Overview

Our Recommendation

Financial Breakdown

Synergy Analysis

Key Takeaways

LVMH-Hermès Timeline

- **2002**: LVMH acquired 4.9% through subsidiaries.
- **2007**: LVMH continues buying equity derivatives.
- **2007, Oct.**: Hermès creates private holding company.
- **2010, Dec.**: LVMH not allowed to buy out minority Hermès shareholders.
- **2010, Jan.**: LVMH acquires a cumulative 14.2% stake.
- **2010, Nov.**: AMF announces investigation of LVMH.
- **2010, Dec.**: LVMH raises stake to 22.6%.
- **2011, Jul.**: AMF ruled to penalize LVMH with a $10.4 million fine.
- **2011, Sep.**: LVMH increased its stake in Hermès to 23.1%.
- **2011, Jul.**: AMF found evidence of "wrongdoing" by LVMH.
- **2012, May**: Hermès files lawsuit, seeking cancellation of equity.
- **2012, Jul.**: LVMH increased its stake in Hermès to 23.1%.
- **2012, Sep.**: LVMH announced that it would not appeal the AMF ruling.
- **2012, Oct.**: AMF found evidence of "wrongdoing" by LVMH.
- **2012, Dec.**: Hermès filed a criminal complaint against LVMH in Paris court.
- **2013, Jun.**: AMF ruled to penalize LVMH with a $10.4 million fine.
- **2013, Jul.**: LVMH announced that it would not appeal the AMF ruling.
- **2013, Sep.**: LVMH increased its stake in Hermès to 23.1%.
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- **2013, Sep.**: LVMH announced that it would not appeal the AMF ruling.
- **2013, Oct.**: AMF found evidence of "wrongdoing" by LVMH.
- **2013, Dec.**: Hermès filed a criminal complaint against LVMH in Paris court.
Our Recommendation
Retain Stake in Hermès, Venture in eCommerce

Our Recommendation

- Hold 23.1% stake in Hermès for high price or until lawsuit requires LVMH to relinquish shares
- Expand operations in increasingly opportunistic eCommerce markets

Financial Breakdown

- 31.21% Increase in equity stake from 2010-2013
- Chinese eCommerce market expanded 66.5% from 2011 to 2012

Synergy Analysis

1. Gain Asian eCommerce market share, development of mobile App
2. Ease tensions, earn investment income on 23.1% stake
3. Leverage market share in eCommerce & increased income, outperform luxury brands in near future

Key Takeaways

Overview  Our Recommendation  Financial Breakdown  Synergy Analysis  Key Takeaways
Financial Breakdown
The following information assesses the viability of acquiring Hermès:

- By our valuation, Hermès is worth €27,856 million.
- Key figures:
  - EV/EBITDA = 39.20
  - EV/Sales = 6.61
  - P/E Ratio (Sep 2013) = 38.31
- Hermès is expensive compared to its competitors
  - Therefore it may be expensive for LVMH to acquire
Valuation of Hermès Acquisition

- The main method used was Discounted Cash Flow valuation
  \[
  \text{NPV} = €5,865.27 \\
  \text{IRR} = 2.74\% \\
  \text{MIRR} = 2.60\% \\
  \text{Simple Payback} = 16.295 \text{ years}
  \]
- The WACC used was very low: 1.178%
- On paper, the acquisition is profitable.
- However, financial and qualitative synergies are unrepresented in the above figures.

Selected Data
Expansion into Asian eCommerce Market

- Chinese eCommerce Market expanded 66.5% in 2012
- Expanding Mobile Apps accounted for 53.6% of total sales
- Average money spent by consumer increased 25% in 2012
- Chinese eCommerce market will overtake American market
- Few main competitors have Chinese eCommerce campaigns

High promise of sales and profitability

Expansion into increasingly popular purchasing medium of eCommerce through website

Utilize Mobile App to market to increasingly mobile market

Overview   Our Recommendation   Financial Breakdown   Synergy Analysis   Key Takeaways
Synergy Analysis
“The Selective Retailing Houses in the LVMH group all share a single objective: transform shopping into a unique experience. With specialist product selection, upgrading of stores and services, constant innovation, digitalization and personalization of relationships, customers are the key drivers for their daily activities.”
Hermès Operating Model

**Sourcing**
- Vertical Integration
  - Control quality & cost of RM

**Production**
- Controls 80% of sold products, only selecting subcontractors in segments they lack expertise
- On avg. 15 hours for a single Kelly/Birkin handbag

**Zero Marketing**
- No Marketing Department
- No Brand Ambassadors (as opposed to LVMH)

**Consistency**
- Same product collections are sold worldwide

**Distribution**
- Limited online presence with directly operated stores
  - Control level of client care
- Increased stores while decreasing distribution through 3rd party

---

**Overview**

**Our Recommendation**

**Financial Breakdown**

**Synergy Analysis**

**Key Takeaways**
“The quality is in the eye and the hand of the artisan.”

- Axel Dumas, chief operating officer
Hermès Culture

• Labeled as one of the world’s most innovative companies
  ○ Innovation maintains the interest of their customer base and protects their intellectual property
  ○ Recruits craftsmen through partnerships with schools and puts emphasis on cultural training

• Focuses on family ties
  ○ Hermès family shareholders hold about 73.4 percent of the company
  ○ Created a family holding company, H51, to secure 50.2% of shares for the next 20 years (2011)
"There is a part of our world that is playing on abundance, on glitz and glamour. And there is another part that is concentrated on refinement, basically making beautiful objects. It's not a financial fight, because we would lose that. It's a cultural fight."

- Patrick Thomas, executive chairman

- This social commentary gives insight as to how the Hermès views their company culture in comparison to that of LVMH

- How accurate is this analysis?
“The mission of the LVMH group is to represent the most refined qualities of Western "Art de Vivre" around the world. LVMH must continue to be synonymous with both elegance and creativity. Our products, and the cultural values they embody, blend tradition and innovation, and kindle dream and fantasy.”
LVMH Culture

- 1987 merger between Moët Hennessy and Louis Vuitton began the LVMH empire of luxury goods
  - “Inherited a long history, deeply rooted traditions, and a unique combination of internationally renowned brands.”

- Culture revolves around the ideas of CEO, Bernard Arnault
  - Gained over 60 brands for LVMH through his emphasis on dozens of strategic acquisitions
  - Visionary, bold, and innovative

- Hermès dismisses Arnault, and LVMH, of being brash and uncultured
  - American-style entrepreneurship, creating a sprawling luxury empire
  - Does this align with how LVMH views its own culture?
LVMH Values

01 Be creative and innovative
02 Aim for product excellence
03 Bolster the image of our brands with passionate determination
04 Act as entrepreneurs
05 Strive to be the best in all we do
LVMH Strengths

Diversified luxury portfolio

Multiple Brands with strong potential

Geographic Diversity

Diversified Retail Channels
3,384 store operations
Accounts receivables increased by 9.5% indicating higher credit sales.
Increasing accounts receivable reflects inefficient credit management.
Ineffective in converting short term assets into sales.
Consistent decline in current asset turnover for FY 2013 from 1.2 to 1.1 --> cannot generate high sales through conversion of assets.

LVMH Weaknesses

Decline in Current Asset Turnover

Increasing Trade Receivables

Hermès

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Directly Operated Stores

Franchise Stores

Duty Free

Third Party

Hermès Customers

Leather/Skin

Other Suppliers

Silk

Various Suppliers

Watch Movements

Various Suppliers

Perfume, Raw

Various Suppliers

Porcelain, Raw

Various Suppliers

Industrial Subsidiaries

Designs 100% Products

Manufactures 80% of

Products

Markets 57% of Products

Ready to Wear

French & Italian

Subcontractors

Jewelry

Various Subcontractors

Ready to Wear

French & Italian

Subcontractors

Hermès Sellier John Lobb Shoes

Perrin Ateliers Sports Soie

La Montre Hermes

Comptoir Nouveau De La Perfumerie

Cristalleries De Saint-Louis Puiforcat Orfevre Porcelaine Perigod

Leather/Skin

Other Suppliers

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Perrin Ateliers Sports Soie

La Montre Hermes

Comptoir Nouveau De La Perfumerie

Cristalleries De Saint-Louis Puiforcat Orfevre Porcelaine Perigod
1. Growth Prospects: E-Retail
   As a new form of retail emerges, Hermès has great opportunity to expand digitally and reach a wider customer base.

2. Changing Dynamics of Global Fashion Market
   The global apparel and accessories markets in the recent past have witnessed a paradigm shift, inclining more towards increased product differentiation and catering to a diverse, more aware and a demanding customer base.

3. Strategic Acquisition
   - 2014 Feb: New Partnership with Marco De Vincenzo through a Joint enter
   - 2013 Nov: Established Helios (cosmetics and research center)
     Focus on development of new processes and to secure new patents

4. Strategic Initiatives
   Aimed at enhancing its business operations and existing product line
LVMH Threats

Intense Competition
- Constant need to maintain quality and customer loyalty

Counterfeit Goods
- Profusion of imitative products

Governmental Regulations
- Extensive gov. regulations at national & state level
Hermès Strengths

Diversified Product Portfolio
- Tanning, dyeing, exotic skins, leather goods, equestrian items, ready to wear, accessories, jewelry, tableware, perfumes, watches, silk, textiles, luggage, diaries

Operational Facility
- From 2011 - 2012 increase of 22.6% in revenue (2.8M Euros)
- Increased operating Margin 2011 - 2012 (32.10% to 31.15%)

Robust Facilities
- Network of -> 323 exclusive stores + 205 directly operated stores.
- 45 production units – 34 in France and 39 elsewhere (UK, Switzerland, Italy and one in the USa)
Hermès Weaknesses

Declining Liquidity Position

Facing difficulty in:
1. Fulfilling its operational needs
2. Working capital needs

Total Liquidity

Increment in current liabilities is relatively higher than increment in current assets

Liabilities + Assets = Net

Overview Our Recommendation Financial Breakdown Synergy Analysis Key Takeaways
Hermès Opportunities

E-Retailing
As a new form of retail emerges, Hermès has great opportunity to expand digitally and reach a wider customer base.

Store Expansion
Focuses on strengthening and the expansion of its business operations through the addition of new store.

New Business Initiatives
New product launches: Bleus d’Ailleurs porcelain, Tie 7 tie, Roulis bag, Berline bag, Toolbox 33 bag, iPad station, Un Jardin sur le Toit fragrance, Jewellery: exceptional creations, and Arceau Le temps suspendu watch.
Hermès Threats

Highly Competitive Environment

Key competitors include Chanel S.A, LVMH Moet Hennessy Louis Vuitton SA, Gucci Group NV

Counterfeit Goods

With global annual sales of around $500 billion, the sales of counterfeit goods are expected to cross $2 trillion in sales by 2026

Changing Consumer Demands

With its core business being beauty and beauty related products, the changing customer spending patterns will pose a major challenge to the company
Cultural Comparison

Hermes
- Family-owned
- Hands-on production
- Elite customer base
- Authentic
- Love of craftsmanship

LVMH
- Corporate
- Upper-class customer base
- Diverse portfolio of luxury goods
- High-end luxury
- European culture

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Breakdown of Revenue by Product Line: Hermès
Key Takeaways
The acquisition has a positive return, but it is very expensive. The financial pros are potentially outweighed by the qualitative cons. Due to the culture difference, corporate structure and lack of synergy, we do not recommend the acquisition of Hermès.
Appendix
<table>
<thead>
<tr>
<th>Weight of Debt</th>
<th>Financial values in millions of euros</th>
<th>2014</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
<th>Average</th>
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<tbody>
<tr>
<td>Long Term Debt</td>
<td></td>
<td>€15.90</td>
<td>€24.60</td>
<td>€23.70</td>
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<td>Short Term Debt</td>
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<td>Trade and Other Payables</td>
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<td>€303.50</td>
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<td>Cash/Cash Equivalents</td>
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<td>-€970.60</td>
<td>-€1,053.70</td>
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<td>FMV Debt</td>
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<td>-€635.00</td>
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<td>Gross Debt</td>
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<table>
<thead>
<tr>
<th>Weight of Equity</th>
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<tr>
<td>Stock Price</td>
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<td>€265.65</td>
<td>€251.64</td>
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<td>Number of Shares (millions)</td>
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<td>104.814324</td>
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<td>104.556945</td>
<td>105.162445</td>
<td>104.8093328</td>
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<td>Market Cap (millions of euros)</td>
<td></td>
<td>€27,856.16</td>
<td>€26,375.48</td>
<td>€24,183.30</td>
<td>€23,642.42</td>
<td>€16,218.15</td>
<td>€23,659.91</td>
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**TAX RATE**

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<tr>
<th>Income Tax</th>
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<th>€203.70</th>
<th>€397.60</th>
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<tbody>
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<td>EBIT</td>
<td></td>
<td>€621.40</td>
<td>€1,218.00</td>
<td>€1,118.60</td>
<td>€885.20</td>
<td>€668.20</td>
<td>€902.28</td>
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<td>Effective Tax Rate</td>
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<td>32.78%</td>
<td>32.64%</td>
<td>31.21%</td>
<td>32.74%</td>
<td>33.06%</td>
<td>32.39%</td>
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<tr>
<td>Adjusted EBITDA</td>
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<td>€694.50</td>
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<tr>
<td>Weight of Debt</td>
<td>2014</td>
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<tr>
<td>-2.47%</td>
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<tr>
<td><strong>Weight with Gross Debt</strong></td>
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<td></td>
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<td>1.47%</td>
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<tr>
<td><strong>Weight of Equity</strong></td>
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<tr>
<td><strong>Weight of Equity assuming Gross Debt</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>98.53%</td>
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<table>
<thead>
<tr>
<th>Average Yearly Return (2010 - 2012)</th>
<th>WACC 1</th>
<th>WACC 2</th>
<th>WACC 3</th>
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<tbody>
<tr>
<td>2010 Return</td>
<td>74.12%</td>
<td></td>
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</tr>
<tr>
<td>2011 Return</td>
<td>50.86%</td>
<td></td>
<td></td>
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<tr>
<td>2012 Return</td>
<td>2.42%</td>
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</tr>
<tr>
<td>2013 Return</td>
<td>-2.53%</td>
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</tr>
<tr>
<td>Average return</td>
<td>31.21%</td>
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</tbody>
</table>

**RATES**

- $r(d)$ - cost of debt
- $r(e)$ - cost of capital

- Interest Expense: 0.5
- Debt: 19.5
- $r(d)$: 2.56%
- Risk Free Rate: 0.093778%
- Beta: 0.03458
- MRP: 31.12%
- $r(e)$: 1.169937%

Return to Valuation
<table>
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<tr>
<th>Description</th>
<th>Value</th>
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<tr>
<td>Total PV of Cash Flows</td>
<td>€33,721.43</td>
</tr>
<tr>
<td>Less: Acquisition Cost</td>
<td>-€27,856.16</td>
</tr>
<tr>
<td>NPV</td>
<td>€5,865.27</td>
</tr>
<tr>
<td>EV/EBITDA</td>
<td>39.20771559</td>
</tr>
<tr>
<td>EV/Sales</td>
<td>6.611411274</td>
</tr>
<tr>
<td>IRR</td>
<td>2.74%</td>
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<tr>
<td>MIRR</td>
<td>2.60%</td>
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<tr>
<td>Simple Payback</td>
<td>16.295 years</td>
</tr>
<tr>
<td>Cost to Acquire</td>
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</tr>
<tr>
<td>0</td>
<td>-€27,856.16</td>
</tr>
<tr>
<td>1</td>
<td>€686.68</td>
</tr>
<tr>
<td>2</td>
<td>€815.75</td>
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<td>3</td>
<td>€899.74</td>
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<td>4</td>
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<td></td>
<td>€1,181.31</td>
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Return to Valuation
<table>
<thead>
<tr>
<th>A</th>
<th>B</th>
<th>C</th>
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<th>G</th>
<th>H</th>
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<th>J</th>
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<tbody>
<tr>
<td>Years since Acquisition</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>8</td>
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<tr>
<td>Revenue (millions)</td>
<td>€4,118.60</td>
<td>€4,324.53</td>
<td>€4,540.76</td>
<td>€4,767.79</td>
<td>€5,006.18</td>
<td>€5,256.49</td>
<td>€5,519.32</td>
<td>€5,795.28</td>
<td>€6,085.05</td>
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<tr>
<td>COGS</td>
<td>-€1,365.60</td>
<td>-€1,392.91</td>
<td>-€1,420.77</td>
<td>-€1,449.19</td>
<td>-€1,478.17</td>
<td>-€1,507.73</td>
<td>-€1,537.89</td>
<td>-€1,568.65</td>
<td>-€1,600.02</td>
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<tr>
<td>Gross Profit</td>
<td>€2,753.00</td>
<td>€2,931.62</td>
<td>€3,119.99</td>
<td>€3,318.61</td>
<td>€3,528.01</td>
<td>€3,748.76</td>
<td>€3,981.43</td>
<td>€4,226.64</td>
<td>€4,485.03</td>
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<tr>
<td>Gross Profit Margin</td>
<td>66.84%</td>
<td>67.79%</td>
<td>68.71%</td>
<td>69.60%</td>
<td>70.47%</td>
<td>71.32%</td>
<td>72.14%</td>
<td>72.93%</td>
<td>73.71%</td>
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<tr>
<td>Depreciation (asset)</td>
<td>-€145.90</td>
<td>-€153.20</td>
<td>-€160.85</td>
<td>-€168.90</td>
<td>-€177.34</td>
<td>-€186.21</td>
<td>-€195.52</td>
<td>-€205.30</td>
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<td>Incremental SG&amp;A</td>
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<td>-€1,356.29</td>
<td>-€1,424.10</td>
<td>-€1,495.30</td>
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<td>EBIT</td>
<td>€1,315.40</td>
<td>€1,422.14</td>
<td>€1,535.03</td>
<td>€1,654.41</td>
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<td>€2,054.91</td>
<td>€2,203.79</td>
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<tr>
<td>1-Tax Rate</td>
<td>67.61%</td>
<td>67.61%</td>
<td>67.61%</td>
<td>67.61%</td>
<td>67.61%</td>
<td>67.61%</td>
<td>67.61%</td>
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<td>67.61%</td>
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<td>NOPAT</td>
<td>€889.38</td>
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<td>€145.90</td>
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<td>Gain on Disposition of Assets</td>
<td>€1.20</td>
<td>€1.00</td>
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<td>FCF</td>
<td>€686.68</td>
<td>€815.75</td>
<td>€899.74</td>
<td>€988.49</td>
<td>€1,082.26</td>
<td>€1,181.31</td>
<td>€1,285.91</td>
<td>€1,396.35</td>
<td>€1,512.93</td>
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<td>FCF for calculations</td>
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<td>€815.75</td>
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<td>€1,285.91</td>
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<td>Present Value of FCF</td>
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<td>€806.25</td>
<td>€878.91</td>
<td>€954.36</td>
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<td>€1,114.11</td>
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<td>€1,263.69</td>
<td>€1,372.18</td>
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## Breakeven Discount Rate - 20 Years Post Acquisition

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<td>$8,396.58</td>
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<td>0.80%</td>
<td>$7,494.64</td>
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<td>1.00%</td>
<td>$6,620.90</td>
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<td>1.20%</td>
<td>$5,774.37</td>
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<td>4.00%</td>
<td>-$3,695.98</td>
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![NPV vs. Discount Rate Graph](#)
### Global Company Shares

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<th>Data Type</th>
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<th>2011</th>
<th>2012</th>
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<tbody>
<tr>
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<tr>
<td>North America</td>
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<td>Retail Value RSP</td>
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<tr>
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</tbody>
</table>

Note: Historic regional/global values are the aggregation of local currency country data at current prices converted into the common currency using y-o-y exchange rates.


References


Merci