
Total Liabilities + E	36,506	38,982	41,157	42822	43297	43,591	43,783	43,879	43,982	44,084

TABLE 12
TURNOVER FOR TOP 20 SUPERMARKET COMPANIES

	2006 Sales (mill. €)	2005 Sales (mill. €)	Nº of employees	Own Stores	# of m2 for sales
Mercadona SA	12,158	10,338	57,000	1,050	1,400,000
Grupo Eroski	6,415	6,006	31,000	546	
Dist. Int. Alimentación SA	3,855	3,660	15,300	2,806	850,000
Grupo Caprabo	2,194	2,574	17,630	569	606,000
Dinosol Supermercados SL	1,995		14,000		
Lidl Supermercados SAU	1,700	1,500	5,500	398	316,000
Ahorramas SA	1,080	982		177	133,652
Miquel Alimentación Grup SA	1,045	836	4,100	154	39,712
Consum Soc. Coop.	1,035	862	6,545	572	312,000
GADISA SA	886	849	5,499	190	147,065
GADISA SA	793	760	5,183	210	
Grupo El Arbol Dist. Y Sup. SAU	720	684	5,600	366	22,954
Condis supermercats SA	703	652	5,000	191	100,249
Vegalsa	631	562	3,619	155	104,498
Plus supermerrcados SA	524,	355	2,182	238	175,000
Grupo Froiz	420	385	3,500	171	106,770
Alimerka SA	395	370	4,030	163	119,200
Covirán SCA	380	350		2,175	326,769
Bon Preu SA	378	316	2,600	60	
H.D. Covalco Grupo	355	350	970	25	10,000
Source: Distribucion y Actualidad 2007					

TABLE 13
COMPANY RANKINGS
DATA IN EUROS (000'S)

	2006 profit	2005 Profit	% Change in Profit	Sales 2006	Sales 2005
Carrefour	563,200	544,400	3.50%	9,133,000	9,071,000
Mercadona SA	242,000	183,000	32.20%	11,286,253	9,601,593
Grupo eroski	190,000	143,000	32.90%	6,415,000	6,006,000
Hipercor	161.863	152.860	5.90%	3.400.112	3.231.626
Alcampo SA	97.500	86.600	12.60%	3.741.000	3.616.000
Consum S. Coop. Val.	22.300	18.300	21.90%	1.034.700	862.600
Vegalsa	8.824	6.000	47.10%	590.200	562.085
Grupo Caprabo	7.500	-32.500	123.10%	2.194.000	2.300.000
Dinosol Sup. SL	6.436	3.223	99.70%	1.958.367	1.971.344
Sup. De Alimentación SA	3.783	2.729	38.60%	161.083	165.323
Unide Sdad. Coop.	3.709	2.143	73.10%	509.933	488.498
Jose Padilla Frances SL	3.333	767	334.60%	69.000	58.443
H.D. Covalco SA	2.226	2.950	-24.50%	412.000	349.000
Tiendas De Conven. (Opencor)	1.970	1.690	16.60%	319,910	267,990
Supercor	1,749	1,630	7.30%	352,580	272,106
Deza Calidad SA	1,448	1,368	5.80%	52,747	48,193
Fragadis	1,126	636	77%	52,225	51,823
Cabrero e hijos	778	818	-4.90%	41,022	39,675
Hiperber DYL SAU	500	310	61.30%	69,800	61,500
Hermanos Jimenez Cayuela SA	500	800	-37.50%	12,000	12,500

Source: Anuario de Distribución 2007-2008