CASE OF ECONOMIC VALUE CREATION ANALYSIS: FOOD RETAIL INDUSTRY IN CANADA

(ALIMENTATION COUCHE TARD – GEORGE WESTON – LOBLAW COMPANIES – METRO – SAPUTO – MAPLE LEAF FOODS)

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WHAT IS ECONOMIC VALUE CREATION OR EVA®?

a) Economic Value Creation, also known as Economic Profit or as Economic Value Added EVA® is the monetary value created in excess after covering the cost of financing all resources invested in the company. In other words, Economic Value Creation is the profit left after paying cost of funding both for external sources (for example, bank loans) and internal sources (shareholders).

b) In a simple way to understand this concept, a company has $18 of profit in a year (later we will say what specific definition of profit we are talking about) and has $100 invested in assets (later we will talk about invested capital or capital employed). These invested assets are financed by debt (liabilities) and shareholders (equity). Let's assume this cost of financing is 10% a year (could be 8% debt and 12% equity, with an average rate of 10%). Therefore, this company has to pay $10 to banks (debt) and shareholders. After paying this, $8 are left ($18 minus $10). The Economic Value Creation is $8.

c) For whom is the Economic Value Creation? Eventually for the shareholder. Therefore, the shareholder will get the opportunity cost previously established and incorporated in the cost of financing plus the Economic Value Creation or EVA®.

WHAT IS THE RELATIONSHIP BETWEEN ECONOMIC VALUE CREATION OR EVA® AND PROFITABILITY OR RETURN ON CAPITAL EMPLOYED?

a) In order to obtain profitability, measured with Return on Capital Employed (ROCE), two initial variables are needed: Net Operating Profit after Taxes (NOPAT) and the Capital Employed. Once obtained the ROCE, this can be compared with other companies, history, other references, but also it is expected to be above the cost of capital (WACC) in order to say the company is really a profitable business.

b) In order to obtain Economic Value Creation or EVA® these same three variables are used: NOPAT, Capital Employed and WACC.

c) Profitability or ROCE is a percentage measure, while Economic Value Creation or EVA® is a dollar amount measure. If we are comparing two companies with different size, one can have a larger ROCE (it is more profitable) but the other can have a larger EVA® (because it is larger).

d) This is the case between Metro and Saputo. In the last five years, Metro has had an annual average ROCE (profitability) of 11.9% while Saputo has had an annual average ROCE of 11.7%. But, Saputo is almost 40% larger than Metro and therefore creates more economic value. Saputo in average in the last five years has had an EVA® of 1.3 times that of Metro.

e) In business there are two things (among others, probably) for which we have to compensate a team of top executives. One is their ability to make a profitable company. The other one is their ability to manage a large (very large) company. One person can have a small coffee shop that is very profitable. But that person will never become rich (really rich) because the company is too small. But the top executives of a large chain of coffee shops make a lot of money because of their ability to manage a large size of invested capital, even though it is probably not as profitable as the small coffee shop.

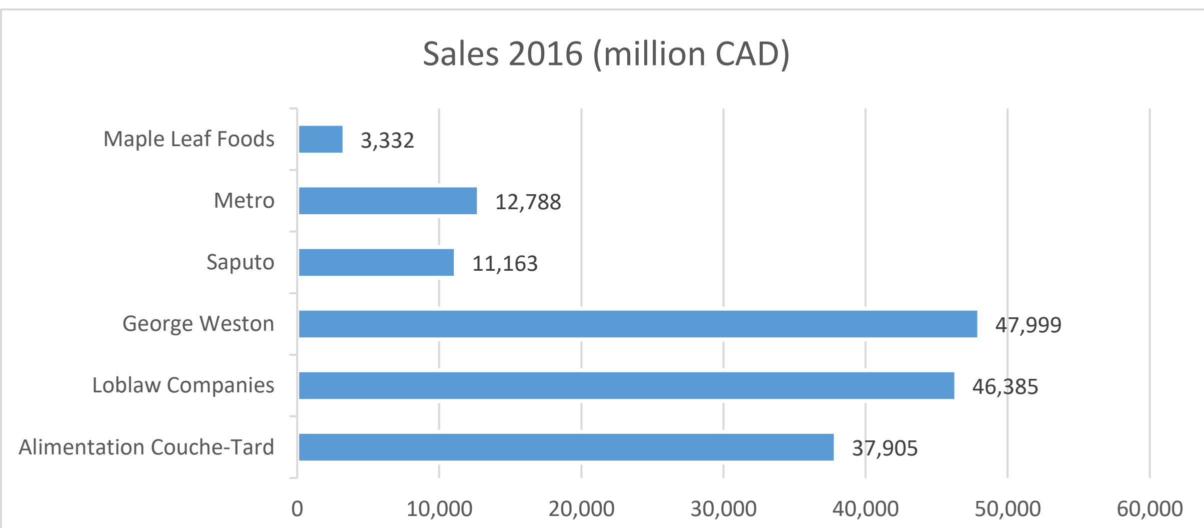
WHAT WE DO FOR THIS ANALYSIS

a) This is a more or less common analysis that we do at Acus Consulting Ltd.

b) Specifically for this analysis we selected six of the largest public companies in the food retail industry in Canada. All of them are listed in the Toronto Stock Exchange (TSX).

c) The six companies analyzed are Alimentation Couche-Tard Inc (ATD), George Weston Ltd (WN), Loblaw Companies Ltd (L), Metro Inc (MRU), Saputo Inc (SAP) and Maple Leaf Foods Inc (MFI).

d) Their relative size is quite different. The largest in sales is George Weston and the smallest is Maple Leaf Foods. Fiscal years of three of these companies do not end in December, so the period considered is the closest to the period January to December of 2016. If we set the annual sales of George Weston as an index of 100, then Loblaw is 97, Alimentation Couche-Tard 79, Metro is 27, Saputo is 23 and Maple Leaf Foods is 7. Sales of George Weston were 48 billion CAD in 2016.



e) We based our analysis in the financial statements that each company reported for the last five years in their annual reports. We gathered all the financial information in our computer in a standardized format. Then we did some calculations needed for the analysis (like EBIT, NOPAT and capital employed). After this we do rough estimations of the cost of financing of each company and for each year, both with debt that has financing explicit cost and cost of shareholders equity. At last, the analysis based on this information, our knowledge and experience took place.

f) For practical reasons, we work with the figures of the balance sheet at the end of the year. It is definitively better to work with the average figures of the year (average of the 4 quarters or average of the 12 months). Doing the calculation of the ratios this way may imply certain imperfection in the process, although working with averages is not a perfect process neither.

SIX COMPANIES WITH DIFFERENT SIZES

a) In Table I we are presenting some relevant figures for 2016 in millions of Canadian Dollars (CAD) for each of the six companies here analyzed: sales, NOPAT and capital employed. George Weston is clearly the largest in all measurements, followed by Loblaw Companies, Alimentation Couche-Tard, Metro, Saputo and Maple Leaf Foods. Maple Leaf Foods is less than one tenth of George Weston.

Table I: Relevant figures for 2016 (million CAD)

	Sales	**NOPAT**	**Capital employed**	***Sales***	***NOPAT***	***Capital employed***
Alimentation Couche-Tard	37,905	1,302	10,617	*79*	*82*	*36*
Loblaw Companies	46,385	1,439	27,362	*97*	*91*	*93*
George Weston	47,999	1,581	29,543	*100*	*100*	*100*
Saputo	11,163	761	6,247	*23*	*48*	*21*
Metro	12,788	563	4,527	*27*	*36*	*15*
Maple Leaf Foods	3,332	194	1,951	*7*	*12*	*7*

b) NOPAT is net operating profit after taxes and is equal to EBIT (earnings before interests and taxes) minus adjusted taxes (this is, taxes calculated at the corporate rate specifically for EBIT). EBIT is close to operating income, although some differences can be found in between them.

c) Capital employed is the total assets minus liabilities with non-financial cost minus cash and cash equivalents.

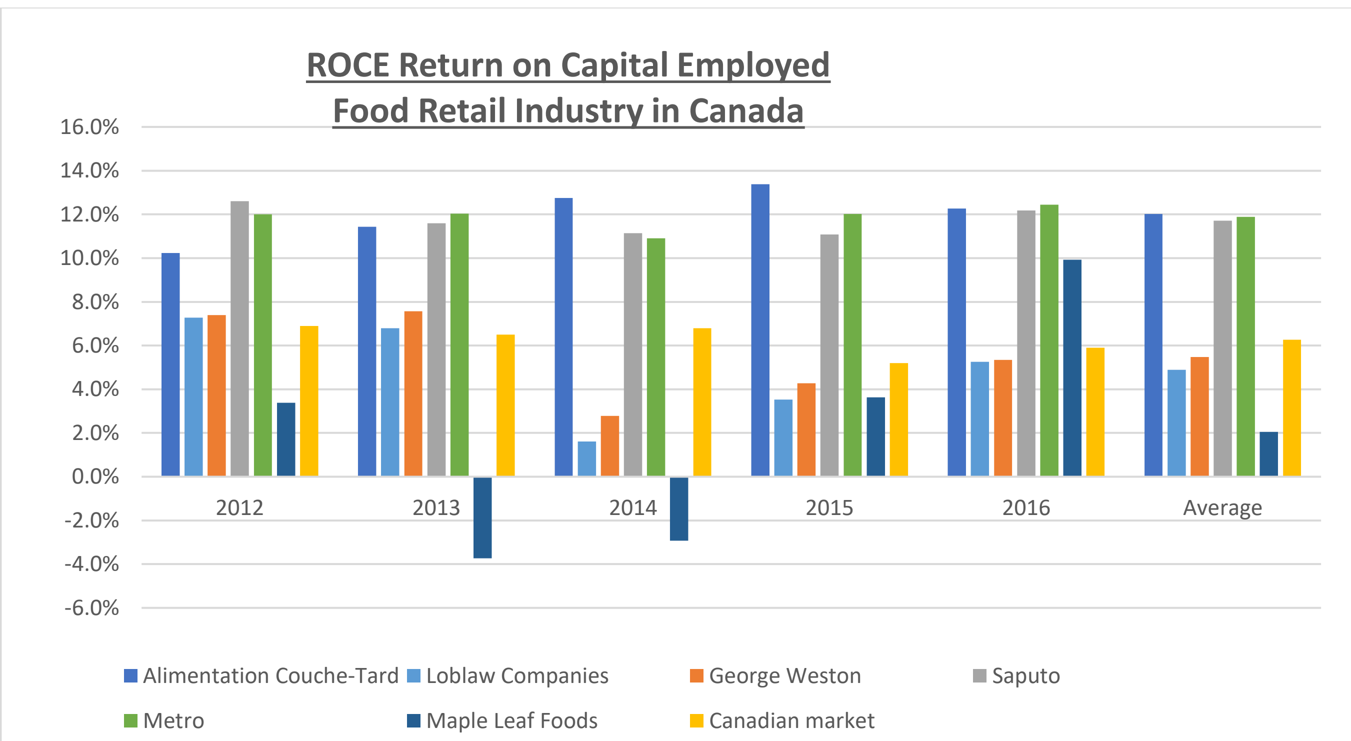
d) Eventually we use the cost of capital or WACC (weighted average cost of capital) and is a weighted average of the cost of financing with debt and with equity.

RETURN ON CAPITAL EMPLOYED (ROCE)

a) In Table II we are presenting the Return on Capital Employed (ROCE) for the last five years for each of these six companies. This is probably the most important measurement in financial ratios. At the end, profitability is the reason why we have a business running. ROCE is defined as NOPAT over capital employed. ROCE gives us a measurement of wealth creation based on invested resources in the company. The larger this figure the better. The central idea behind this ratio is that we should intend to create wealth with the least invested resources. If we invest more in a company (or business unit) a larger profit should be expected to justify the additional investment. Nevertheless, a company can be very profitable but also very small and therefore a dollar value will be still small.

Table II: Return on Capital Employed = NOPAT / Capital Employed

	2012	2013	2014	2015	2016	*Average*
Alimentation Couche-Tard	10.2%	11.4%	12.8%	13.4%	12.3%	*12.0%*
Loblaw Companies	7.3%	6.8%	1.6%	3.5%	5.3%	*4.9%*
George Weston	7.4%	7.6%	2.8%	4.3%	5.4%	*5.5%*
Saputo	12.6%	11.6%	11.1%	11.1%	12.2%	*11.7%*
Metro	12.0%	12.0%	10.9%	12.0%	12.4%	*11.9%*
Maple Leaf Foods	3.4%	-3.7%	-2.9%	3.6%	9.9%	*2.1%*
Canadian market	6.9%	6.5%	6.8%	5.2%	5.9%	*6.3%*



b) As we can see in Table II, in average for the last 5 years, Alimentation Couche-Tard has the largest ROCE with 12.0%. It is followed very close by Metro with 11.9% and by Saputo with 11.7%. Behind are George Weston 5.5%, Loblaw Companies 4.9% and Maple Leaf Foods 2.1%. All six companies have positive ROCE, but only three of them are above the average of the Canadian market. How important is 1.0 percentage point for Alimentation Couche-Tard? Well, it is a matter of size. The capital employed of Alimentation Couche-Tard in 2016 is around $10.6 billion CAD. Therefore, 1.0 percentage point will mean close to $106 million CAD a year of additional profit. In the case of Loblaw Companies, its capital employed in 2016 is around $27.4 billion CAD. Therefore an extra 1.0 percentage point will mean close to $274 million CAD a year of additional profit. Not bad at all. Very likely, performance bonuses of the executive team should be based in these accomplishments.

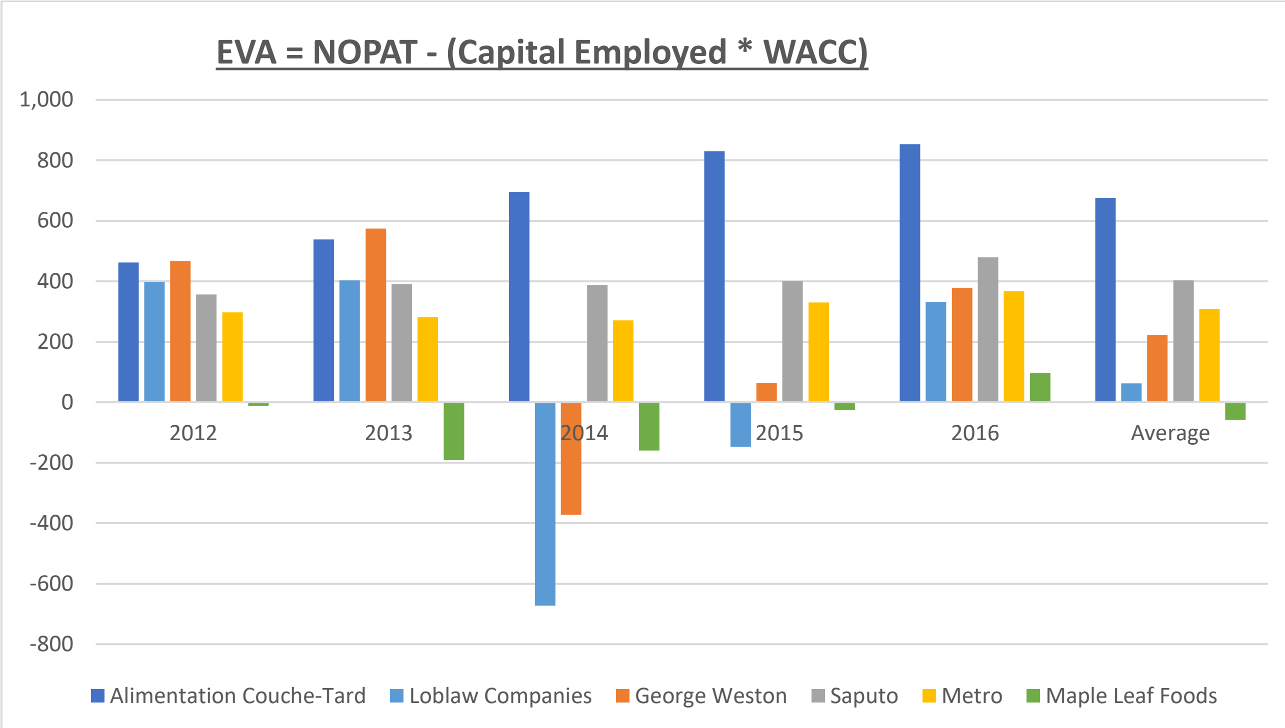
ECONOMIC VALUE CREATION OR EVA®

a) In Table III we are presenting the Economic Value Creation or EVA® for the last five years for each of these six companies. This is probably the most important measurement in financial ratios. At the end, profitability is the reason why we have a business running. ROCE is defined as NOPAT over capital employed. ROCE gives us a measurement of wealth creation based on invested resources in the company. The larger this figure the better. The central idea behind this ratio is that we should intend to create wealth with the least invested resources. If we invest more in a company (or business unit) a larger profit should be expected to justify the additional investment. Nevertheless, a company can be very profitable but also very small and therefore a dollar value will be still small.

Table III: EVA = NOPAT - (Capital Employed * WACC) (million CAD)

	2012	2013	2014	2015	2016	*Average*
Alimentation Couche-Tard	462	538	696	830	854	*676*
Loblaw Companies	397	403	-672	-147	332	*63*
George Weston	468	574	-372	65	379	*223*
Saputo	357	391	388	401	480	*403*
Metro	297	281	270	330	367	*309*
Maple Leaf Foods	-12	-192	-160	-27	97	*-59*

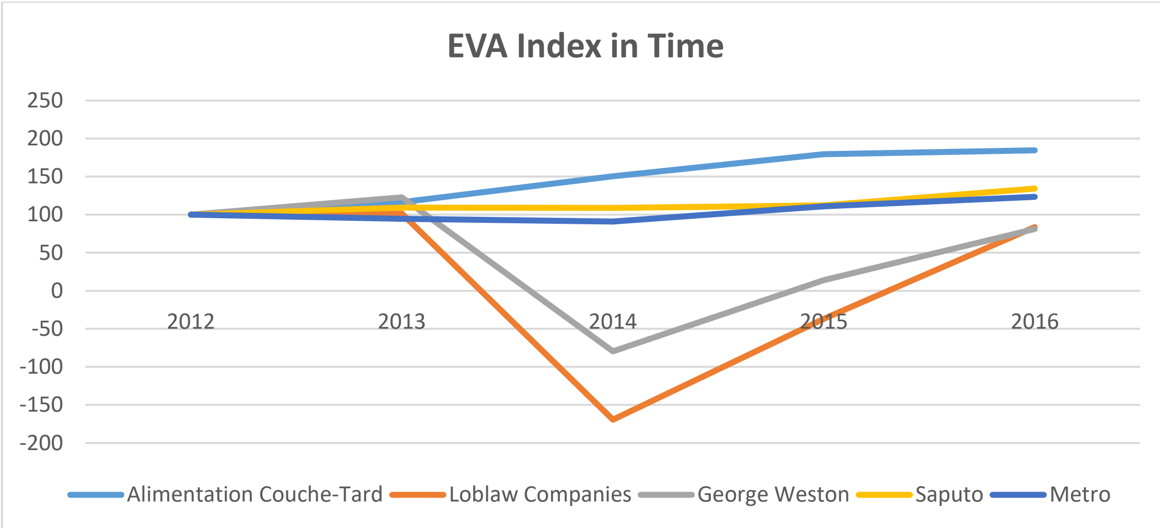
b) If we compare Table II (ROCE or profitability) and Table III (EVA®) we can find some interesting apparently contradictions. In Table II, best profitability is Alimentation Couche-Tard, followed by Metro, Saputo, George Weston, Loblaw Companies and Maple Leaf Foods. But in Table III, best EVA® is Alimentation Couche-Tard, followed by Saputo, Metro, George Weston, Loblaw Companies and Maple Leaf Foods. This is, Alimentation Couche-Tard has the largest profitability and largest EVA®, but Saputo that is third in profitability is second in EVA®, Metro is third in profitability but is second in EVA®. Important to mention (and sad to say) that Maple Leaf Foods has been destroying economic value in average for the last five years (although they did have positive EVA® in 2016).



c) Also trend is interesting. Alimentation Couche-Tard and Saputo have increased its EVA® in time, Metro has increased it in the last two years, while Loblaw Companies and George Weston have had negative EVA® in 2014 and 2015 (starting to recover in 2016) and Maple Leaf Foods had a negative EVA® from 2012 to 2015 and positive EVA® only on 2016. Here below, in Table IV we are presenting the EVA® as a 100 base index in 2012 for each company.

Table IV: EVA Index in Time (2012 = 100)

	2012	2013	2014	2015	2016
Alimentation Couche-Tard	100	116	151	180	185
Loblaw Companies	100	102	-169	-37	84
George Weston	100	123	-79	14	81
Saputo	100	110	109	112	134
Metro	100	95	91	111	124
Maple Leaf Foods	N/A	N/A	N/A	N/A	N/A



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About Alberto Calva. His expertise field is finance and economy. He has been a business consultant for more than 20 years. He has given seminars and workshops in 8 different countries having trained with this around 10,000 executives and entrepreneurs from 20 different countries. He has a unique mix of academic, practical, entrepreneurial, hands on experience and board member background. He holds a Bachelor degree of Industrial Engineering, a Master degree of Economics and an MBA with a major of Finance.

About this report. We prepare several reports every month regarding financial, economic and business issues. These reports are sent free of any charge to our database of clients and friends. We have been preparing and sending our reports for 20 years. We send each report to around 16,000 people.

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