

Food Retail

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Industry Rating: Outperform

Buxton Luncheon: A Closer Look at the White Space Analysis

We recently hosted senior representatives from Buxton, including Paul Schlesinger (Senior VP of Business Intelligence), and Todd Walls (Chief Innovation Officer), for a luncheon to discuss the company's in-depth analytical process for developing long-term new store growth potential for retailers, or white space analyses. For a retail white space analysis, Buxton takes into account both: (1) data from 250-plus databases; and (2) company specific data, such as unit level volume, acceptable levels of cannibalization, and any customer analytical/loyalty card data, if available. Buxton also provides similar analyses for private equity firms in their due diligence processes and, on occasion, for retailers looking to gauge the competitive impact of another growing retailer in their space. Buxton's white space results are founded on a bottom-up geo-spacial trade area specific analysis. They reflect current macroeconomic conditions and the subject company's current business model.

Buxton *does not* incorporate current competitors and their sites into its analysis, but does *not* incorporate announced growth plans (either based on publicly disclosed information or from its proprietary information in working with other retailers) of the competitors into their analysis by design. See page 3 for additional details on this topic.

Additionally, Buxton's core offerings to client retailers include deployment via the company's web-based SCOUT platform of revenue forecasting site selection models, giving the client the ability to score any specific site and to receive a full evaluation of that site, including a revenue forecast.

Buxton's process for developing white space analyses could aid investors in understanding published long-term new store growth targets for companies such as Sprouts (1,200-store potential), The Fresh Market (500-store potential) and Fairway (300-store potential).

Summary

- We recently hosted senior representatives from Buxton for a luncheon to discuss its in-depth analytical process for developing retail white space analyses, or long-term US store growth potential.
- Buxton's white space analysis takes into account both: (1) data from 250-plus databases; and (2) company-specific data, such as unit level volume, acceptable levels of cannibalization, and any customer analytical/loyalty card data, if available.
- Buxton does *not* incorporate announced growth plans of competitors into its analysis by design. Buxton does not provide site-specific real estate criteria such as available occupancy or rents.
- Buxton's process for developing white space analyses could aid investors in understanding published long-term new-store growth targets for companies such as Sprouts (1,200-store potential), The Fresh Market (500-store potential), and Fairway (300-store potential).

Refer to pages 5 to 6 for Important Disclosures, including Analyst's Certification.

About Buxton

The Buxton Co. is a leading customer analytics firm founded in 1994 by Tom Buxton. It is based in Fort Worth, Texas and has worked with more than 2,000 clients in areas such as Retail & Restaurants, Consumer Packaged Goods companies, Healthcare, Community Governments, Private Equity/Investors, and Public Affairs. Buxton utilizes data from more than 250 databases and 119 million household files, along with a highly trained and knowledgeable staff of ~120 to help their clients identify: **(1) who their best customers are, (2) where they and others like them are located, and (3) the value these customers have to the organization.** Several sample retail clients of Buxton's include:

- **Sprouts Farmers Market**
- **The Fresh Market**
- **Fairway**
- Grocery Outlet
- Jamba Juice
- Red Wing Shoes
- Bojangles
- Planet Fitness
- California Pizza Kitchen
- GNC
- Firehouse Subs
- Marriott
- Fogo do Chao
- FedEx
- Sally Beauty

Source: The company.

A Closer Look at the Buxton White Space Analysis

Buxton's retail white space analysis, or US store potential analysis, takes into account both: (1) data from 250-plus databases; and (2) company-specific data, such as unit level volumes, acceptable levels of cannibalization (which generally runs as high as 10%, but can vary by retailer), and any customer analytical/loyalty card data, if available. Buxton also provides similar analysis for private equity firms in their due diligence process and, on occasion, for retailers looking to gauge the competitive impact of another growing retailer in their space. Buxton's white space analysis also takes into consideration: (1) macroeconomic conditions, (2) changes in a company's business model, and (3) major changes in the competitive landscape. Buxton estimates that its long-term white space potential is generally accurate in the 10-15% range, with a higher degree of accuracy for retailers that follow Buxton's trade area guidelines and a lower degree of accuracy for those that have less consistent business models (example: franchised chains with limited cannibalization guidelines and/or models that are highly dependent on the execution of a store manager, such as pawn shops). If a retailer were to open new stores outside Buxton's recommended trade area or change the model (i.e., pursue an untested urban store or small store strategy when the company's strategy is based on a suburban model or large store strategy), that creates risk to Buxton's analysis. The key, in our view, to Buxton's proprietary process for its retail white space analysis is that it helps retailers identify how many potential customers it has per trade area.

Exhibit 1: Examples of Buxton's "White Space" Analyses

Company	Current Locations	Long-Term Potential	% Penetration
Fairway Group	14	300	5%
Natural Grocers	70	1,100	6%
Sprouts	167	1,200	14%
Fresh Market	136	500	27%
Vitamin Shoppe	579	900	64%

Source: Company reports/Buxton, BMO Capital Markets.

What Is Not Incorporated Into Buxton's White Space Analysis?

Buxton does not incorporate potential growth of the competitors into its analysis (either based on publicly disclosed information or from its proprietary information in working with other retailers). There are a variety of reasons why Buxton chooses not to include potential growth or announced growth plans of competitors in its forecast: (1) Buxton clients typically want to prioritize locations across markets to immediately begin the site selection process and 10-year projections don't translate appropriately; (2) competitor-announced plans for growth don't necessarily result in real world locations; and (3) business models change over time, influencing growth potential for both the retailer and competitor set being studied. Buxton does not monitor "site-specific" characteristics for sites selected by retailers. Retailers must incorporate their own "boots on the ground" real-estate knowledge into Buxton's recommendations. For example, Buxton provided an example in our meeting of a retailer that opened a store in a Buxton-defined trade area but experienced 60% less than expected new-store productivity. The retailer's management team later identified that shrubbery had significantly blocked visibility to the retailer's location and, once removed, the productivity of the store began to perform in line with the company's expectations.

Buxton's 250-Plus Databases Include Proprietary Visa Data

Buxton utilizes more than 250 databases, including purchased data from vendors such as Experian to credit card data to proprietary survey data, with the goal of identifying the characteristics and locations of a company's customer. Buxton also has a proprietary relationship with Visa that, with client permission, provides Buxton with rolling 12 months of transaction data and allows Buxton the ability to identify purchase activity at ZIP +4 level (which protects the anonymity of the actual customer). This data further enhances the accuracy of customer profiles and trade areas used in the modeling process, as well as providing clients with additional customer insights. We estimate that Visa is on 75% of US debit cards. Additionally, given Buxton's vast databases, resources, and knowledge analyzing the data, Buxton can generally determine where a customer is located 25-40% of the time with simply an email address. With this data, in conjunction with additional unit-level data provided by the client, Buxton is able to identify a set of certain variables that are predictive of performance. Included variables would typically include customer profile, drive-time trade area, competitive presence and relevant demographic, psychographic and retail (cotenancy, GLA or Gross Leasable Area) elements, further refined by geographic region and population density. Clients use the resulting model to provide a revenue score for potential sites, as well as to identify, prioritize, and optimize markets for growth and expansion.

SCOUT: Buxton's Proprietary Web-Based Tool for Retail Clients

Buxton's retail clients are provided access to a proprietary web-based Buxton tool, called SCOUT, which allows retailers to follow Buxton's recommendation for potential stores per trade area (which is generally defined as a region from which 75% of a company's sales dollars are generated), as well as to generate revenue forecasts for specific sites as they are being considered. Therefore, Buxton's white space analysis may be thought of as a snapshot in time of a potential retailer's long-term new store growth potential, subject to revisions, either when recommended by Buxton or at client's request, but generally every 2-3 years given potential changes to the factors mentioned above.

Exhibit 2: BMO Food Retailing Universe Fiscal Year Valuations: P/E and EV/EBITDA

Date Thursday, November 14, 2013																			
P/E																			
Company	Ticker	Current Price	Target Price	Rating	Market Cap	FY End	L-T EPS Growth	BMO Capital EPS estimates (FY)				P/E (based on BMO figures)				Historical 2-Yr Fwd P/E			PEG FY2014E
								FY2012	FY2013E	FY2014E	FY2015E	FY2012	FY2013E	FY2014E	FY2015E	Peak	Trough	Avg	
Whole Foods	WFM	\$59.26	\$68	OP	21,990	Sep	18%	\$1.26	\$1.47	\$1.67	\$1.95	47.0x	40.3x	35.5x	30.4x	49x	10x	29x	2.0
Sprouts	SFM	\$43.65	\$48	Mkt	6,540	Dec	22%	\$0.36	\$0.47	\$0.54	\$0.68	120.5x	93.1x	80.3x	64.4x	--	--	--	3.6
Fresh Market	TFM	\$50.82	\$60	OP	2,427	Jan	20%	\$1.07	\$1.33	\$1.53	\$1.85	47.5x	38.2x	33.2x	27.5x	36x	22x	29x	1.7
United Natural Foods	UNFI	\$72.09	\$83	OP	3,574	Jul	13%	\$1.95	\$2.20	\$2.50	\$2.85	37.0x	32.8x	28.8x	25.3x	29x	9x	20x	2.2
Fairway	FWM	\$22.17	\$24	OP	899	Mar	28%	(\$0.17)	(\$0.28)	(\$0.35)	\$0.02	NM	NM	NM	1108.5x	--	--	--	NM
Kroger	KR	\$42.68	\$44	Mkt	21,925	Jan	9%	\$2.00	\$2.63	\$2.80	\$3.12	21.3x	16.2x	15.2x	13.7x	16x	8x	12x	1.7
Safeway	SWY	\$34.46	\$38	OP	8,369	Dec	8%	\$2.17	\$0.96	\$1.80	\$1.96	15.9x	35.9x	19.1x	17.6x	18x	7x	12x	2.4
Casey's	CASY	\$76.57	\$66	Und	2,929	Apr	8%	\$3.04	\$2.94	\$3.65	\$3.90	25.2x	26.0x	21.0x	19.6x	19x	11x	15x	2.6
Susser	SUSS	\$61.59	\$62	OP	1,324	Dec	13%	\$2.36	\$1.80	\$2.55	\$2.80	26.1x	34.2x	24.2x	22.0x	47x	8x	23x	1.9

EV/EBITDA																			
Company	Ticker	Current Price	Target Price	Rating	Enterprise Value	FY End	Net Debt	BMO Capital EBITDA (FY)				EV/EBITDA (based on BMO figures)				Historical 1-Yr Fwd			Net Debt/ EBITDA F14E
								FY2012	FY2013E	FY2014E	FY2015E	FY2012	FY2013E	FY2014E	FY2015E	Peak	Trough	Avg	
Whole Foods	WFM	\$59.26	\$68	OP	21,726	Sep	(264)	\$1,051	\$1,208	\$1,364	\$1,561	20.7x	18.0x	15.9x	13.9x	23x	4x	13x	-0.2
Sprouts	SFM	\$43.65	\$48	Mkt	6,216	Jan	(324)	\$147	\$190	\$222	\$262	42.4x	32.8x	28.0x	23.7x	--	--	--	-1.5
Fresh Market	TFM	\$50.82	\$60	OP	2,456	Jan	29	\$119	\$147	\$175	\$210	20.6x	16.7x	14.1x	11.7x	20x	15x	18x	0.2
United Natural Foods	UNFI	\$72.09	\$83	OP	3,727	Jul	153	\$202	\$230	\$259	\$291	18.5x	16.2x	14.4x	12.8x	17x	5x	11x	0.6
Fairway	FWM	\$22.17	\$24	OP	1,020	Mar	-	\$36	\$45	\$53	\$68	28.5x	22.8x	19.4x	15.0x	--	--	--	0.0
Kroger	KR	\$42.68	\$44	Mkt	29,093	Jan	7,158	\$3,869	\$4,300	\$4,379	\$4,851	7.5x	6.8x	6.6x	6.0x	8x	4x	6x	1.6
Safeway	SWY	\$34.46	\$38	OP	12,214	Dec	3,815	\$2,192	\$1,556	\$1,638	\$1,690	5.6x	7.9x	7.5x	7.2x	8x	4x	6x	2.3
Casey's	CASY	\$76.57	\$66	Und	3,542	Apr	613	\$315	\$325	\$393	\$423	11.2x	10.9x	9.0x	8.4x	9x	5x	7x	1.6
Susser	SUSS	\$61.59	\$62	OP	1,495	Dec	(35)	\$177	\$162	\$190	\$207	8.4x	9.2x	7.9x	7.2x	10x	5x	7x	-0.2

Source: Company reports, Thomson Financial, BMO Capital Markets. OP-Outperform, Mkt-Market Perform, Und-Underperform.

Important Disclosures

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Hold	Market Perform	59.4%	13.1%	51.1%	56.9%	50.2%	41.7%
Sell	Underperform	4.9%	3.4%	1.1%	6.4%	1.5%	5.6%

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Mkt = Market Perform - Forecast to perform roughly in line with the analyst's coverage universe on a total return basis;

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(S) = Speculative investment;

NR = No rating at this time; and

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