**W4: Discussion [Peter Schuld](https://canvas.stanford.edu/courses/68404/users/148562" \o "Author's name)**

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**Axfood AB (AXFO)**

* **Products:**Axfood Group is a food retailer (service company) that operates discount grocery shops under the **willys** brand (45% of FY 2016 operating profit) and traditional grocery shops under the **Hemköp** brand (13%). In addition, **Axfood Närlivs** (10%) is a B2B wholesaler and **Dagab** (33%) is the support company for the Group’s purchasing and logistics operations. Increasingly, Axfood Group produces private label products (28% of 2016 group sales) that get delivered to Dagab by suppliers and distributed to stores. The production of higher margin private labels help Axfood Group to improve its operating margins above the groups target rate of 4% (4.4% in 2016 and 4.1% in 2015). Axfood focuses on cost control through centralized logistics to maintain a sufficient profit margin. Suppliers and the assortment are decided on and negotiated centrally for all Axfood’s stores. Each store thereafter can adapt its assortment to local demand.  
    
  In 2017 Axfood acquired the Nasdaq First North Stockholm quoted online grocery company **Matse Holding AB** ([www.Mat.se (Links to an external site.)Links to an external site.](http://www.Mat.se)) for SEK 554 m. In 2016 the online store had food retail sales of approximately SEK 256 m and the delisted company will be fully consolidated into the segmented reporting of **Dagab**. In January 2017 Axfood and Norgesgruppen (Norway) jointly acquired **Eurocash Food AB**. Through this acquisition Axfood enters the cross-border shopping segment with affluent Norwegian duty-free shoppers. Eurocash is the second-largest food retailer along Sweden's border with Norway, with eight stores and sales of approximately SEK 1.2 billion.
* **Customers:**Axfood’s customers are predominantly Swedish consumers and Norwegian cross-border shoppers who regularly visit their retail outlets or increasingly shop online using the groups truck delivery service. Axfood’s customers are price conscious and **willys** pledges to offer Sweden’s cheapest bag of groceries. **Hemköp** is a mid-market grocery store chain that is increasingly offering a wide variety of high quality fresh food and organic vegetables (value for money).
* **Industry:**The food retail and wholesale industry in Scandinavia is characterized by a stagnating market size despite a high and growing GDP per capita due to a moderate population growth and a relative decline of food retail expenditure on disposable income. Traditionally, high taxation on consumer goods, long transport routes and low levels of domestic competition contributed to high price levels in Scandinavian countries (OECD 2016 price level indices for Sweden at 119% and Norway at 136% of OECD average. Source:  https://data.oecd.org/price/price-level-indices.htm). Albeit, Sweden is a member of the European Union’s single market and most of its population live in the south of the country with easy access to seaborne and land-based trade routes connected to major logistical hubs (e.g. port of Hamburg). Consequently, Axfood’s discount chain Willys faces strong competition from the hard discount market segment (e.g. German competitors Lidl and Netto).
* **Form:**Axfood Aktiebolag (AB) is a Nasdaq Stockholm Large Cap quoted company that collaborates with 1,083 retail stores, of which 263 are wholly owned stores. Axfood has agreements with 820 retailer-owned stores for cooperation under the Hemköp, Tempo and Handlar’n franchise brands. The grocers pay an annual sales-based fee to Axfood for participation in marketing programmes, purchasing coordination and support in such areas as technical support, administration and store operations. Franchise income (store fees) is recognized in profit or loss as it is earned.   
    
  The principal owner is Axel Johnson AB, with ownership of 50.1% of the shares (votes and capital). No other shareholder owns – directly or indirectly – more than 10% of the shares in Axfood (votes and capital).

Axfood Group consists of the Parent Holding company that owns 100% of the share capital of seven operating companies (e.g. willys AB, Hemköpskedjan AB). Profits from those Group companies are transferred to the parent and during the last five years, the ordinary dividend has averaged 79.4% of group profit after tax. In 2016, Axfood Group participates in two small associated companies (25%-50% ownership) and one small joint ventures (50% ownership). After the acquisition of 51% of **Eurocash** in January 2017 it will be fully consolidated in the Axfood Group and will be included under **Willys** in the segment reporting. However, the business will continue to operate under the Eurocash brand.

* **Geography:**Axfood Group AB is domicile in Stockholm, Sweden. The group has strong presents in the three metropolitan centres of Sweden (Stockholm, Gothenburg and Malmö) and with Eurocash near the border with Norway. In addition, through collaboration with Mini-Marts chains they have a presents all over rural Sweden (Tempo, Handlar’n and Direktenretail).
* **Status:** Axfood is the 2nd biggest food retailer in Sweden with a market share of 21%. Its major competitors are ICA with 48% market share, COOP 19%, Bergendahls 6%, Lidl 4% and Netto 2%. The Willys chain is Sweden’s market leader in discount grocery shops.

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| (1.)  Return on Capital Employed (ROCE) | |  |  |
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| (1a.) Capitalizing Operating leases | 2016 | 2015 | Comment |
| Total leasing costs during the financial year | SEK 1,490,000,000 | SEK 1,362,000,000 | (Note 11 p.96 pdf) Operating Leases |
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| Contracted future minimum lease payments within one year | SEK 1,298,000,000 | SEK 1,246,000,000 | (Note 11 p.96 pdf) Operating Leases |
| Between one and five years | SEK 3,883,000,000 | SEK 3,044,000,000 | (Note 11 p.96 pdf) Operating Leases |
| Longer than five years | SEK 893,000,000 | SEK 1,263,000,000 | (Note 11 p.96 pdf) Operating Leases |
| Total future lease payments | SEK 6,074,000,000 | SEK 5,553,000,000 | (Note 11 p.96 pdf) Operating Leases |
| Capitalized Leases PV (Discount Rate 0.81%) | SEK 5,899,859,649 | SEK 5,379,500,218 | Note 30 Effective interest rate on  interest-bearing liabilities = 0.81% |
|  |  |  |  |
| (1b.) Calculating Capital Employed | 2016 | 2015 | Comment |
| Total Asset | SEK 10,539,000,000 | SEK 10,537,000,000 | (p.52-53 pdf) Balance Sheet |
| Capitalized Leases PV (Discount Rate 0.81%) | SEK 5,899,859,649 | SEK 5,379,500,218 | Note 30 Effective interest rate on  interest-bearing liabilities = 0.81% |
| Accounts payable – trade | -SEK 3,224,000,000 | -SEK 2,782,000,000 | Non-interest bearing current liability |
| Current tax liabilities | -SEK 32,000,000 | -SEK 41,000,000 | Non-interest bearing current liability |
| Other current liabilities | -SEK 168,000,000 | -SEK 199,000,000 | Non-interest bearing current liability |
| Accrued expenses and deferred income | -SEK 1,798,000,000 | -SEK 1,881,000,000 | Non-interest bearing current liability |
| Goodwill | -SEK 1,864,000,000 | -SEK 1,860,000,000 | Intangible Assets & Goodwill |
| Other intangible assets | -SEK 614,000,000 | -SEK 668,000,000 | Intangible Assets & Goodwill |
| Capital Employed (max.) | SEK 8,738,859,649 | SEK 8,485,500,218 |  |
| Cash and bank balances | -SEK 1,726,000,000 | -SEK 1,933,000,000 | Cash approx. 16% of Total Assets is high, but Working Capital gets negative |
| Capital Employed (min.) | SEK 7,012,859,649 | SEK 6,552,500,218 |  |
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| (1b.) Determine Required cash position by looking at Working capital |  |  | (p.53 pdf) "Of current assets, inventories make up the single largest item, SEK 2,191 m (2,035). Inventories consist of finished goods in the retail operations, 52% (53%), and wholesale operations, 48% (47%). Trade payables make up the  single largest item in current liabilities, totalling SEK 3,224 m (2,782). |
| Finished products and goods for resale | SEK 2,191,000,000 | SEK 2,035,000,000 |  |
| Accounts payable – trade | -SEK 3,224,000,000 | -SEK 2,782,000,000 |  |
| Working Capital ex. Cash | -SEK 1,033,000,000 | -SEK 747,000,000 | Negative WC is typical for retailers, but it can not be assumed that 10% of Axfood's capital base is provided interest free by trading suppliers indefinitely |
| Cash and bank balances | SEK 1,726,000,000 | SEK 1,933,000,000 |  |
| Working Capital incl. Cash | SEK 693,000,000 | SEK 1,186,000,000 | Proxi for Excess Cash |
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| (1c.) Adjusting Operating Income for Capitalized Operating Leases | 2016 | 2015 | Comment |
| Operating Income | SEK 1,902,000,000 | SEK 1,760,000,000 | P&L (p.50 pdf) |
| Total leasing costs during the financial year | SEK 1,490,000,000 | SEK 1,362,000,000 | Operating Leases (Note 11 p.96) |
| Additional Depreciation from Capitalizing Operating Leases | -SEK 1,440,800,600 | -SEK 1,317,020,700 | It is assumed that Additional Depreciation + Additional Interest Expense =  Operating Leasing Cost |
| Operating Income (adjusted for Capitalized Leases) | SEK 1,951,199,400 | SEK 1,804,979,300 | Numerator for ROCE calculation (below) |
| Additional Interest Expense from from Capitalizing Operating Leases | -SEK 49,199,400 | -SEK 44,979,300 | Total future lease payments \* Interest Rate of 0.81% (probably too low) |
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| (1d.) Calculating Range for ROCE | 2016 | 2015 | Comment |
| ROCE on 2016 asset values (no excess cash) | 22.3% | 21.3% | Conclusion: |
| ROCE on 2016 asset values (all cash extracted) | 27.8% | 27.5% | ROCE is approx. 25% (see note on excess cash) |
| ROCE on 2015  (no excess cash) | 23.0% |  |  |
| ROCE on 2015 asset values (all cash extracted) | 29.8% |  |  |
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| (2.)  Free Cash Flow return on capital employed ( FCFROCE = FCF / CE ) | | |  |
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| (2a.) Calculating FCF | 2016 | 2015 | Comment |
| Cash flow from operating activities | SEK 2,241,000,000 | SEK 2,495,000,000 | (p.54 pdf) Statement of Cash Flow |
| Maintainance CAPEX | -SEK 580,000,000 | -SEK 764,000,000 | (p.53 pdf) "Total capital expenditures by the Group amounted to SEK 580 m (764). |
| Free Cash Flow (FCF) | SEK 1,661,000,000 | SEK 1,731,000,000 |  |
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| (2b.) Calculating Ranges for CE |  |  |  |
| Capital Employed (max.) | SEK 8,738,859,649 | SEK 8,485,500,218 |  |
| Cash and bank balances | -SEK 1,726,000,000 | -SEK 1,933,000,000 |  |
| Capital Employed (min.) | SEK 7,012,859,649 | SEK 6,552,500,218 |  |
|  |  |  |  |
| (2c.) Calculating Ranges for FCFOCE |  |  |  |
|  | 2016 | 2015 | Comment |
| ROCE on 2016 asset values (no excess cash) | 19.0% | 20.4% | Conclusion: |
| ROCE on 2016 asset values (all cash extracted) | 23.7% | 26.4% | FCFROCE is approx. 22% (see note on excess cash) |
| ROCE on 2015  (no excess cash) | 19.6% |  |  |
| ROCE on 2015 asset values (all cash extracted) | 25.3% |  |  |
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| (3.) growth in operating income per fully diluted share | |  |  |
|  | 2016 | 2015 | Comment |
| Operating profit | SEK 1,902,000,000 | SEK 1,760,000,000 | P&L (p.50 pdf) |
| Shares Outstanding | 209,870,712 | 209,870,712 | (Note 16 p.98 pdf) "Since Axfood does not have, nor has had any outstanding convertible or stock option programmes during the year, there is no dilutive effect on calculations of earnings per share. The number of shares outstanding is 209,870,712 (209,870,712), and the average number of shares outstanding  was 209,870,712 (209,870,712)". |
| operating income per fully diluted share | SEK 9.06 | SEK 8.39 |  |
| growth in operating income per fully diluted share | 8.1% |  |  |
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| (4.) growth in free cash flow per fully diluted share | |  |  |
|  |  |  |  |
|  | 2016 | 2015 | Comment |
| Free Cash Flow (FCF) | SEK 1,661,000,000 | SEK 1,731,000,000 |  |
| Shares Outstanding | 209,870,712 | 209,870,712 | (Note 16 p.98 pdf) |
| free cash flow per fully diluted share | SEK 7.91 | SEK 8.25 |  |
| growth in free cash flow per fully diluted share | -4.0% |  |  |
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| (5.) growth in book value per fully diluted share | |  |  |
|  | 2016 | 2015 | Comment |
| Shareholders’ equity | SEK 4,118,000,000 | SEK 4,531,000,000 | When applied to a whole company, book value means equity |
| Shares Outstanding | 209,870,712 | 209,870,712 | (Note 16 p.98 pdf) |
| Book Value per fully diluted share | SEK 19.62 | SEK 21.59 |  |
| growth in book value per fully diluted share | -9.1% |  | Conclusion: Negative trend, but dividend payment is not concidered |
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| (6.) growth in tangible book value per fully diluted share | |  |  |
|  |  |  |  |
| (6a.) Calculating Tangible BV | 2016 | 2015 | Comment |
| Shareholders’ equity | SEK 4,118,000,000 | SEK 4,531,000,000 |  |
| Goodwill | -SEK 1,864,000,000 | -SEK 1,860,000,000 |  |
| Other intangible assets | -SEK 614,000,000 | -SEK 668,000,000 |  |
| tangible book value | SEK 1,640,000,000 | SEK 2,003,000,000 | Tangible book value is simply book value minus intangible assets |
|  |  |  |  |
| (6b.) Calculating Tangible BV per share |  |  |  |
| Shares Outstanding | 209,870,712 | 209,870,712 | (Note 16 p.98 pdf) |
| tangible book value per fully diluted share | SEK 7.81 | SEK 9.54 |  |
|  |  |  |  |
| growth in tangible book value per fully diluted share | -18.1% |  | Conclusion: Negative trend, but dividend payment is not concidered |
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| (7.) liabilities to equity ratio |  |  |  |
|  | 2016 | 2015 | Comment |
| Non-current liabilities | SEK 1,160,000,000 | SEK 1,063,000,000 |  |
| Current liabilities | SEK 5,261,000,000 | SEK 4,943,000,000 |  |
| Total Liability | SEK 6,421,000,000 | SEK 6,006,000,000 |  |
| Shareholders’ equity | SEK 4,118,000,000 | SEK 4,531,000,000 |  |
| Liabilities-to-equity ratio | 155.9% | 133% | Leverage ratios start increasing (very low interest rate for secured and unsecured debt financing) |
|  |  |  |  |
| TOTAL SHAREHOLDERS’ EQUITY AND LIABILITIES | SEK 10,539,000,000 | SEK 10,537,000,000 |  |
| Liabilities-to-Total Assets ratio | 61% | 57% | Investment Grade Rating Total Debt Levels, but leverage is rising |

Edited by [Peter Schuld](https://canvas.stanford.edu/courses/68404/users/148562) on Jul 23 at 12:24pm

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