Koninklijke Ahold Delhaize NV AD (XAMS) | ★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
18.15 EUR	20.00 EUR	Medium	None	Stable	Standard	Retail - Defensive

We're Reducing Our Ahold Delhaize Fair Value Estimate by 7% to EUR 20 After Disappointing Q3

See Page 2 for the full Analyst Note from 17 Nov 2016

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Important Disclosure

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The primary analyst covering this company does not own its stock.

Research as of 17 Nov 2016
Estimates as of 17 Nov 2016
Pricing data through 02 Dec 2016
Rating updated as of 02 Dec 2016

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

Contents

Investment Thesis 28 Oct 2016

A key investor concern is whether Ahold Delhaize can make a success of its July 2016 merger. Large-scale mergers in food retail can be fraught with difficulty, as logistics can malfunction and customers can be inconvenienced by store remodellings, banner and price changes, and favourite products being dereferenced or otherwise out of stock.

We think the firm has taken a low-risk approach to merging. First, its geographies contain several adjacencies, notably in the U.S. and Benelux markets, there is limited store overlap, and Ahold Delhaize will keep all existing store banners, with each business unit functioning independently. Secondly, the EUR 500 million of expected synergies comprises only EUR 350 million or so from procurement benefits, barely 60 basis points of combined sales. This looks conservative, as we would have expected a figure in the range of 100-200 basis points. Furthermore, Ahold Delhaize will invest almost all of the benefits over and above this amount, should they arise, so there is a commitment to reinvesting in the business.

Albert Heijn, the Dutch supermarket business, is the jewel in the crown. We think it has the best margins and return on invested capital in the group, thanks to best-in-class execution, high efficiency, outstanding logistics, strong market share (35%), and a high share of sales from private-label. However, this is as good as it gets, and as Albert Heijn is not price-competitive in the Dutch marketplace relative to other players, margins could be eroded in the longer term. The U.S. business may already be at peak margins of 4%, given a more far-flung network of stores that are more expensive to service, a unionised workforce, and an already-high share of sales from private label (38% at Ahold's existing U.S. network). Besides, the U.S. market is competitive, even if this is usually localised.

We forecast unchanged underlying operating margins for the Benelux and U.S. markets (91% of sales), where growth is negligible and competition strong. There is only margin upside in the near term from the merger synergies, as we expect limited operating leverage from sluggish growth rates to be fully offset by pricing pressure.

Vital Statistics

Market Cap (EUR Mil)	23,091
52-Week High (EUR)	23.02
52-Week Low (EUR)	17.88
52-Week Total Return %	-12.6
YTD Total Return %	-9.6
Last Fiscal Year End	31 Dec 2015
5-Yr Forward Revenue CAGR %	11.2
5-Yr Forward EPS CAGR %	11.0
Price/Fair Value	0.91

Valuation Summary and Forecasts

Fiscal Year:	2014	2015	*2016(E)*	*2017(E)*
Price/Earnings	24.2	20.9	*17.0*	*14.1*
EV/EBITDA	5.6	6.5	*8.8*	*6.8*
EV/EBIT	9.5	10.9	*15.7*	*11.1*
Free Cash Flow Yield %	9.4	8.2	*6.8*	*10.2*
Dividend Yield %	3.4	2.4	*2.5*	*3.7*

Financial Summary and Forecasts (EUR Mil)

Fiscal Year:	2014	2015	*2016(E)*	*2017(E)*
Revenue	32,774	38,203	*49,124*	*62,723*
Revenue YoY %	0.5	16.6	*28.6*	*27.7*
EBIT	1,267	1,461	*1,720*	*2,433*
EBIT YoY %	-8.1	15.3	*17.7*	*41.5*
Net Income, Adjusted	594	852	*1,089*	*1,644*
Net Income YoY %	-76.6	43.4	*27.9*	*50.9*
Diluted EPS	0.64	0.99	*1.07*	*1.29*
Diluted EPS YoY %	-72.9	54.7	*7.5*	*20.9*
Free Cash Flow	2,389	1,177	*-8,824*	*2,607*
Free Cash Flow YoY %	NM	-50.7	*-849.9*	*-129.5*

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.
Analyst Note: Delhaize is integrated from July 24 2016.

Profile

Tracing its origins back to the late 19th century, Ahold Delhaize is the product of the July 2016 merger between Dutch-based Ahold and Belgium's Delhaize, both food retailers. The United States is the largest market, accounting for 62% of sales, with Ahold Delhaize being the leader on the eastern starboard. The Netherlands and Belgium account for 21% and 8% of sales, and Ahold Delhaize is in number-one and -two positions, respectively. A further 9% of sales is in central and south eastern Europe, the only business unit that is not yet mature.

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Morningstar Analysis

We're Reducing Our Ahold Delhaize Fair Value Estimate by 7% to EUR 20 After Disappointing Q3 17 Nov 2016

Ahold Delhaize, or AD, reported disappointing third-quarter results showing poor cash generation and higher net debt levels than expected, coupled with weak U.S. performance due to pricing pressure. We trim our EBIT estimates by around 3%-4% for 2016 and beyond, and reduce our fair value estimate by 7% to EUR 20. Around two thirds of this reduction is due to adjustments to our net debt balance, with one third due to weaker operating estimates.

Generally, top-line performance everywhere was reasonably good, but AD's U.S. store banners are suffering from deflation brought about mostly by lower commodity prices, but also by competitive pressure affecting Food Lion in the southeastern states, where Wal-Mart has been cutting prices. In the northeastern states, margins at Stop & Shop and Hannaford seem to have been less affected. Giant Carlisle has been cutting shelf prices more to offset for fewer promotions. This echoes our view (stated in last month's initiation report) that AD is too dependent on promotions in the U.S. market and needs to further cut shelf prices.

Margins in the Netherlands were also disappointing, but this is due to heavy investment in online businesses, including bol.com, where AD wants to further build scale, driving a wedge between itself and the competition. Top-line sales growth remained strong at 3.3%; we estimate that growth in online accounts for nearly all of this, with close to no growth from stores. Food prices also benefited from 1% inflation.

Belgium's performance was good in terms of the top line and margins, and we raise our margin forecasts. Sales are benefiting from the significant store revamp program, while earnings are benefiting from cost savings, notably lower labour costs.

Central and southeastern Europe remains on fire with strong growth in same-store sales and a good boost from new stores opening while margins are increasing. This region is only 9% of group sales, which is insufficient to drive group earnings alone.

Valuation, Growth and Profitability 17 Nov 2016

We are revising our fair value estimate to EUR 20 following disappointing third-quarter results. The new estimate is based on an 8.4% weighted average cost of capital, or WACC, and a Stage II EBI growth rate of 2.0%. Our base-case scenario involves an estimate of 2.4% organic sales growth in the long term, of which 1.6% is from same-store sales growth and 0.8% is from new stores.

Our EBIT margin forecasts are prudent: We forecast no underlying improvement in EBIT margins apart from a temporary uplift in Belgium in 2017 arising from cost savings and the benefits of the wide-reaching store renovation program currently under way, and from scale benefits in central and southeastern Europe. This is because of the intensely competitive price environment. With organic sales growing only slowly, operating leverage is expected to be low, and any benefits Ahold Delhaize can generate will likely be recycled in the form of lower prices. Besides, we feel that Ahold Delhaize needs to trim prices in the Netherlands, and also in some of its U.S. store network.

We forecast the group EBIT margin to improve from 3.5% in 2016 to 4.7% in 2020, almost all of which is driven by the merger synergies. We are assuming EUR 510 million of merger synergies are earned by 2019, a similar figure to guidance (EUR 500 million).

We expect Ahold Delhaize to remain capital-efficient, and forecast capital spending to remain low, averaging 2.5% of sales in the remaining years of this decade, similar to the 2.4% ratio held on average in the five years to 2015. Capital

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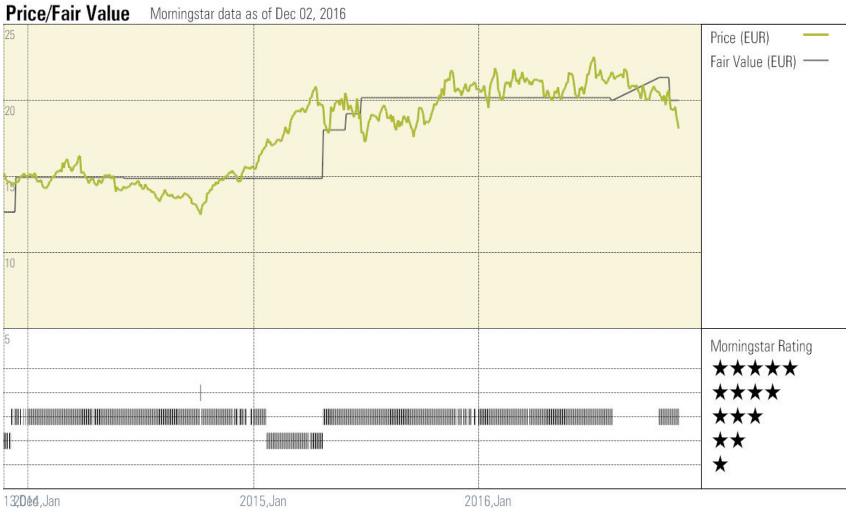
Price/Fair Value Morningstar data as of Dec 02, 2016



spending can be kept low because of Ahold Delhaize's high exposure to developed markets, where the extent of new store openings is low.

We have consolidated Delhaize from July 24, 2016, and expect it to contribute around 45% of a full year's sales in 2016. There is a significant impact on ROIC from the merger, as we see it dropping to 9.1% and 9.0% in 2016 and 2017 respectively (from 12.4% in 2015) before recovering later. These levels of ROIC are still slightly higher than Ahold Delhaize's WACC, so the company is expected to continue earning an economic profit.

Scenario Analysis

We assign a medium uncertainty rating to Ahold Delhaize. This is based on the company's low operating margin (3.5% expected in 2016), where small changes can generate large differences in our fair value estimate. However Ahold Delhaize has almost no exposure to volatile emerging markets, where currency swings can often be large and unpredictable, and can contribute to an even higher uncertainty rating.

Our bull-case scenario generates a fair value estimate of EUR 26, 30% above our base-case scenario. It is based on long-term organic sales growth of 3.8% (compared with 2.4% in our base case), composed of 2.6% same-store sales growth, coupled with new stores contributing 1.2% to sales. In this scenario, there is increased ease of store opening and faster market growth, coupled with less pricing pressure and greater customer traffic to the stores. Likewise, we are more optimistic on operating margins, which we see improving to reach 5.5% in 2020 (versus 4.7% in our base case) from 3.8% in 2015. This is a significant annual improvement of 34 basis points over the five-year period. Capital spending declines to reach 2.1% of sales in 2020, versus 2.7% in 2016. ROIC (including goodwill) improves from 12.4% in 2015 to 13.3% in 2020 (compared with 10.5% in our base case).

Our bear-case scenario generates a fair value estimate of EUR 14.50, 28% below our base-case scenario. It is based on long-term organic sales growth of just 1.0% (compared with 2.4% in our base case), composed of 0.6% same-store sales growth, and a 0.4% contribution to sales from new stores. In this scenario, the firm sees increased difficulty in opening new stores and slower market growth, coupled with increased pricing pressure and lower customer traffic to its stores. Likewise, we are less optimistic on operating margins, which we see improving only moderately to reach 3.7% in 2020 (versus 4.7% in our base case), up from 3.3% in 2016. Excluding the merger synergies, underlying margins in 2020 are lower than in 2015 or 2016. ROIC (including goodwill) declines to 8.0% in 2020 (compared with 10.5% in our base case) from 12.4% in 2015.

Economic Moat

We do not ascribe an economic moat to Ahold Delhaize because of intense price competition in the food retail sector. The company has a mostly mature market exposure (U.S. and Benelux sales account for 91% of the group), which implies sluggish top-line growth, more limited operating leverage, and more intense price competition than a food retailer with a significant emerging-market presence would experience. This limits operating margins and return on invested capital, or ROIC, even if Ahold Delhaize has respectable profitability on both of these metrics.

Switching costs are negligible in food retail, with price and store location being the two main drivers of the customer decision to shop at a particular store. Ahold Delhaize is at the start of a three-year merger integration process that will result in enhanced scale, and though we think Ahold Delhaize's synergy expectations are conservative, we feel that profitability will simply be improved in the near term rather than transformed in the long term, with price competition limiting the potential to retain these synergy benefits. Thus, while synergies will raise margin and ROIC levels in the near term, they will not limit price competition from peers, which threatens long-term profitability.

Enhanced scale will also not procure Ahold Delhaize an advantage relative to peers that is sufficient to justify a moat. The merger will see Ahold Delhaize hold number-one or -two positions in all its mature markets, and some in southeastern Europe (Greece). We think that Ahold Delhaize will need to use the benefits of this enhanced scale to reinvest in price in markets where it is currently uncompetitive (Netherlands) and where it is too reliant on promotions (U.S.) relative to practicing a strategy of everyday low prices.

In the Dutch market, Ahold Delhaize's position looks relatively unassailable, with high market share (35%), high margins (estimated at 6% for the Albert Heijn supermarkets) and ROIC, and planning controls that imply the near impossibility of peers opening sufficient numbers of new stores to challenge Ahold Delhaize's leadership position. However, we think the competition is catching up, as it is composed largely of regional chains that have yet to perfect their operating systems and customer focus. Besides, Albert Heijn is not price-competitive in the Dutch market, where it is charging 5%-6% more than number-two player Jumbo, or 1%-2% more after accounting for promotions, a gap we think is unsustainable.

In the U.S. market, consumers have a large choice of store formats for buying groceries beyond the traditional supermarkets operated by Ahold Delhaize: online, dollar stores, warehouse clubs, convenience stores, gas stations, and Wal-Mart to name but a few. Furthermore, evidence suggests that traditional supermarkets are losing share to other channels, as the choices available to customers increase and they are more likely to choose alternatives to the previous mainstream formats. There is greater ease of opening stores in the U.S., and Ahold Delhaize's stores are replicable by peers.

Moat Trend

We see no noticeable trend in Ahold Delhaize's competitive environment, and we therefore assign it a stable moat trend. The benefits from the merger synergies will raise near-term profitability and provide a buffer to intense price competition. We have no information that convinces us that competition is either intensifying or ebbing.

Ahold is a major player in e-commerce in its main markets of the U.S. and Benelux, as it entered the market early and built up strong positions over the years. It bought its U.S. online business Peapod as long ago as 2000, and we estimate it has multiplied turnover by a factor of 5 or 6 since. Peapod is the largest online grocery delivery business in the U.S., which means that Ahold Delhaize remains at the forefront of the shift to shopping for groceries online. We estimate Peapod accounts for 2% of the Ahold USA division by sales.

It is a similar story in the Netherlands, where ah.nl is a

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well-established online grocer: we estimate some 3.5% of Ahold Delhaize's Dutch grocery sales are online. The company also has a leading presence in Dutch nonfood online sales with the bol.com website, which it acquired in 2012. It generates sales of around EUR 1 billion, making it a clear leader in the Dutch market. Continued investments mean bol.com is still loss-making, but this acts as a deterrent to new entrants, while Ahold Delhaize continues to strengthen its presence in online sales.

As a result of its long-standing presence and commitment to the online channel, we feel that Ahold Delhaize will fully participate in the growth of sales from this emerging channel. As such, we do not feel that Ahold Delhaize's competitive position is threatened by the shift of sales from stores to online. In any case, this shift is taking place gradually and will only play out fully over many years. Though this entails replacing profitable store sales by unprofitable online sales, we think online profitability will improve in the long term through scale. Besides, all players in the online channel are currently confronted by the same economics of poor returns, as the online industry is currently lacking critical size and is in a strong growth phase requiring high incremental investment.

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Bulls Say/Bears Say

Bulls Say

- Ahold Delhaize boasts an almost unassailable position in the Netherlands: high market share (35%), best-in-class operating metrics and efficiency, high share of private-label, and good profitability, underpinned by a de facto bar on new stores opening.
- Ahold Delhaize was wise enough to enter the online grocery business in its infancy, enabling it build up strong positions in its markets.
- The company has mostly avoided developing the large hypermarket store format, which is underperforming in mature markets.

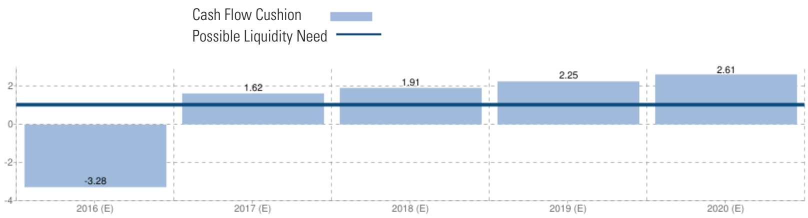
Bears Say

- There is a virtual absence of an emerging-market presence, unless central and southeastern Europe is included, which is where growth is usually far faster.
- Ahold Delhaize is still too dependent on promotional campaigns and might need to reset prices in certain markets, including the Netherlands and parts of the US.
- Growth will likely be slow, even if profitable, because Ahold Delhaize does not have an overambitious store-opening programme.

Five Year Adjusted Cash Flow Forecast (EUR Mil)

	2016(E)	2017(E)	2018(E)	2019(E)	2020(E)
Cash and Equivalents (beginning of period)	1,826	829	2,064	2,742	3,543
Adjusted Available Cash Flow	-8,505	2,883	2,287	2,377	2,406
Total Cash Available before Debt Service	-6,679	3,711	4,351	5,119	5,948
Principal Payments	-437	-401	-401	-401	-401
Interest Payments	-270	-245	-223	-203	-185
Other Cash Obligations and Commitments	-1,333	-1,644	-1,660	-1,676	-1,694
Total Cash Obligations and Commitments	-2,039	-2,290	-2,283	-2,280	-2,280

Cumulative Annual Cash Flow Cushion



Adjusted Cash Flow Summary

	EUR Millions	% of Commitments
Beginning Cash Balance	1,826	16.3
Sum of 5-Year Adjusted Free Cash Flow	1,447	13.0
Sum of Cash and 5-Year Cash Generation	3,273	29.3
Revolver Availability	—	—
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	3,273	29.3
Sum of 5-Year Cash Commitments	-11,173	—

Financial Health

Ahold Delhaize has demonstrated prudent financial management. Financial leverage has been kept at a low level, and free cash flow has been used to pay the dividend and to finance share buybacks. The target dividend payout ratio is 40%-50% of earnings, a policy that has largely been respected this decade. The company has spent several years focusing on core geographies and businesses, which has involved various sales of nonstrategic assets.Over the past decade, net debt/EBITDA has mostly been below 1.0 time, especially this decade, which is prudent. Interest coverage ratios are around 5 times, which is healthy. Given that Delhaize's net debt will be consolidated, we expect Ahold Delhaize to end 2016 with a strong balance sheet, higher net debt than the preceding year, Ahold's last year as a stand-alone entity, due to the impact of the consolidation of Delhaize's net debt and PPA adjustments.Given the free cash flow generation capacity of the combined entity, we think Ahold Delhaize could be almost net debt-free by end 2018, assuming no share buybacks or acquisitions paid in cash between now and then. We estimate free cash flow to the firm/sales will average around 3-4% in the remaining years of this decade.The company has been quite capital-efficient, with capital expenditure/sales averaging only 2.4% in the five years to 2015, which is generally less than other European peers. This might be explained by Ahold Delhaize's limited emerging-market exposure, which is more capital-intensive, and its reliance on same-store sales for growth, as opposed to opening new stores. The corollary is a relatively attractive ROIC (including goodwill), which has averaged 12% over the past decade.Ahold Dehaize is unlike peers in another respect: It mainly rents its stores, with only 20% of them owned. The 80% of stores that are rented are mostly under operating leases, which we capitalise for our calculation of ROIC.

Enterprise Risk

The main operating risk relates to the merger integration currently under way. Food retail can be a tricky business for integrating acquired companies or store chains, particularly on this scale. However, we are comforted by Ahold Delhaize's decision to maintain all existing store banners and allow them to continue running autonomously. There will therefore not be any banner changes, and presumably no significant alterations to the product assortment or pricing strategy, factors that can contribute to customer loss. A properly functioning supply chain is crucial to prevent products from going out of stock.Aside from the merger, price competition is the key business risk. We think this risk is more acute in the Benelux countries. In Belgium, Delhaize is not market leader and is competing against soft discounter Colruyt and hard discount chains, all of which have better pricing. Similarly, in the Netherlands, Albert Heijn is not price-competitive in its home market, and Jumbo is significantly undercutting it. This increases the risk of it making a major investment to reset prices in these two markets.In the U.S., there is no single competitor across all of Ahold Delhaize's store network, and competition is therefore more local or regional. Still, new store openings are easier to come by, and the Stop & Shop chain in particular has relied heavily on promotions, which account for 40% of its sales. A high share of sales from promotions is usually not sustainable; in that case, the retailer resets prices and cuts the level of promotions. This would have a negative impact on earnings.We do not think the economic cycle poses much of a threat because people still have to eat in difficult times, and stores pick up business from customers eating out less often in restaurants. They can also change ranges and introduce more budget-line items to accommodate lower-income customers and preferences for trading down. Food retail is therefore a relatively recession-proof industry.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
NA	NA	NA	NA	NA

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Vanguard Total Intl Stock Idx Fund	1.12	0.14	14,234	31 Oct 2016
iShares MSCI EAFE (AU)	0.48	0.21	—	30 Nov 2016
Thornburg Investment Income Builder Fund	0.41	0.75	5,174	31 Oct 2016
Vanguard Developed Markets Index Fund	0.40	0.18	5,071	31 Oct 2016
GMO International Equity Fund	0.36	1.49	1,956	31 Aug 2016
Concentrated Holders				
iShares STOXX Europe 600 Retail (DE)	0.01	10.91	—	29 Nov 2016
AEGON Dutch Equity Index Fund	0.02	7.57	305	31 Jul 2016
SPDR® AEX ETF	0.01	6.32	3	31 Oct 2016
Maxima	—	6.18	5	31 Oct 2016
BNP Paribas AEX Index	0.03	6.10	—	31 Oct 2016

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
Vanguard Group Inc	2.01	0.16	25,572	31 Oct 2016
Thornburg Investment Management Inc	0.41	0.75	5,174	31 Oct 2016
Dimensional Fund Advisors LP	0.42	0.30	4,081	31 Oct 2016
Henderson Global Investors (NA) Inc	0.29	1.24	3,721	31 Oct 2016
Principal Management Corp	0.26	0.57	3,293	31 Oct 2016
Top 5 Sellers				
BlackRock Investment Management (UK) Ltd.	0.80	1.00	-2,042	31 Oct 2016
Eleva Capital LLP	0.03	0.84	-637	30 Sep 2016
Allianz Global Investors GmbH – Frankfurt	0.07	0.69	-481	30 Sep 2016
Jyske Invest Fund Management A/S	0.11	0.58	-470	31 Oct 2016
Henderson Global Investors Ltd	0.22	1.70	-432	31 Oct 2016

Management 28 Oct 2016

We attribute a Standard stewardship rating to Ahold Delhaize. We base our decision on the information in Ahold's 2015 annual report, as we expect governance will evolve as the merger more fully takes shape.

Many investors will still remember the accounting scandal that broke in February 2003, which involved the overstatement of profit by some USD 500 million and a collapse in the share price, but this was a long time ago and took place under a different management team. During its subsequent recovery phase, Ahold suspended its dividend payment to hasten a return to financial health.

In recent times, management has generally been conservative. In the past decade, the company has pulled out of a number of businesses and regions that were no longer strategic, selling its U.S. food service business and its Dutch wholesale business Schuitema, and pulling out of Latin America, Asia, Poland, and Spain. It also sold U.S. store chains Bi-Lo, Bruno's, and Tops. The sale proceeds of the U.S. food service business were returned to shareholders in 2007 through an exceptional share buyback.

Even though it is still early days, we think management will ultimately make a success of the merger with Delhaize because it will lead to enhanced scale, and the manner of the integration is low-risk, with no change in banners and each business continuing to run as an autonomous unit.

Financial leverage has been kept at low levels. Ahold Delhaize has exhibited low capital intensity, partly because it has such a low exposure to emerging markets, which are more capital-intensive than developed markets due to greater opportunities to open new stores. This has limited capital spending and enabled Ahold Delhaize to return cash to shareholders through a regular dividend and share buybacks. We think the focus going forward will be on internal growth, and the priority is to integrate Delhaize and succeed the merger, so we don't think a major acquisition is likely.

The main members of the management team have solid and relevant experience for the positons they occupy. CEO Dick Boer has been in his current position since March 2011, but has been with Ahold since 1998, so he has lengthy and relevant experience of food retail and of the company. Previously he was CEO of the Dutch supermarket chain Albert Heijn for over 10 years. Prior to joining Ahold, Mr. Boer spent 17 years in retail positions with two other Dutch companies.

Jeff Carr has been group CFO since November 2011, and was previously Group CFO of FirstGroup, a transport company, and prior to that, CFO of Easyjet, the discount airline. He began his career at Unilever and has additionally occupied positons with several other leading consumer companies.

Early in October 2016, James McCann, COO of Ahold USA and a management board member, resigned unexpectedly to take up various nonexecutive and advisory roles. We do not think his departure signals anything untoward about the ongoing merger, but only time will tell. The timing appears awkward, given that McCann was only appointed to the management board in July 2016, and his resignation comes so early in the merger process.

The management board counts only seven members (up from only three prior to the merger) and is reasonably diverse in terms of gender and nationality. The executive committee comprises the management board members plus several other key executives. Board members are elected for four-year terms, which might not seem consistent with best governance practices, but the supervisory board can suspend a management board member at any time, and shareholders can also vote to dismiss a board member at the annual general meeting.

Executive remuneration is in line with food retailers of a similar size in Europe, and structured to encourage good performance: The CEO's base salary of EUR 1 million is less than a fourth of his total target earnings including bonuses. Executive remuneration is benchmarked to both European and U.S. peers in the defensive retail industry. The annual cash bonus depends on three operating metrics--net sales growth (30%), operating margin (30%), and operating cash flow (30%)--and one non-financial metric (10%) relating to a responsible retailing initiative. There is also a stock award scheme, with shares awarded based on a return on capital hurdle or a total shareholder return hurdle at vesting.

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Ahold Delhaize, or AD, reported disappointing third-quarter results showing poor cash generation and higher net debt levels than expected, coupled with weak U.S. performance due to pricing pressure. We trim our EBIT estimates by around 3%-4% for 2016 and beyond, and reduce our fair value estimate by 7% to EUR 20. Around two thirds of this reduction is due to adjustments to our net debt balance, with one third due to weaker operating estimates.

Generally, top-line performance everywhere was reasonably good, but AD's U.S. store banners are suffering from deflation brought about mostly by lower commodity prices, but also by competitive pressure affecting Food Lion in the southeastern states, where Wal-Mart has been cutting prices. In the northeastern states, margins at Stop & Shop and Hannaford seem to have been less affected. Giant Carlisle has been cutting shelf prices more to offset for fewer promotions. This echoes our view (stated in last month's initiation report) that AD is too dependent on promotions in the U.S. market and needs to further cut shelf prices.

Margins in the Netherlands were also disappointing, but this is due to heavy investment in online businesses, including bol.com, where AD wants to further build scale, driving a wedge between itself and the competition. Top-line sales growth remained strong at 3.3%; we estimate that growth in online accounts for nearly all of this, with close to no growth from stores. Food prices also benefited from 1% inflation.

Belgium's performance was good in terms of the top line and margins, and we raise our margin forecasts. Sales are benefiting from the significant store revamp program, while earnings are benefiting from cost savings, notably lower labour costs.

Central and southeastern Europe remains on fire with strong growth in same-store sales and a good boost from new stores opening while margins are increasing. This region is only 9% of group sales, which is insufficient to drive group earnings alone.

Reinitiation of Coverage With No-Moat Rating and EUR 21.50 Fair Value Estimate 28 Oct 2016

We reinitiate coverage of Ahold Delhaize following a change of analyst, with a no-moat rating and a EUR 21.5 fair value estimate, implying negligible upside potential.

The investment case hinges on the likelihood of success in the merger with Delhaize, currently in its very early stages. The company's approach is comforting: No store banners will be changed, and each business unit will continue to function autonomously within the group. Thus, customer disruption will be limited, as this normally occurs from banner and price changes and favorite products being dereferenced or otherwise out of stock.

The merger makes sense geographically, given the store network adjacencies in the Benelux and U.S. markets (91% of sales together), and in terms of improving scale. We find the firm's EUR 500 million synergy target conservative, though it is promising to reinvest any additional amount.

Merger synergies will be almost the only near-term driver of higher margins. In the longer term, Ahold Delhaize will experience slow but profitable growth, given its underexposure to fast-growth emerging markets, which will limit operating leverage. Besides, any gains will normally need to be reinvested in price, given intense price competition in food retail. We think Ahold Delhaize is too dependent on promotional campaigns in the U.S. and Benelux markets and will need to move closer to everyday

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Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
18.15 EUR	20.00 EUR	Medium	None	Stable	Standard	Retail - Defensive

Analyst Notes

low pricing which will hurt earnings initially.

AD has an almost unassailable position in the Netherlands at Albert Heijn, which benefits from best-in-class execution, high efficiency, outstanding logistics, strong market share (35%), and high private-label penetration. There is also a de facto block on new stores opening, which keeps new entrants out of the Dutch market. However, this is as good as it gets. The U.S. business may also be at peak margins, owing to its far-flung store network that is more expensive to service, a unionised workforce, and already-high private-label penetration.

Ahold's Q2 Results Impress by Overcoming Market Challenges 25 Aug 2016

Ahold Delhaize reported solid second-quarter results showing good performance across the board, with comparable-store sales growth coupled with margin expansion. The firm achieved this despite several challenges, including persistent price deflation, competitive pressures in the U.S. market, price investments across the store network, and disruption from store transformations at Delhaize Belgium. Our fair value estimate and moat rating remain under review.

Ahold's Dutch business was the main driving force this quarter. Same-store Dutch sales rose by 3.2%; we estimate that around half of this came from over 30% growth in online sales. The Dutch operating margin soared 70 basis points to 5.2% as efficiency savings more than offset investments in price and product quality improvements. Ahold continues to improve its price position relative to peers.

Ahold's U.S. business was a little more challenged: Same-store sales excluding gas increased by only 1.2%, but this was after 1.0% price deflation, concentrated in meat and dairy products. Volume trends continued to improve, but online sales growth was disappointing due to logistical issues in the Chicago area. Cost savings were fully reinvested, leaving the underlying operating margin flat at 3.9%.

Delhaize's U.S. business performed a bit better. Comparative sales increased by 2.9% after 1.0% deflation, and the underlying operating margin grew 20 basis points to 4.1%, helped by a favourable product mix and lower shrink, but offset by price investments. Delhaize Belgium increased comparable-store sales by 2.1%, gaining 30 basis points of market share, with a slight increase in its underlying operating margin.

We see some risks linked to the merger: logistical--increased shrink and out-of-stocks; operational--customer disapproval of new product ranges, physical position of products in stores and price points; and financial--part of the EUR 500 million merger synergies will need to be reinvested in the business.

Ahold Delhaize Under Review 15 Aug 2016

We are placing our fair value estimate for Ahold Delhaize under review as we transfer coverage to a new analyst. We expect to have a new fair value estimate published by Jan. 1, 2017.

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Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
18.15 EUR	20.00 EUR	Medium	None	Stable	Standard	Retail - Defensive

Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in December

Growth (% YoY)	3-Year Hist. CAGR	2013	2014	2015	*Forecast* *2016*	*2017*	*5-Year Proj. CAGR*
Revenue	*5.3*	-0.2	0.5	16.6	*28.6*	*27.7*	*11.2*
EBIT	*1.1*	-2.3	-8.1	15.3	*17.7*	*41.5*	*15.7*
EBITDA	*3.4*	-1.1	-2.6	14.9	*24.2*	*29.3*	*13.3*
Net Income	*-9.0*	124.9	-76.6	43.4	*27.9*	*50.9*	*20.2*
Diluted EPS	*-1.1*	130.8	-72.9	54.7	*7.5*	*20.9*	*11.0*
Earnings Before Interest, after Tax	*-3.5*	-5.4	-16.3	13.6	*-57.1*	*209.5*	*10.6*
Free Cash Flow	*5.7*	-86.0	NM	-50.7	*-849.9*	*-129.5*	*14.4*

Profitability	3-Year Hist. Avg	2013	2014	2015	*2016*	*2017*	*5-Year Proj. Avg*
Operating Margin %	*4.0*	4.2	3.9	3.8	*3.5*	*3.9*	*4.2*
EBITDA Margin %	*6.6*	6.8	6.6	6.5	*6.2*	*6.3*	*6.7*
Net Margin %	*3.9*	7.8	1.8	2.2	*2.2*	*2.6*	*2.9*
Free Cash Flow Margin %	*3.6*	0.4	7.3	3.1	*-18.0*	*4.2*	*-0.7*
ROIC %	*13.1*	13.1	12.2	13.9	*10.6*	*10.7*	*11.4*
Adjusted ROIC %	*11.9*	12.1	11.1	12.4	*9.1*	*9.0*	*9.7*
Return on Assets %	*8.9*	17.1	4.1	5.7	*5.1*	*6.0*	*6.3*
Return on Equity %	*23.4*	43.5	10.5	16.3	*10.5*	*10.6*	*11.3*

Leverage	3-Year Hist. Avg	2013	2014	2015	*2016*	*2017*	*5-Year Proj. Avg*
Debt/Capital	*0.40*	0.35	0.44	0.42	*0.20*	*0.17*	*0.15*
Total Debt/EBITDA	*1.65*	1.57	1.74	1.64	*1.20*	*0.84*	*0.78*
EBITDA/Interest Expense	*8.48*	7.40	8.90	9.13	*11.35*	*16.14*	*18.79*

Valuation Summary and Forecasts

	2014	2015	*2016(E)*	*2017(E)*
Price/Fair Value	1.04	—	—	—
Price/Earnings	24.2	20.9	*17.0*	*14.1*
EV/EBITDA	5.6	6.5	*8.8*	*6.8*
EV/EBIT	9.5	10.9	*15.7*	*11.1*
Free Cash Flow Yield %	9.4	8.2	*6.8*	*10.2*
Dividend Yield %	3.4	2.4	*2.5*	*3.7*

Key Valuation Drivers

Cost of Equity %	9.0
Pre-Tax Cost of Debt %	6.5
Weighted Average Cost of Capital %	8.4
Long-Run Tax Rate %	25.0
Stage II EBI Growth Rate %	2.0
Stage II Investment Rate %	14.3
Perpetuity Year	10

Additional estimates and scenarios available for download at http://select.morningstar.com.

Discounted Cash Flow Valuation

	EUR Mil	Firm Value (%)	Per Share Value
Present Value Stage I	-1,108	-6.2	-0.87
Present Value Stage II	5,409	30.5	4.25
Present Value Stage III	13,450	75.8	10.57
Total Firm Value	**17,751**	**100.0**	**13.95**
Cash and Equivalents	1,826	—	1.44
Debt	-4,039	—	-3.18
Preferred Stock	—	—	—
Other Adjustments	8,590	—	6.75
Equity Value	**24,128**	**—**	**18.97**
Projected Diluted Shares	1,272		
Fair Value per Share (EUR)	—		

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

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Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
18.15 EUR	20.00 EUR	Medium	None	Stable	Standard	Retail - Defensive

Morningstar Analyst Forecasts

Income Statement (EUR Mil)
Fiscal Year Ends in December

	2013	2014	2015	*Forecast* 2016	*Forecast* 2017
Revenue	**32,615**	**32,774**	**38,203**	***49,124***	***62,723***
Cost of Goods Sold	23,933	24,088	27,835	*36,038*	*45,889*
Gross Profit	**8,682**	**8,686**	**10,368**	***13,086***	***16,834***
Selling, General & Administrative Expenses	6,478	6,540	7,903	*10,026*	*12,878*
	—	—	—	—	—
	—	—	—	—	—
Depreciation & Amortization (if reported separately)	825	879	1,004	*1,340*	*1,523*
Operating Income (ex charges)	**1,379**	**1,267**	**1,461**	***1,720***	***2,433***
Restructuring & Other Cash Charges	85	6	122	—	—
Impairment Charges (if reported separately)	83	31	39	—	—
Other Non-Cash (Income)/Charges	-28	-20	-18	—	—
Operating Income (incl charges)	**1,239**	**1,250**	**1,318**	***1,720***	***2,433***
Interest Expense	298	241	270	*270*	*245*
Interest Income	7	6	5	*1*	*2*
Pre-Tax Income	**948**	**1,015**	**1,053**	***1,451***	***2,190***
Income Tax Expense	153	248	224	*363*	*548*
Other After-Tax Cash Gains (Losses)	1,732	-197	2	—	—
Other After-Tax Non-Cash Gains (Losses)	10	24	20	—	—
(Minority Interest)	—	—	1	*1*	*1*
(Preferred Dividends)	—	—	—	—	—
Net Income	**2,537**	**594**	**852**	***1,089***	***1,644***
Weighted Average Diluted Shares Outstanding	1,072	924	857	*1,020*	*1,272*
Diluted Earnings Per Share	**2.37**	**0.64**	**0.99**	***1.07***	***1.29***
Adjusted Net Income	2,539	594	852	*1,089*	*1,644*
Diluted Earnings Per Share (Adjusted)	**2.37**	**0.64**	**0.99**	***1.07***	***1.29***
Dividends Per Common Share	0.47	0.48	0.52	*0.57*	*0.67*
EBITDA	**2,064**	**2,129**	**2,322**	***3,060***	***3,956***
Adjusted EBITDA	**2,204**	**2,146**	**2,465**	***3,060***	***3,956***

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Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
18.15 EUR	20.00 EUR	Medium	None	Stable	Standard	Retail - Defensive

Morningstar Analyst Forecasts

Balance Sheet (EUR Mil)

Fiscal Year Ends in December	2013	2014	2015	Forecast 2016	Forecast 2017
Cash and Equivalents	2,496	1,624	1,826	*829*	*2,064*
Investments	—	—	—	—	—
Accounts Receivable	665	728	837	*1,076*	*1,374*
Inventory	1,450	1,589	1,676	*2,170*	*2,763*
Deferred Tax Assets (Current)	—	—	—	—	—
Other Short Term Assets	1,657	507	921	*930*	*940*
Current Assets	**6,268**	**4,448**	**5,260**	***5,005***	***7,141***
Net Property Plant, and Equipment	5,712	6,150	6,677	*11,006*	*11,029*
Goodwill	837	1,031	1,236	*3,887*	*3,885*
Other Intangibles	726	732	732	*4,612*	*4,594*
Deferred Tax Assets (Long-Term)	411	494	628	*634*	*641*
Other Long-Term Operating Assets	—	—	—	—	—
Long-Term Non-Operating Assets	1,188	1,283	1,347	*1,347*	*1,347*
Total Assets	**15,142**	**14,138**	**15,880**	***26,491***	***28,636***
Accounts Payable	2,387	2,655	2,800	*3,625*	*4,616*
Short-Term Debt	262	280	330	*330*	*330*
Deferred Tax Liabilities (Current)	97	22	39	*39*	*40*
Other Short-Term Liabilities	1,396	1,509	1,833	*2,485*	*3,168*
Current Liabilities	**4,142**	**4,466**	**5,002**	***6,480***	***8,154***
Long-Term Debt	3,189	3,449	3,709	*3,338*	*3,004*
Deferred Tax Liabilities (Long-Term)	123	150	110	*111*	*112*
Other Long-Term Operating Liabilities	1,168	1,229	1,438	*1,452*	*1,467*
Long-Term Non-Operating Liabilities	—	—	—	—	—
Total Liabilities	**8,622**	**9,294**	**10,259**	***11,381***	***12,738***
Preferred Stock	—	—	—	—	—
Common Stock	6,520	4,844	5,622	*5,622*	*5,622*
Additional Paid-in Capital	—	—	—	*8,977*	*8,977*
Retained Earnings (Deficit)	—	—	—	*512*	*1,301*
(Treasury Stock)	—	—	—	—	—
Other Equity	—	—	—	—	—
Shareholder's Equity	**6,520**	**4,844**	**5,622**	***15,111***	***15,900***
Minority Interest	—	—	-1	*-1*	*-2*
Total Equity	**6,520**	**4,844**	**5,621**	***15,110***	***15,898***

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Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
18.15 EUR	20.00 EUR	Medium	None	Stable	Standard	Retail - Defensive

Morningstar Analyst Forecasts

Cash Flow (EUR Mil)

Fiscal Year Ends in December	2013	2014	2015	Forecast *2016*	*2017*
Net Income	2,537	594	853	*1,088*	*1,643*
Depreciation	825	879	1,004	*1,340*	*1,523*
Amortization	—	—	—	—	—
Stock-Based Compensation	—	—	—	—	—
Impairment of Goodwill	—	—	—	—	—
Impairment of Other Intangibles	—	—	—	*-698*	—
Deferred Taxes	—	—	—	*-5*	*-5*
Other Non-Cash Adjustments	-1,324	424	300	—	—
(Increase) Decrease in Accounts Receivable	—	—	—	*-239*	*-298*
(Increase) Decrease in Inventory	—	—	—	*-494*	*-593*
Change in Other Short-Term Assets	—	—	—	*521*	*-14*
Increase (Decrease) in Accounts Payable	—	—	—	*825*	*991*
Change in Other Short-Term Liabilities	-3	-21	-24	*652*	*683*
Cash From Operations	**2,035**	**1,876**	**2,133**	***2,991***	***3,930***
(Capital Expenditures)	-811	-732	-804	*-1,427*	*-1,571*
Net (Acquisitions), Asset Sales, and Disposals	-9	-190	-150	*-10,605*	*50*
Net Sales (Purchases) of Investments	2,404	-214	51	—	—
Other Investing Cash Flows	-1,305	1,245	-221	*14*	*15*
Cash From Investing	**279**	**109**	**-1,124**	***-12,017***	***-1,506***
Common Stock Issuance (or Repurchase)	-768	-2,240	-161	*8,977*	—
Common Stock (Dividends)	-457	-414	-396	*-577*	*-855*
Short-Term Debt Issuance (or Retirement)	-21	-24	-31	—	—
Long-Term Debt Issuance (or Retirement)	-73	-80	-104	*-371*	*-334*
Other Financing Cash Flows	-337	-222	-246	*1*	*1*
Cash From Financing	**-1,656**	**-2,980**	**-938**	***8,029***	***-1,188***
Exchange Rates, Discontinued Ops, etc. (net)	-48	123	131	—	—
Net Change in Cash	**610**	**-872**	**202**	***-997***	***1,235***

Koninklijke Ahold Delhaize NV AD (XAMS) | ★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
18.15 EUR	20.00 EUR	Medium	None	Stable	Standard	Retail - Defensive

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

		Price/Earnings			EV/EBITDA			Price/Free Cash Flow			Price/Book			Price/Sales		
Company/Ticker	Price/Fair Value	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)
Tesco PLC TSCO GBR	—	NM	93.5	30.2	9.8	10.4	8.7	-6.3	9.3	41.0	2.8	1.7	2.0	0.3	0.3	0.3
Carrefour CA FRA	0.92	16.9	12.8	11.8	8.1	7.0	6.5	44.7	32.9	16.6	2.0	1.5	1.4	0.2	0.2	0.2
Casino Guichard-Perrachon SA CO FRA	0.89	NM	17.0	9.5	5.8	5.9	5.0	3.3	NM	10.4	0.8	0.9	0.9	0.1	0.1	0.1
Average		16.9	41.1	17.2	7.9	7.8	6.7	13.9	21.1	22.7	1.9	1.4	1.4	0.2	0.2	0.2
Koninklijke Ahold Delhaize NV AD	**0.91**	**20.9**	**17.0**	**14.1**	**6.5**	**8.8**	**6.8**	**12.2**	**14.8**	**9.8**	**2.9**	**1.5**	**1.5**	**0.4**	**0.5**	**0.4**

Returns Analysis

		ROIC %			Adjusted ROIC %			Return on Equity %			Return on Assets %			Dividend Yield %		
Company/Ticker	Last Historical Year Total Assets (Mil)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)
Tesco PLC TSCO GBR	— GBP	5.8	5.4	6.6	6.3	5.9	7.0	-52.7	2.8	6.4	-12.2	0.5	1.3	4.6	—	—
Carrefour CA FRA	45,095 EUR	13.2	13.1	13.1	8.2	8.3	8.5	10.4	11.4	12.3	2.2	2.5	2.8	2.5	3.4	3.5
Casino Guichard-Perrachon SA CO FRA	39,833 EUR	7.3	6.8	8.8	4.6	4.3	5.7	-0.6	5.5	10.0	-0.1	0.8	1.6	12.1	7.5	7.5
Average		8.8	8.4	9.5	6.4	6.2	7.1	-14.3	6.6	9.6	-3.4	1.3	1.9	6.4	5.5	5.5
Koninklijke Ahold Delhaize NV AD	**15,880** EUR	**13.9**	**10.6**	**10.7**	**12.4**	**9.1**	**9.0**	**16.3**	**10.5**	**10.6**	**5.7**	**5.1**	**6.0**	**2.4**	**2.5**	**3.7**

Growth Analysis

		Revenue Growth %			EBIT Growth %			EPS Growth %			Free Cash Flow Growth %			Dividend/Share Growth %		
Company/Ticker	Last Historical Year Revenue (Mil)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)
Tesco PLC TSCO GBR	62,284 GBP	-2.0	-12.6	1.1	-299.8	-120.4	37.4	-389.5	-103.2	252.7	-220.7	-313.1	-90.9	-23.4	-100.0	—
Carrefour CA FRA	78,857 EUR	3.3	0.5	3.2	2.5	4.2	6.4	2.7	7.2	7.5	-177.2	-8.1	75.5	2.9	5.7	2.7
Casino Guichard-Perrachon SA CO FRA	46,145 EUR	-4.8	-9.2	4.6	-35.2	-20.0	21.2	-171.4	-307.9	79.6	34.7	167.9	-93.3	—	—	—
Average		-1.2	-7.1	3.0	-110.8	-45.4	21.7	-186.1	-134.6	113.3	-121.1	-51.1	-36.2	-10.3	-47.2	2.7
Koninklijke Ahold Delhaize NV AD	**38,203** EUR	**16.6**	**28.6**	**27.7**	**15.3**	**17.7**	**41.5**	**54.7**	**7.5**	**20.9**	**-50.7**	**-849.9**	**-129.5**	**8.3**	**8.9**	**18.6**

Koninklijke Ahold Delhaize NV AD (XAMS) | ★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
18.15 EUR	20.00 EUR	Medium	None	Stable	Standard	Retail - Defensive

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

Company/Ticker	Last Historical Year Net Income (Mil)	Gross Margin % 2015	2016(E)	2017(E)	EBITDA Margin % 2015	2016(E)	2017(E)	Operating Margin % 2015	2016(E)	2017(E)	Net Margin % 2015	2016(E)	2017(E)	Free Cash Flow Margin % 2015	2016(E)	2017(E)
Tesco PLC TSCO GBR	-4,860 GBP	-3.4	*5.2*	*5.5*	4.7	*4.4*	*4.8*	-7.7	*1.8*	*2.5*	-7.8	*0.3*	*1.0*	-5.1	*2.9*	*0.7*
Carrefour CA FRA	1,142 EUR	22.9	*23.1*	*23.3*	5.0	*5.2*	*5.4*	3.1	*3.2*	*3.3*	1.5	*1.6*	*1.6*	0.6	*0.6*	*1.2*
Casino Guichard-Perrachon SA CO FRA	-134 EUR	24.2	*24.5*	*24.7*	5.1	*4.7*	*5.2*	3.1	*2.8*	*3.2*	-0.3	*0.7*	*1.1*	3.1	*-0.8*	*1.0*
Average		14.6	*17.6*	*17.8*	4.9	*4.8*	*5.1*	-0.5	*2.6*	*3.0*	-2.2	*0.9*	*1.2*	-0.5	*0.9*	*1.0*
Koninklijke Ahold Delhaize NV AD	**852** EUR	**27.1**	***26.6***	***26.8***	**6.5**	***6.2***	***6.3***	**3.8**	***3.5***	***3.9***	**2.2**	***2.2***	***2.6***	**3.5**	***3.2***	***3.8***

Leverage Analysis

Company/Ticker	Last Historical Year Total Debt (Mil)	Debt/Equity % 2015	2016(E)	2017(E)	Debt/Total Cap % 2015	2016(E)	2017(E)	EBITDA/Interest Exp. 2015	2016(E)	2017(E)	Total Debt/EBITDA 2015	2016(E)	2017(E)	Assets/Equity 2015	2016(E)	2017(E)
Tesco PLC TSCO GBR	12,659 GBP	179.0	*156.9*	*136.8*	64.2	*61.1*	*57.8*	4.5	*2.7*	*3.8*	4.3	*5.7*	*4.4*	6.3	*5.1*	*4.8*
Carrefour CA FRA	7,628 EUR	79.2	*73.3*	*68.2*	44.2	*42.3*	*40.6*	10.3	*12.0*	*12.8*	1.9	*1.9*	*1.7*	4.7	*4.5*	*4.3*
Casino Guichard-Perrachon SA CO FRA	11,734 EUR	199.5	*130.3*	*113.4*	66.6	*56.6*	*53.1*	1.9	*2.2*	*3.8*	5.0	*3.4*	*2.6*	6.8	*6.4*	*6.2*
Average		152.6	*120.2*	*106.1*	58.3	*53.3*	*50.5*	5.6	*5.6*	*6.8*	3.7	*3.7*	*2.9*	5.9	*5.3*	*5.1*
Koninklijke Ahold Delhaize NV AD	**4,039** EUR	**71.8**	***24.3***	***21.0***	**41.8**	***19.5***	***17.3***	**9.1**	***11.3***	***16.1***	**1.6**	***1.2***	***0.8***	**2.8**	***1.8***	***1.8***

Liquidity Analysis

Company/Ticker	Market Cap (Mil)	Cash per Share 2015	2016(E)	2017(E)	Current Ratio 2015	2016(E)	2017(E)	Quick Ratio 2015	2016(E)	2017(E)	Cash/Short-Term Debt 2015	2016(E)	2017(E)	Payout Ratio % 2015	2016(E)	2017(E)
Tesco PLC TSCO GBR	16,802 GBP	0.27	*0.38*	*0.06*	0.60	*0.75*	*0.74*	0.45	*0.63*	*0.59*	1.08	*1.09*	*1.41*	-15.9	—	—
Carrefour CA FRA	15,921 EUR	3.77	*3.76*	*4.22*	0.78	*0.78*	*0.79*	0.49	*0.50*	*0.51*	2.82	*2.85*	*3.19*	51.7	*47.5*	*41.8*
Casino Guichard-Perrachon SA CO FRA	4,680 EUR	40.66	*35.47*	*27.13*	0.89	*0.76*	*0.69*	0.57	*0.43*	*0.36*	2.14	*2.07*	*1.76*	-818.7	*115.9*	*66.6*
Average		14.90	*13.20*	*10.47*	0.76	*0.76*	*0.74*	0.50	*0.52*	*0.49*	2.01	*2.00*	*2.12*	-261.0	*81.7*	*54.2*
Koninklijke Ahold Delhaize NV AD	**23,091** EUR	**2.13**	***0.81***	***1.62***	**1.05**	***0.77***	***0.88***	**0.72**	***0.44***	***0.54***	**5.53**	***2.51***	***6.25***	**52.3**	***53.0***	***52.0***

Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, in-depth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss short-term market-price movements), but we believe these negatives are mitigated by deep analysis and our long-term approach.

Morningstar, Inc. and its affiliates ("Morningstar", "we", "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk-adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate and (4) the current market price. This process ultimately culminates in our single-point star rating.

1. Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

To assess the sustainability of excess profits, analysts perform ongoing assessments of the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

2. Estimated Fair Value

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in working-capital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and the net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested ("RONIC")—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total pres-

Morningstar Research Methodology for Valuing Companies

Economic Moat
Financial Health
Stewardship
Uncertainty
Moat Trend

Morningstar Fair Value

Margin of Safety
Market Pricing

Morningstar Rating™ For Stocks
★★★★★

Research Methodology for Valuing Companies

ent value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market-value weights.

3. Uncertainty around that fair value estimate

Morningstar's Uncertainty Rating captures a range of likely potential intrinsic values for a company and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating represents the analysts' ability to bound the estimated value of the shares in a company around the Fair Value Estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, and other company-specific factors.

Analysts consider at least two scenarios in addition to their base case: a bull case and a bear case. Assumptions are chosen such that the analyst believes there is a 25% probability that the company will perform better than the bull case, and a 25% probability that the company will perform worse than the bear case. The distance between the bull and bear cases is an important indicator of the uncertainty underlying the fair value estimate.

Our recommended margin of safety widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the estimated value of the equity, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the uncertainty rating provides guidance in portfolio construction based on risk tolerance.

Our uncertainty ratings for our qualitative analysis are low, medium, high, very high, and extreme.

- ►**Low:** margin of safety for 5-star rating is a 20% discount and for 1-star rating is 25% premium.
- ►**Medium:** margin of safety for 5-star rating is a 30% discount and for 1-star rating is 35% premium.
- ►**High:** margin of safety for 5-star rating is a 40% discount and for 1-star rating is 55% premium.
- ►**Very High:** margin of safety for 5-star rating is a 50% discount and for 1-star rating is 75% premium.
- ►**Extreme:** Stock's uncertainty exceeds the parameters we have set for assigning the appropriate margin of safety.

4. Market Price

The market prices used in this analysis and noted in the report come from exchange on which the stock is listed which we believe is a reliable source.

For more detail information about our methodology, please go to http://global.morningstar.com/equitydisclosures

Morningstar Star Rating for Stocks

Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time, generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

Five Stars ★★★★★

We believe appreciation beyond a fair risk-adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

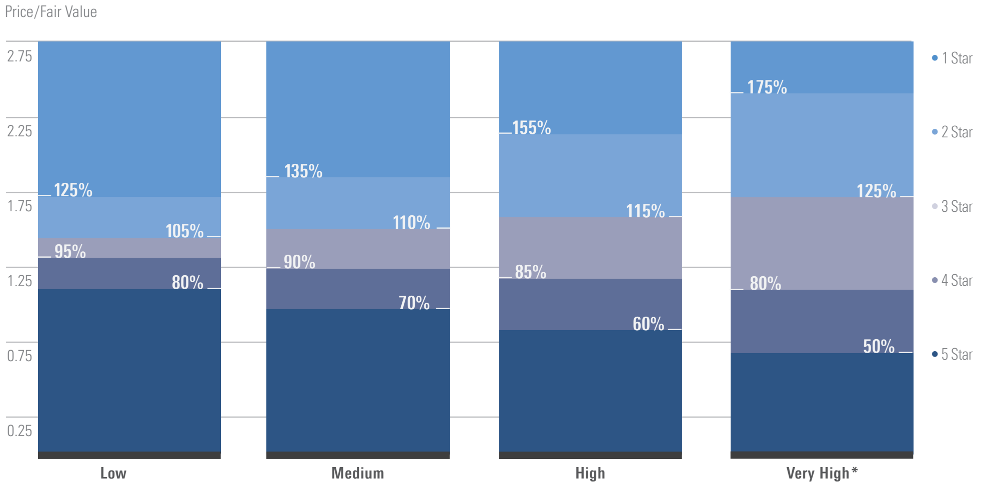
Four Stars ★★★★

We believe appreciation beyond a fair risk-adjusted return is likely.

Three Stars ★★★

Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

Morningstar Research Methodology for Valuing Companies



* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

Research Methodology for Valuing Companies

Two Stars ★★
We believe investors are likely to receive a less than fair risk-adjusted return.

One Star ★
Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

Other Definitions:

Last Price: Price of the stock as of the close of the market of the last trading day before date of the report.

Stewardship Rating: Represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

Quantitative Valuation: Using the below terms, intended to denote the relationship between the security's Last Price and Morningstar's quantitative fair value estimate for that security.

- **Undervalued:** Last Price is below Morningstar's quantitative fair value estimate.
- **Farily Valued:** Last Price is in line with Morningstar's quantitative fair value estimate.
- **Overvalued:** Last Price is above Morningstar's quantitative fair value estimate.

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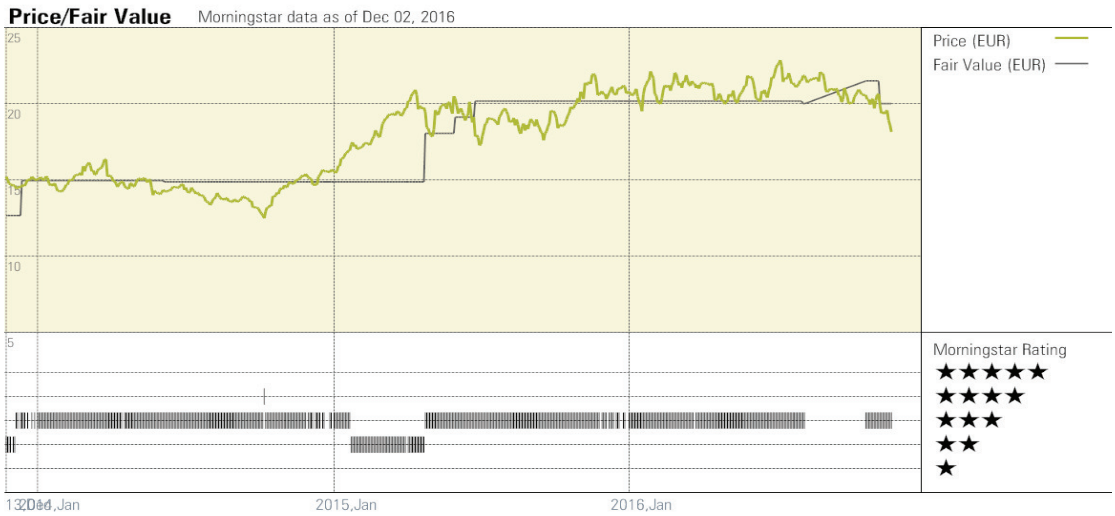
Please note that investments in securities are subject to market and other risks and there is no assurance or guarantee that the intended investment objectives will be achieved. Past performance of a security may or may not be sustained in future and is no indication of future performance. A security investment return and an investor's principal value will fluctuate so that, when redeemed, an investor's shares may be worth more or less than their original cost. A security's current investment performance may be lower or higher than the investment performance noted within the report. Morningstar's Uncertainty Rating serves as a useful data point with respect to sensitivity analysis of the assumptions used in our determining a fair value price.

Koninklijke Ahold Delhaize NV AD (XAMS) | ★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
18.15 EUR	20.00 EUR	Medium	None	Stable	Standard	Retail - Defensive



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Koninklijke Ahold Delhaize NV AD (XAMS) | ★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
18.15 EUR	20.00 EUR	Medium	None	Stable	Standard	Retail - Defensive

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Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
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