

## DIA

RETAIL SECTOR

STUDENT: MARIA JOSÉ PRATA

## COMPANY REPORT

JANUARY 2015

**About to get more convenient***... But need to focus on sales growth*

- **Iberia to continue the centre:** representing 86% of our EV, operations in Iberia shall face an easier macro environment but a still tough competition – focus on market shares growth rather than margins efficiency (already largely above competitors) is now key;
  - **Franchisees all the way:** from 27% in 2009, franchisees represent now 44% of DIA's global store network (our estimate for 2020: 55%), being an important contribution for higher margins;
  - **Emerging Markets growth offset by FX:** DIA is growing above main competitors average in Brazil and Argentina and the convenience format has attractive growth prospects for the future, with FX movements getting in the way; China has a large retail market growth potential but DIA's positioning in the country is still unclear;
  - **Shopping season in Spain:** DIA consolidated its market share in Spain (2013 pro-forma market share 1.4 pp above), announcing two acquisitions this year, which we expect to have a positive NPV;
  - **Upgrading the diversification segment:** Schleckers beauty and household stores acquired in 2013 are being upgraded to the new format Clarel (app. 55% of the network), with sales rising in new stores;
  - **Au Revoir France:** DIA successfully completed the exit of its loss-making segment, selling France stores to Carrefour for an EV of EURm 600 (10x EV/EBITDA13) that generated a cash inflow of EURm 283.
- **More convenient market outlook and strategic goals:** we expect the planned investment in prices and new product categories (fresh products, etc.), as well as the proximity advantage (app. 87% of stores), to increase store visits in the medium-term and support future growth.

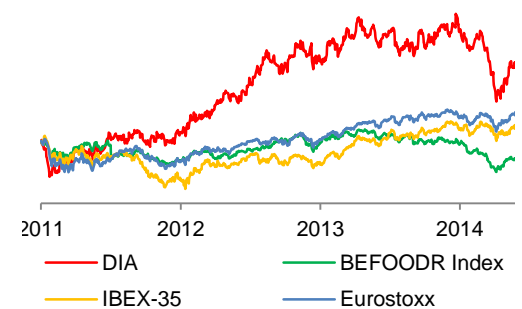
Distribuidora Internacional de Alimentación, S.A. (DIA) is a Spanish retail chain with global operations in Iberia, Argentina, Brazil and China. The company is traded in the Madrid Stock Exchange since July 2011 and is a member of the IBEX-35.

**Recommendation: BUY****Price Target FY15: 6.53 €****Price (as of 2-Jan-2015) 5.72 €**

Reuters: DIDA.MC, Bloomberg: DIA SM Equity

52-week range (EUR)	4.50 - 7.11
Market Cap (EURm)	3,724.12
Outstanding Shares (m)	651.1

Source: Bloomberg



Source: Bloomberg

(Values in EUR millions)	2013	2014E	2015E
Net Sales	9844	7958	9020
EBITDA	642	576	585
NOPLAT	257	259	257
Net Profit	209	237	211
EPS	0.32	0.36	0.32
DPS	0.13	0.16	0.53
Net Debt	651	423	579
D/E Mkt Values	16%	22.8%	23.5%

Source: Company Data, Analyst Estimates

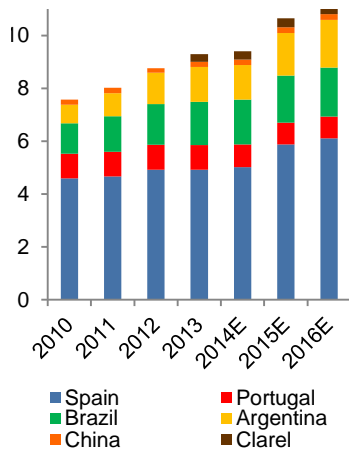
THIS REPORT WAS PREPARED BY MARIA JOSÉ PRATA, A MASTERS IN FINANCE STUDENT OF THE NOVA SCHOOL OF BUSINESS AND ECONOMICS, EXCLUSIVELY FOR ACADEMIC PURPOSES. THIS REPORT WAS SUPERVISED BY ROSÁRIO ANDRÉ WHO REVIEWED THE VALUATION METHODOLOGY AND THE FINANCIAL MODEL. (SEE DISCLOSURES AND DISCLAIMERS AT END OF DOCUMENT)

## Table of Contents

<b>COMPANY OVERVIEW .....</b>	<b>3</b>
<b>ORGANIZATIONAL STRUCTURE.....</b>	<b>3</b>
<b>OWNERSHIP .....</b>	<b>4</b>
<b>BUSINESS MODEL .....</b>	<b>5</b>
<b>SEGMENT ANALYSIS .....</b>	<b>9</b>
<b>IBERIA.....</b>	<b>9</b>
Macroeconomic Scenario .....	9
Performance .....	11
M&A in Spain .....	13
Market & Competitors .....	14
<b>EMERGING MARKETS (EM).....</b>	<b>18</b>
Macroeconomic Scenario .....	18
Performance .....	20
Market & Competitors .....	21
<b>VALUATION .....</b>	<b>24</b>
<b>FRANCE TRANSACTION.....</b>	<b>24</b>
<b>MAIN DRIVERS .....</b>	<b>24</b>
<b>WACC ASSUMPTIONS.....</b>	<b>31</b>
<b>SENSITIVITY ANALYSIS AND SOTP RESULTS.....</b>	<b>32</b>
<b>WACC AND G SCENARIO ANALYSIS.....</b>	<b>33</b>
<b>FINANCIAL STATEMENTS.....</b>	<b>34</b>
<b>DISCLOSURES AND DISCLAIMER .....</b>	<b>37</b>

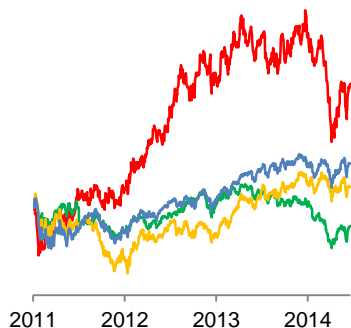
## Company Overview

**Exhibit 1 – Gross Sales per Region (EURb)**



Source: Company Data; Analyst Estimates

**Exhibit 2 – DIA's Market Performance (base 100)**



	2011	2012	2013	2014
<b>DIA</b>	-0.5%	38%	35%	-12%
<b>Be Food</b>	-1.9%	-7.1%	16%	-18%
<b>Ibex 35</b>	-11%	-4.7%	21%	4.8%
<b>Euro Stoxx</b>	-16%	16%	20%	2.7%

Source: Bloomberg

Distribuidora Internacional de Alimentación, S.A. (DIA) is a Spanish retail chain with global operations in Iberia and Emerging Markets. The company is traded in the Madrid Stock Exchange since July 2011 and is a member of the IBEX-35. DIA is a discounter whose strategic advantage is based on a price and proximity (2P) model, strong operational efficiencies, and a system of owned and franchised stores.

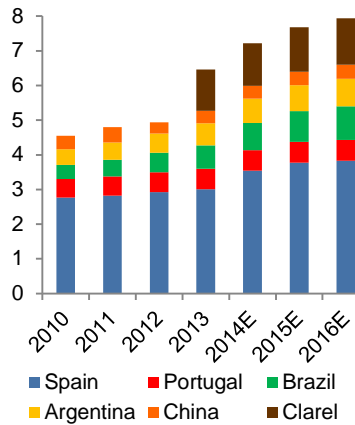
DIA opened its first Madrid store in 1979, differentiating itself from competitors by introducing the discount model in the country's retail sector. It was only ten years later that franchising agreements started to be part of DIA's business model. Portugal was the first international destination in 1993. Greece followed in 1995 and Turkey in 1999 (presence in both these geographies ended in 2010 and 2013, respectively). In 1997, expansion in Emerging Markets began through Argentina, continued in 2001 in Brazil and two years later in China.

In the meantime, in 2000, DIA was acquired by the French retailer Carrefour Group when the latter merged with the Promodes group, DIA's founder and owner at the time. The deal allowed DIA to expand its operations to France in the same year, integrating the French ED Chain. Then in 2010, DIA was spun-off from the group. Limited synergies and interaction between Carrefour and DIA and the fact that the Group's management saw the opportunity to develop a Carrefour-branded discount offer were the main reasons for the transaction. The demerger allowed DIA to fully control its own strategy and focus on its growth potential. Its operations were already relatively autonomous due to independent supply chains, IT systems and management teams. DIA shares were launched in the Madrid's Stock Exchange in July 2011 at a price of EUR 3.5 for each, implying an equity value of EURm 2,378. At year-end, the share closed at EUR 3.49, positive when comparing with the 11% and 16% fall of the IBEX-35 and the EuroStoxx, respectively, in the same period. The Bloomberg Europe Food Retailers Index (BEFOODR) performed negatively as well dropping 1.9%. 2012 and 2013 were very good years for DIA in terms of market performance with 38% and 35% share price growth in each, above the three comparable indexes that, nevertheless, presented a very good performance in 2013. During the last year, the European and Spanish indexes had a low thus positive return but DIA's share followed the performance of other retailers falling 12% during the year and hitting a 2-year low in October of EUR 4.6, recovering since then but still far from the all-time high of EUR 7.08 in July 2014.

## Organizational Structure

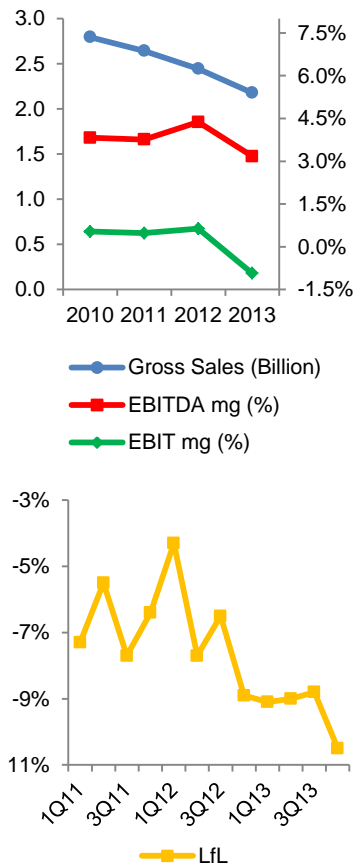
DIA is based in Spain and operates in other four regions through fully consolidated subsidiaries under two banners: DIA/Minipreço and Clarel. Additionally, DIA recently

**Exhibit 3 – Stores per Region (EURthnd)**



Source: Company Data; Analyst Estimates

**Exhibit 4 – France Operating Indicators**



Source: Company Data

acquired in Spain one retail chain with 455 stores, El Árbol, as well as 160 stores of the Eroski brand. These will be considered in the consolidated accounts from 2014 and 2015 onwards, respectively. Globally, DIA runs 6707 stores, of which 3740 are proprietary and 2967 are franchises, and 44 warehouses, serving more than 45 million customers and generating around 39,331 jobs. Aside to the expansion via M&A in Spain and new store openings in each of its countries, DIA has also been scaling down its global presence by selling some units and focusing on the most profitable ones. Since the IPO, DIA has abandoned Beijing, Turkey and France. These operations were classified as discontinued in 2012, 2013 and 2014, respectively. France disposal was recently concluded. DIA confirmed in the 1<sup>st</sup> quarter of 2014 its willingness to sell the operation due to the weak performance in the country: in 2013, EBITDA margin was 6.4 pp below Iberia’s one, EBIT was negative (minus EURm 17.7) and sales growth was negative as well. Discounters struggle in France due to the competition created by major supermarket chains: according to an article from *Retail Detail*, discounters’ joint market share declined from 15% in 2009 to 12% in 2013. DIA France quarterly like-for-likes (LfL’s<sup>1</sup>) has been negative since 2010. In June, DIA signed a put option and an exclusivity agreement with Carrefour, having the latter agreed to acquire the entire share capital of DIA France would DIA exercise the option at an EV of EURm 600. The option was exercised and DIA announced in November the closing of the operation.

### Ownership

All 651,070,558 shares of DIA are ordinary and of the same class, conferring upon their holder one voting right. The majority of shares (90.0%) are free-floating, while 1% is held as treasury stock and 9% is concerted action. Treasury stock is maintained in the balance sheet to cover potential distribution of shares under the 2014-2016 Long-Term Incentive Plan for directors<sup>2</sup>. The amount of own shares changes periodically in order to meet the Plan requirements. The 9% concerted action refers to an arrangement between two shareholders (Blue Partners, Sà.r.l and Cervinia Europe) that comprises the obligation to come to a mutual agreement to determine a joint position before Board or shareholders meetings. This structure has been relatively stable since the IPO. On September 2013, DIA redeemed 28,265,442 of its shares (4.2% of equity). There are 13 shareholders with a stake of more than 1%, owning a total of 38% of equity. The largest 5 shareholders are Baillie Gifford & Co. (8.1%), Cervinia Europe (5%), Blue Partners (4%), Vanguard Group Inc. (3%) and Blackrock Inc. (3%). The Board of Directors is composed by 10

<sup>1</sup> LfL’s are a widely used indicator in retail and measure the growth of sales that do not come from expansion (same-store sales).

<sup>2</sup> The LTIP targets around 250 beneficiaries and pays a variable remuneration according to the fulfilment of pre-defined business targets of EBITDA and TSR (total shareholder return).

**Exhibit 5 – Dividend Payments**

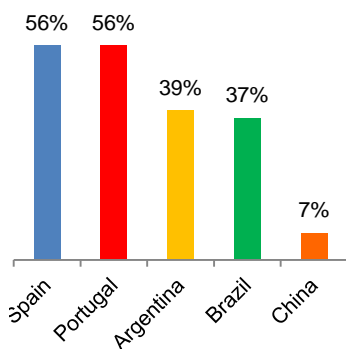
	July '12	July '13	July '14
EUR/ Share	0.11	0.13	0.16
% of Net Pr.	74%	53%	49%
% of Und. Net Pr.	47%	47%	46%

Source: Company Data

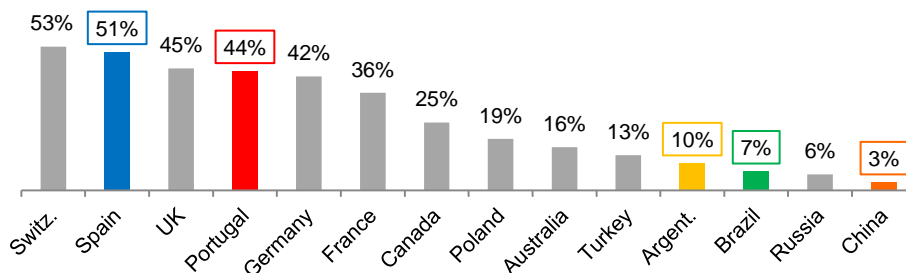
members that in all hold 0.05% of total voting rights. Since the IPO, DIA has distributed dividends to its shareholders three times. Its dividend distribution policy consists on the payment of a dividend up to 50% of the underlying net profit<sup>3</sup>.

**Business Model**

There are 4 main aspects in which DIA bases its business model that contribute to differentiate it from competitors: price, proximity, franchises and efficiency. As a discounter, DIA states as its goal the provision of a “balanced selection of top-quality goods at unbeatable prices”. The company claims having a **good price image** amongst clients in most of its geographies and that it regularly invests in prices to keep its competitive edge. DIA’s private-label (PL) brands support this low price image. The current 7600 DIA-branded SKU’s<sup>4</sup> became a core growth driver due to the large proportion of sales they represent.

**Exhibit 6 – DIA PL-brand Sales as a % of Total Sales (2013)**

Source: Company Data

**Exhibit 7 – PL Penetration (Share of Total Retail Sales by Country) 2013**

Source: Core Solutions (Nielsen, PLMA, IRI)

In Europe, penetration of PL’s is greater than in Emerging economies, as customers are more used to buy these products and their packaging/quality approaches branded products standards. Developing economies, with more fragmented retail markets and less established modern retailing, see less PL development, a trend that should change as Advanced economies chains continue expanding to these countries. Another initiative that supports the low price strategy is the customer loyalty system *Club DIA* created in 1998, that gives members access to products at lower prices, discounts in the form of coupons, etc. This system provides insight regarding clients’ preferences, making it possible to better manage the supply chain and the commercial offer. The effectiveness of this strategy depends on the contribution of Club DIA purchases to total sales, which is above 70% in each of DIA’s geographies (excluding Brazil, where Club DIA was launched only in 2014). The second pillar of DIA’s strategy is **proximity**, making it a 2P (price and proximity) player. Most of DIA’s network (appr. 87% of stores in October 2014) consists of neighbourhood stores in urban and rural areas. Those include:

<sup>3</sup> Underlying net profit corresponds to the net profit after adding back non-recurring items (restructuring costs, impairments and gains/losses on the disposal of assets) and the impact of discontinued operations.

<sup>4</sup> A SKU (Stock Keeping Unit) corresponds to one distinct item in the store’s portfolio.

Exhibit 8 – DIA Retail Formats



	Sqm	SKU's	Main Characteristics
DIA Market	400 - 700	2800	- Designed and placed in dense areas for everyday shopping;
Minipreço (*)			- Expanded offer of perishables.
DIA fresh	c. 150	n.a	- Offer based on perishables: fruit, vegetables, bread and pastries;
Fresh by DIA			- Ampler opening hours (9.30am-9.30pm).
Schlecker	160 - 200	6200	- Specialized in health, beauty, household and personal care items;
Clarel			- Schlecker stores currently being transformed in Clarel.
Cada Dia (SP)	n.a	n.a	- Franchise format for small rural areas;
Mais Perto (PT)			- Owner does not need to adapt the store to DIA format.

(\*) Located in rural/urban centres

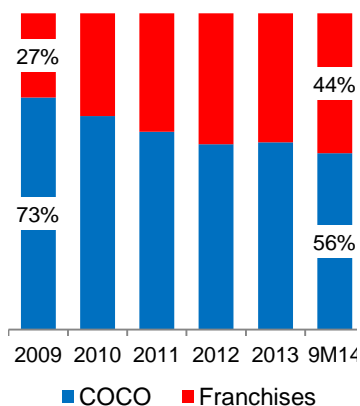
To diversify its offer and targeting a different type of customers, DIA runs larger attraction stores (the remaining 13% of the store network):

	Sqm	SKU's	Main Characteristics
DIA Maxi	700 -1000	3500	- Adapted to larger and less frequent purchases;
Minipreço (**)			- Located around urban centres, includes parking lots.

(\*\*) Located in suburbs of cities

Source: Company Data

Exhibit 9 – DIA's Store Management Model (% of Stores)



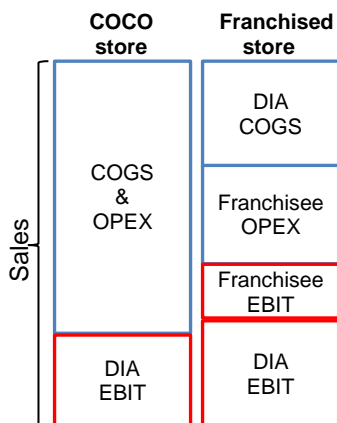
Source: Company Data

The third differentiating aspect is the use of the **franchise model** to manage part of the store network. This model has been running for 26 years and is one important source of value creation for DIA, which ranks #10 in the Top 100 Global Franchises from Franchise Direct<sup>5</sup>. Except for DIA, all top 14 remaining companies are from the US. DIA operates its stores under three management models. COCO stores (Company Owned, Company Operated) are managed by DIA employees, being especially important to test new concepts before replication to franchises. Most of Maxi stores are also COCO's, due to the higher complexity of management. Even though COCO still represent the majority of stores, DIA aims to further decrease its weight in the network. FOFO (Franchise Owned, Franchise Operated) was the initial model of franchises, representing since 2009 around 20% of the network. COFO (Company Owned, Franchise Operated) is a model being used since 2006 but growing rapidly – from 5% (312) of the stores in 2009 to 22% (1509) in the end of the 3<sup>rd</sup> quarter 2014. Under this model, DIA is in charge of investing the initial Capex and then transfers the management of the store to the entrepreneur.

COFO/FOFO models fit into DIA's aim of proximity for combining the company's business model, known brand and stronger purchasing power with the franchisee's focus and practical know-how about the customer needs, as well as its potential

<sup>5</sup>This ranking is based on the system size, sales, stability, growth perspectives, years in operation, practices of franchisee support and training, etc.

**Exhibit 10 – DIA’s Graphical Explanation for Franchisees Advantage**



Source: Company Data

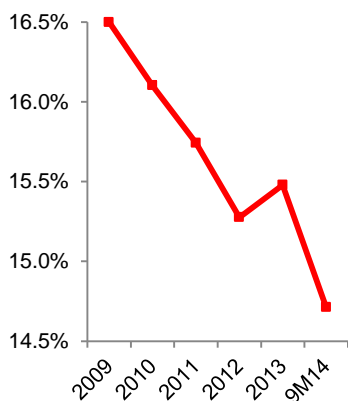
ability and high incentives to better manage store expenses (see Exhibit 10). Moreover, DIA has been transferring stores from COCO to franchise models and opening new COFO/FOFO stores because of the positive impact on P&L:

- Gross Profit: DIA is the commercial intermediary between suppliers and franchised stores, retaining a margin of the gross profit lower than the one obtained from COCO sales. The “lost” portion is the franchisees margin<sup>6</sup>.
- Opex: operating and personnel expenses are supported by the franchisee, having no impact on DIA’s P&L. Rentals are DIA’s expenses in the case of COFO stores.
- EBITDA: by letting go most of the costs necessary to run the stores, namely personnel expenses (that represent around 50% of Opex), DIA is able to obtain a higher EBITDA margin from franchised stores, compared to COCO ones (not quantifiable due to the lack of information provided by DIA).

There are however some risks and disadvantages attached to this model. As DIA transfers to the franchisee the management of the store there is a general loss of control, even though the company’s strategy is also passed on and franchisees stores are often supervised. This loss of control may create deviations from the core pricing policy, store display and refurbishment, etc. and ultimately result in a deterioration of the company’s image amongst clients. Another risk to consider is the consequences of an improving economic environment, especially in Iberia, in the DIA-franchisee relationship. There is the possibility of DIA not being able to retain in its network as many COFO’s and FOFO’s as it wishes without giving up an higher margin of the gross profit, as opportunity costs from a franchisee perspective are more relevant in a growing economy. This could be offset by a higher satisfaction of franchisees for potentially achieving larger levels of sales.

At last, **efficiency** in the sales support system has also been an important contributor to margins improvement and growth, which can be observed by the negative trend of Opex (including personnel expenses, rents and distribution costs) as a % of sales. Between 2009 and 2013, this ratio fell at a CAGR of 1.6% (-2.4% if we exclude Clarel/Schlecker). In 2014, we expect this ratio to decrease even further due to the behaviour in the first 9 months of the year (Opex/Sales of 14.7%), in part justified by the exit of France. DIA developed an IT system that is globally used to manage the supply chain, from the supplier (mostly local ones) to the warehouse and the store, simplifying the exchange of information and accelerating the process. In 2013, DIA’s logistics were supported by 44 warehouses worldwide (35 excl. France), with a total area of 872,709 sqm. These are placed close to the largest cities, with an average distance between 30-50 kms, resulting in lower fuel expenses. Transportation is

**Exhibit 11 – DIA’s Opex as a % of Sales**



Source: Company Data

<sup>6</sup>In its P&L, DIA distinguishes between Gross Sales under Banner (the total turnover obtained in DIA-branded stores, including VAT) and Net Sales (that excludes VAT as well as the gross margin franchisees retain in their P&L). In this note, for analysis purposes, we will also use the term and estimate Net Sales under Banner (which is the total turnover of DIA stores, COCO and franchises, excluding VAT).

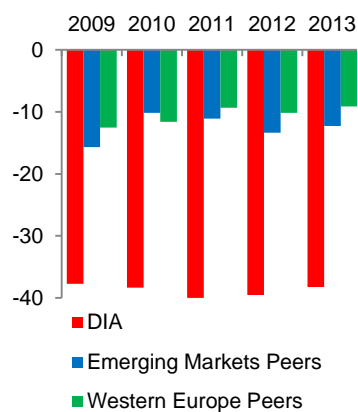
made in multi-temperature trucks with increased load capacity that carry perishables and regular products at once. The company considers future promotions, including the ones to loyalty card owners, seasonality and store planogram to forecast sales. Stores are restocked on a daily basis and products can be put for sale shortly after arriving to the store (through “shelf-ready packaging”), which saves time and avoids waste of packaging materials. Additionally, DIA implemented a large-scale project to save on energy expenditures, changing light systems in stores to LED technology: in Spain, energy costs decreased 6.1% in 2013. The efficiency also translates on better days of working capital. Among other publicly listed Western European and Emerging Market peers, DIA manages to operate under much less days of NWC. During the period graphically represented, this difference was on average 27 days, mainly from better payables and inventories.

There are two further topics in which DIA has been investing to improve its reputation towards the customer and/or create new sources of growth:

i) **Fresh products and DIA Market III:** the weight of perishable goods (including fruit, vegetables, bread, meat and fish) has been increasing in most of DIA stores as part of the strategy to drive more frequent visits through daily shopping and to improve customer's perception. In 2013, fresh products represented more 12 % of shelf space than in the previous year. The main disadvantage associated to this type of offer is a more complex management of the supply chain. In Spain, DIA has been upgrading some of its proximity stores to the DIA Market III format to have a more customer-friendly environment (closer to supermarkets) and offer more of these fresh products and other new categories (healthy food and organic ranges). In September, 190 stores were already upgraded, and DIA expected to refurbish another 170 before year-end 2014, with an average investment of EUR 50 thousand per store. DIA claims that upgraded stores see higher growth in sales than remaining ones, as the fresh products category is a key one in Spain.

ii) **Sector diversification (HPC) and Clarel:** in 2012, DIA acquired 1129 stores of the German Schlegler in Portugal and in Spain (having open another 97 until September 2014), aiming to become a benchmark specialist in the health, beauty and household product segments through the offer of both name and PL products. The transaction price of EURm 67 implied an EV/EBITDA below 3. Many of the stores have already been upgraded to the new brand Clarel (55% of the network), and DIA sees sales going up by app. 8% in the refurbished stores. For the following quarters, as the private brand of Clarel is being very well received by customers and DIA sees a demand with very good elasticity, it plans to invest in prices and growth to be even above the 8%. According to a Kantar Retail<sup>7</sup> comment, good customer

**Exhibit 12 – Days of NWC Comparison**

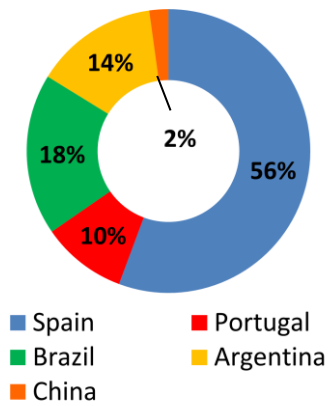


Source: Bloomberg

<sup>7</sup> “Store of the Week: Clarel”, Nov. 2014, Bryan Robets (Kantar Retail)

service and a friendly and welcoming attitude of employees, as well as the wide range of branded lines and private labels across all categories, make the shopping experience a pleasant one and Clarel's value proposition fairly compelling. Regarding expansion, DIA forecasts the continuous opening of Clarel stores in Iberia in the years to come, considering further international expansion as a possibility.

**Exhibit 13 – DIA's Gross Sales under Banner 9M2014**



Source: Company Data

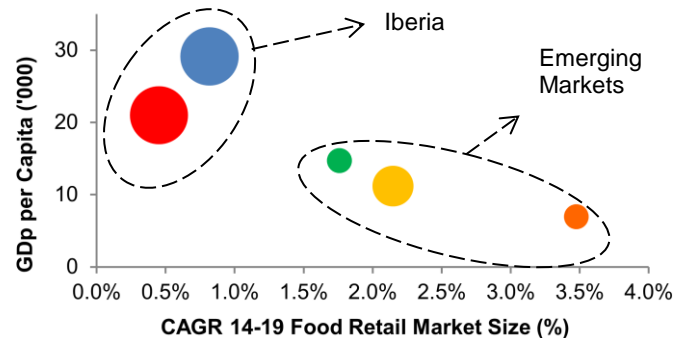
### Segment Analysis

DIA's activities can be segmented in **Iberia** and **Emerging Markets (EM)** due to the different growth/risk profiles of the countries in each of these groups, as well as to the strategy implemented in each of them. In Spain and Portugal, the company is well established and owns more significant market shares, even though expansion to new retail sectors has been in DIA's vision. Brazil, Argentina and China can be seen as a source of income growth, where the chances of expansion and market share gains are larger, as these countries do not have yet matured food retail sectors. The size of these countries food retail market per capita is much smaller (size of the circles in Exhibit 15) and their expected growth is, on average, more than 3x that of Iberia.

	Real GDP (YoY%)		Inflation (%)		Unemployment (%)	
	2013	2014F	2013	2014F	2013	2014F
Spain	-1.2	1.3	1.5	0.0	26.1	24.6
Portugal	-1.4	1.0	0.4	0.0	16.2	14.2
Brazil	2.5	0.3	6.2	6.3	5.4	5.5
Argentina	2.9	-1.7	10.6	25.0	7.1	8.8
China	7.7	7.4	2.6	2.3	4.1	4.1

**Exhibit 14 – Main Macro Indicators**

Source: IMF WEO, Bloomberg for Inflation Argentina 2014F



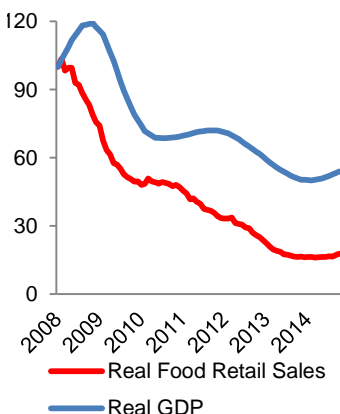
**Exhibit 15 – GDP per Capita and Expected Growth of Food Retail Market**  
Source: IMF WEO, Euromonitor

### Iberia

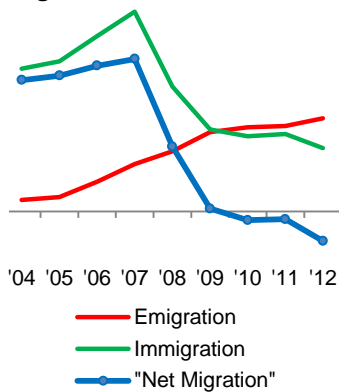
#### Macroeconomic Scenario

Spain and Portugal have been particularly hit by the recent recession and sovereign crisis, which strongly affected purchasing power of consumers. In **Spain**, the main issue was the collapse of the housing market bubble and its spillover for the banking sector with the rising defaults on loans and mortgages, which eventually called for a banks bailout. Austerity measures, including lower benefit payouts and higher standard VAT (16% in 2009, 18% in 2010 and 21% in 2012), and the shy credit flow further contributed to reduce disposable income of the population, affecting economic growth and job creation. Real GDP fell throughout 2009 and 2013 at a CAGR of 1.4%. Unemployment rose to 19.85% in 2010, peaking at 26.1% in 2013. Real food retail sales reaction was even larger, falling since 2008 until last year at a CAGR of

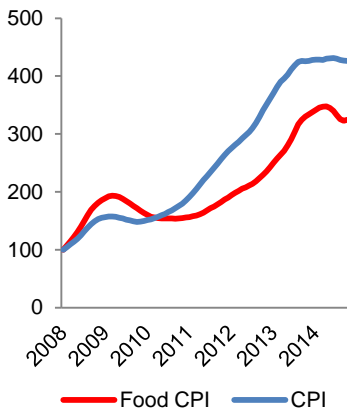
**Exhibit 16 – Spanish Food Retail Sales and GDP Indexes**



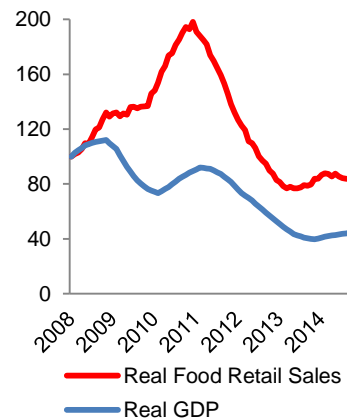
Source: Bloomberg

**Exhibit 17 – Spanish Net Migration**

Source: Eurostat

**Exhibit 18 – Spanish Food CPI and CPI Indexes**

Source: Bloomberg

**Exhibit 19 – Portuguese Food Retail Sales and GDP Indexes**

Source: Bloomberg

2.95%. This demand contraction faced by retailers can be seen as a result of the reduction of the purchasing power of Spanish citizens created by the crisis because even though there was a major slowdown in the population growth since 2009, it was only in 2013 that, for the first time since population records exist (first census was in 1857), Spain's official population fell by 90 thousand to 46.7 million, according to the Eurostat. Migration flows are in part accounted for this change in trend: net migration hit negative levels between 2010 and 2012 (no information available for 2013). Positive or close to zero food CPI and all-goods CPI helped smoothing the negative GDP and retail sales growth in nominal terms (compared to real terms), even though food CPI was always lower than all-goods CPI (except for 2013).

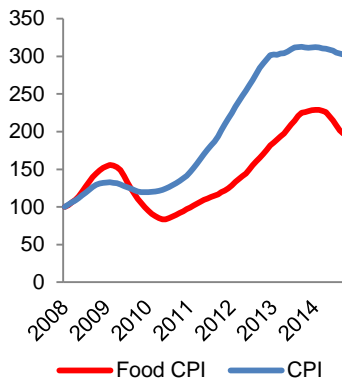
Throughout this period, Spain managed to go from a country over-dependent on construction and real estate to a country more supported by exports, a healthier financial system and rising demand – the European Commission's business and consumer confidence monthly survey results have been rising since July 2013. Growth is gathering momentum: for the first time since 2011, real GDP increased in the 1<sup>st</sup> and 2<sup>nd</sup> quarters of 2014 at a YoY growth rate of 0.1% and 2.2%, respectively. Real food retail sales performed positively, growing at 1.5% in the 3<sup>rd</sup> quarter. Food prices, however, started to decline in the 2<sup>nd</sup> and 3<sup>rd</sup> quarter (at 0.7% and 1.7%).

Even though Spain is currently outperforming some of its larger European peers in terms of growth, the following quarters and the course of the still very high unemployment rate (IMF estimate for year-end 2014 is 24.6%) should be critical to determine if the seen recovery is self-sustainable. IMF estimate for year-end GDP real growth is 1.3% and growth should steadily approach the 2% until 2019. CPI is expected to be positive during this period but remaining below ECB's targets.

In **Portugal**, it was in 2010 that pressure from bond markets and sovereign bonds downgrading led the Government to reduce the large budget deficit and announce austerity measures, including cuts in public spending and tax increases. Less than one year later the country applied for EU and IMF financial assistance, receiving a EURb 78 bailout package and committing to lower the deficit as a % of GDP (6.8 pp above EU regulation in 2010). State downsizing led to freezing and cuts in public servants wages and further tax hikes, including standard VAT to 23%. Similarly to the Spanish economy reaction, in Portugal real GDP and real food retail sales trended negatively as a result of the lower purchasing power and consumer confidence between 2012 and 2013 at a CAGR of -3.5% and -3.2%, respectively. Unemployment rose to 15.5% in 2013 (from 9.4% in 2009). CPI and food CPI were positive until the last quarter of 2013, remaining negative since then.

After regaining complete access to financial markets in 2013 and exiting the bailout programme in 2014, the economy has been improving in terms of unemployment (IMF estimate for 2014 of 14.2%, a 2 pp YoY decrease), consumer confidence

**Exhibit 20 – Portuguese Food CPI and CPI Indexes**

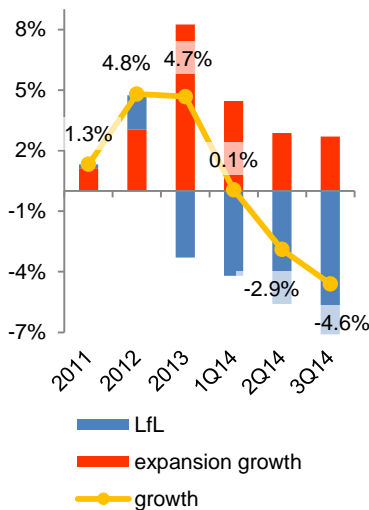


Source: Bloomberg

(positive YoY change since July 2013) and real GDP (IMF estimate for 2014 of 1% growth). Food retail sales, however, were stagnant in the first 9 months of the year, compared to the same period in 2013. As overall and food inflation have been negative during the whole year, especially in the summer, in nominal terms sales have been falling. Until 2019, the IMF estimates unemployment to fall at approximately 0.5 pp per year and real GDP growth and inflation to stabilize at 1.8% and 1.5%, respectively.

**Risks for Spain and Portugal outlook** include the recovery of the Euro-Area economy, which is expected to continue but remain subdued due to geopolitical tensions and a slowdown of major economies growth: German, French and Italian YoY real GDP growth on the last quarter was below Spanish and Portuguese. ECB recent measures to provide additional monetary policy accommodation should increase investors' confidence and gradually remove deflationary pressures in the Euro-Area (IMF forecast for inflation is 1.2% in 2016, 0.7 pp increase from 2014).

**Exhibit 21 – Iberia Gross Sales Growth Breakdown**



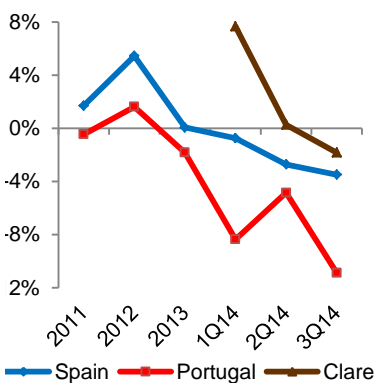
Source: Company Data

**Performance**

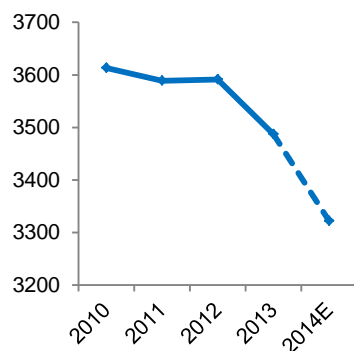
The period described was not the most favourable for retailers in Iberia due to the path of food retail sales. Even though, **gross sales** of DIA increased between 2010 and 2013 at a CAGR of 3.6%. Exhibit 21 displays the growth breakdown between LfL growth and growth coming from store openings:  $(1 + \text{sales growth}) = (1 + \text{LfL}) * (1 + \text{expansion growth})$ . An important part of the 3.6% CAGR came from new stores (DIA's net new stores in Spain and Portugal were on average 82 and 17 per year, respectively). More recently, in 2013, LfL's became negative and equal to -3.3%. During the 2<sup>nd</sup> and 3<sup>rd</sup> quarters of 2014, expansion was not enough to keep YoY gross sales rising, as LfL's kept on going down at even larger rates.

Breaking down this **growth across countries and brands** leads to the conclusion that DIA has been performing worst in Portugal, where gross sales in 2013 are below 2010's level and average YoY growth during 2014's quarters has been -8% (DIA Spain: -2.3%; Clarel: -2%). DIA reported that it will invest in prices to widen the gap with competitors, stating in its last results that the company has already strengthened its price leadership in Spain with a more deflationary position than the market during the quarter and that its sales actually increased in real terms. In this country, the drop in gross sales is a consequence of the business environment and deflation, as DIA claims to be grabbing some market share in the first 9 months of 2014. In Portugal, DIA recognized that to reverse the market share negative trend (later on analysed) it will have to make an extra effort of price investment. Another negative aspect during the last quarter was the mild summer weather that did not support sales of seasonal products. Clarel, accounted for consolidation since the 1<sup>st</sup> quarter of 2013, presented on the last quarter a negative YoY gross sales growth with an extra 96 stores under

**Exhibit 22 – Iberia Gross Sales Growth per Country**



Source: Company Data

**Exhibit 23 – DIA Portugal and Spain Net Sales under Banner per Sqm (EURm)**

Source: Company Data, Analyst Estimates

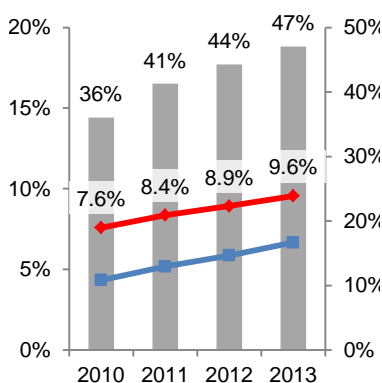
its network, even though the fact that a large number of stores have been under revamping could contribute for this negative result. Clarel results should be more dependent on the macroeconomic scenario as the goods sold on these stores are not primary and thus show higher income elasticity.

An important measure of performance is **sales under banner per sqm**, corresponding to sales on both COCO and franchised stores divided by the total sales area. For that purpose we had to make an assumption regarding DIA Spain, DIA Portugal and Clarel average VAT rate<sup>8</sup>. Excluding Clarel, Iberia sales per sqm declined between 2010 and 2014 (estimating the last quarter of 2014) at a CAGR of 2.1%, slightly recovering in 2012. This fall was likely caused by the overall drop in sales affecting the retail market as selling space kept rising at app. the same rates.

The weak sales performance diverges from **operating results** before and after depreciation that grew between 2010 and 2013 at a CAGR of 10.4% and 18%, respectively. This trend is explained by three operating aspects: (i) DIA's attempt to make operations more efficient, through electricity structure improvements, for instance; (ii) a more flexible cost structure (less dependent on volumes sold) and (iii) better negotiating power with suppliers. However, another main contribution for margin improvements came from the earlier described effect that increase the proportion of franchised stores on the network has on the P&L. In Iberia, this proportion increased 11 pp from 2010 to 2013 (including Clarel, this ratio would be 36% in 2013). DIA does not disclose information that would be required to split the margin growth between these two effects, but the company did mention that the franchise effect was the main driver for margins in the last results.

DIA classifies other costs, including impairments, gains/losses on the disposal of assets and restructuring costs as non-recurring items. Nevertheless, considering that restructuring costs are the main component of this P&L line and that these are related to new stores integration and other operating requirements we considered them as recurring and estimate their split between Iberia and Emerging Markets. These costs represent in Iberia an average of 0.4% of sales between 2010 and 2013.

**Iberia's operating gross cash flow** grew between 2010 and 2013 at a CAGR of 15.2% to EURm 385. For working capital of Iberia, we have estimated the same average days DIA has in all its geographies, which leads to a relatively stable and negative working capital of app. EURm 500, requiring little year-on-year investment. Between 2011 and 2013, Capex represented 35%, 36% and 64% of each year's EBITDA (in this last year, 19% of Capex is goodwill associated to Schlecker acquisition). As a result, Iberia's FCF was of EURm 178, 194 and 182 between 2011 and 2013.

**Exhibit 24 – Iberia Operating Indicators**

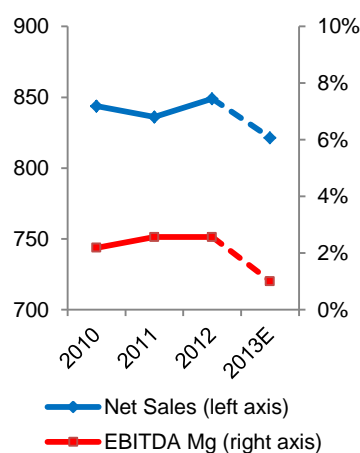
■ % of Franchised Stores ex-Clare (right axis)  
 ● Adj EBITDA Mg (left axis)  
 ■ Adj EBIT Mg (left axis)

Source: Company Data

<sup>8</sup>We used information disclosed in the IPO prospectus regarding average VAT in 2010 (Portugal: 11.6%, Spain: 8.6%), estimating for the following years based on standard VAT changes in those years. As Clarel initially had no franchisees, we inferred average VAT (15.8%).

**Exhibit 25 – 2014 M&A Announcements**


Source: Company Data

**Exhibit 26 – El Arbol Operating Indicators**


Source: Company Data

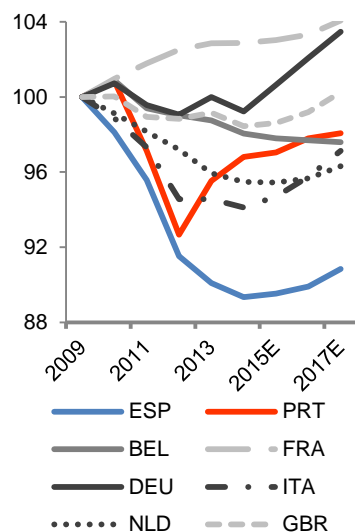
## M&A in Spain

As part of its strategy of inorganic growth and market consolidation in Spain, DIA announced the acquisition of the fresh products specialist supermarket chain **Grupo El Árbol's** for EURm 120 (share capital of EUR 1, participative loan owned by shareholders of EURm 21, net debt of EURm 99). The transaction has been approved by the Spanish National Markets and Competition Commission (CNMC) subject on the divestment of 7 stores, representing 1% of gross sales in 2013. El Árbol is the #14 food retailer in Spain with 455 stores: 425 supermarkets with average 700 sqm (between DIA Market and DIA Maxi stores) and 30 Cash & Carry with average 950 sqm. Besides the 7 stores to be sold as imposed by CNMC, DIA will also sell another 21 stores that have been presenting especially bad results. For the good reputation that DIA believes El Árbol has developed among its customers, namely in the perishables offer, the company plans to keep the banner in most of the store network, with the exception of app. 8 stores that will be transformed to DIA. **El Árbol's past performance** is not very promising, as the company has been loss making for several years and in a distressed situation. 2013 accounts were not disclosed but in 2012 net sales were EURm 849, with a 3-year CAGR of 0.3% (DIA Spain: 1.7%), sales per sqm of EUR 2.56 thousand (DIA Spain: 3.5) and EBITDA margin of 2.6% (Dia Iberia: 8.9%). DIA announced that in 2013 El Árbol sales went down 3.2% YoY (Dia Spain: -1.2%). Overall, this transaction allowed DIA to increase its scale and market share in Spain at a relatively attractive valuation considering the potential synergies (later on analyzed): EV/Sales13 multiple is 0.15.

The second acquisition announced this year, in November, was 160 **Eroski stores** for a maximum of EURm 146, still subject to the approval of CNMC. These stores are from the formats Eroski Center, Eroski City and Caprabo, with an average of 800 sqm. DIA expects the operation to be closed in the 2<sup>nd</sup> quarter of 2015 (consolidated from the 3<sup>rd</sup> quarter onwards) planning to rebrand the smaller stores to the DIA Maxi and Market formats. DIA has not yet announced a definitive plan regarding the larger stores, which may be rebranded to the El Árbol format or to a new one. This acquisition has an important impact in terms of market share in Madrid. According to Kantar, DIA is currently #4 in Madrid in terms of sales, becoming #2 with the 108 Eroski stores to be acquired in the capital. There is limited information available regarding the performance of the 160 Eroski stores, but DIA disclosed that their gross sales in 2013 were EURm 487 and that the stores were profitable at the EBIT level. The expected cash payment of EURm 146 implies an EV/Sales13 multiple of 0.33, twice as what DIA paid for El Árbol.

These two acquisitions result in a consolidation of DIA's market share in Spain which is currently very positive for two main reasons: it strengthens DIA's competitive

**Exhibit 27 – Food Retail Market Size Volume Growth**



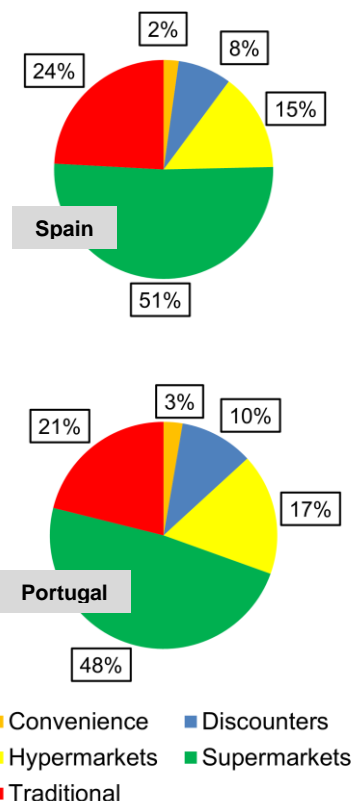
Source: Euromonitor

position in a quite fragmented market and it replaces part of the bargaining power to suppliers lost with the sale of France. Moreover, the multiples agreed upon should not harm DIA in terms of Balance Sheet since the cash outflow is expected to be less than the cash-in coming from the sale of DIA France (later on analyzed).

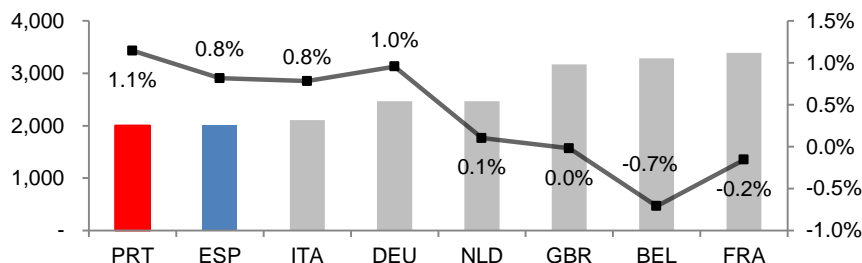
### Market & Competitors

**Spain and Portugal food retail markets** have been two of the most affected among a sample of 8 European countries (Exhibit 27), aside with Italy and the Netherlands, due to the already analysed loss of consumer purchasing power. Additionally, in 2013 these were the countries with the lowest food retail sales per capita. According to Euromonitor estimates, however, in the following years market size will grow in volume and in per capita terms this growth will be one of the largest in this sample: CAGR between 2013 and 2019 of 1.1% and 0.8% in Portugal and Spain, respectively.

**Exhibit 29 – Retail Formats Market Share (2013)**



Source: Euromonitor



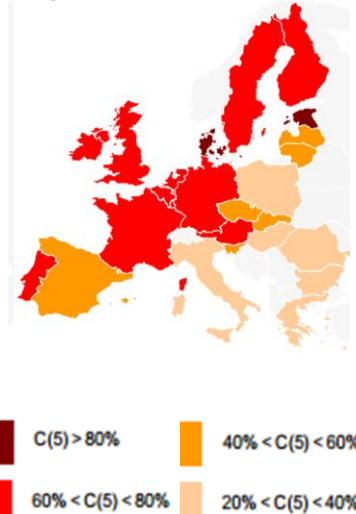
**Exhibit 28 – Market Size per Capita (2013 values and CAGR13-19)**

Source: Euromonitor

Regarding the **performance of different formats** operating in both these retail markets, we may see that supermarkets is the winning format in terms of sales, and this format market share has risen between 2008 and 2013 in Iberia, especially in Portugal, to near half of the market size in both countries. The following format includes traditional types of retailing, whose market share declined approximately 3 pp in both countries, a trend that is likely to continue in the future as large retail chains, benefiting from scale economies, continue to expand. Hypermarkets come in third place, with a loss of 2 pp during the same period. The two smallest formats are convenience and discount stores. The former saw a large decline of market share in Iberia, explained by the inability of consumers to pay a premium for proximity in the last few years. Discounters, however, saw the largest market share growth in Spain, of 18.7%, representing 8% of the market in 2013. In Portugal, this market share is 10.5%, also improved since 2008. According to an European Commission report<sup>9</sup>, there are a few main factors shaping the **European retail market landscape**: low prices became a key priority; specific product categories (fresh products, organic food, etc.) gain more shelf space due to the ageing population and the increased

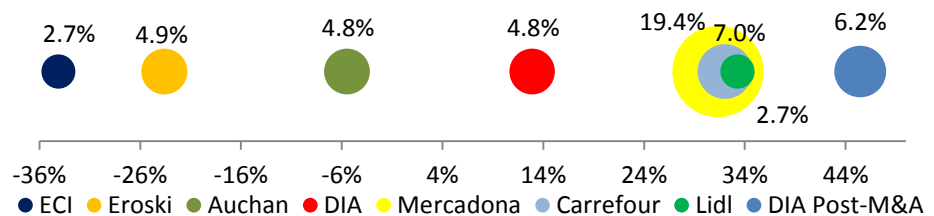
<sup>9</sup> “The Economic Impact of Modern Retail on Choice and Innovation in the EU food sector”, Sept. 2014, European Commission.

**Exhibit 30 – Market Share of 5 Largest Retailers (2011)**



Source: Planet Retail

interest in health and environmental issues; modern retail is seeing a strong development, especially discounters (81% growth of floor space between 2000 and 2011); increase of PL market share across most product categories, having as main causes the good value for money perception from consumers, the opportunity of higher margins for retailers, and a solution for using spare capacity by manufacturers. The **Spanish food retail market** is still very fragmented when compared to other Euro-Area countries (see Exhibit 30): the 5 main players held in 2013 41% of the market share<sup>10</sup>. This percentage was lower in previous years, and the consolidation trend is expected to continue. DIA is one of the retailers taking advantage of this tendency to gain market share, as the two acquisitions of 2014 demonstrate. The main players are depicted in Exhibit 31, being the dot's size the market share of each company in 2013 and the correspondent value in the X-axis its market share growth between 2008 and 2013.



**Exhibit 31 – Spain Market Shares: Value 2013 and Growth 08-13 (X-axis)** Source: Euromonitor

In 2013, **DIA's market share was 4.8%**, an increase of 12.9% since 2008, being in that year the #4 retailer in Spain. This position has improved since then considering El Árbol and Eroski acquisitions: a pro-forma market share of DIA in 2013 would be 6.2% (contribution to enhance market share of 0.9 pp from El Árbol and 0.5 pp from Eroski stores). Now we analyse some characteristics of the other 5 main players:

- Mercadona: it had a market share of 19.6% in 2013, with a substantial growth of 31% since 2008, being the undisputable dominant player in Spain. It is a family-owned business since foundation with a strong focus on offering the customer low prices and a complete private-label portfolio. In 2013, Mercadona operated 1467 supermarkets (the company's only format) with an average size of 1,369 sqm, having net sales of EURm 18,034 growing at a CAGR 10-13 of 5.8%. Since 2010, it kept on increasing the number of stores at a pace of app. 51 stores per year. In its most recent report, Mercadona reinforced its focus on the client (called "The Boss" by the company) and described its recent investment in a new model for selling fresh products that included introducing daily orders and training employees to closely monitor and handle these goods. Despite the outstanding sales performance, Mercadona's EBITDA margin has been slightly decreasing since 2010 at an average of 0.23 pp per year to 5.9%, retaining less 3.7 pp of EBITDA margin than DIA.

**Exhibit 32 – DIA Spain vs. Main Competitors (2013)**

	Sales (€b)	CAGR 10-13	EBITDA mg
DIA	4.4	1.4%	9.6%(*)
Mercad.	18.0	5.8%	5.9%
Carref.	6.5	7.8%	-
Eroski	4.6	-7.8%	3.8%
Lidl	2.5	0.6%	-

(\*) Data for DIA Ibeira

Source: Company Data and Euromonitor

<sup>10</sup> Market shares were calculated using Euromonitor statistics for retail chains net sales and the grocery retail market size.

- Lidl: with the largest CAGR 08-13 (5.9%) of market share amongst the described companies, in 2013 Lidl represented 2.7% of the Spanish grocery retail market and its store network comprised 528 supermarkets (relatively stable since 2010). This company is an important competitor for DIA for its discounter positioning and high growth seen in recent quarters. According to Kantar Worldpanel, such growth is not a result from the cycle but instead of an improved reputation of product quality – comparing to 2013, more 10% of households see Lidl as a trustful chain and more 6% believe in its products quality. Lidl was nominated in 2014 by the consulting firm GfK (survey on 16,000 consumers) as the retailer with the best fruit and vegetables offer, among the six largest retailers in Spain, based on the assortment offered and its presentation. Lidl has currently going on expansion (2014 – 20 new stores) and remodelling projects that include enlargement of the sales area per store (from 800-1000 sqm to 1000-1200 sqm) and improvement of the fresh products segment.
- Carrefour: with a market share of 7% in 2013 and EURm 6,524 worth of sales, the French retailer operates through three formats – hypermarkets (172 stores), supermarkets (118 stores) and convenience (166 stores) – having recently increased its focus in the latter two due to the slower performance of hypermarkets. It offers packaged food and also non-food product lines, being positioned in the middle of the price spectrum in Spanish retailing. The convenience stores Carrefour Express are a direct competitor for DIA. With an average size of at least 100 sqm (closer to DIA Fresh stores than to DIA Market stores), Carrefour estimates these stores to have sales of EUR 1,000 per sqm (versus DIA Spain average of EUR 3,308).
- Eroski: this company is still one of the largest retailers in Spain, with a market share of 4.9%, but it has been downsizing in recent years both in terms of number of stores (1596 in 2009 to 1454 in 2013) and sales (CAGR10-13 of -7.8%, according to Euromonitor data). It operates supermarkets (app. 93% of the network), hypermarkets and 19 Cash & Carry stores. Eroski has been struggling with too much debt but in 2014 the company reached an agreement with its main financial creditors to restructure its capital structure by 2019, subject to the divestment of non-strategic assets (the sale of Eroski stores to DIA is part of this plan).

In the **Portuguese food retail market** the main retailers have a much wider presence in the market: Jerónimo Martins, Sonae, Intermarché, Auchan and Lidl have a joint market share of 56%, versus 47.5% in 2008. The six main players are:

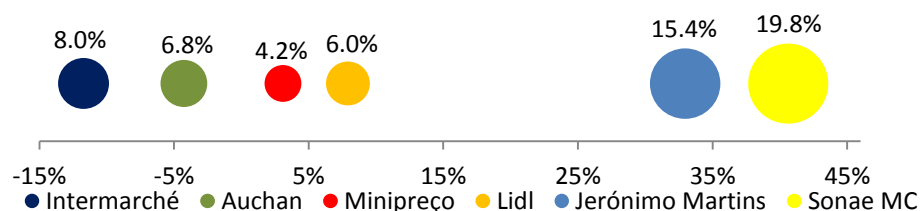


Exhibit 33 – Portugal Market Shares: Value 2013 and Growth 08-13 (X-axis) Source: Euromonitor

**Exhibit 34 – DIA Portugal vs. Main Competitors (2013)**

	Sales (€b)	CAGR 10-13	EBITDA mg
DIA	0.8	-0.8%	9.6% (*)
Sonae MC	4.1	8.3%	7.6%
JMR	3.2	5.4%	5.8%
Lidl	1.2	1.3%	-

(\*) Data for DIA Ibeira

Source: Company Data and Euromonitor

With a **market share of 4.2%**, **Minipreço** was in 2013 the #6 player, only 3.1% above 2008's share. Unlike Spain, in Portugal DIA lost market share in recent years (value in 2011/2012 was 4.4%). The key aspects of growing DIA competitors are:

- **Sonae MC**: the #1 Portuguese player for several years, Sonae has been since 2011 widening the gap to the next player's market share that stood in 2013 at 4.4 pp. Sonae specializes in hypermarkets (285 stores in 2013), supermarkets (250 stores), convenience (35 stores) and franchisings (14 stores). One important differentiating tool for Sonae MC is its loyalty card owned by 75% of the Portuguese households that accounts for more than 90% of sales. With sales continuously growing throughout the crisis period, the company recently reported its interest in growing the convenience channel in large cities, which could potentially harm DIA's sales.

- **Jerónimo Martins**: the company's retail segment has in Portugal supermarkets (376 stores) and cash & carry stores (41 stores) that represent a market share of 15.4%, 33% more than in 2008. Thanks to the very wide network of stores located at city centres, JMR has an important competitive advantage of proximity, which aligned to the investment in competitive prices and promotions the company has been implementing (such as the May 2012 50% discount), increased its popularity and brand awareness amongst customers. Accordingly, sales have been presenting a solid growth (CAGR 10-13 of 5.4%) and EBITDA margin, even if lower than DIA or Sonae MC's margin, has improved 1.1 pp from 2012 to 2013.

- **Lidl**: with a growth of 7.9% since 2008, Lidl discount stores in Portugal had in 2013 a market share of 4.2%. Placed in urban areas, the 241 stores offered very competitive prices, supported by PL sales that represent 70% of total sales, and a narrow SKUs portfolio. The fall in disposable income of Portuguese consumers made these favour discount stores, being Lidl the #1 in the country. One important difference to DIA stores is the fact that most Lidl stores have parking lots which contributes to larger purchasing volumes per visit, even if the store is not as close as DIA's. Lidl's network is slowly expanding, with 6 new stores in the last three years.

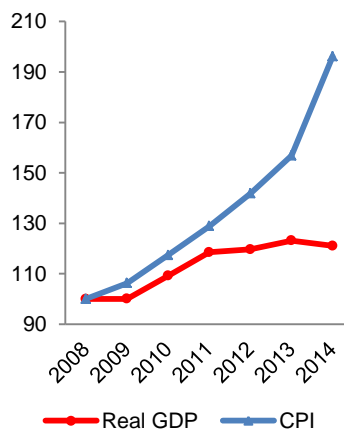
The **implications for DIA of the current market trends and competitive scenario** in Portugal and Spain should be carefully considered by the company. On the one hand, discounters continue to grow and such trend is positive for DIA's outlook as the firm implements a strategy of combining a discount model with proximity that suits a few characteristics of Iberian consumers such as the lower income and the highest proportion of aged individuals. The fact that the company has also been investing in perishables is once again very good because aligned with proximity it may contribute for DIA to become the store that clients visit almost every day for their fresh products daily needs. Nevertheless, DIA faces strong competitors in both markets that have been increasing market share at very healthy rates. We see Mercadona and Lidl, in Spain, and Jerónimo Martins and Lidl, in Portugal, as the retailers for DIA to be

cautious about. Lidl is an important competitor for operating the same broad format as DIA and even though it has a greater market share only in Portugal, also in Spain the discounter showed a relative growth above that of DIA. The parking lots, perishables quality and low prices are in our view important sources of growth that shall continue supporting it in the future. Mercadona has a very solid competitive position in Spain for several years now, continuously improved and reinforced. Positive for DIA is its convenience advantage, in which neither of these two Spanish competitors has specialized. In Portugal, Jerónimo Martins, for operating small supermarkets at city centres may also contribute for DIA's market share to continue falling in the following quarters. Accordingly, we believe that DIA may need to invest more in these two countries to keep up with the competition: in Spain, trying to appeal to customers need for quality and different categories, as the economy starts to see signs of improvement and confidence is now at better levels; in Portugal, where economic growth is still not that clear and DIA is losing market share, investing in lower prices, as suggested in previous conference calls, is in our vision one possible way to revert the losing trend. Such moves would result in a more encouraging sales growth rate that we see now as a priority, even if at the expense of a lower margin in the short-term. As DIA is already very efficient in terms of margin amongst its peers in Iberia, it should focus on ensuring the business sustainability in the long-term by grabbing competitors' market shares.

## Emerging Markets (EM)

### Macroeconomic Scenario

**Exhibit 35 – Argentinian Real GDP and CPI Indexes**



Source: IMF, Bloomberg

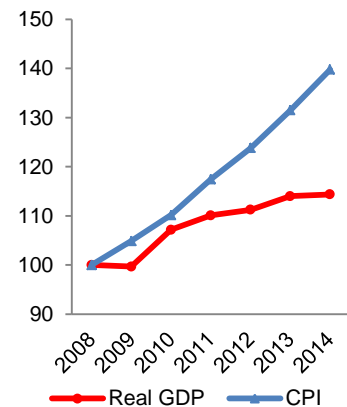
**Argentina's economy** has been going through ups and downs for several years, with periods of high economic growth followed by strong recessions. Recently this volatility continues to show: real GDP growth in the years between 2009 and 2012 was 0.1%, 9.1%, 8.6% and 0.9%. Past the 2008 financial crisis, growth was mainly created by expansionary fiscal and monetary policies, which resulted in a rise of inflation in 2010 to 10.5%. Concerns of an overheated economy led the Government to a period of fiscal austerity in 2012, the same year in which capital controls were imposed to increase dollar reserves and slowdown capital flight and measures to restrict imports and exports, through taxation, were created. Earlier in 2014, the Government was forced to devalue the Argentinian peso and in June it faced what some rating agencies called of a "selective default" on around USDb 30 related to debt restructurings, far from the USDb 100 bonds it did not pay in the previous default of 2001. For the slowdown of growth, with an end-of-year estimated real GDP drop of 1.7%, are also contributing the fall of commodity prices in global markets and the lower consumer and business confidence on Government policies. Inflation is

expected to hit 25%<sup>11</sup>. For 2015, the IMF estimates real growth to remain negative (at -1.5%) and inflation is expected to rise further in 2015 and 2016, to 26.2% and 28.3% (Bloomberg data), respectively. The mandate of the current President will end up in late-2015. Some economists believe that the perspectives could change afterwards if a new ideology more prone to attract foreign investment is implemented.

The **Brazilian economy** was considered a very attractive one in terms of growth since the beginning of the millennium based on positive steps taken towards fiscal sustainability and market liberalization, which made the business environment of the country more competitive and better suited for foreign investment. Brazil faced however a light recession after the financial crisis with real GDP falling 0.3% in 2009. It was then one of the first Emerging countries recovering with a growth of 7.5% in the following year, the highest for the last 25 years. On the downside, the rise of inflation to 6.6% in 2011 led the government to ease the expansionary policies. Between 2011 and 2013 growth slowed down to a CAGR of 2.1% but unemployment gradually improved until 5.4% in 2013, while inflation continued a bit high at 6.2% in 2013. During 2014, real GDP drop in the first half, influenced by the slowdown in China's growth and the fall in commodities prices, while a small expansion of 0.1% QoQ in the 3<sup>rd</sup> quarter place the country out of technical recession, even though growth was negative on a YoY basis (-0.2%). This small growth being a result of government spending rather than private or external demand and the fact that the recently re-elected President and respective economic team foresee the need to tighten fiscal and monetary policy, to correct both the high inflation and fiscal imbalances, are not good indicators for growth in the near-future. Accordingly, the IMF forecasts a 0.3% increase in real GDP for 2014 (with inflation at 6.3%) and a CAGR 15-19 for the same indicator of 2.5%. Nevertheless, we believe such growth will be achieved if the Government indeed takes fast action to correct the economic imbalances.

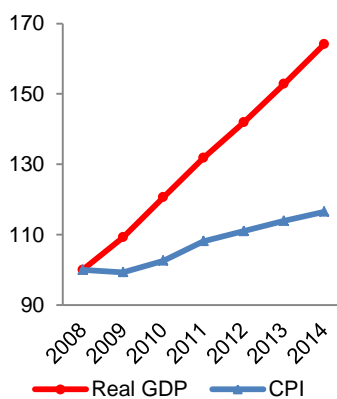
The **Chinese economy** has shown for several years high real GDP growth rates resulting from a less centralized and more market-oriented business environment and from its major role in global trade markets: China became in 2010 the world largest exporter. Additionally, it continues to be a country with great growth potential and the one with the lowest GDP per capita among DIA geographies. The financial crisis did not set China apart from its growth but it did slow it down from 14.2% in 2007 to 9.6% and 9.2% in 2008 and 2009, respectively. As US and Europe countries entered into recession, the fall in China's external demand was sharp and exports fell 17% in 2009, according to the IMF. At the time, China's strong fiscal position allowed the Government the adoption of active fiscal and loose monetary policies aiming the increase of consumption and business investment (even though a substantial portion

**Exhibit 36 – Brazilian Real GDP and CPI Indexes**



Source: IMF, Bloomberg

**Exhibit 37 – Chinese Real GDP and CPI Indexes**



Source: IMF, Bloomberg

<sup>11</sup>According to Bloomberg, as there has been some controversy regarding Argentinian authorities underreporting inflation. Other private sources forecast inflation at 39.9%.

of the credit expansion was directed to the stock and real estate markets). Resulting inflation and other imbalances, such as the very low level of private demand in GDP, as well as external factors continued to slowdown growth after 2010 to a CAGR of 8.2% until 2013. The structural transformation of the economy growth model from exports-based to consumption-based on the demand side and from industry to services sector on the supply side is expected to continue decelerating GDP growth in the short/medium-term: IMF forecast for 2014 is 7.4% and thereafter a CAGR of 6.7% until 2019. Inflation, currently at 2.3%, shall stabilize in the forecasting period until 3%, while unemployment estimates project a 4.1% rate.

### Performance

In EM, the potential for food retailers and the favourable economic scenario of the last four years were reflected in the growth of sales. **Gross sales** of DIA increased between 2010 and 2013 at a CAGR of 11.5%. This growth can be split in same store sales, store openings and FX movements:

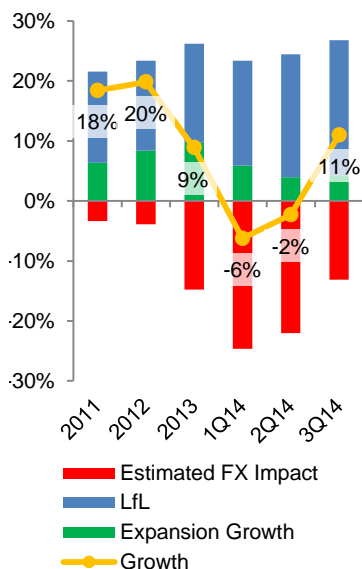
$$(1 + \text{growth}) = (1 + \text{LfL}) * (1 + \text{expansion growth}) * (1 + \text{FX impact}),$$

$$\text{where } (1 + \text{FX impact}) = (1 + \text{EUR growth}) / (1 + \text{local currency growth})$$

The FX impact is calculated through a weighted average of each countries FX impact weighted by their respective gross sales proportion. As Exhibit 38 demonstrates, and unlike Iberia, in EM the largest portion of growth comes from already established stores capability to increase their sales: LfL was on average 15.5% between 2010 and 2013 and in 2014, so far, the mean of the first three quarters LfL is 20.2%. Expansion growth has also an important impact and DIA claimed in the last conference call to be “opening more stores than ever” in EM. In Argentina, DIA opened 195 stores between 2011 and 2013 and in Brazil this figure amounts to 259. During 2014, DIA added a new region (Bahia) with 14 million habitants to its store network in the country (states of São Paulo, Minas Gerais and Rio Grande do Sul). In China, DIA moved out from the region of Beijing in 2012 but in 2013 the company increased its store network in Shanghai by 45 stores. FX has been the one factor contributing for sales growth slowdown, especially in the first half of 2014. The Brazilian real and the Argentinean peso have been depreciating to the Euro in almost all quarters since 2011. Even though the Chinese yuan became more valuable during the same period, this effect does not compensate for the other currencies depreciation due to the lower weight of China in this segment.

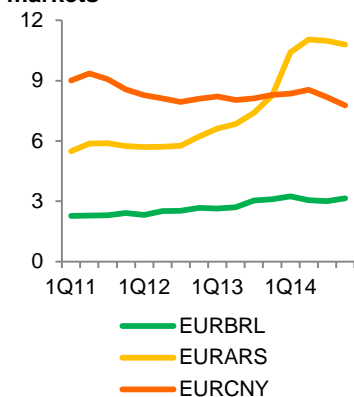
Breaking down this **growth across countries**, and considering sales in local currency, we see that China is the country with the worst sales performance, hitting a negative sales growth in the last reported quarter for the first time. Brazil went through a growth slowdown during the first half of the year and recovered in the 3<sup>rd</sup>

**Exhibit 38 – Emerging Markets Gross Sales Growth Breakdown**



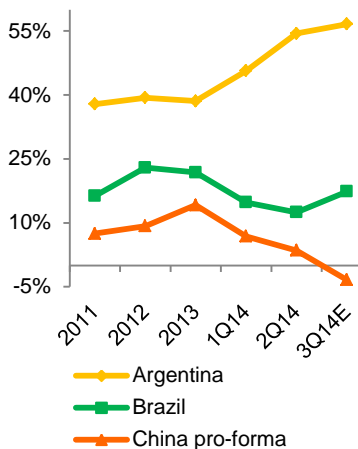
Source: Company Data

**Exhibit 39 – FX rates in DIA's markets**



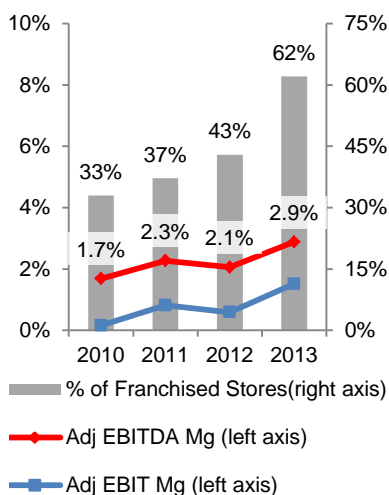
Source: Company Data

**Exhibit 40 – Emerging Markets Gross Sales Growth per Country**



Source: Company Data

**Exhibit 41 – Emerging Markets Operating Indicators**



Source: Company Data

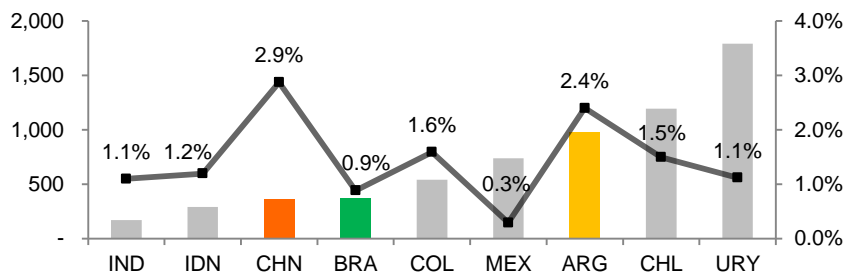
quarter. Overall gross sales increased at a CAGR of 20.3% between 2010 and 2013 in the country. Argentina stands out for the very high growth (CAGR of 38.6% between 2010 and 2013) with an average YoY growth during the first three quarters of 2014 of 52.2%. Being this a high inflation country explains in part the high rates. DIA mentioned in its results presentation that market shares in EM have been improving at very dynamic rates, especially in Argentina and Brazil.

A less efficient cost structure in EM is reflected in much lower **operating margins** than the ones in Iberia: this gap was on average 6.4 pp and 4.7 pp for results before and after depreciation, respectively, between 2010 and 2013. Still, and as in Iberia, margins have been improving in recent years being in 2013 equal to 2.9% (before depreciation) and 1.5% (after depreciation). EBITDA and EBIT increased at a CAGR of 28.8% and 130.1% (from a very low base of EURm 3.3). The positive trend is explained by the same factors as in Iberia, being one of them the increase in franchises proportion in the store network that was of 29 pp between 2010 and 2013 to 62% (15 pp above Iberia).

Considering restructuring costs (of approximately 0.5% of sales) as operating and an average notional income tax rate weighted by each country sales, EM operating gross cash flow in 2013 amounts to EURm 57, having increased since 2010 at a CAGR of 24.5%. Working capital requirements stood during this period at app. EURm -268. As DIA moved out from Turkey in 2013, a country that in the previous year represented 14.5% of this segment sales, Capex is positive in that year. In 2011 and 2012, however, Capex was 116.1% and 109.9% of EBITDA, reflecting DIA's focus on expanding in these regions that is in part financed by each year's operating results. **Free cash flow** in Emerging Markets was EURm 20.4, 8.9 and 47.5 between 2011 and 2013.

### Market & Competitors

The plotted Emerging economies from China, Brazil and Argentina geographical regions all present **food retail sales per capita** denominated in EUR below any of the previously analysed Western Europe countries.



**Exhibit 42 – Market Size per Capita (2013 values and CAGR13-19)** Source: Euromonitor

China and Brazil levels are approximately 1/6 and 1/5 the one from Spain, respectively, while Argentina is about half. Euromonitor estimates that China will be

the market with the largest growth of food retail sales per capita, with a CAGR of 2.9% between 2013 and 2019. For Argentina and Brazil this same growth is forecasted to be 2.4% and 0.9%, respectively. According to an Euromonitor report<sup>12</sup>, not only Emerging economies drove global growth of grocery retail after the crisis, due to their increasing middle class, but this growth is also expected to carry on and soon change the market size breakdown between these countries and Advanced economies: the former represented 46% of the global market in 2013 and is expected to be 50% in 2018. Rising incomes in these economies and reduction of poverty, as well as the rapid urbanisation, created new needs in terms of grocery retailing. In Latin America, consumers continued to rely on traditional retail formats (independent small grocers), while the shift to more modern forms of retailing shall benefit convenience formats growth rather than supermarkets. This latter format is already seeing a growth slowdown in this region explained by its greater maturity, strong competition from discounters/cash & carry stores, and demographic shifts (more urban population and smaller average households). China, on the other hand, is one of the biggest markets for hypermarkets in terms of value and growth prospects, especially in the country more rural areas where car ownership (that influences the number of visits to large stores) is expected to increase.

**Exhibit 43 – DIA Latin America vs. Main Competitors (2013)**

<u>Argentina</u>	Sales (ARS b)	CAGR 10-13
Carrefour	21.1	25.7%
Cencosud	19.0	25.9%
Coto	11.6	26.1%
La Anónima	9.4	25.7%
Wal-Mart	8.2	28.2%
DIA	7.7	38.2%
Average	12.8	28.3%

Regarding **market consolidation**, one common characteristic to DIA's Emerging Markets is the high level of market fragmentation: the largest five retail chains have in Argentina, Brazil and China a joint market share of 18.9%, 32.7% and 9.0%, respectively. This scenario stands as a potential medium/long-term opportunity for market consolidation and market share gains through M&A in these economies, especially in the ones where DIA has already a relevant size (in the Latin America countries DIA is part of the top 5 largest retailers).

In **Brazil and Argentina** DIA has a similar position: market share of 2.1% and 2.2% that increased since 2008 61% and 53%, respectively. Some of the largest competitors are also common between the two Latin countries:

- Wal-Mart: with a market share of 2.2% in Argentina and 9.4% in Brazil, this company top position in Latin America relied on a first-mover advantage and low prices. Wal-Mart owns 557 stores in Brazil and 105 in Argentina, operating under several brands and retail formats, namely hypermarkets and discounters. Its presence in the convenience segment is not relevant and sales growth between 2010 and 2013 were slightly below other main player's average.

- Carrefour: it has a market share of 5.8% in Argentina, where it is the #1 player, and 5.9% in Brazil, where sales have been underperforming since 2010 compared to other peers. Carrefour operates hypermarkets, supermarkets and convenience

Source: Company Data and Euromonitor

<sup>12</sup>“Emerging Markets: Overview and Growth Opportunities in Grocery Channels”, Sept. 2014, Euromonitor Passport

stores, being the number of stores in each region in 2013 equal to 460 and 790, respectively. In Argentina, Carrefour acquired in 2012 a retail chain and then converted its stores to Carrefour Express convenience stores, ending 2013 with 250 stores under this format.

- Cencosud: the publicly listed Chilean retail chain is the largest local player in Latin America and has a market share of 5.2% in Argentina and 4.3% in Brazil. With high sales growth in both countries between 2010 and 2013, especially in Brazil, Cencosud operates in Argentina and Brazil 270 and 181 supermarkets and 20 and 39 hypermarkets, respectively.

Another relevant operator in Brazil is Casino Guichard-Perrachon (11% market share), the largest country player. It is part of a French retail chain that acquired in 2012 a controlling interest of Grupo Pão de Açúcar. Casino had in 2013 a food retail network of app. 1000 stores (138 hypermarkets, 381 supermarkets, 75 cash & carry stores and 406 convenience stores). In the last group presentation, the company describes the steady expansion of discount and convenience formats and the strengthening of its positioning in premium formats, among others, as the main strategic priorities. Coto and La Anónima, with 3.2% and 2.6% market share, respectively, are other relevant players in Argentina, even though both chains specialized in the supermarket format. Between 2010 and 2013, these companies present a sales growth in line with the remaining largest players.

In **China** the competitive landscape is very different, with a wide number of operators each with low market shares. The largest food retail chain is part of the China Resources Enterprise group and had in 2013 a market share of 2.9%. It is followed by three already mentioned international groups (Auchan, Wal-Mart and Carrefour) with a joint market share of 4.7%. DIA does not have a relevant market share in the Chinese market since it only operates in the region of Shanghai, where it owned 348 stores in September 2014.

**The implications for DIA of the current market trends and competitive scenario** in Emerging Markets seem positive for us, particularly in Brazil and Argentina. In both countries DIA sales have been growing largely above the main players' average (7.2 pp and 9.9 pp, respectively) and the company operates a format that has attractive growth prospects for the described current customers' profile and needs. There are however other players with a larger established network that have already recognized this potential market trend and incorporated it in their strategies, namely Carrefour and Casino. In China, DIA is not quite comparable to the other main peers as it still has a very premature positioning for being located in only one region. Even though sales growth has been below main players' average, the fact that this is the country with the largest retail market growth potential could be an opportunity for DIA to maintain another source of revenue growth.

**Exhibit 44 – DIA China vs. Main Competitors (2013)**

China	Sales (CNY b)	CAGR 10-13
China R.E.	118.1	17.1%
Auchan	84.0	15.2%
Wal-Mart	65.1	9.3%
Bailian	55.9	7.0%
Carrefour	40.6	2.4%
DIA (*)	1.4	3.9%
Average	60.8	9.1%

(\*) Pro-forma excluding Beijing

Source: Company Data and Euromonitor

## Valuation

To determine a target price for DIA's shares for year-end 2015 we used a Sum-of-the-Parts (SOTP) approach to account for the different levels of risk present in Iberia and EM, considering as well the value coming from the recently acquired El Arból and Eroski stores, cash flows arising from France sale and value of non-operating assets and liabilities. We set a base case using a Discounted Cash Flow (DCF) analysis. To assess the robustness of our target price and how it is affected by changes in the main drivers established we set a scenario analysis for different sales growth and margins, running as well a sensitivity analysis to the cost of capital and terminal value growth rate.

### France Transaction

A cash inflow of EURm 283 was received in November 2014 for the entire share capital of DIA France, which was added to the Cash line of the Balance Sheet. Because there have not been results announcements since then, we tried to assess the existence of any capital gain loss at the consolidated level to be accounted in the P&L: we estimated the book value of France by subtracting to the last reported assets and liabilities held for sale (3<sup>rd</sup> quarter 2014) the value in these lines before France was classified as discontinued (a few remaining assets of Beijing are still held for sale), taking France's book value of equity as the difference. The result was EURm 212, which is close to the equity value received and led us to assume that the impact would not be relevant for accounting adjustments. However, DIA mentioned that at the France individual accounts level it was generated a fiscal credit of approximately EURm 180 for Spain's income tax in the following years. The last fiscal reform for 2015 and 2016 proposed by the Spanish Parliament determines that companies will only be allowed to use the loss carry forward deduction up to 60% of the taxable income of the year with no time limit. Assuming DIA Spain net income will remain in line with past years and considering the fiscal reform restriction, we broke down the fiscal credit in the years in which it will be used and calculated its NPV in 2015 using Iberia's WACC.

### Main Drivers

In order to forecast DIA's cash flows we selected a set of inputs that are critical to determine the main components of the DCF analysis:

- **Growth of net sales under banner per sqm:** we analysed the past relationship between this variable and nominal food retail sales growth of each country<sup>13</sup>, estimating for the future the pp difference between the two considering our vision

<sup>13</sup> Except for Argentina that had not enough information available (we used only CPI and real GDP growth).

**Exhibit 45 – Past Annual Correlation**

	Food CPI vs. CPI	Food Retail Sales vs. Real GDP
Spain	0.9	0.8
Portugal	0.8	0.6
Brazil	0.7	0.1
China	1.0	0.6

Source: IMF, Bloomberg

regarding DIA's competitiveness and ability to outperform or underperform the market sales growth. We estimated each country's nominal food retail sales by forecasting food CPI and real food retail sales growth, based on their correlation with CPI and real GDP growth (Exhibit 45) and IMF estimates for these two variables.

- **Number and size of new stores:** at this point we incorporated information regarding DIA's expansion plans, as well as the typical store size, at each of the geographies. Adding the new stores area to last year total sqm, we calculated total net sales under banner:  $\text{Net Sales UB}_t = (\text{Net Sales UB/Sqm})_t * \text{Total Sqm}_t$ .

- **Percentage of franchisees' stores:** we considered the negative impact that increasing the proportion of franchisees is likely to have in the growth of DIA's net sales, as this change in the format portfolio is one strategy DIA has continuously discussed for future years.

- **Franchisees margin:** we analysed the relationship throughout time between the estimated franchisees margin as a % of net sales under banner and the percentage of franchisees' stores. A lower ratio between these two variables should indicate a loss of franchisees negotiating power<sup>14</sup>. We estimate such evolution in a conservative manner, i.e. assuming that the risk of DIA having to give up on some margin for franchisees, as previously explained, is a likely outcome. By subtracting the franchisees margin to net sales under banner we obtained DIA's net sales.

- **EBITDA margin:** we tried to adjust this margin considering three main aspects: (i) the impact of a rise in the proportion of franchisees, (ii) our vision concerning the need to invest in prices to keep sales growing and (iii) possible efficiency gains or losses. As there is no information per segment regarding the different P&L lines between net sales and EBITDA, being therefore difficult to quantify the impact of the several described shocks on the margin, we will compare our estimates with the market consensus for Western Europe and EM listed peers margins.

In the following sections we describe our **base case** and the inputs selected for each country/store format, mentioning the macroeconomic forecasts and our strategic/competitive vision for DIA, and presenting as well the main DCF components results.

For **Iberia** (Exhibit 46), a relatively mature market, we forecast a gradual slowdown on the number of new stores. Even though expansion continued relatively high in recent years in Spain, DIA mentioned in the last conference call that some of the new stores were cannibalizing established store sales, so we see the slowdown as the most likely outcome. Clarel, on the other hand, should continue to expand in the following years as announced by the company.

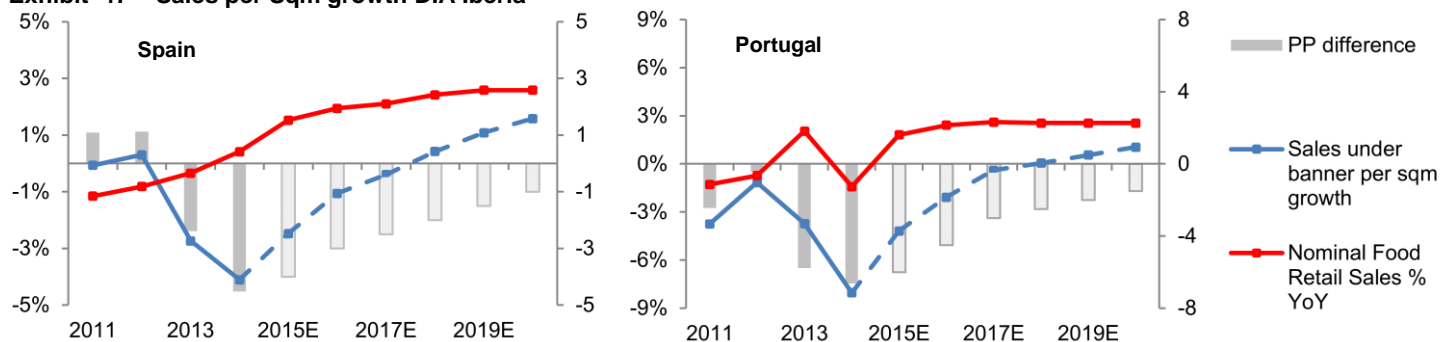
<sup>14</sup> Notice that important effects are not being considered in this analysis such as the different store sizes and level of sales between COCO's and franchises, etc. This information is not disclosed by DIA.

**Exhibit 46 – Iberia Sales Main Drivers**

	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E	CAGR15-20
Net Sales (EUR m)	5118	5284	5124	5102	5083	5084	5086	5120	5164	0.2%
DIA Spain	4317	4260	4149	4134	4120	4106	4099	4129	4167	0.2%
New Stores	98	87	104	75	50	30	15	10	0	
Sales/Sqm growth	0.3%	-2.7%	-4.1%	-2.5%	-1.1%	-0.4%	0.4%	1.1%	1.6%	
% of Franchisees	45%	47%	50%	53%	55%	57%	60%	60%	60%	
DIA Portugal	800	774	708	685	669	670	670	672	679	-0.2%
New Stores	19	19	2	5	5	5	2	2	0	
Sales/Sqm growth	-1.2%	-3.7%	-8.0%	-4.2%	-2.1%	-0.4%	0.1%	0.6%	1.1%	
% of Franchisees	42%	45%	46%	47%	49%	50%	52%	55%	55%	
Clarel	-	250	267	283	294	308	317	319	318	2.4%
New Stores	-	1189	47	50	50	50	40	30	20	
Sales/Sqm growth	-	-	4.5%	1.8%	2.3%	2.4%	2.7%	2.9%	2.9%	
% of Franchisees	-	2%	2%	2%	5%	7%	10%	15%	20%	

As analysed, net sales under banner per sqm growth has been particularly disappointing in Iberia both for macroeconomic and competitive reasons: the pp difference between this indicator and food retail sales nominal growth (Exhibit 47) has been consistently falling in both countries. For coming years, as nominal food retail sales growth is expected to recover, we forecast sales per sqm to rise as well and the pp difference between the two to be less significant, continuing nevertheless negative. This gradual improve of sales growth reflects the forecast of a more positive market outlook for grocery retailers in Iberia and of DIA investment in prices and in product quality/customer perception, through store refurbishment and offer of a more diversified product portfolio. For the recent bad performance, we believe it may take a while for DIA to obtain this alternative strategic positioning and push growth into positive levels, forecasting the years of 2017/2018 to be the turning point. Clarel growth was estimated considering Spain and Portugal expected nominal GDP growth and each country's weight in the total sales of the brand. With Clarel, DIA explored another income source besides grocery retailing that is more correlated to GDP and thus positive for the following years, especially for the previously described good acceptance it has achieved within customers and investment on store upgrade and more affordable prices.

**Exhibit 47 – Sales per Sqm growth DIA Iberia**



Source: IMF, Bloomberg, Analyst Estimates

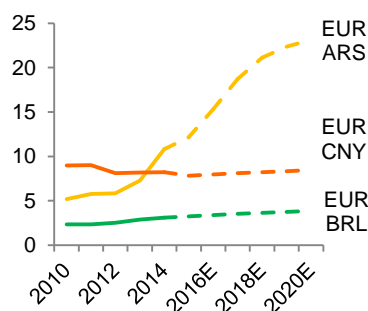
The **Emerging Markets** countries (Exhibit 48) Brazil and Argentina shall see DIA sales continuing to grow, in the short-term from new stores openings and in the long-term from improving sales per sqm growth. We believe that there is still space in these markets for DIA to grow because our market analysis supports that modern retailing formats, namely convenience stores, are likely to increase their market share and benefit from the rising of middle classes and urbanization. An increased penetration of PL products in EM, as previously described, would be another upside for DIA sales growth. We estimated stores openings in the following years in line with past years expansion as this has been a strategy announced by the firm. In China it is still uncertain if DIA will be able to expand into new cities across the country besides Shanghai, as other competitors are doing, since DIA has already exited Beijing and larger formats are expected to benefit more from the country's growth.

**Exhibit 48 – Emerging Markets Sales Main Drivers**

	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E	CAGR15-20
Net Sales (EUR m)	2867	2662	2713	3023	3222	3378	3473	3566	3648	3.8%
DIA Argentina (ARSm)	5566	7669	11385	15608	21824	28334	32910	35974	38741	19.9%
EURm	952	1052	1051	1283	1424	1514	1557	1608	1675	5.5%
New Stores	64	84	58	50	40	30	15	10	5	
Sales/Sqm growth	25%	21%	36%	29%	34%	25%	14%	8%	7%	
% of Franchisees	28%	70%	70%	70%	70%	70%	70%	70%	70%	
Δ FX	-2%	-20%	-33%	-11%	-21%	-18%	-11%	-5%	-3%	
DIA Brazil (BRLm)	3391	4135	4637	5036	5456	5890	6270	6604	6845	6.3%
EURm	1351	1441	1492	1557	1613	1675	1725	1764	1775	2.7%
New Stores	81	106	113	100	90	80	60	40	10	
Sales/Sqm growth	-0.2%	-4.3%	-5.6%	-3.1%	-0.9%	-0.1%	0.8%	1.8%	2.8%	
% of Franchisees	56%	62%	61%	62%	64%	66%	67%	69%	70%	
Δ FX	-7%	-13%	-8%	-4%	-4%	-4%	-3%	-3%	-3%	
DIA China (CNYm)	1203	1378	1392	1428	1479	1528	1572	1622	1681	3.3%
EURm	148	169	170	182	186	189	191	194	199	1.7%
New Stores	-	45	7	20	20	15	10	5	2	
Sales/Sqm growth	8.3%	1.0%	-1.7%	-3.1%	-0.3%	0.9%	1.7%	2.6%	3.6%	
% of Franchisees	44%	48%	47%	48%	50%	52%	54%	57%	60%	
Δ FX	11.0%	-0.7%	-0.6%	4.9%	-1.6%	-1.7%	-1.5%	-1.5%	-1.4%	

Source: Company Data, Analyst Estimates

**Exhibit 49 – Estimated FX Rates**

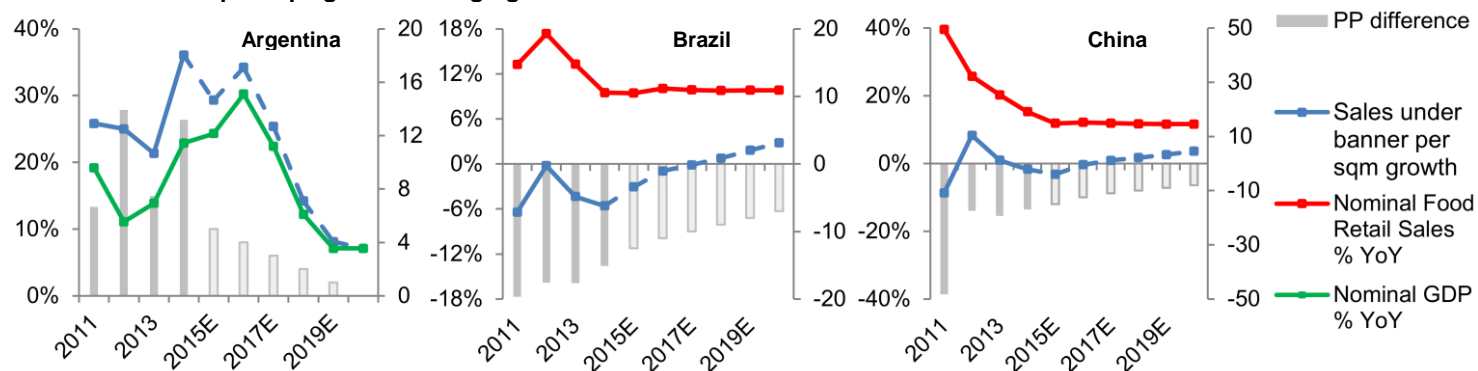


Source: Bloomberg, Analyst Estimates

Regarding the forecast of the evolution of net sales under banner per sqm growth (Exhibit 50), and as mentioned, we analysed the relationship with the market nominal food retail sales growth for Brazil and China and with the nominal GDP growth for Argentina due to the lack of data. Argentina is the country where the evolution of this variable has been the most positive, in part driven by inflation (which is expected to trend to more healthy levels in the long-run). We estimate DIA sales per sqm to keep growing above nominal GDP and that difference to become smoother in time. In China and Brazil, where recently sales per sqm growth dropped to negative numbers, in line with the slowdown of nominal food retail sales, we estimate the gap between DIA stores sales per sqm growth and food retail sales growth to widen. The

FX depreciation shall continue to negatively impact the growth of sales in Emerging Markets, creating a difference of 14.4 pp and 3.7 pp in the CAGR 2015-20 of sales in local currency vs. EUR in Argentina and Brazil, respectively. We estimated future FX rates through the relative purchasing power parity<sup>15</sup> and IMF and Bloomberg inflation estimates (Exhibit 49).

**Exhibit 50 – Sales per Sqm growth Emerging Markets**



Source: IMF, Bloomberg, Analyst Estimates

We forecast **EBITDA margin** to decrease 0.6 pp between 2013 and 2017, mainly driven by Iberia, and then to slightly improve as the weight of EM becomes greater (22% of EBITDA in 2020 vs. 13% in 2013). Despite the drop in margins, we expect overall EBITDA to grow at a CAGR of 1.6% between 2015 and 2020.

**Exhibit 51 – Iberia and Emerging Markets Adjusted EBITDA**

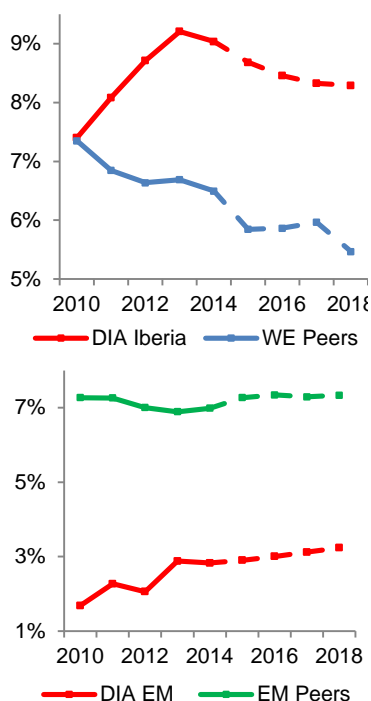
	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E	CAGR 15-20 / pp growth
Adj. EBITDA (EUR m) (*)	516	581	565	555	555	560	570	584	600	1.6%
Margin	6.5%	7.3%	7.2%	6.8%	6.7%	6.6%	6.7%	6.7%	6.8%	-0.03
Iberia	457	505	488	468	458	454	457	462	467	0.0%
Margin	8.9%	9.6%	9.5%	9.2%	9.0%	8.9%	9.0%	9.0%	9.0%	-0.12
% of total	89%	87%	86%	84%	83%	81%	80%	79%	78%	-6.33
Emerging Markets	59	77	77	88	97	105	112	122	133	8.7%
Margin	2.1%	2.9%	2.8%	2.9%	3.0%	3.1%	3.2%	3.4%	3.6%	0.74
% of total	11%	13%	14%	16%	17%	19%	20%	21%	22%	6.33

Source: Company Data, Analyst Estimates

(\*) Excluding France

For the estimation of each region's margin we modelled three different effects: franchisees contribution (assumption that each pp increase in the proportion of franchisees leads to a 0.02 pp higher margin), efficiency gains and price investment. Iberia's margin is expected to improve for the estimated greater proportion of franchisees but to be negatively affected by the need to invest in prices in this region, especially in 2015, to recover market shares and by a relatively less efficient supply chain due to the increased offer of fresh products. This estimate is in line with the

<sup>15</sup> This parity establishes a relation between two countries expected inflation rates and the change in their exchange rates, assuming that the latter will vary in order to maintain each currency's purchasing power and compensating for inflation differentials. For instance:  $EURARS_{t+1}/EURARS_t = (1 + \Pi_{ARS})/(1 + \Pi_{EUR})$

**Exhibit 52 – Peers EBITDA Margin Market Consensus**


Source: Bloomberg, Analyst Estimates

median of the market consensus for Western European (Exhibit 52) listed peers margin. In EM, besides franchisees proportion increasing, we expect further improvements in margins due to efficiency gains, especially in the long-run, as DIA becomes able to focus less on store openings and more on improving its supply chain management and on exporting to the possible extent its good operating practices from Iberia to Argentina, Brazil and China. The market also expects overall margins in this region to increase in future years.

Other operating indicators, such as **Depreciation** and **Restructuring Expenses** were estimated considering their historical value as a % of Fixed Assets and net sales, respectively. We forecasted **NWC** based on past days of sales, assuming that DIA will be able to maintain its efficiency at managing inventories, payables and receivables. Days of inventories may be negatively affected by the mentioned change in the product portfolio but that impact can be offset by the higher proportion of franchisees<sup>16</sup>. We separated the forecast of required **Capex** (Exhibit 53) in two different components: investment required for opening new stores and for established stores remodelling/on-going expenses<sup>17</sup>. The former was calculated considering the estimated Euro amount per new sqm of floor space times each year's new area and the latter as a % of each region total revenues. This percentage is set at 2% in both geographies in the long-run, while in Iberia we forecast it to be slightly higher in the near-future due to the analysed required investment in this region to improve store's and quality customer perception. For Emerging Markets, we have also added an adjustment for FX changes, considering the forecasted annual appreciation of each foreign country's currency weighted by the proportion of Capex required for each country (this proportion was calculated splitting the two types of Capex by the three regions considering new stores and net sales at each of them).

**Exhibit 53 – Iberia and Emerging Markets Capex**

	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E	CAGR 15-20
Capex (EUR m) (*)	239	315	299	283	242	229	212	197	181	-8.6%
Iberia	133	187	190	194	157	144	130	117	106	-11.3%
Openings (%)	25%	36%	37%	21%	19%	15%	10%	8%	3%	
Remodelling/On-going (%)	75%	64%	63%	79%	81%	85%	90%	92%	97%	
Emerging Markets (Const. FX)	106	128	108	94	95	93	88	83	76	-4.2%
FX Adjustment	-	-	-	-5	-10	-8	-5	-3	-2	
Openings (%)	27%	36%	40%	38%	35%	30%	22%	15%	5%	
Remodelling/On-going (%)	73%	64%	60%	62%	65%	70%	78%	85%	95%	

Source: Company Data, Analyst Estimates

(\*) Excluding France

Despite the poor performance in recent years, conditioned by its financial situation, **EI Árbol** results (Exhibit 54) should be positively influenced by the integration into DIA's operations, especially from a cost perspective: the adoption of DIA's superior

<sup>16</sup> When products arrive to the franchisee store they are no longer DIA's assets.

<sup>17</sup> Historically, DIA provides this breakdown each quarter but not per segment (we have assumed the same percentage of Capex for openings vs. remodelling across the firm).

logistics, possible transfer of some stores to the franchise format, access to better pricing conditions with suppliers and employees dismissals (DIA plans to dismiss 259 employees, 106 from management positions) should all contribute to improve El Árbol's EBITDA margin. On the revenue side, the impact should be smoother. DIA announced it may need to carry out EURm 80 Capex in store remodeling and purchase of fixed assets, a cash outflow that will be divided between 2015 and 2016 and could increase store visits. Moreover, pricing policy will also be readapted and 1100 DIA's PL products were already integrated in El Árbol shelves. DIA plans to increase this offer to 1700 in 2015, discontinuing El Árbol's PL, an exchange that may contribute to improve gross sales under the new stores as DIA's PL is much more penetrated in the Spanish PL market (with a 17% market share) than El Árbol's (1% market share). Accordingly, we forecast net sales to drop in 2014 as a result of the tough competitive and macroeconomic environment in Spain, growing overall at a CAGR of 0.3% between 2015 and 2020. Results should start to improve at the EBITDA level for the efficiency upgrades earlier mentioned, and so we expect El Árbol EBITDA margin to gradually approach the levels of the benchmark Mercadona from 2019 onwards, as the store operational model is more complex than that of DIA due to the greater offer of fresh products.

#### Exhibit 54 – Eroski and El Arbol Main Drivers

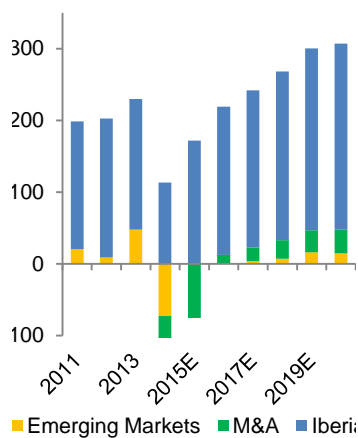
	2014E	2015E	2016E	2017E	2018E	2019E	2020E	CAGR 16-20 / pp growth
Net Sales (EUR m)	121	895	1088	1083	1088	1100	1117	0.7%
Sales/sqm growth	-6.1%	-4.5%	-1.1%	-0.4%	0.4%	1.1%	1.6%	2.6
El Arbol	121	691	684	681	684	692	703	0.7%
Eroski	-	204	404	402	404	408	415	0.7%
Adjusted EBITDA (EURm)	2	22	37	47	58	66	67	16%
El Arbol	2.0%	2.0%	3.0%	4.0%	5.0%	6.0%	6.0%	3.0
Eroski	-	4.0%	4.0%	5.0%	6.0%	6.0%	6.0%	2.0

Source: Company Data, Analyst Estimates

(\*) Results consolidated only from November 2014 onwards (2014E sales: EURm 724)

(\*\*) Results consolidated only from July 2015 onwards (2015E sales: EURm 408)

**Eroski** sales could be positively impacted by a wider product offer if DIA leverages on the bigger size of these stores to showcase new categories and fresh food. On the cost side, DIA said one should expect further gains in terms of procurement associated with the increased scale in Spain, especially because Eroski's market share in 2013 was just 4.7% and spread over a much wider number of SKU's. Moving forward, we estimate a fall in sales during 2015 for this should be a period of integration into DIA's store network. Similarly to El Árbol, we expect Eroski stores to reach an EBITDA margin of 6% but sooner, supported by DIA efficiency in logistics. Regarding NWC, we have assumed for both types of stores the same days of NWC of DIA. For El Arbol, as mentioned, Capex is estimated at EURm 40 in 2014 and 2015, while for Eroski we have assumed an investment of EUR 100 thousand to rebrand each store. In further years, Capex is assumed to be 2% of sales.

**Exhibit 55 – DIA Operating Free Cash Flow (EURm) (\*)**

(\*) Excl. France

Source: Company Data, Analyst Estimates

Our analysis and forecasts for Iberia, EM and new M&A stores result in a CAGR 2016-20 for **DIA's operating FCF** of 8.8% (Exhibit 55), mainly supported by Iberia's growth of 5.8%. In EM, the negative FCF in 2014 and 2015 results from the high Capex required for the aimed expansion. Under this scenario, El Abol's and Eroski transactions should enhance ex-M&A FCF only from 2016 onwards by an average of 5.8% and 3.8% per year, respectively. At the end of the forecasting period, Iberia, EM and El Arbol/Eroski stores represent 84%, 5% and 11% of the FCF, respectively. For the **growth rate of terminal value**, since an analysis of ROIC (return on invested capital) and RR (reinvestment rate) would not yield a result per segment and we believe that DIA faces different long-term growth perspectives across its segments, we have conservatively set a growth rate of 1.5% in Iberia and 2.5% in EM, reflecting once more this region growth potential in the long-run. The sensitivity of our target price to changes in both growth rates is later on presented.

### WACC Assumptions

The Weighted Average Cost of Capital (WACC) was used to discount each segment cash flows, reflecting the opportunity cost for DIA bond and shareholders weighted by the proportion of the company each owns. Exhibit 56 specifies our inputs. Two different WACC's were estimated to account for the risk profile of each segment. This differentiation was made through two main aspects: an unlevered Beta and a segment risk premium for each segment. For the **risk-free**, a measure of the alternative asset with the highest return available for investors in the absence of default and reinvestment risk, we used the last 5-years average yield of a German bund maturing in 2037. The reason to use a normalized rate<sup>18</sup> instead of a spot one is that the German government yield has hit a historical low of 1.2% that we believe to be partly artificial, i.e. caused not only by the financial crisis and its consequent "flight to quality" but also by the implementation of unconventional monetary policies by the ECB specifically targeted at leading investors to buy riskier assets.

To determine each segment's **Equity Risk Premium (ERP)** we followed a method by Aswath Damodaran<sup>19</sup> that consists on adding to a mature market risk premium (MMRP) a country risk premium (CRP) that reflects the additional risk relatively to buying US shares of investing in a non-US market, for this being either a less developed/ less liquid capital market or for the fact that the country may show some relevant macroeconomic imbalances that affect companies performance. The selected MRP of 5% reflects the average premium over the risk-free the US market provided to investors for them to incur in extra-risk. As a measure of CRP we used

**Exhibit 56 – WACC Inputs**

	Iberia	Emerging Markets
Rf	2.7%	
MMRP	5%	
Segment RP	1.7%	11.7%
Cost of Equity	8.5%	15.8%
Unlevered $\beta$	0.71	0.64
Levered $\beta$	0.87	0.78
Cost of Debt	1.0%	
Yield	1.1%	
Default Rate	0.14%	
Recovery Rate	75%	
D/E	23%	
<b>WACC</b>	<b>7.2%</b>	<b>13.2%</b>

Source: Bloomberg, Analyst Estimates

<sup>18</sup> See Duff & Phelps comment on normalizing risk-free rates: "Client Alert: Duff & Phelps Decreases US Equity Risk Premium Recommendation to 5.0%", March 20, 2013.

<sup>19</sup> "Equity Risk Premiums (ERP): Determinants, Estimation and Implications – The 2013 Edition", Aswath Damodaran, March 2013.

**Exhibit 57 – Country and Segment Risk Premiums**

	Weight	CRP
Iberia	-	1.7%
Spain	85%	1.5%
Portugal	15%	2.8%
Emerging Markets	-	11.7%
Brazil	55%	2.5%
Argentina	39%	26.5%
China	6%	1.3%

Source: Bloomberg (as of Dec/14)

current USD CDS spreads for 10-year senior corporate bonds. For each segment we have weighted the CRP by the different countries sales proportion (Exhibit 57).

According to DIA reports, the company **capital structure** is adjusted each period through dividends payment, capital reimbursement, debt issuance, etc. on a debt-ratio basis, measured as Net Debt to Adjusted EBITDA. At each year-end since the IPO, this ratio has been kept at 1 and we assumed that DIA will continue targeting this same level, which according to our estimates of yearly enterprise value leads to a stable capital structure throughout the forecasting period of 23% Debt-to-Equity. The level of Net Debt was adjusted in 2014 and 2015 to the cash flows associated with the sale of France and M&A in Spain, leading to a post-transactions ratio of 0.7 in 2014 (no relevant impact in the following years).

The **cost of equity** was estimated through the Capital Asset Pricing Model (CAPM)<sup>20</sup> using for each segment the median of peers unlevered Beta. As there is not a large number of publicly listed retailers operating in DIA's countries, we considered as comparables companies operating in Western Europe and in EM<sup>21</sup>, resulting in an unlevered Beta of 0.71 and 0.64, respectively. These Betas were levered considering the firm's target capital structure and a debt Beta of zero.

DIA's debt structure consisted of bank loans until July 2014 when the firm issued senior unsecured notes amounting to EURm 500 with 1.5% annual coupon rate. For the **cost of debt** we have computed the expected return for debtholders<sup>22</sup> using the following inputs: spot yield rate of the listed debt instrument, DIA's default probability as determined by Bloomberg, assumed recovery rate of 75%.

**Exhibit 58 – Different Scenarios and Operating Indicators**

	Very bad	Base	Very good
2020 Sales per Sqm growth			
Spain	1.1%	1.6%	2.6%
Portugal	0.6%	1.1%	2.1%
Clarel	1.4%	2.9%	3.4%
Argent.	4.1%	7.1%	8.1%
Brazil	1.8%	2.8%	4.3%
China	1.6%	3.6%	4.6%
El Arbol	1.1%	1.6%	2.6%
Eroski	1.1%	1.6%	2.6%
2020 EBITDA Margin			
Iberia	7.8%	9.0%	10.1%
EM	3.2%	3.6%	4.9%
El Arbol	4.0%	6.0%	7.0%
Eroski	5.5%	6.0%	8.0%

Source: Analyst Estimates

**Sensitivity Analysis and SOTP Results**

To the described base case, which we considered to be statistically more relevant and reflecting our market/company analysis, was given a probability of 75%. As there are important risks to be considered, we set other two possible and in our view less likely scenarios (see Exhibit 58 for the long-term operating drivers in each scenario):

- **Very bad scenario** (probability of 15%): in this scenario DIA would not be able to follow the Iberian macroeconomic improvement and the growth potential of Emerging Markets, resulting in depressed sales per sqm growth relative to the base case. In Iberia, DIA's margin would further decrease but remain above competitors, while integration of M&A stores would not create the expected efficiency synergies. Implementation in EM of more efficient supply chain management techniques would not be feasible and EBITDA margin would stay stable.

- **Very good scenario** (probability of 10%): in this very optimistic scenario DIA sales

<sup>20</sup> Modified with Damodaran's adjustment for CRP: Cost of Equity = Riskfree + Lvrdbeta \* (MRP + Segment RP)

<sup>21</sup> The selected peers for Iberia are Tesco, Carrefour, Metro, Ahold, Morrison, Casino, Sainsbury, Delhaize and Colruyt. The selected peers for EM are Magnit, BIM, Migros, X5 Retail, Exito, Walmex, CBD, Cencosud, Soriana, Chedraui, Eurocash and Jerónimo Martins.

<sup>22</sup> Cost of Debt = [(1 + yield) \* (1 - default rate) + (recovery rate \* default rate)] - 1

**Exhibit 59 – Scenario Analysis**

	Very bad	Base	Very good
<b>Enterprise Value (EURm)</b>			
Iberia	3,389	4,210	5,059
EM	40	100	319
El Arbol & Eroski	271	513	730
<b>Target Price (EUR)</b>			
15E			

Source: Analyst Estimates

per sqm in Spain would grow at the same forecasted rate as the market food retail sales and Clarel sales would follow GDP growth. The need to invest in prices would not impact EBITDA margins as badly as in the base case and DIA would manage to continue optimizing its operational structure. Penetration in EM would improve and margins would approach peers levels in this region. El Arbol and Eroski margins would surpass the benchmark Mercadona's margin.

Exhibit 59 presents the enterprise value of each segment and the target price under the different scenarios. Considering the defined probabilities, the **target price** we estimate is 6.53, implying a total expected return of 23% considering the payment of a dividend of EUR 0.53 during 2015 (respective to 2014 earnings). Exhibit 60 summarizes our results and specifies the cost of capital we considered for each line:

**Exhibit 60 – Valuation Summary**

	EV (EUR m)	Per share (EUR)	WACC	#Shares (m)
Iberia	4,171.7	6.4	7.2%	651.1
Emerging Markets	113.3	0.2	13.2%	Last Share Price (EUR)
Sale of France	167.2	0.3	7.2%	5.72
Eroski & El Arbol	498.6	0.8	7.2%	3M Avg Share Price (EUR)
Non-Operating Assets/Liabilities	-103.0	-0.2	-	5.30
<b>DIA Enterprise Value</b>	<b>4,847.9</b>	<b>7.4</b>	<b>-</b>	<b>Total Expected Return</b>
Net Debt (15E)	595.0	0.91	-	23.4%
<b>Target Price</b>	<b>4,252.9</b>	<b>6.53</b>	<b>-</b>	<b>Recommendation</b>
Dividends (15E)	342.6	0.53	-	Buy

Source: Analyst Estimates, Bloomberg

**WACC and g Scenario Analysis**

Because of the large portion of each segment's enterprise value that the terminal value represents, we present our base case target price sensitivity to changes in the growth rates defined. The impact of changes in the cost of capital is also analysed.

**Exhibit 61 – WACC and g Sensitivity Analysis**

Iberia	g %	WACC %				
		5.0%	6.0%	7.2%	8.0%	9.0%
	0.5%	8.9	7.1	5.7	5.0	4.3
	1.0%	9.9	7.8	6.1	5.3	4.5
	1.5%	11.3	8.6	6.59	5.7	4.8
	2.0%	13.0	9.6	7.2	6.1	5.1
	2.5%	15.5	10.8	7.9	6.6	5.5

Emerg. Markets	g %	WACC %				
		11%	12%	13%	14%	15%
	1.5%	6.62	6.60	6.58	6.57	6.56
	2.0%	6.63	6.61	6.59	6.58	6.56
	2.5%	6.64	6.62	6.59	6.58	6.57
	3.0%	6.65	6.62	6.60	6.59	6.57
	3.5%	6.66	6.63	6.61	6.59	6.58

Source: Analyst Estimates

For the low weight of EM in DIA's enterprise value, changes in its WACC or growth rate have a marginal effect on price. Iberia's inputs have on the other hand a much larger impact: with WACC ranging from 6% to 8% and the growth rate from 1% to 2%, our base case target price varies between EUR 5.3 and 9.6, implying nevertheless a positive total expected return between 1.9% and 77%, respectively.

## Financial Statements

Income Statement (EURm)	2012	2013	2014E	2015E	2016E	2017E
<b>Gross Sales</b>	11679	11476	9402	10646	11167	11407
<b>Net Sales</b>	10124	9844	7958	9020	9393	9545
<b>Adjusted EBITDA</b>	610	642	576	585	595	611
<b>Depreciation</b>	-279	-267	-187	-208	-224	-227
<b>Non-recurring items</b>	-43	-49	-43	-41	-42	-42
<b>EBIT</b>	288	326	337	328	326	337
<b>Net Financial Expenses</b>	-33	-40	-42	-40	-40	-41
<b>Associates</b>	1	1	0	0	0	0
<b>Income Tax</b>	-102	-95	-84	-77	-73	-76
<b>Discontinued Operations</b>	-7	5	26	0	0	0
<b>Minorities</b>	11	13	0	0	0	0
<b>Net Profit</b>	158	209	237	211	213	221

Balance Sheet (EURm)	2012	2013	2014E	2015E	2016E	2017E
<b>Non-current Assets</b>	2202	2240	1859	2136	2176	2200
PPE & Other Intangibles	1657	1647	1201	1292	1329	1350
Goodwill	423	454	307	307	307	307
El Arbol & Eroski Non-current Assets	-	-	223	409	412	414
<b>Current Assets</b>	1203	1131	2012	1081	1094	1106
Inventories	527	545	451	467	478	487
Trade and Other Receivables	180	210	172	178	182	185
Cash & Equivalents	350	262	425	279	279	279
El Arbol & Eroski Current Assets	-	-	54	87	86	86
<b>Total Assets</b>	3404	3370	3871	3217	3271	3306
<b>Non-current Liabilities</b>	769	839	410	480	487	495
Long-Term Debt	553	701	359	429	436	445
<b>Current Liabilities</b>	2488	2347	2934	2343	2381	2415
Short-Term Debt	427	212	489	429	436	445
Trade and Other Payables	1759	1787	1374	1425	1456	1484
El Arbol & Eroski Current Liabilities			120	193	191	190
<b>Total Liabilities</b>	3257	3187	3344	2823	2868	2911
<b>Equity</b>	148	184	528	394	403	395

Cash Flows Iberia (EURm)	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E
<b>Net Sales</b>	5118	5284	5124	5102	5083	5084	5086	5120	5164
Spain	4317	4260	4149	4134	4120	4106	4099	4129	4167
Portugal	800	774	708	685	669	670	670	672	679
Clarel	-	250	267	283	294	308	317	319	318
<b>Adjusted EBITDA</b>	457	505	488	468	458	454	457	462	467
adj EBITDA Margin	8.9%	9.6%	9.5%	9.2%	9.0%	8.9%	9.0%	9.0%	9.0%
Depreciation	-157	-153	-154	-154	-161	-160	-157	-153	-146
Restructuring Expenses	-11	-18	-23	-26	-25	-25	-25	-26	-26
<b>EBIT</b>	289	334	311	288	271	269	275	284	295
EBIT Margin	5.6%	6.3%	6.1%	5.7%	5.3%	5.3%	5.4%	5.5%	5.7%
<b>Notional Income Tax</b>	-87	-95	-88	-75	-66	-65	-67	-69	-72
Joint Tax Rate	30%	28%	28%	26%	24%	24%	24%	24%	24%
Tax Adjustments	-24	-6.5	0.5	-	-	-	-	-	-
<b>NOPLAT</b>	178	233	224	213	205	203	208	215	224
<b>Gross Operating CF</b>	334	385	377	367	366	364	365	368	370
<b>Δ NWC</b>	-8.1	22	-63	-2.2	-1.8	0.0	0.2	3.3	-3.5
<b>CAPEX</b>	-124	-252	-187	-194	-157	-144	-130	-117	-106
<b>Δ Other Op. Assets/Liabilities</b>	-8.4	26	-14	0.7	-0.3	-0.5	-0.2	-0.3	-0.4
<b>FCF Iberia</b>	194	182	113	172	207	219	235	253	259

Cash Flows Emerg. Markets (*)	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E
<b>Net Sales (Local Currency)</b>									
Argentina (ARS)	5566	7669	11385	15608	21824	28334	32910	35974	38741
Brazil (BRL)	3391	4135	4637	5036	5456	5890	6270	6604	6845
China (CNY)	1203	1378	1392	1428	1479	1528	1572	1622	1681
<b>Net Sales</b>	2451	2662	2713	3023	3222	3378	3473	3566	3648
Argentina	952	1052	1051	1283	1424	1514	1557	1608	1675
Brazil	1351	1441	1492	1557	1613	1675	1725	1764	1775
China	148	169	170	182	186	189	191	194	199
<b>Adjusted EBITDA</b>	59	77	77	88	97	105	112	122	133
adj EBITDA Margin	2.1%	2.9%	2.8%	2.9%	3.0%	3.1%	3.2%	3.4%	3.6%
Depreciation	-42	-36	-31	-38	-44	-48	-52	-56	-58
Restructuring Expenses	-6.4	-9.2	-13	-15	-16	-17	-17	-18	-18
<b>EBIT</b>	11	31	33	34	37	40	43	49	56
EBIT Margin	0.4%	1.2%	1.2%	1.1%	1.1%	1.2%	1.2%	1.4%	1.5%
<b>Notional Income Tax</b>	-3.3	-10	-11	-12	-13	-14	-15	-16	-19
Joint Tax Rate	32%	34%	34%	34%	34%	34%	34%	34%	34%
<b>NOPLAT</b>	7.2	21	22	23	24	27	28	32	37
<b>Gross Operating CF</b>	49	57	53	61	68	75	81	88	95
<b>Δ NWC</b>	28	-19	-19	30	19	15	9.2	8.9	-6.5
<b>CAPEX</b>	-65	1.1	-97	-89	-85	-85	-82	-80	-74
<b>Δ Other Op. Assets/Liabilities</b>	-3.4	8.2	-10	-1.6	-1.4	-1.0	-0.6	-0.4	-0.3
<b>FCF Emerging Markets</b>	8.9	47	-73	-0.1	0.8	3.8	7.0	16	15

(\*) in EURm, unless otherwise stated. From Adjusted EBITDA downwards, it includes Turkey and Shanghai

Cash Flows El Arbol & Eroski (EURm)	2014E	2015E	2016E	2017E	2018E	2019E	2020E
<b>Net Sales</b>	121	895	1088	1083	1088	1100	1117
El Arbol	121	691	684	681	684	692	703
Eroski	-	204	404	402	404	408	415
<b>Adjusted EBITDA</b>	2.4	22	37	47	58	66	67
adj EBITDA Margin	2.0%	2.5%	3.4%	4.4%	5.4%	6.0%	6.0%
Depreciation	-2.4	-17	-19	-19	-19	-19	-19
<b>EBIT</b>	0.1	5.5	18	28	40	47	48
EBIT Margin	0.1%	0.6%	1.6%	2.6%	3.6%	4.3%	4.3%
<b>Notional Income Tax</b>	0.0	-1.6	-4.6	-7.4	-10	-12	-13
Joint Tax Rate	30%	28%	26%	26%	26%	26%	26%
<b>NOPLAT</b>	0.0	3.9	13	21	29	35	36
<b>Gross Operating CF</b>	2.4	20	32	40	48	54	55
<b>Δ NWC</b>	0.0	-39	1.1	0.4	-0.4	-1.1	1.1
<b>CAPEX</b>	-40	-56	-22	-22	-22	-22	-22
<b>FCF El Arbol &amp; Eroski</b>	-38	-75	11	19	26	31	33

## Disclosures and Disclaimer

### Research Recommendations

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<b>Buy</b>	Expected total return (including dividends) of more than 15% over a 12-month period.
<b>Hold</b>	Expected total return (including dividends) between 0% and 15% over a 12-month period.
<b>Sell</b>	Expected negative total return (including dividends) over a 12-month period.

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