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Kroger and Albertsons Merger for $24.6bn

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Source: Coupon in the News

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DEAL INTRODUCTION

DETAILS ABOUT THE DEAL

In late October, it was announced that the two US supermarket giants, Kroger and Albertsons, were planning to merge for a staggering $24.6 billion.

The Ohio-based company Kroger will buy Albertsons for $34.10 per share, an almost 33% premium to the grocery chain's average share price as of October 12th.

The deal is expected to close in 2024, and if it goes through, it will create a supermarket chain capable of challenging Walmart's current #1 spot as top grocer with 18% in market share.

In comparison, Kroger retained 8.8% and Albertsons captured 4.7% of market share in 2021, allowing the two to close the gap to Walmart.

However, the deal is expected to face scrutiny from regulators due to the potential of store closure and increases in prices.

This is especially important at a time when food inflation has reached its highest level in the decade and unemployment is expected to increase in 2023.

Source: Supermarket News

REASONS FOR M&A

This merger allows for two giant supermarkets to merge and directly compete with the likes of Walmart and Costco. By competition they hope to establish more manageable prices for consumers especially in difficult times as the current one.

It could capture up to 14% of market share and therefore have significant influence on price changes - arguably they could control the prices of a variety of key household goods according to their own interests - one of the FTC's largest concerns. Although Walmart currently has a market share of 18%, during the post-merger integration period we could see the share of Albertsons and Kruger increase further and pose a challenge to Walmart that it has never seen before.

Although there is a concern for the merger allowing the companies to change the prices for their own profit purposes, this interest won't be pursued most likely due to the risk of loss of market share to Walmart should they have relatively high prices. In this case, the merger would completely fail to make use of the captured market share and therefore not be a valuable investment. This action could therefore be considered as a non-credible threat, but it remains to be seen how it evolves.

Source: Supermarket News

INDUSTRY OVERVIEW - SUPERMARKETS

HISTORICAL TRENDS

The supermarket industry is a major contributor to the global economy, with industry players generating billions of dollars in annual revenue. Global supermarket sales reached approximately $8 trillion in 2020.

The industry is highly competitive, with major players such as Walmart, Kroger, and Tesco operating thousands of stores around the world. These companies have strong financials, with Walmart, the largest player in the industry, reporting over $524 billion in revenue in 2020. Kroger, the second-largest player in the industry, reported over $132 billion in revenue in the same year.

In addition to traditional supermarkets, the industry includes a range of other retail formats such as discount stores, warehouse clubs, and online retailers. These different formats offer consumers a variety of options for purchasing groceries, and many supermarkets have begun to offer online ordering and delivery services to compete with alternative retailers. To remain competitive, supermarkets will need to continue to adapt and innovate to meet the changing needs and preferences of consumers.

Source: SOPA Images Limited / Alamy Stock Photo

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ACQUIRER OVERVIEW

Source: Wikimedia Commons

TICKER: KR

KROGER

- Supermarket chain in the US with a leading presence across the country, headquartered in Ohio
- ‘Fresh’ is core competitive brand - number 1 determinant of store choice
- Subsidiaries include: Kroger, Ralphs, Dillons, Smith's, King Soopers, Fry's, QFC, City Market, Owen's, Jay C, Pay Less, Baker's, Gerbes, Harris Teeter, Pick 'n Save, Metro Market, Mariano's.

BUSINESS MODEL

- 3-tier distribution system
- Production of high quality label products
- Broad differentiation strategy

KEY FINANCIALS

Revenue: **$146.5 billion**

EBITDA: **$7.1 billion**

Net income: **$2.96 billion**

P/E ratio: **11.15**

Market cap: **$31.5 billion**

Share price: **$44.3**

Market Share: **8.8%**

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ESG PRACTICES

- People, systems, planet
  - People: food access, health and safety / just and inclusive economy
  - Planet: climate impact and resource conservation
  - Systems: business integration / responsible and resilient systems
- Sustainability
- Supporting underrepresented communities
- Zero waste and zero hunger
- Potential negative of not considering the impact of consumers in this deal - will need to implement policies to ensure consumers are not hurt by food prices rising etc
- Climate change - reduce carbon emissions
- Approach to ESG:

TARGET OVERVIEW

Source: Fonts In Use

Ticker: ACI

ALBERTSONS

American grocery store company with headquarters in Boise (Idaho).

It currently has 2253 stores, which places it as the 2nd largest supermarket chain in North America after Kroger (acquirer).

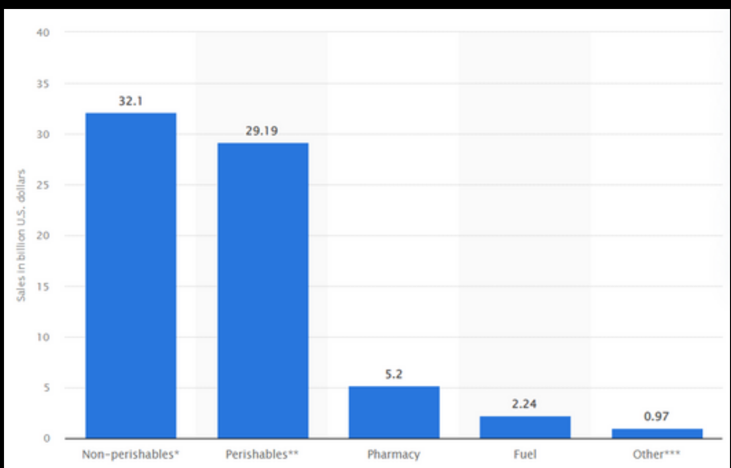
Albertsons has 290,000 employees.

BUSINESS MODEL

The business has a heavy focus on being loyalty based to its customers and achieves this through digital connection.

Modernising capabilities through an improved supply chain, enhanced data and data analytics, and ongoing productivity, all built on the foundation of being locally great and nationally strong.

Albertonts generates its revenue mostly based on groceries, i.e perishable and non-perishable food items. The revenue breakdown can is highlighted in the figure below:



ESG PRACTICES

- **Carbon emissions have been reduced by 19% between 2019 and 2021, with increasing recycling of 875 million pounds of cardboards and 25 million pounds of plastic film and bags.**
- **Delivered more than 430 workshops about leading with inclusion.**
- **Diverted more than 215 million pounds of food from landfill through anaerobic digestions.**
- **Donated more than 78 million pounds of food to Feeding America partners.**
- **Raised nearly 40 million to hunger relief.**

KEY FINANCIALS

Revenue: **$62.5 billion**

Market cap: **$11.05 billion**

EBITDA: **$4.953 billion**

EBIT: **$2.473 billion**

Share price: **$20.66**

Net income: **$466.4 million**

Market Share: **7.3%**

P/E ratio: **6.52**

Source: Progressive Grocer

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DEAL ANALYSIS

STRENGTHS

- Create market share to rival Walmart and increase customer base
- Enhances customer experience and wages/benefits to employees
- Less competition in market through merger
- Stronger ESG initiatives

OPPORTUNITIES

- Become #1 food grocer supplier in USA - incr consumer base, revenue, competitiveness
- Opportunity for increased production from combined resources and finances

Source: Provisioner Online

DEAL ANALYSIS

WEAKNESSES

- **Potential store closure from merger and increase in prices**
- **Uncertainty with how consumers may react to merger**
- **Fewer options of store home-brands (usually more affordable for consumers)**
- **Less choice for consumers (bear main cost of merger)**

THREATS

- **Food inflation and cost of living could hurt revenue especially if prices increase due to merger**
- **Watchdog says reduced competition could hurt consumers (more market power to the merged firms)**
- **FTC regulator blockages for deal**
- **Food deserts for customers**
- **Creation of oligopoly-type market between merger and Walmart**
- **Fall in share price**

VALUATION ANALYSIS

DISCOUNTED CASH FLOW ANALYSIS (DCF)

Terminal Value	32,739,812.53
Present Value of Terminal Value	23,237,379.47
Enterprise Value	32,062,318.73
(+) Cash	3,392,000.00
(-) Debt	7,933,000.00
Equity Value	27,521,318.73
Shares	580,000.00
Implied Share Price	47.45
Share Price at Acquisition Date	21.13
Premium (Discount)	-125%

Please click on the table to access full model.

As calculated by the Discounted Cash Flow (DCF) Analysis, the Albertsons stock was $47.45 at the time of the merger. Through the DCF analysis, the discount at which it was traded at could also be derived, which amounted to 125%.

To build the model, various assumptions were taken into consideration, two crucial ones being the Terminal Growth Rate (2.5% in the base case), and the Weighted Average Cost of Capital (WACC) (10.6% in the base case). Therefore, it must be noted that the valuation obtained from the model was affected by these assumptions.

In order to build the forecasts, past performance and the future outlook of Albertsons was taken into consideration, resulting in the implied share price obtained through the DCF.

VALUATION ANALYSIS

COMPARABLE COMPANIES ANALYSIS (CCA)

	Low	High
Selected EBITDA Multiple:	10.5x	12.2x
Implied Enterprise Value	42,985	49,582
Net Debt	(10,650)	(10,650)
Implied Equity Value	32,335	38,932
Equity Value per share	$ 60.44	$ 72.77
Premium / (Discount) %	77.24%	113.40%

Please click on the table to access full model.

Based on the comparable company analysis (CCA), Albertsons valuation multiples appear to be lower than the mean and median of the companies chosen.

As a result of the multiples, the low and high EBITDA multiples were chosen to be (10.5x) and (12.2x), giving the implied equity values per share of $60.44 and $72.77, respectively. This implies that Albertsons was undervalued at the time of the offer, and that Kroger paid a significant premium.

However, it must also be noted that, although the companies chosen operate in the same industry and geography, their size did vary, which certainly impacted the CCA analysis conducted.

CONCLUSION

IMPACT ON INDUSTRY

The supermarket industry is expected to continue to grow in the coming years, with an estimated compound annual growth rate of 3.5% between 2021 and 2026.

In the short term, high inflation will be significant to the supermarket industry. With already increasing costs, UK's grocery inflation hit record highs of 14.7% with many hesitant to predict when costs stop rising. Subsequently, the cost of supermarket goods has risen faster than CPI inflation. As recession fears rise, supermarkets may struggle as consumers become weary of spending more than necessary.

With the increase in e-commerce platforms and the rise of mobile technology, more and more consumers are opting to purchase their groceries online. This trend is especially pronounced during the COVID-19 pandemic, as consumers opted for the convenience and safety of home delivery. In response, many supermarkets have begun to offer online ordering and delivery services, as well as in-store pickup options. Sustainability is also expected to be a key trend in the supermarket industry.

As consumers become more environmentally conscious, supermarkets are expected to focus on reducing waste and increasing the use of eco-friendly products and packaging. Finally, the increasing use of technology is expected to continue to shape the supermarket industry. This includes the use of artificial intelligence, automation, and other technologies to improve the shopping experience and streamline operations.

GLOSSARY

CAGR (Compound Annual Growth Rate): ***The rate at which an investment would grow with reinvested profits at the end of each year.***

Discount: ***Decreased amount paid per share in comparison to the share price at the time of the M&A transaction, often presented as a percentage.***

EBITDA: ***Earnings before Interest, Tax, Depreciation and Amortisation. A useful measure to compare companies profitability.***

EV/EBITDA: ***Enterprise Value 'Multiple', gives insight into the value of companies against their cash earnings less their non-cash expenses.***

Premium: ***Increased amount paid per share in comparison to the share price at the time of the M&A transaction, often presented as a percentage.***

Terminal Growth Rate: ***A growth rate that a company is expected to grow at forever based on the market and industry conditions.***

Valuation Multiples: ***Financial tool providing one metric as a ratio of another; often used to compare similar companies.***