Spartan Stores and NashFinch – Merger Case Study of Bidder Size Smaller Than the Target Size

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Spartan Stores a publicly traded company in the grocery industry made a bid to acquire Nash-Finch Company in 2013. Nash Finch shareholders received 1.2 shares of Spartan stores and the transaction was valued at $340 million. The merger was unusual that the target firm Nash Finch was larger than the bidding firm Spartan stores. Its 2012 revenue was almost double Spartan Stores and its shares traded for more on the NASDAQ. It was losing market share in its retail stores and their wholesale customers were experiencing competitive pressure. The case study is written for students in advanced managerial finance course. Students are asked to understand the motives of the merger, method of payment and its signaling content, valuation of the two firms prior to the takeover offer, and learn about the post-merger performance.

Keywords: mergers, gains, method of payment, valuation

INTRODUCTION

The years following the recession were rough for players in the grocery and supermarket industry. Food costs rose and grocery sales declined to the lowest they had been in years. In 2013, costs started to fall, and grocery giants such as Walmart and Target were under pressure to offer discounts to boost sales. This pressure did not bode well for the industry especially smaller players like Nash Finch who did not have the scale and purchasing power like Walmart. In 2012, Nash Finch posted a net loss of $93 million on flat sales of about $4.8 billion as competitors ate into its business.

In 2013, the company was acquired by Grand Rapids based Spartan Stores in a $1.3 billion stock swap deal. Nash Finch shareholders received a fixed ratio of 1.2 shares of Spartan Stores common stock for each share of Nash Finch stock that they own.

Comparison of the Two Grocery Distributors

Nash Finch was larger than its acquirer Spartan stores. Its 2012 revenue was almost double Spartan Stores and its shares traded for more on the NASDAQ. However, it was losing market share in its retail stores and their wholesale customers were experiencing competitive pressure. Spartan stores was a smaller distributor, distributing to smaller retail stores. Its competitive strength was in its retail business. Although it was smaller than Nash Finch and faced similar pressures, it was a better managed company that was experiencing growth at a time its competitors revenues were shrinking. In 2012, its revenues exceeded analysts' expectations for that year.

See summary of both companies below :

- **Annual revenue (pre-merger)**
  Nash Finch: $4.6 billion
  Spartan Stores: $2.61 billion
- **Stock price (Pre-merger)**
  Nash Finch: $25.43
  Spartan Stores: $21.20
- **Distribution**
  Nash Finch: Second largest publicly traded wholesale food distributor in the country. Company distributes food products and provides support services to 1,300 retail formats including conventional supermarkets, military commissaries, multicultural stores and extreme value stores.
  Spartan Stores: Ninth largest grocery distributor in U.S., distributing more than 40,000 private and national brand products to approximately 390 independent grocery locations in Michigan, Indiana and Ohio, and to the Company's 102 corporate owned stores.
- **Retail**
  Nash Finch operates 75 stores, mainly in the Midwest including Nebraska, North Dakota, Ohio and Iowa, the under banners of Avanza Supermarket, Bag 'N Save, Econofoods, Family Fresh Market, Family Thrift Center, No Frills Supermarkets (USA), Pick 'n Save, Prairie Market, SunMart Foods, Savers Choice and Wholesale Food Outlet.
  Spartan Stores operates 102 stores, in Michigan, under the banners of D&W Fresh Market, Family Fare Supermarkets, VG's Grocery, Glen's Market and Valu Land.

Motive of the Merger

The motive of the acquisition was for synergies. Spartan hoped to achieve the following from the acquisition:

1. **Improved market reach, distribution network and visibility -** Nash had wholesale and some retail business in Minnesota and the Dakotas. Its core business also included distribution to military commissaries in the US and in some locations abroad. Through this acquisition, Spartan (operations in Michigan, Indiana and Ohio) has expanded its market reach to these areas. It has also acquired a successful business - military commissaries and has improved its standing in the investment community.
2. **Cost Synergies -** The transaction was expected to create "cost synergies" of approximately $20 million, $35 million and $52 million in fiscal years 2014, 2015 and 2016, respectively through staff reduction, purchasing etc. This was an important factor given the conditions and competitors in the industry. They can enjoy better economies of scale and negotiate better prices from vendors.

The goal of the merger was to bring together two highly complementary organizations to form a leader in the grocery wholesale, retail and military commissary and exchange channels.

The Deal

Given its most recent financial performance, Nash Finch was at the verge of a hostile takeover. So its executives sought a white knight in this acquisition. In white knight acquisitions, company executives (in this case, Nash Finch CEO Alec Covington) seek out acquirers that preserve the company's core business and negotiate better terms.

Spartan stores, a smaller but better run company was the white knight. They negotiated a more attractive deal for both parties. For example, the purchase was as an all-stock transactions which cleared out the regulatory hurdles involved in cash and debt purchases. Secondly, Spartan Stores was able to keep the Grand Rapids location as a headquarters even though Nash Finch Headquarters in Minneapolis was larger. They also received $2.75 million is state and local tax incentives to stay in Grand Rapids, Michigan.

Acquisition

Post announcement, the share price of both companies went up; Nash Finch shares went up 3% while Spartan Stores was up 4% signalling that investors on both sides were happy with the deal. Former Spartan Stores shareholders now own approximately 57.7 percent of the equity of the combined company, and former Nash Finch shareholders own approximately 42.3 percent.

SpartanNash became a Fortune 500 company and the largest food distributor serving military commissaries and exchanges in the U.S., in terms of revenue. Combined revenue is expected to be $7.5 billion. The company's core businesses now include distributing food to military commissaries and exchanges and independent and corporate-owned retail stores in 44 states and the District of Columbia, Europe, Cuba, Puerto Rico, the Azores, Bahrain and Egypt. It operates 22 distribution centers covering 37 states and 177 supermarkets, primarily under the banners of Family Fare Supermarkets, No Frills, Bag 'n Save and Econofoods.

Post-Merger Performance

To determine whether the merger was successful and whether the bidders overpaid, we had to determine the valuation using the Stock Price as a multiple of 2013 EPS and Enterprise Value as a multiple of 2013 EBITDA. It appears Spartan Stores did not overpay for the merger. See below

Metrics	**Spartan Stores**	**Nash-Finch**
EV(2013 EBITDA multiples)	18.49 - $22.17	14.98 - $20.68
Stock Price (2013 Multiples)	15.90 - $20.19	21.98 - $27.98

Also, from the financial highlights below, SpartanNash has seen experienced some growth in sales but operating income has fluctuated wildly and trending downwards. Given the highly competitive industry they operate in, these results are not unusual. The following are possible reasons for the results:

1. Competitive pricing in retail segments - SpartanNash brands are more expensive than Walmart and many other grocery retailers
2. Challenges in the military commissary system
3. Merger related synergies and excitement are dying down

The merger was successful and although post-merger performance is slow, SpartanNash with its strong management team is capable of making the company successful.

FIGURE 1
POST-MERGER REVENUES OF THE MERGED ENTITIES

	Period Ended	Year Ended				
	39 Weeks[1] 12/28/2013	51 Weeks[2] 12/28/2013	53 Weeks[3] 1/3/2015	52 Weeks 1/2/2016	52 Weeks 12/31/2016	**52 Weeks 12/30/2017**
Net Sales	$ 2,597	$ 3,190	$ 7,916	$ 7,652	$ 7,735	**$ 8,128**
Gross profit margin	18.7%	19.4%	14.6%	14.6%	14.4%	**14.1%**
Operating earnings	17	36	115	123	109	**(106)**
Adjusted operating earnings	57	77	136	141	149	**144**
Earnings from continuing operations	1	9	59	63	57	**(53)**
Adjusted earnings from continuing operations	30	40	70	75	82	**79**
Earnings from continuing operations per diluted share	0.05	0.39	1.57	1.67	1.52	**(1.41)**
Adjusted earnings from continuing operations per diluted share	1.23	1.70	1.85	1.98	2.19	**2.10**
Adjusted EDITBA	97	127	234	230	231	**236**
Cash provided from operating activities	65	97	139	219	155	**53**
Total debt	595	595	561	487	431	**750**
Total net long debt	586	586	555	464	407	**734**

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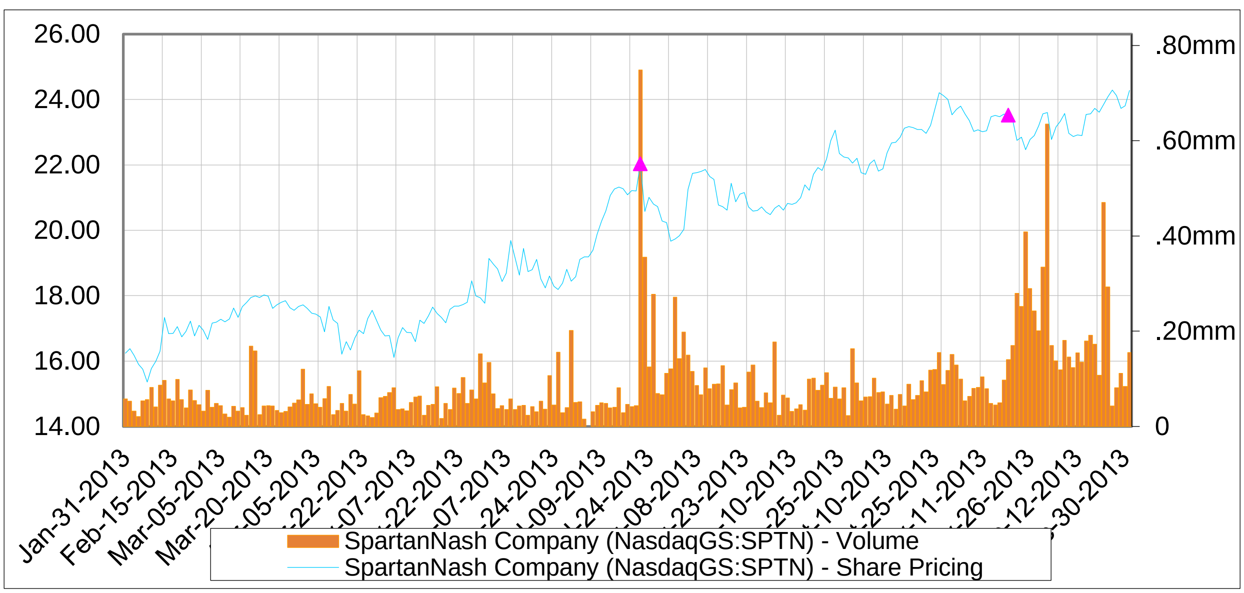
APPENDIX

Acquisition Information

Bidder	Spartan Stores	
Target	Nash Finch	
Offer Date	7/22/2013	
Merger Date	11/19/2013	
Transaction type	Stock	
Bid Price	1.2 : 1	Spartan Stores Shares to Nash Finch Shares
Total Transaction Price	$1.3 billion	
Target Final Share Price		



SpartanNash questions:

1. How was this merger an anomalous one on the basis of sizes of the bidder and target? Who was the bidder and the target? Why did the headquarters of the merged company stay in Michigan?
2. What were the motives of this union? Refer to the merger motives paper by M.P. Narayanan.
3. The CEO of Spartan Stores Dennis Eidson proclaimed the merged entity to be successful. What was his rationale for this announcement? Provide a strategic perspective.
4. The balance sheets, income statements, and cash flow statements have been provided in the appendix. Conduct a valuation exercise for each firm separately before the merger.

5. Conduct a financial statement analysis for the bidder and target separately. Comment on their pre-merger performance.
6. Identify the stage of life cycle of each company based on the cash flow analysis.
7. Conduct an elaborate DuPont analysis based on Hawawini- Viallet Models.
8. Discuss the financing of the merger? What was the method of payment deployed by the bidder? How was the merger financed? What was the impact of the financing arrangement on the value of the bidder and target pre and post announcement of the merger?
9. Conduct a post-merger analysis of firm performance.
10. Were the motives for merger given by you in question 2 accomplished?