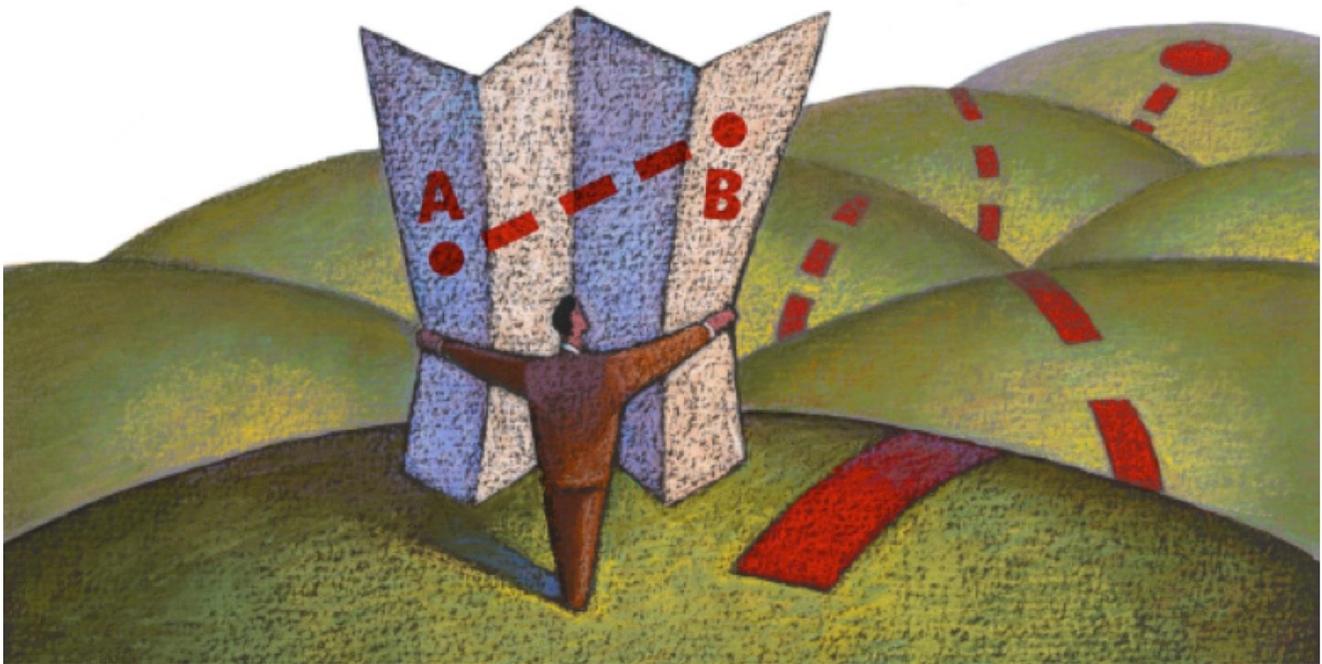
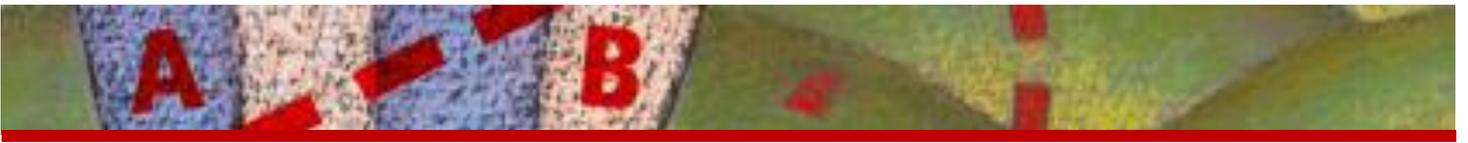


Strategic Initiatives

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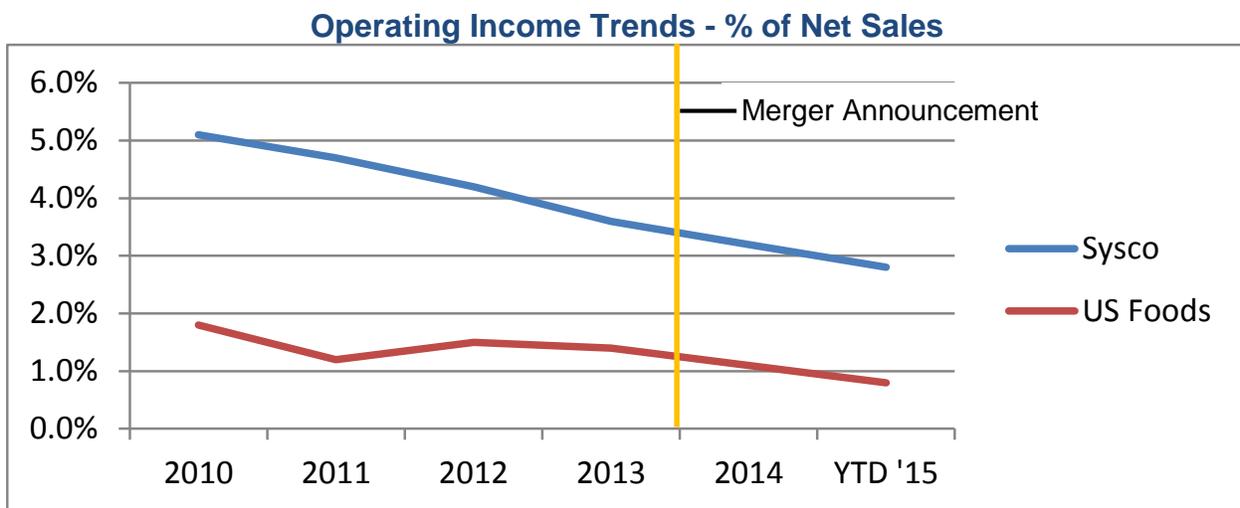
SYSCO – US FOODS MERGER CESSATION **Initial Perspectives: Potential Outcomes & Implications**



Overview

With Sysco's decision to end the merger efforts with US Foods based on last week's preliminary injunction blocking the proposed merger, the focus turns to the implications across the foodservice supply chain. This development produces more turbulence in the foodservice channel, creating both challenges and opportunities for market participants.

Although it is unclear at this point what Sysco's and US Foods' next steps will be, it is clear that both organizations have faced business challenges, particularly related to operating income, since the merger was announced in December 2013.



While this business performance can be attributed to a variety of factors, including the merger plans, we believe that both organizations will focus their immediate efforts on strengthening their business dynamics while evaluating longer-term opportunities. This paper provides our initial perspectives regarding the implications of the failed merger.

Sysco

Sysco faces a challenge to drive top-line growth while improving operating margins. With the cessation of the US Foods merger efforts, Sysco has lost a significant opportunity to reset operating margins and scale by integrating US Foods. Moving forward, we believe that Sysco management will continue to pursue strategic opportunities to redefine business dynamics on a significant scale.

Potential initiatives may include:

- **Acquire a super-regional broadline distributor** to expand Sysco's market position and drive operating efficiencies without crossing the FTC's perceived thresholds for market share. If Sysco pursues this course of action, we view this approach as part of a to-be-articulated broader



growth and efficiency strategy because the addition of a \$2 - \$14 billion distributor would still not provide sufficient scale for Sysco to achieve the operating efficiencies and margin improvements that the US Foods merger would have generated, particularly in the more profitable broadline segment.

- **Expand into new channels via acquisitions.** Sysco could expand beyond the traditional foodservice channel by acquiring participants within ancillary channels such as: Convenience Stores, Cash & Carry, Grocery, System, etc. This strategic approach could enable Sysco to expand top-line growth while leveraging existing assets and capabilities to drive operating efficiencies.
- **Expand internationally** outside of the U.S. While the U.S. is likely to remain Sysco's core business focus, the organization could look outside of the U.S. for growth acceleration. Sysco could build upon their relatively small international business by continuing to acquire or align with leading distributors in strategic international markets. Recently, Sysco has expanded operations in Mexico, Costa Rica and Canada; in addition to its established businesses in Ireland / Northern Ireland.
- **Build capabilities in new, or non-core, categories** such as Non-Foods, which accounts for an estimated 12% - 15% of the foodservice channel and 11% of Sysco's revenue; or potentially Alcohol, which would most likely require acquisition given alcohol distribution regulations and licensing dynamics.
- **In the immediate term**, Sysco will most likely increase focus on previously-announced margin enhancing initiatives, including Category Management, Sysco brand development and Sysco broker network development.

US Foods

We believe that U.S. Foods' leadership and financial owners will pursue alternative options to strengthen, and potentially sell, the business. In the aftermath of the failed merger efforts, US Foods has been weakened due to employee and management turnover, merger-related resource requirements and focus, loss of operator contracts and an uncertain future. It will be imperative for US Foods leadership to rapidly communicate a new strategy to assure trading partners of their ongoing strength and commitment to continued success. Potential options for US Foods include:

- **Form an alliance with a super-regional broadline distributor** via merger or acquisition to build scale and improve operating performance as an enhanced national alternative to Sysco.
- **Divest unprofitable, non-strategic business** to become more profitable and efficient. This may include an assessment and rationalization of customer segments or national account contracts.
- **Explore a sale to financial buyers** with a new strategy for US Foods' future. PFG's financial owners may represent a logical focal point, as the two companies have already negotiated the potential sale of Sysco / US Foods assets to PFG.
- **Develop a clearly differentiated value proposition** to Sysco. As Sysco proceeds with technology-driven automation, sales force reductions, centralized functions, category management, brand development, etc., US Foods may have an opportunity to create a competitive advantage by providing different capabilities for trading partners. The challenge will be to create a differentiated value proposition that also enables US Foods to improve profit



margins. This value proposition must be based on customer-relevant products, services, technologies, insights and brands.

Other Broadline Distributors

We believe that the primary broadline distributors will continue to consolidate and / or expand their geographies to achieve greater scale and market relevancy. As a group, the other broadline foodservice distributors in the Top 10 have exceeded Sysco's and US Foods' performance since the merger was announced. This overall success was driven by continued focus on their growth strategies and by gaining customers due to operator uncertainty and reduced focus by Sysco / US Foods during the post-merger announcement period. As this period of uncertainty related to the merger announcement ends, each major distributor will reassess and refine their growth strategies.

Manufacturer Implications

There are a number of implications for manufacturers as the industry adjusts to these new market dynamics. At a minimum, manufacturers must review and refine their Distribution and Trade Investment Strategies. Specific implications include:

- **Reassess distributor resource allocations**

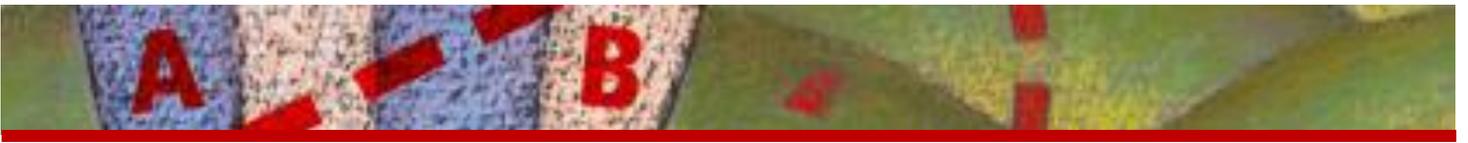
As the distribution channel resets, it is important for manufacturers to determine where they will focus to drive growth. In anticipation of the announced merger as well as other dynamics such as category management, many manufacturers have begun to align greater resources against Sysco. As Sysco and US Foods move forward independently, manufacturers must reevaluate resources applied to not only Sysco and US Foods, but to all primary distributors. In our opinion, Sysco and US Foods each independently require a focused strategy, yet the elements of those strategies may be different without the merger. This requires a reassessment of go-to-market resource alignment, trade investment, brand strategies, product development priorities and system alignment across the distribution channel.

- **Establish distributor strategies based on operator customer dynamics**

While we believe that the distributor universe will continue to evolve and consolidate, it is difficult to predict how individual distributors will be impacted. At the same time, manufacturers must make informed decisions regarding where and how to invest resources for growth. By analyzing their operator customer dynamics and identifying the distribution systems aligned with their most strategic, profitable customer groups, manufacturers can identify which distributors are most important for providing market access for their business, and can allocate resources accordingly. This analysis will drive priorities for targeted distribution strategies.

- **Prepare for refocused Sysco and US Foods organizations**

As Sysco and US Foods move forward independently, each organization will focus on key initiatives to improve both top-line and bottom line performance. It is our expectation that both organizations will increase efforts related to category management and distributor brand development in order to improve margins. Manufacturers will face increased requests for investment and alignment, and will need to make fact-based decisions based on a clearly defined distribution strategy.



- **Reevaluate trade investment strategies in the light of greater transparency and visibility into programs and spending levels**

Trade and Marketing program information has been shared between parties as part of the proposed Sysco / US Foods merger; and this dynamic will continue as other distributors evaluate merger and acquisition opportunities. This increased visibility compels manufacturers to reevaluate their trade investment strategies and clearly define the role of distributors within their business development efforts. While distributors are the primary route-to-market and important supply chain partners, operators drive the majority of purchasing decisions. Evolved trade investment strategies must focus distributor efforts on the specific customer groups, brands and products that manufacturers rely on them to impact, without allocating resources to areas that are either not a strategic priority or addressed elsewhere in the manufacturer's go-to-market model.

We will continue to refine these initial perspectives in the days ahead. We would welcome the opportunity to discuss these developments and implications in greater detail; and would like to hear your point of view as well. Please contact me to schedule a call or meeting.

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