



## **Mergers & Acquisitions Analysis:**

# **SAB Miller Plc. Acquisition of Royal Grolsch NV**

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### **I. MANAGEMENT SUMMARY**

SABMiller plc ([www.sabmiller.com](http://www.sabmiller.com)), publicly listed on the London Stock Exchange (LSE:SAB) and Johannesburg Stock Exchange (JSE:SAB), and available via the US OTC market (OTC:SBMRF), is a global brewing and bottling group. Founded in South Africa in 1895, SABMiller today is an international enterprise with a market value of £21 billion, producing a range of premium beers, including six numbering amongst the top 50 brands in the world: Pilsner Urquell, Peroni, Miller Genuine Draft, Miller Lite, Castle and Grolsch. The Grolsch brand, previously purveyed by 392-year-old Royal Grolsch NV, was the target of a notable acquisition in the brewery industry in November of 2007, with SABMiller paying a premium €816 million (\$1.2bn; £583m), an 84% premium over Grolsch's then share price. A premium price for a premium brand, the acquisition of Grolsch added a northern European product to SABMiller's portfolio and expanded its native and foreign market share. Riding a wave of merger mania in the brewing industry, hindsight and the global recession ask: was it worth it? This case study takes a close look at the fundamentals in addressing this question.

#### **Keywords**

*SABMiller, Grolsch, beer, breweries, acquisitions, valuation, case study*

### **II. KEY DYNAMICS**

## A. Introduction

*"Grolsch will provide SABMiller with a powerful addition to its international brand portfolio. Within the SABMiller family Grolsch will continue to build on almost 400 years of brewing heritage, and together we will establish new positions in the most important emerging beer markets around the world. Both companies share a passion for the brewing tradition, and we are delighted to be part of this new chapter in Grolsch's development."*

*- Graham Mackay, Chief Executive of SABMiller (SABMiller, 2007)*

On the cusp of SABMiller's takeover of Royal Grolsch, CEO Mackay's words speak to the 'contested core' at the heart of merger and acquisition transactions: what synergies drive this transaction and, most significantly, how much are they worth on paper? The final offer came in at €48.25 a share (SABMiller plc., 2008). Hindsight is 20/20, but it is clear today that this transaction came at the tail end of a decade-plus long bubble bull market and, specific to the brewing industry, in the closing chapter of nearly eight years of unprecedented global brewery and beer brand consolidation. Given what is known today, can it be said that this particular deal was worthwhile? Or, as some charged at the time, was the deal an expensive glass of premium beer half filled with suds? We take a close look at the fundamentals in an attempt to answer this question: did SABMiller overpay?

## B. Strategic Rationale

The initial rationale surrounding the acquisition of Grolsch was that the deal would enhance SABMiller's market share in premium beer markets. SABMiller's motivation in the deal was to exploit the potential of the brand extensions in international markets, both in native, established areas (South Africa, Europe and America), as well as in burgeoning emerging markets. The company envisioned significant additional potential for the Grolsch brand across Africa and Latin America in particular, where the premium segment was and is still in its infancy.

The acquisition added a business with annual sales of more than €300 million (Wilson, 2007). During November of 2007, Royal Grolsch's company profile was characterized as such:

*In 2006, Grolsch reported turnover of €317.6 million and net profit of €19.2 million. Total worldwide sales volumes were 3.2 million hectoliters (hls), comprising 1.6 million hls of domestic volumes in the Netherlands, and 1.6 million of international volumes... Grolsch achieves approximately 80% of its international sales volumes in the UK, the United States, Canada, France, Australia and New Zealand through a network of alliances. (SABMiller, 2007)*

The SABMiller deal came on the wave of a spate of other brewing industry mergers and acquisitions, including Inbev's historic aggressive takeover of Anheuser Bush (\$46 billion initial unfriendly bid that was accepted when raised to \$52 billion final bid), Carlsberg / Heineken's takeover of Scottish Newcastle and SABMiller's own previous acquisition of Molson Coors. SABMiller paid a premium 14.7 X 2006 reported EBITDA earnings, comparing with similar deals such as SABMiller buying Italy's Peroni in 2003 at 12.6 times, and InBev purchasing Germany's Beck's at 13 times in 2001 (Jones, 2007). In context and from their view, SABMiller's acquisition was a sequential chess move in a high-stakes global conglomerate game of 'expand or die'.

Adding Grolsch to its portfolio in particular filled a gap in SABMiller's brand portfolio, which lacked an established beer brand from northern Europe. Grolsch was viewed as an iconic Dutch brand whose rich Northern European heritage and premium positioning would complement and further build SABMiller's existing international brand portfolio. Grolsch component brands like Grolsch Premium Weizen, Lemon 2.5, Grolsch Dunkel Weizen and Premium, and Premium Malt could fit and fill the current trend of consumer brand fragmentation and individuation seen in many markets.

Further, SABMiller's management envisioned exploring existing and new opportunities to grow the brand as follows:

- In Grolsch's existing focus markets: working with its existing partners to find opportunities to accelerate current growth trends or, if commercial and appropriate, utilizing SABMiller's platform in some of those markets, to facilitate more growth, in line with the appropriate positioning of the brands,
- In markets where SABMiller has a significant infrastructure like South Africa, and countries in Latin America, Central and Eastern Europe, Africa and Asia: SABMiller would work with Grolsch to identify appropriate portfolio opportunities to introduce Grolsch as a premium North European beer,
- In smaller markets or markets where SABMiller or Grolsch does not have a significant distribution or production presence: SABMiller would work with Grolsch to identify opportunities to grow the brand via a portfolio approach with SABMiller's international brands. This was viewed as moreso a revenue synergy.

Other envisioned synergies included:

- SABMiller and Grolsch would benefit from sharing marketing and innovation skills and knowledge. SABMiller was impressed by Grolsch's distinctive and innovative green bottles and packaging as key differentiators of the brand. In addition, the SABMiller Group expected to benefit from Grolsch's track record for innovation and marketing, evidenced by the various advertising campaigns, new beers and state-of-the-art website.
- Also SABMiller had stated its commitment to people development and training and saw many opportunities for the management and staff of both Groups as a result of a combination through best practice transfer, skill development and international career enhancement.

SABMiller publicized the deal mainly on expanding the brand across 60 countries and downplayed cost synergies, as per comments from Finance Director Malcom Wyman when the deal was announced (Jones, 2007).

Finally, it can be noted that speculation surrounding takeover motivation in particular revolved around SABMiller losing a contract to produce Heineken, a Dutch brewing powerhouse, in its home-base market, South Africa. Taking over a storied Dutch brand thus occurs potentially as a 'tit-for-tat' move amongst global giants. More cynically characterized, perhaps the motivation was simply a testosterone-laced big business playground fight between South Africa, an erstwhile Dutch colony, and their long-ago colonial parents. Even if there is a grain of truth to this angle, it is worthwhile to examine the business fundamentals underlying the transaction. From examining the stated and unstated strategic motivations, we turn to the financial details.

### **C. Bid Price Premium**

Based on the offer memorandum and our own calculation for the standalone value of Grolsch, the price of €48.25 per share represents a premium of, variously:

- 79.4%: based on the closing price as at 16 November 2007 (€26.90), the last trading day before the public announcement that conditional agreement had been reached between SABMiller and Grolsch on the Offer for Grolsch by SABMiller
- 84.3%: based on the average closing price over the one-month period ending 16 November 2007 (€26.17)
- 64.2%: based on the average closing price over the six-month period ending 16 November 2007 (€29.38)
- 59.0%: based on the average closing price over the twelve-month period ending 16 November 2007 (€30.34)
- 118.33%: based on our calculation for the standalone value of Grolsch as of 1 January 2007, assuming WACC of 10.2% and terminal growth of 2% (€22.10)

Over the one-month period before the announcement of the deal, the average stock prices of SABMiller and of Grolsch were £1,406.80 and €26.10 respectively. Both stocks moved approximately 5% in the opposite direction in the one-month period | the last trading day before the announcement of the deal. We can imply from the share price reaction of SABMiller and Grolsch that investors expected the transaction, which SABMiller would pay for Grolsch only at its market capitalization or around €442 million (average price of Grolsch in the one-month period before the announcement of the deal multiplies by number of shares outstanding, 16,921,507 shares).

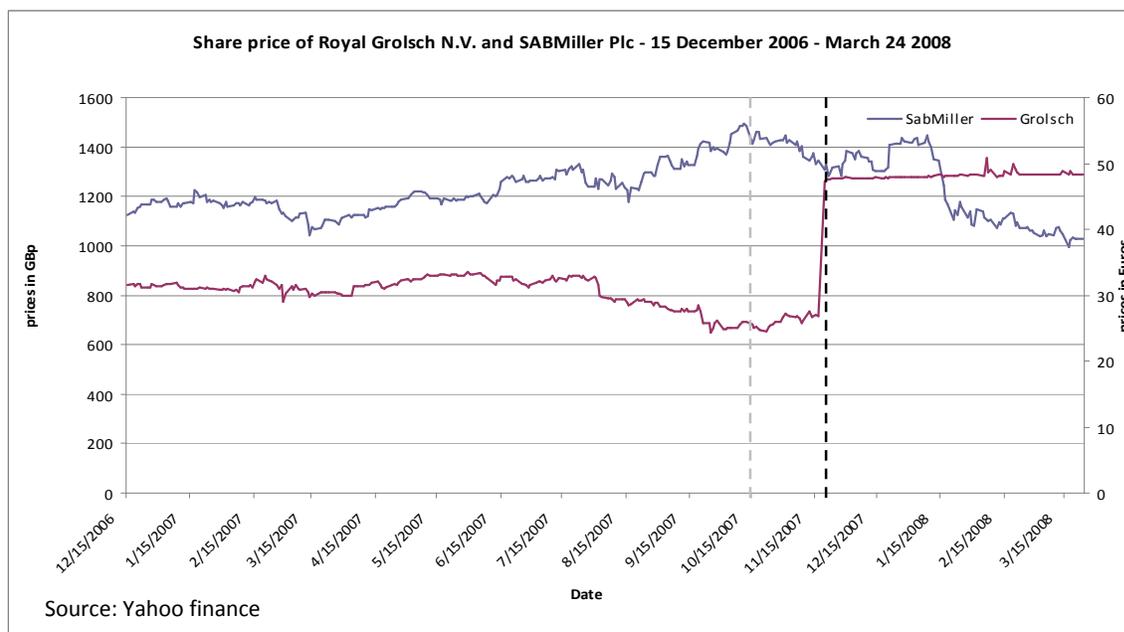


Figure 1: Bid Price Premium (Yahoo Finance)

#### D. Synergies (Value Impact and Break Even Level)

Underlying assumptions and results of the DCF valuation and WACC are as demonstrated in Figures 2 and 3 below, beginning with a calculation of the standalone value of Royal Grolsch NV. From the buyer's perspective, SABMiller expects to leverage Grolsch sales growth in its established markets, Eastern and Central Europe, South Africa, and Latin America. We expect that the wider distribution channels of SABMiller will help increase the international sales revenue of Grolsch as shown in Figure 4, following.

From Figure 4, we assume that only revenue synergies are created. Therefore, we assume an average EBITDA margin between year 2005 and 2006 of Grolsch at 17.6% (refer to income statement of Grolsch in G. Appendix). Note that with the stated assumptions, Grolsch would contribute around 17% of the sales revenue of the premium beer segment of SABMiller<sup>1</sup>. Since our assumption of the additional revenues is quite optimistic, we employ 10.2% WACC as in the calculation of the standalone value of Grolsch NV. Value commercial synergies of €49.2 million is derived as a result.

<sup>1</sup> We estimated the sales revenue of the premium beer segment for SABMiller by using the proportion between the forecasted global industry premium volumes and the total industry volumes in 2008, and then multiplied by the sales revenue of Latin America, South Africa, and 50% of sales revenue in Europe (as a proxy for sales in Eastern and Central Europe).

Financial Statement	2005A	2006A	2007F	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F	2016F	2017F
<b>DCF valuation (in EUR millions)</b>													
EBITA			31	32	36	37	38	40	41	42	43	44	45
- Tax on EBITA			7	7	8	9	9	9	10	10	10	10	11
<b>NOPLAT</b>			<b>24</b>	<b>24</b>	<b>27</b>	<b>28</b>	<b>29</b>	<b>30</b>	<b>31</b>	<b>32</b>	<b>33</b>	<b>34</b>	<b>34</b>
+ Depreciation tangible assets			29	28	27	26	25	25	24	24	23	23	23
- Investment intangibles			-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1
- Investment tangibles			-17	-17	-18	-18	-19	-19	-19	-20	-20	-20	-21
- Investment operating working capital			-2	2	3	2	2	2	1	1	1	1	1
+ Change in provisions			0	0	0	0	0	0	0	0	0	0	0
<b>FREE CASH FLOW</b>			<b>33</b>	<b>36</b>	<b>39</b>	<b>37</b>							
Discount rate	WACC	10.2%	0.9078	0.8241	0.7482	0.6792	0.6166	0.5597	0.5082	0.4613	0.4188	0.3802	0.3451
Present value			30	30	29	25	23	21	19	17	15	14	13
Value during planning period			236										
Terminal growth rate			2%										
Terminal value			158	40%									
Constraint: GDP growth and industry growth. Taking also effect of inflation in according to nominal WACC (NOPLAT*(1-G/ROIC))/(WACC-G) or NOPLAT/WACC (for normal company)													
<b>Enterprise value</b>			<b>394</b>										
+ Excess cash			50										
- Interest bearing debt			-110										
+ Financial fixed assets			38										
- Dividend payable			0										
- Pension liability			2										
<b>Equity value</b>			<b>374</b>										
- Value preferred equity			0										
<b>Value ordinaries</b>			<b>374</b>										
Number of shares			17										
<b>Value per share</b>			<b>22.1</b>										

Figure 2: Financial Statement - DCF Valuation

WACC calculation		Note:
Risk free rate	4.08%	10 year government bond
Market risk premium	6%	5-6% on average for developed countries, 6-6.5% for the period of economic downturn
Beta	0.74	
Small firm premium	1%	because market capitalization is between USD700 and USD1,100 million
Liquidity premium	2%	2-4%. Assume liquidity premium of 2% since Grolsch is considered a small-cap stock in AMS.
Cost of equity	12%	
Cost of debt	5%	average interest rate of 2006
Cost of preferred equity		
Marginal tax rate	25.5%	
D/V	0.21	
E/V	0.79	
Preferred equity/V	0	
<b>WACC</b>	<b>10.2%</b>	

Figure 3: WACC Calculation

Financial Statement	2006A	2007F	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F	2016F	2017F
<b>Synergies</b>												
<b>Commercial synergies</b>												
Standalone revenues		342	349	356	363	370	378	385	393	401	409	417
Upside		0%	5%	10%	10%	10%	10%	10%	10%	10%	10%	10%
Additional revenues		0	17	36	36	37	38	39	39	40	41	42
EBITDA margin		18%	18%	18%	18%	18%	18%	18%	18%	18%	18%	18%
Additional EBITDA		0	3	6	6	7	7	7	7	7	7	7
Taxes		25.5%	25.5%	25.5%	25.5%	25.5%	25.5%	25.5%	25.5%	25.5%	25.5%	25.5%
After tax cash flow		0	2	5	5	5	5	5	5	5	5	5
Discount rate	10.2%	0.9078	0.8241	0.7482	0.6792	0.6166	0.5597	0.5082	0.4613	0.4188	0.3802	0.3451
Present value		0	2	3	3	3	3	3	2	2	2	2
Value commercial synergies		49.2										
As % standalone value		13.1%										

Figure 4: Financial Statement – Commercial Synergies

WACC effect			
WACC		10%	6%
Equity value		374	700
Value commercial synergies		49	97
Value to bidder		423	797
Upside		13%	14%
WACC effect			374
As % standalone value			100%
<b>WACC calculation</b>			
Risk free rate	4.08%		Note:
Market risk premium	6%		
Beta	0.74		
Small firm premium	0%		because SABMiller is considered to be a large-cap stock
Liquidity premium	0%		because SABMiller is considered to be a large-cap stock
Cost of equity	9%		
Cost of debt	5%		
Cost of preferred equity			
Marginal tax rate	25.5%		
DIV	0.45		assume forecasted capital structure of SABMiller in 2007
EBV	0.55		(based on Deutsche Bank analyst report, Jan 8, 07)
Preferred equity/V	0		
WACC	6.3%		

Figure 5: WACC Effect

For the WACC effect, we assume the operative capital structure of SABMiller. Also, we assume that Grolsch is treated as a big firm, thus no small firm and liquidity premiums are assumed. This results in WACC of 6.3% as shown above in Figure 5.

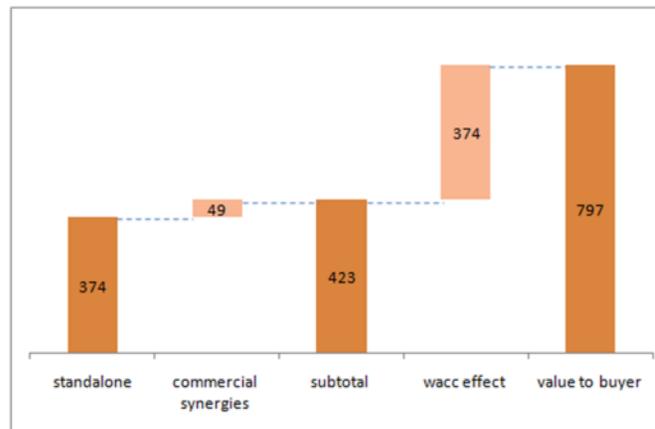


Figure 6: Acquisition Synergy Valuation

As per Figure 6 above, the overall potential synergies created from the acquisition of Grolsch by SABMiller result in an end value of €797million to SABMiller as the buyer.

If we assume that the market expects a bid premium of 30% over the standalone value, the breakeven EBITDA to justify the bid premium would be €12.3 million or 21% of current EBITDA (see Figure 7 below). However, if we take the alternate premium of 118% over the standalone value (bid amount of €816 million as announced by SABMiller / calculated equity value of Grolsch €374 million), the breakeven EBITDA to justify the bid premium increases to €48.4 million or up to 83% of the current EBITDA (see Figure 8 below).

Break even level	
Premium	30%
<b>Value enhancement</b>	<b>112.2</b>
WACC	10.2%
Growth	2%
<b>Annual FCF</b>	<b>9.1</b>
Tax effect	25.5%
<b>EBITDA</b>	<b>12.3</b>
As % current EBITDA	21.0%

**Figure 7: Market Bid Premium 30%**

Break even level	
Premium	118%
<b>Value enhancement</b>	<b>441.9</b>
WACC	10.2%
Growth	2%
<b>Annual FCF</b>	<b>36.0</b>
Tax effect	25.5%
<b>EBITDA</b>	<b>48.4</b>
As % current EBITDA	82.8%

**Figure 8: Alternate Bid Premium 118%**

## E. Final Assessment / Concluding Remarks

The quantitative analysis undertaken suggests that SABMiller overpaid for Grolsch. Based on our value to buyer calculation of €797million, SABMiller overpaid €19 million for Grolsch (€816million accepted bid), resulting in a negative NPV for itself. In other words, SABMiller paid at EV/EBITDA of 14.1x while the implied EV/EBITDA of Grolsch was just 6.7x.

Extended synergies cannot be factored in too heavily to justify the bid, as SABMiller itself downplayed synergies in publicizing the deal, remarking that the main driver was adding a brand to its portfolio and extending it in existing markets (Jones, 2007).

One of the reasons attributed for the bid 'generosity' is that SABMiller wanted to knock-out the other potential bidder, Anheuser-Busch, in a defensive competitive move. As well, it cannot be discounted that there was not a 'bigger bully' motivator in confronting Netherlands-based Heineken on their home soil after they had snubbed SABMiller on an earlier, substantial South African contract brewing bid.

Although the takeover offer is 84% higher than Grolsch's average share price the preceding month, SAB was able to easily finance the deal from cash flow. Analysts for Standard & Poor's commented in a note that the price was high but would not change SABMiller's debt rating (Ewing, 2007).

Thus, although SABMiller overpaid, it had ancillary motivations beyond pure NPV realization. In particular, within the historical context, the major breweries were all aggressively expanding via expensive acquisitions. The brewery conglomerate acquisition mania from 2000 – 2008 was sold to investors as a 'winner-take-all' long-term game plan: building a massive brand portfolio supported by a global operational juggernaut and riding expanding economic growth in emerging markets (Asia and South America in particular, with Russia and Africa also being considerations).

Now, however, the emerging and/or BRIC nation notion of economic decoupling has been proven a myth. The recent economic crisis has deeply and broadly affected consumer confidence and spending worldwide. Premium beer brands in particular will be hit hard. The logic of the Grolsch deal, as well as many other similar brewery industry acquisitions during the heady days of the M&A bubble are looking quite fantastical.

In terms of the final assessment, much will depend on the prospects for consumer spending recovery from this point onwards. If global economies stabilize in late 2009, as many analysts anticipate, there could yet be a silver lining and logic to the notion of super-brewery conglomerates. However, if economic circumstances induce a prolonged consumer malaise, similar to 1990's Japanese stagflation, premium brand beer conglomerates will be put under pressure to divest. The final conclusion thus defers to broad macroeconomic events now underway for the final chapter.

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**G. APPENDIX**

**Grolsch Balance Sheet and Income Statement (2005 – 7)**

<b>BALANCE SHEET: Annual</b>				<b>% of Total Assets</b>			<b>% growth</b>	
<b>(EUR mil)</b>	<b>2005A</b>	<b>2006A</b>	<b>2007F</b>	<b>2005A</b>	<b>2006A</b>	<b>2007F</b>	<b>2006A</b>	<b>2007F</b>
<b>TOTAL ASSETS</b>	<b>453</b>	<b>467</b>	<b>464</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>3%</b>	<b>-1%</b>
<b>Current Assets</b>	<b>89</b>	<b>123</b>	<b>134</b>	<b>20%</b>	<b>26%</b>	<b>29%</b>	<b>39%</b>	<b>8%</b>
Cash and cash equivalents	14	49	58	3%	11%	12%	241%	18%
Current Investments	0	1	0	0%	0%	0%	n/a	-100%
Accounts Receivable	41	41	42	9%	9%	9%	0%	3%
Inventories	17	17	17	4%	4%	4%	-1%	4%
Income taxes receivable	7	5	6	1%	1%	1%	-21%	16%
Prepayments and accrued income	10	11	11	2%	2%	2%	9%	-1%
Other Current Assets	0	0	0	0%	0%	0%	n/a	n/a
<b>Non-Current Assets</b>	<b>364</b>	<b>343</b>	<b>330</b>	<b>80%</b>	<b>74%</b>	<b>71%</b>	<b>-6%</b>	<b>-4%</b>
Tangible fixed assets	313	299	287	69%	64%	62%	-4%	-4%
Intangible fixed assets	5	4	2	1%	1%	0%	-30%	-42%
Financial fixed assets	2	2	2	0%	0%	0%	12%	0%
Trade loans	42	36	36	9%	8%	8%	-15%	0%
Pension receivables	2	2	2	1%	1%	1%	10%	0%
Other Non-Current Assets	0	0	0	0%	0%	0%	n/a	n/a
<b>TOTAL LIABILITIES</b>	<b>209</b>	<b>211</b>	<b>197</b>	<b>46%</b>	<b>45%</b>	<b>43%</b>	<b>1%</b>	<b>-6%</b>
<b>Current Liabilities</b>	<b>84</b>	<b>112</b>	<b>105</b>	<b>18%</b>	<b>24%</b>	<b>23%</b>	<b>34%</b>	<b>-6%</b>
ST Loans	7	34	27	2%	7%	6%	366%	-20%
Accounts Payable	17	20	19	4%	4%	4%	17%	-4%
Current Portion of LT Loans	0	0	0	0%	0%	0%	n/a	n/a
Provisions	2	2	2	0%	0%	0%	-7%	7%
Dividend payable	0	0	0	0%	0%	0%	n/a	n/a
Derivatives	3	0	0	1%	0%	0%	-87%	0%
Other Current Liabilities	55	56	57	12%	12%	12%	2%	2%
<b>Non-Current Liabilities</b>	<b>126</b>	<b>99</b>	<b>92</b>	<b>28%</b>	<b>21%</b>	<b>20%</b>	<b>-21%</b>	<b>-7%</b>
LT Loans	102	76	69	22%	16%	15%	-25%	-10%
Derivatives	2	0	0	1%	0%	0%	-87%	0%
Deferred tax liabilities	14	16	16	3%	3%	4%	16%	3%
Provisions	8	7	7	2%	1%	1%	-17%	0%
Other Non-Current Liabilities	0	0	0	0%	0%	0%	n/a	n/a
<b>SHAREHOLDERS' EQUITY</b>	<b>244</b>	<b>256</b>	<b>266</b>	<b>54%</b>	<b>55%</b>	<b>57%</b>	<b>5%</b>	<b>4%</b>
Common Stock	17	17	17	4%	4%	4%	0%	0%
Premium (discount) on common stocks	29	29	29	6%	6%	6%	0%	0%
Retained Earnings	197	209	220	44%	45%	47%	6%	5%
Preferred Stock	0	0	0	0%	0%	0%	n/a	n/a
Minority Interest	0	0	0	0%	0%	0%	n/a	n/a

<b>PROFIT &amp; LOSS: Annual</b>				<b>% of revenue</b>			<b>% growth</b>	
<b>(EUR mil)</b>	<b>2005A</b>	<b>2006A</b>	<b>2007F</b>	<b>2005A</b>	<b>2006A</b>	<b>2007F</b>	<b>2006A</b>	<b>2007F</b>
<b>Sales</b>	<b>329</b>	<b>335</b>	<b>342</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>2%</b>	<b>2%</b>
COGs	97	103	105	30%	31%	31%	6%	2%
<b>Gross Profit</b>	<b>232</b>	<b>232</b>	<b>237</b>	<b>70%</b>	<b>69%</b>	<b>69%</b>	<b>0%</b>	<b>2%</b>
Operating Expenses	177	176	179	54%	53%	52%	0%	2%
Depreciation	30	31	29	9%	9%	9%	3%	-4%
<b>Operating Profit</b>	<b>25</b>	<b>26</b>	<b>29</b>	<b>8%</b>	<b>8%</b>	<b>8%</b>	<b>2%</b>	<b>12%</b>
Net Interest	-3	-2	-3	-1%	-1%	-1%	-10%	39%
Share in results of associates	0	0	0	0%	0%	0%	190%	0%
<b>Pretax Income</b>	<b>23</b>	<b>24</b>	<b>26</b>	<b>7%</b>	<b>7%</b>	<b>8%</b>	<b>4%</b>	<b>9%</b>
Income Taxes	5	4	6	1%	1%	2%	-4%	46%
<b>Net income (before extraordinary items)</b>	<b>18</b>	<b>19</b>	<b>19</b>	<b>5%</b>	<b>6%</b>	<b>6%</b>	<b>7%</b>	<b>1%</b>
Extraordinary item	0	0	0	0%	0%	0%	n/a	n/a
<b>Net Profit</b>	<b>18</b>	<b>19</b>	<b>19</b>	<b>5%</b>	<b>6%</b>	<b>6%</b>	<b>7%</b>	<b>1%</b>
EBITDA	59	58	60	18%	17%	18%	0%	3%
EPS (EUR)	1.06	1.13	1.12					
Diluted EPS (EUR)	1.06	1.13	1.12					