Sysco Corporation SYY [XNYS] | ★★★★

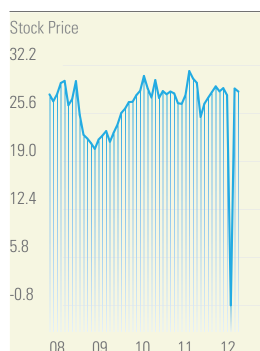
Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
30.3 USD	36.00 USD	25.20 USD	48.60 USD	Medium	Wide	Exemplary	A+	Food Distribution

Case Volume Growth, Moderating Inflation Prop Up Sysco in 4Q; Shares Slightly Undervalued

by Erin Lash, CFA
Senior Stock Analyst
Analyst covering this company do not own its stock.

Pricing data through Aug 31, 2012.
Rating Updated as of Aug 31, 2012.

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



Analyst Note Aug. 13, 2012
Sysco's SYY fourth-quarter and full-year results, reported Monday, indicate to us that while the firm is not out of the woods, there are some underlying positive trends that support our thesis that an expansive distribution network will enable it to remain the dominant player in North American food-service distribution, generating strong cash flows and outsize returns for shareholders longer term. For instance, food cost inflation, while still a challenge, continued to moderate throughout fiscal 2012, falling to 3.3% in the fourth quarter, which is down from 7.3% in the first quarter and compares with 5.5% for the full year. In addition, case volume growth was a notable positive, in our view, amounting to 3.3% excluding acquisitions in the fourth quarter and 2.5% for the full year, which is despite the lumpy economic recovery that continues to plague domestic consumer spending and ultimately restaurant traffic. Results for the full year came in about where we expected, and while we intend to update our model to account for recent results, we don't anticipate a material change to our $36 fair value estimate or our long-term outlook. At less than 13 times our fiscal 2013 earnings estimate (versus our fair value of 16 times), we contend that the shares are slightly undervalued. In our view, the market's concerns regarding sluggish restaurant traffic and food cost inflation are overdone and are unjustly weighing on the shares.

Adjusting for foreign currency movements and acquisitions, fourth-quarter sales increased 5.8% (on top of 6.9% growth in the year-ago quarter), reflecting 3.3% food cost inflation combined with case volume growth. The fourth quarter tends to be particularly strong for Sysco, in light of the Mother's Day holiday, which is usually one of the busiest days for restaurants during the entire year. As a result, we look forward to hearing management's thoughts regarding the sustainability of recent case volume growth during the conference call as well as how volume trended throughout the quarter. As we've pointed out in the past, a modest level of food inflation (2%-3%) is ideal for Sysco, but high levels of food costs could pressure the firm and its customers. In light of the unfavorable weather conditions that have plagued the United States this summer, we think food cost inflation could accelerate into calendar 2013, a topic that we hope management addresses during its earnings conference call.

Even though fuel and payroll expenses were higher in the quarter, Sysco's focus on driving further cost savings was evident, as the adjusted operating margin expanded 10 basis points to 5.5%, despite a 40-basis-point contraction in reported gross margins to 18.2%. Sysco is working to redefine associates' sales and marketing functions to improve execution; standardize, centralize, and automate functions to the cost structure; and capture and utilize the data received to better serve customers. However, we think the firm will reinvest the bulk of any savings realized back into the business. By fiscal 2016, we forecast operating margins of 5.3% (up from 5.0% adjusted operating margins in fiscal 2012).

Overall, we take a longer-term view of the firm's prospects and believe management's focus to expand Sysco's distribution platform, improve supply-chain efficiency, and increase salesforce productivity will drive growth and prevent its competitive advantages from eroding. We continue to believe that Sysco should be well positioned when there is a more consistent, positive cadence to restaurant sales. Although we expect sales volume to remain lumpy in the near term, we believe Sysco's expansive distribution network will enable the firm to remain the dominant player, and we think the firm will continue building out its geographic footprint as well as its product portfolio by pursuing small bolt-on acquisitions.

Thesis May. 21, 2012
Sysco is the leading foodservice distributor in the U.S. and Canada, with about a 17.5% share of this estimated $225 billion market. Although food distributing is generally a low-margin, capital-intensive business, economies of scale have allowed Sysco to post returns consistently on invested

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Close Competitors	Currency (Mil)	Market Cap	TTM Sales	Oper Income	Net Income
Kroger Co	USD	12,135	91,978	1,281	609

capital in excess of our estimate of the firm's cost of capital. Through more than 150 acquisitions since its founding about 40 years ago, Sysco has developed a wide-reaching distribution network over which to spread high fixed costs, and which no other competitor has been able to replicate.

The firm distributes more than 400,000 traditional food and nonfood products, serving 400,000 customers in various industries, and has expanded into other profitable niche segments, such as health care, education, and lodging. In an effort to solidify customer relationships, Sysco has made it a priority to consult with clients on how they can drive sales and minimize costs (an advantageous undertaking, given that about 80% of its sales are derived from smaller customers).

Despite being a low-cost operator, Sysco is keenly focused on trimming additional costs from its already lean operating structure. For instance, the company is working to improve its supply chain by more efficiently routing deliveries, as well as optimizing its product sourcing and supplier relationships. However, what has been most impressive to us is the pace by which Sysco is rolling out this vast undertaking. The firm has spent three years designing and testing these new processes and procedures thus far, and in light of some performance issues that have surfaced, Sysco is extending the testing phase in order to minimize problems on a broader scale--a wise move, from our perspective. Management expects cost savings from this project to amount to around $600 million over the next few years, and we forecast operating margins to improve to 5.3% by fiscal 2015 (about the same level generated in fiscal 2010 and about 40 basis points above fiscal 2011). But in our view, the potential for higher customer retention, the ability to better serve customers, and improved reporting should prop up revenue and limit unnecessary expenses. That said, because the project is still in the very early stages, we aren't forecasting any meaningful benefit over the near term.

Even with these competitive advantages, Sysco is not without its share of challenges. While a modest level of food inflation (2%-3%) is ideal for Sysco, a rapid spike in food costs could pressure the firm and its customers--as it is now. The company estimates that food cost inflation amounted to 4.6% in fiscal 2011 (versus 1.5% deflation in the year-ago period). Historically, the company has been able to pass along these higher costs to its customers, but double-digit inflation in categories such as dairy, meat, and seafood makes this pass-through more challenging. Further, the run-up in raw material prices reflects recent supply constraints, but we think increasing demand for inputs in emerging markets will place upward pressure on commodities over the longer term. Although we expect sales volumes to remain lumpy in the near term, we believe Sysco's expansive distribution network will enable it to remain the dominant North American food distributor, generating strong cash flows and outsized returns for shareholders over the longer term.

Valuation, Growth and Profitability

After incorporating management's updated guidance through fiscal 2015, we're maintaining our $36 per share fair value estimate, which implies forward fiscal 2013 price/earnings of 16 times, enterprise value/EBITDA of 8.8 times, and a free cash flow yield of 4.6%. Given the fragile state of today's consumer, we expect that restaurant traffic (and ultimately consumer spending levels) could remain lumpy, which hinders near-term sales, but that food cost inflation props up sales growth offsetting the pressures created by soft consumer spending. As a result, we forecast that sales will increase 5.1% in fiscal 2012 compared with the year-ago period.

Longer term, we forecast that Sysco will benefit as consumer spending picks up, resulting in 4% annual sales growth through fiscal 2016. In our view, the firm's constant focus on

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improving its cost structure will enable Sysco to offset volatile input costs. By fiscal 2015, we forecast operating margins of 5.3% (about 20 basis points above the firm's average operating margin over the past three years). We expect return on invested capital to average 17.5% compared with our 9.1% cost of capital assumption during the next five years, providing support to our opinion that Sysco maintains a wide economic moat. Looking out through fiscal 2015, management thinks the firm will grow its underlying business at a 4%-6% rate, which seems reasonable in our eyes. This assumes that there will be little to no real industry growth and nominal sales growth of 4%-6%. In addition, Sysco expects the intensely competitive landscape to persist and for margins to remain under pressure, in line with our thinking. While management was originally guiding for $3.00 per share in earnings in fiscal 2015, it now forecasts earnings to approximately $2.50-$2.75 per share. Our current forecast is at the low end of this range.

Risk

If global economic headwinds persist and food inflation accelerates, Sysco's financial results could be pressured. Furthermore, given that two thirds of sales result from the restaurant industry, the firm depends on the strength of consumer spending, which has been fragile, partly as a result of high unemployment and anemic wage growth. Because input costs (such as food and fuel) are a significant component of Sysco's cost structure, high commodity costs can also weigh on results.

Bulls Say

- Sysco is the largest foodservice distributor in North America, with 17.5% share of the market. Its followed by U.S. Foodservice with 9% share, and Performance Food Group with 5%.
- The firm's supply chain initiatives should allow Sysco to consolidate inventory and negotiate more favorable procurement terms with suppliers.
- Because of its continued emphasis on stringent cost management, Sysco has realized returns that are about 3 times the level of its peers.
- Although operating margins only amount to about 5%, Sysco has generated returns on invested capital (including goodwill) of about 18% on average during the last five years.
- We are encouraged by the diversity of the firm's customer base, as no single customer accounts for more than 10% of Sysco's consolidated sales.

Bears Say

- Erratic changes in energy prices, which affect packaging and distribution costs for Sysco, as well as volatile input costs are proving to be a major headwind for foodservice distributors.
- Given that about two thirds of Sysco's sales result from the restaurant sector, we don't expect volume pressure to abate over the near term, as today's consumer still remains fragile.
- Sysco is undergoing a major business transformation, the results of which are far from a guarantee. In addition, any implementation challenges could distract management from the firm's core business operations.
- Elevated gas prices and stubbornly high unemployment levels are plaguing an already fragile consumer, and as a result, restaurants may back away from raising prices over the near term, which would ultimately force Sysco to bear the brunt of higher food costs.

Financial Overview

Financial Health:We aren't concerned about the amount of financial leverage on Sysco's balance sheet. At the end of fiscal 2011, the total debt/capital ratio amounted to around

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0.4, and operating income covered interest expense more than 16 times. During the next five years, we forecast the debt/capital ratio to decline to 0.3 on average and EBIT to cover interest expense 15 times.

Company Overview

Profile: Sysco operates as the largest North American foodservice distributor, controlling 17.5% of the market. The firm distributes more than 400,000 food and nonfood products to 400,000 customers, including restaurants, health care and educational facilities, and lodging establishments. From its founding in 1969 through the end of fiscal 2011, Sysco acquired more than 150 companies or divisions of companies to expand its footprint. Nearly 100% of the firm's sales are derived in North America.

Management: Overall, we think Sysco's management has proven to be exemplary stewards of shareholder capital. The firm has returned in excess of our cost of capital estimate each of the last 10 years. In addition, while Sysco has utilized acquisitions to build out its geographic footprint and assume the dominant position in the North American foodservice industry, we contend the firm has been disciplined acquirers. For instance, Sysco sat on the sidelines when the economic environment became more challenging a few years ago, stating that because of the reduced capital investments required, smaller competitors weren't suffering as much as Sysco, or we, had anticipated. As a result, the valuations of potential targets weren't attractive enough to warrant a deal. As case volume growth has picked up steam, Sysco has once again become an active acquirer, completing a number of small deals this year, and we expect that the firm will remain active acquirers when valuations warrant.

Bill DeLaney, 55, assumed the role of CEO in 2009. With his nearly 25 years at Sysco, we believe DeLaney's experience is a huge asset to this foodservice distributor, particularly given the challenging economic landscape the firm is facing. In our opinion, executive compensation appears reasonable, with about 80%-90% of management's annual pay based on the firm's performance. We commend executive management for taking a 5% reduction in its base pay in 2008 in light of the difficult economic environment. We believe this was a strong signal to the rest of its managers how committed the firm is to maintaining strict expense control. We're pleased that Sysco operates with different individuals holding the CEO and chairman positions. Manuel Fernandez, 65, was appointed as Sysco's executive chairman in June 2009. The firm already enacted majority voting for board members (which we applaud), and we're encouraged that Sysco has proposed to move away from its staggered three-year election structure.

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Analyst Notes

Case Volume Growth, Moderating Inflation Prop Up Sysco in 4Q; Shares Slightly Undervalued Aug. 13, 2012
Sysco's SYY fourth-quarter and full-year results, reported Monday, indicate to us that while the firm is not out of the woods, there are some underlying positive trends that support our thesis that an expansive distribution network will enable it to remain the dominant player in North American food-service distribution, generating strong cash flows and outsize returns for shareholders longer term. For instance, food cost inflation, while still a challenge, continued to moderate throughout fiscal 2012, falling to 3.3% in the fourth quarter, which is down from 7.3% in the first quarter and compares with 5.5% for the full year. In addition, case volume growth was a notable positive, in our view, amounting to 3.3% excluding acquisitions in the fourth quarter and 2.5% for the full year, which is despite the lumpy economic recovery that continues to plague domestic consumer spending and ultimately restaurant traffic. Results for the full year came in about where we expected, and while we intend to update our model to account for recent results, we don't anticipate a material change to our $36 fair value estimate or our long-term outlook. At less than 13 times our fiscal 2013 earnings estimate (versus our fair value of 16 times), we contend that the shares are slightly undervalued. In our view, the market's concerns regarding sluggish restaurant traffic and food cost inflation are overdone and are unjustly weighing on the shares.

Adjusting for foreign currency movements and acquisitions, fourth-quarter sales increased 5.8% (on top of 6.9% growth in the year-ago quarter), reflecting 3.3% food cost inflation combined with case volume growth. The fourth quarter tends to be particularly strong for Sysco, in light of the Mother's Day holiday, which is usually one of the busiest days for restaurants during the entire year. As a result, we look forward to hearing management's thoughts regarding the sustainability of recent case volume growth during the conference call as well as how volume trended throughout the quarter. As we've pointed out in the past, a modest level of food inflation (2%-3%) is ideal for Sysco, but high levels of food costs could pressure the firm and its customers. In light of the unfavorable weather conditions that have plagued the United States this summer, we think food cost inflation could accelerate into calendar 2013, a topic that we hope management addresses during its earnings conference call.

Even though fuel and payroll expenses were higher in the quarter, Sysco's focus on driving further cost savings was evident, as the adjusted operating margin expanded 10 basis points to 5.5%, despite a 40-basis-point contraction in reported gross margins to 18.2%. Sysco is working to redefine associates' sales and marketing functions to improve execution; standardize, centralize, and automate functions to the cost structure; and capture and utilize the data received to better serve customers. However, we think the firm will reinvest the bulk of any savings realized back into the business. By fiscal 2016, we forecast operating margins of 5.3% (up from 5.0% adjusted operating margins in fiscal 2012).

Overall, we take a longer-term view of the firm's prospects and believe management's focus to expand Sysco's distribution platform, improve supply-chain efficiency, and increase salesforce productivity will drive growth and prevent its competitive advantages from eroding. We continue to believe that Sysco should be well positioned when there is a more consistent, positive cadence to restaurant sales. Although we expect sales volume to remain lumpy in the near term, we believe Sysco's expansive distribution network will enable the firm to remain the dominant player, and we think the firm will continue building out its geographic footprint as well as its product portfolio by

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Analyst Notes (continued)

pursuing small bolt-on acquisitions.

Despite a More Modest Outlook, We Think Sysco Should Serve Up Continued Cost Savings and Share Gains May. 21, 2012

We attended Sysco's SYY analyst day in New York on May 17. While just a handful of the firm's senior executives participated in the event, it was a great opportunity to get an update on the business (which has been challenged by soaring food cost inflation and sluggish consumer spending) and its business transformation initiative (which has encountered some delays relative to management's original expectations). In addition, Sysco updated its guidance through fiscal 2015, which was initially put in place at the firm's last analyst day in December 2010, and although we've made some minor adjustments to our model, our $36 per share fair value estimate remains in place. Overall, we continue to believe that Sysco's expansive distribution network will enable it to remain the dominant player in the North American foodservice distribution space, generating strong cash flows and outsize returns for shareholders longer-term. At just 12 times our fiscal 2013 earnings per share estimate, the shares are slightly undervalued, as concerns regarding lackluster restaurant traffic and food cost inflation are unjustly weighing on Sysco's shares.

If there was one thing that management wanted to instill at the meeting, it was that the firm's business transformation is more than a technology project; it is a means by which the company can further differentiate from its competitors. Sysco is working to redefine associates' sales and marketing functions to improve execution; to standardize, centralize, and automate functions to the cost structure; and to capture and utilize the data received to better serve customers. However, not dissimilar from others that have undertaken such a major initiative, the project is taking longer (and subsequently will cost more) than Sysco's original forecast. Management now expects the project will cost around $1.4 billion (up from $900 million previously), with about 75% of the increase related to higher labor expense (which originally wasn't included in its estimates). While management claims that the ERP system appears to be working, the firm has encountered its share of challenges, particularly with regards to the design of the program. For example, not all of its operating companies were strictly adhering to the firm's best practices, and as such, when the platform was rolled out unexpected issues surfaced. In addition, Sysco admits that certain aspects of the model (like order entry) were over-engineered, which has led to additional headaches. That said, we're encouraged to hear Sysco is accelerating the release of other areas of the program that aren't dependent on ERP, and we continue to believe the deliberate pace at which the firm is implementing this should limit any substantial disruptions to the core operations.

For the first time, Sysco also took the opportunity to detail the cost savings it anticipates generating from this initiative. More specifically, management is guiding for a $300 million-$350 million reduction in its operating cost structure (that is, enhanced routing, centralizing its fleet management, and utilizing national purchasing of parts and supplies) and a $250 million-$300 million improvement in its product costs (that is, expanding its sourcing initiative and improving its supplier relationships). With plans to convert the next operating company in early fiscal 2013, followed by an additional five to 15 next year, and 15-25 annually between fiscal 2014 and 2016, the project will end up being about a year and a half behind firm's initial rollout schedule. Of the total savings expected, about 25% are thought to be realized in fiscal 2013, 50%-70% in fiscal 2014, and 100% in fiscal 2015; however, the timing of these savings will depend on the pace of the rollout, which may be accelerated depending

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Analyst Notes (continued)

on the success the firm ultimately realizes. We forecast operating margins to expand to 5.3% by fiscal 2015 (up 40 basis points from fiscal 2011 but in line with fiscal 2010). Although not included in the numbers above, we think these investments will also enable Sysco to garner a larger share of its customers' wallets (which is about 30%-40% on average) by improving its marketing associates' productivity. Despite the significant variability of share Sysco maintains at each customer, management stated that it would like its share to increase to 50%-60% on average, which we believe is a long-term target.

Beyond this initiative, management still maintains an intense focus on expanding its network. According to the company, Sysco controls about 17.5% of the $225 billion North American foodservice distribution market. Over the past 40-plus years, the firm has actively participated in the industry's consolidation, completing more than 150 deals, and we think it is in the hunt for additional targets. In fact, the pace of acquisitions has picked up this year. After averaging just four deals per year since fiscal 2008, Sysco has already completed eight purchases in fiscal 2012, and it anticipates closing more than 10 before the end of June, adding about 1% to consolidated sales growth. While acquiring smaller local and regional distributors (with sales of $10 million-$400 million) is still the most likely prospect, what struck us as interesting was management's apparent openness for pursuing additional deals outside of its home market. Sysco initially branched out into Europe in 2009 when it acquired Pallas Foods, a leading foodservice distributor in Newcastle West, Ireland, with $200 million in annual sales. When we asked CFO Chris Kreidler about this apparent shift in strategy, he noted that although scale is not possible in Europe the way it is in North America (due to different legal and regulatory environments in each country), the firm is still able to leverage the knowledge and experience it's gained, like around brand management and customer service. From our perspective, the biggest challenge related to any deal would result from constraints on its personnel, rather than financial resources. Given the firm's preference to complete smaller deals and because management has proven itself to be exemplary stewards of capital, we don't expect any potential deal to have a material impact on our fair value.

Looking out through fiscal 2015, management thinks the firm will grow its underlying business at a 4%-6% rate, which seems reasonable in our eyes. This assumes there will be little to no real industry growth and nominal sales growth of 4%-6%. In addition, Sysco expects the intensely competitive landscape to persist and for margins to remain under pressure, in line with our thinking. Management stressed that this forecast does not include any costs or benefits from its business transformation. From a sales perspective, the firm expects a 2%-3% contribution from modest inflation; 2%-3% related to increased customer retention, penetration and share gains; and about 0.5% from acquisitions (which is in line with its historic average). While management was originally guiding for $3.00 per share in earnings in fiscal 2015, it now forecasts earnings to approximate $2.50-$2.75 per share. Our current forecast is at the low end of this range.

No Relief From Food Cost Inflation for Sysco, but Case Volume Growth Is a Plus; Shares Undervalued May. 07, 2012

From our perspective, Sysco's SYY third-quarter results support our take that the leading North American food-service distributor should be well positioned when there is a more consistent, positive cadence to restaurant sales. Although we expect sales volume to remain lumpy in the near term, we believe Sysco's expansive distribution network

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Analyst Notes (continued)

will enable the firm to remain the dominant player, generating strong cash flows and outsize returns for shareholders over the longer term. In addition, we think the firm will continue building out its geographic footprint as well as its product portfolio by pursuing small bolt-on acquisitions. In our opinion, appropriately priced acquisitions would be a prudent use of capital, as about 70% of the market remains highly fragmented. Results through the first nine months of fiscal 2012 are tracking in line with our outlook, and as a result, our $36 fair value estimate remains in place. At just 13 times our fiscal 2013 earnings per share estimate, the shares are slightly undervalued. In our view, the market's concerns regarding sluggish restaurant traffic and food cost inflation are overdone and are unjustly weighing on Sysco's shares.

Excluding foreign currency movements and acquisitions, third-quarter sales increased 7.1%, (on top of 7.9% growth in the year-ago quarter) primarily because of 5.5% food cost inflation. While food cost inflation declined from 6.3% in the second quarter, this level of inflation is still significant, particularly the double-digit inflation the firm is realizing in the poultry and meat categories. A modest level of food inflation (2%-3%) is ideal for Sysco, but high levels of food costs could pressure the firm and its customers--as it is now. That said, the fact that case volume growth continued in the third quarter (up 2.3% excluding acquisitions after increasing 2.8% in the prior sequential quarter) is encouraging. We look forward to hearing management's thoughts regarding the sustainability of this growth during the conference call.

Higher payroll expenses took a toll on profitability, as the gross margin contracted 80 basis points to 17.8% while the adjusted operating margin fell 30 basis points to 4.6%. In our view, the firm's constant focus on improving its cost structure will enable Sysco to offset volatile input costs. By fiscal 2015, we forecast operating margins of 5.2% (about 10 basis points above the firm's average operating margin over the past three years). Next week we will attend Sysco's analyst day and hope to garner more details surrounding the firm's business transformation efforts, including the benefits that management believes could be realized as a result of this rollout.

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Sysco Corporation SYY

Sales USD Mil	Mkt Cap USD Mil	Industry	Sector
42,381	17,762	Food Distribution	Consumer Defensive

Morningstar Rating	Last Price	Fair Value	Uncertainty	Economic Moat™	Stewardship
—	30.28	—	—	—	—

Sysco operates as the largest North American foodservice distributor, controlling 17.5% of the market. The firm distributes more than 400,000 food and nonfood products to 400,000 customers, including restaurants, health care and educational facilities, and lodging establishments. From its founding in 1969 through the end of fiscal 2011, Sysco acquired more than 150 companies or divisions of companies to expand its footprint. Nearly 100% of the firm's sales are derived in North America.

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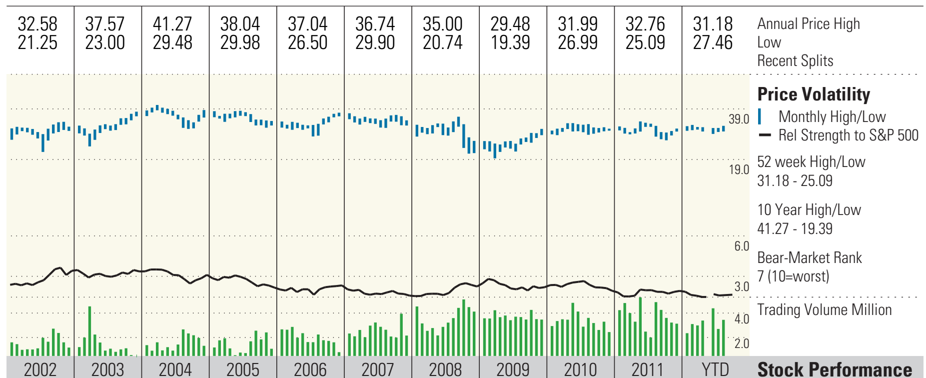
per share prices in USD



	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD
Annual Price High	32.58	37.57	41.27	38.04	37.04	36.74	35.00	29.48	31.99	32.76	31.18
Low	21.25	23.00	29.48	29.98	26.50	29.90	20.74	19.39	26.99	25.09	27.46

Stock Performance

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD
Total Return %	14.2	26.5	3.6	-17.1	20.6	-13.0	-22.9	26.0	7.9	3.3	6.0
+/- Market	37.6	0.1	-5.4	-20.1	7.0	-16.5	15.6	2.6	-4.9	3.3	-6.2
+/- Industry	2.2	-1.5	-3.3	-1.4	-2.7	-1.1	2.2	0.3	-3.8	-1.9	-1.5
Dividend Yield %	1.3	1.2	1.4	1.9	1.9	2.4	3.9	3.5	3.4	3.5	3.5
Market Cap USD Mil	19566	24093	24421	19260	22722	18981	13744	16543	17201	17188	17762

Financials

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	TTM
Revenue USD Mil	26140	29335	30282	32628	35042	37522	36853	37244	39323	42381	42381
Gross Margin %	19.7	19.3	19.1	19.3	19.3	19.2	19.1	19.1	18.6	18.1	18.1
Oper Income USD Mil	1324	1533	1590	1495	1708	1880	1872	1976	1932	1891	1891
Operating Margin %	5.1	5.2	5.2	4.6	4.9	5.0	5.1	5.3	4.9	4.5	4.5
Net Income USD Mil	778	907	961	855	1001	1106	1056	1180	1152	1122	1122
Earnings Per Share USD	1.18	1.37	1.47	1.36	1.60	1.81	1.77	1.99	1.96	1.90	1.90
Dividends USD	0.42	0.50	0.58	0.66	0.74	0.85	0.94	0.99	1.03	1.07	1.07
Shares Mil	660	662	654	629	626	611	596	594	589	589	589
Book Value Per Share USD	3.35	3.66	4.44	4.37	5.15	5.48	5.50	6.64	6.83	8.00	7.99
Oper Cash Flow USD Mil	1373	1190	1192	1124	1403	1596	1582	885	1092	1404	1404
Cap Spending USD Mil	-436	-530	-390	-515	-603	-516	-465	-595	-636	-785	-785
Free Cash Flow USD Mil	937	659	802	609	800	1080	1118	291	455	620	620

Profitability

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	TTM
Return on Assets %	12.0	12.3	11.9	9.9	10.8	11.3	10.4	11.5	10.6	9.6	9.6
Return on Equity %	36.0	38.1	36.1	29.4	31.6	33.1	30.8	32.4	27.0	23.9	23.9
Net Margin %	3.0	3.1	3.2	2.6	2.9	2.9	2.9	3.2	2.9	2.6	2.6
Asset Turnover	4.04	3.97	3.76	3.78	3.79	3.83	3.63	3.63	3.62	3.61	3.61
Financial Leverage	3.2	3.1	3.0	3.0	2.9	3.0	3.0	2.7	2.4	2.6	2.6

Financial Health

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	06-12
Working Capital USD Mil	928	725	544	1173	1260	1676	2121	2067	2158	2661	2661
Long-Term Debt USD Mil	1249	1231	956	1627	1758	1975	2467	2473	2280	2764	2764
Total Equity USD Mil	2198	2565	2759	3052	3278	3409	3450	3828	4705	4685	4685
Debt/Equity	0.57	0.48	0.35	0.53	0.54	0.58	0.72	0.65	0.48	0.59	0.49

Valuation

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM
Price/Earnings	27.5	29.1	26.9	21.8	25.4	17.5	12.7	14.6	15.2	15.1	15.9
P/E vs. Market	—	—	—	—	—	—	—	—	—	0.9	—
Price/Sales	0.8	0.9	0.8	0.6	0.7	0.5	0.4	0.5	0.5	0.4	0.4
Price/Book	8.9	10.2	8.6	7.1	7.1	5.7	4.2	4.2	4.3	3.7	3.8
Price/Cash Flow	16.9	19.1	21.2	17.8	17.0	15.3	7.9	14.2	17.0	12.8	12.7

Growth Rates Compound Annual

Grade: C	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	7.8	4.8	3.9	6.1
Operating Income %	-2.1	0.3	2.0	5.0
Earnings/Share %	-3.1	2.4	3.5	6.5
Dividends %	3.9	4.4	7.7	12.2
Book Value/Share %	0.5	11.0	8.3	9.5
Stock Total Return %	12.6	9.3	1.1	3.6
+/- Industry	-3.3	-2.2	-1.2	-1.5
+/- Market	-4.0	-1.8	1.8	-0.6

Profitability Analysis

Grade: C	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	23.9	29.4	20.5	22.8
Return on Assets %	9.6	10.7	8.5	9.3
Fixed Asset Turns	11.5	12.2	13.1	7.7
Inventory Turns	16.3	16.9	12.8	17.0
Revenue/Employee USD K	886.6	850.4*	—	1055.7
Gross Margin %	18.1	18.8	16.3	39.7
Operating Margin %	4.5	5.0	4.1	16.6
Net Margin %	2.6	2.9	2.4	11.1
Free Cash Flow/Rev %	1.5	1.9	1.4	0.1
R&D/Rev %	—	—	—	9.5

Financial Position

Grade: A	06-11 USD Mil	06-12 USD Mil
Cash	640	689
Inventories	2074	2179
Receivables	2898	2967
Current Assets	5733	6085
Fixed Assets	3512	3884
Intangibles	1743	1779
Total Assets	11386	12095
Payables	2183	2209
Short-Term Debt	389	255
Current Liabilities	3575	3424
Long-Term Debt	2280	2764
Total Liabilities	6680	7410
Total Equity	4705	4685

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	15.9	15.0	18.0	—
Forward P/E	14.3	—	—	13.2
Price/Cash Flow	12.7	13.4	13.5	—
Price/Free Cash Flow	28.8	28.4	41.5	—
Dividend Yield %	3.5	—	2.9	2.0
Price/Book	3.8	4.4	3.1	—
Price/Sales	0.4	0.5	0.4	—
PEG Ratio	2.3	—	—	0.3

Quarterly Results

Revenue USD Mil	Sep 11	Dec 11	Mar 12	Jun 12
Most Recent Period	10586.4	10244.4	10504.8	11045.4
Prior Year Period	9751.3	9384.9	9761.7	10425.7

Rev Growth %	Sep 11	Dec 11	Mar 12	Jun 12
Most Recent Period	8.6	9.2	7.6	5.9
Prior Year Period	7.4	5.8	9.1	0.8

Earnings Per Share USD	Sep 11	Dec 11	Mar 12	Jun 12
Most Recent Period	0.51	0.43	0.44	0.53
Prior Year Period	0.51	0.44	0.44	0.57

Industry Peers by Market Cap

	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
Sysco Corporation	17762	42381	15.9	23.9
Kroger Co	12092	91978	21.1	13.1

Major Fund Holders

	% of shares
	—
	—
	—

*3Yr Avg data is displayed in place of 5Yr Avg

TTM data based on rolling quarterly data if available; otherwise most recent annual data shown.

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MORNINGSTAR®

Morningstar's Approach to Rating Stocks

Our Key Investing Concepts
- Economic Moat™ Rating
- Discounted Cash Flow
- Discount Rate
- Fair Value
- Uncertainty
- Margin of Safety
- Consider Buying/Consider Selling
- Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

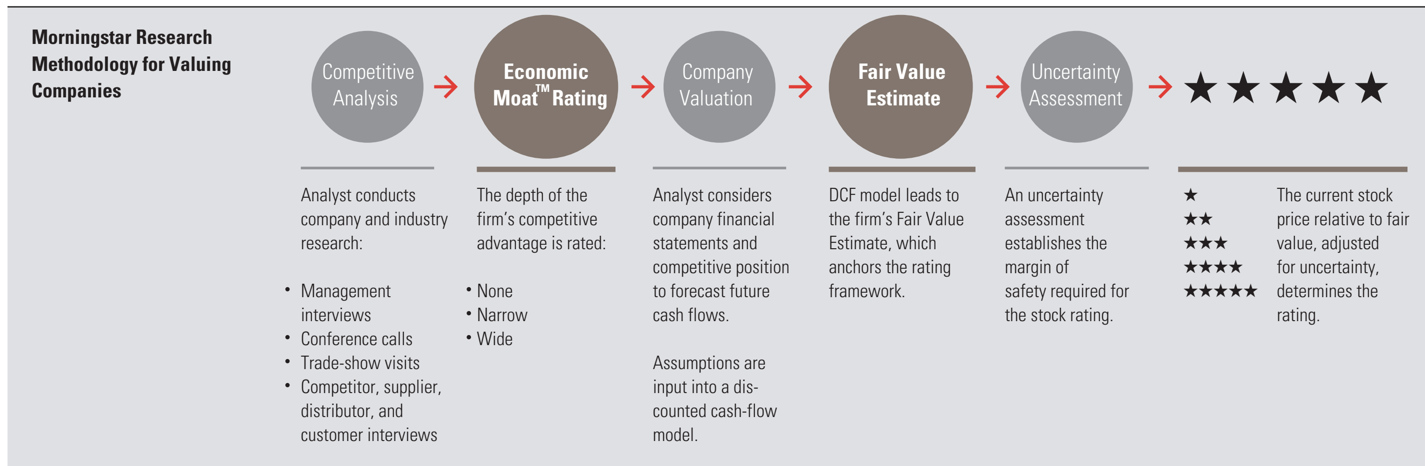
Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based just on movement in the share price. If we think a stock's fair value is $50, and the shares decline to $40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at $40 than they were at $50.

Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such



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economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

Discounted Cash Flow
This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

Discount Rate
We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

Fair Value
This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

Uncertainty
To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

Margin of Safety
This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth.The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

Consider Buying/Consider Selling
The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

Stewardship Grades
Our corporate 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.

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