



**Las Vegas  
October 2012**



# Welcome!

- Housekeeping
- Email and wireless access
- Meeting logistics
- Tonight
- Friday morning



# Appleton Bakery & Cafe





## Confidentiality and Antitrust

- We are not here to ask anyone to disclose sensitive competitive information
- We are not here to encourage anyone to recommend changes to their company policies or practices – those decisions are up to each of you independently
- If you feel something is proprietary or confidential, do not offer that up to the group
- Do not breach any confidentiality agreements you may have with your customers during these discussions
- All information shared during this session should be considered “public domain”



## Agenda for today

- |       |  |
|-------|--|
| 8:30  | Spending Trends – Past 24 months       |
| 12:00 | Lunch                                  |
| 1:00  | Case Study & Group Breakouts           |
| 3:00  | GPO Update<br>General Group Discussion |
| 4:00  | Day 1 summary and Day 2 commentary     |



## Analysis Subject Areas

1. Overall sales vs. macro spending
2. Distributor-focused “Direct Trade”
3. Operator-related “Discounted Trade”
4. Claim processing and discrepancies
5. General process benchmarks
6. External considerations
  
7. Implications



## Methodology and Background

- Year over year comparison of the 52 week period ending 9/30/12
- Considered “finished” transactions only
- Best efforts to remove M&A actions that drove dramatic swings
- Attempted to remove major operator private label direct shipments [e.g., McDonald’s] that skew the street vs. discounted values
- Removed majority of the systems distributors [Sygma, MBM, Northstar] for street vs. discounted metrics.
- Industry M&A aligns with September 2012 ownership for the historical contributions [e.g., Hawkeye]
- Operator evaluation focused on non-commercial



## Significance

265,000 promotions

\$3.1 billion operator-related billbacks

Average billback \$716

\$38 billion customer direct sales

### FOOD & BEVERAGE

Advance Pierre

Cavendish Farms

ConAgra Foods

Continental Mills

Custom Culinary

Flowers Foods

Foster Farms

General Mills

Heinz

Hormel

John Morrell Group

Kraft

Lamb Weston

Mars / Wrigley

Mission Foods

Nestle / Vitality

Norpac

Rich Products

Simplot

Stratas Foods

### DISPOSABLE / JANSAN

Bagcraft

D&W Fine Pack

Genpak

International Paper

Pactiv

Procter & Gamble

Sabert

Solo Cup





## Definitions: Direct Trade

- Based upon 'programs' in the application offering funding to a distributor based upon their purchases or via lump sum
- Includes all local, corporate and buying group offers
- 'Assumption of payment' extended against clients who settle outside of FORGE
- Incorporates off invoice, billback and auto pay mechanics

### Specific Aggregations:

Gordon

PFS

Reinhart

Sysco

Unipro

US Foods



## Definitions: Operator Discounts

- Based upon 'programs' in the application offering funding related to specific operators or groups of operators
- Includes settlements through the distributor and direct to operator
- GPOs aggregated to be inclusive of major members – Sodexo and Entegra, foodbuy and Compass, Avendra and Marriott, etc.

### Specific Aggregations:

Avendra

foodbuy / Compass

Sodexo / Entegra

Premier [all segments]

ARAMARK [all businesses]



## **Definitions: Discounted Share**

- Total business based upon shipments to the distributor unfiltered [e.g., with few exceptions, all purchases were counted]
- Discounted based upon settlements through the distributor via a program associated with one or more operators
- Does not include offers or payments made to operators directly

## **Definitions: 'Street' Business**

- Total business less operator discounted

## **Definitions: Discrepancies**

- Dollars claimed against operator-related programs where the claimed value was greater than the expected value



## Comments

- There are not very many positive storylines
- The data supports your assumptions
- There was less variance across Blacksmith clients than we expected for common product lines
- It is highly likely that 2013 and 2014 will be “worse”



## High Level Story

**+ 9%** Total sales dollar change

**+ 6%** Total sales volume change [ physical cases]

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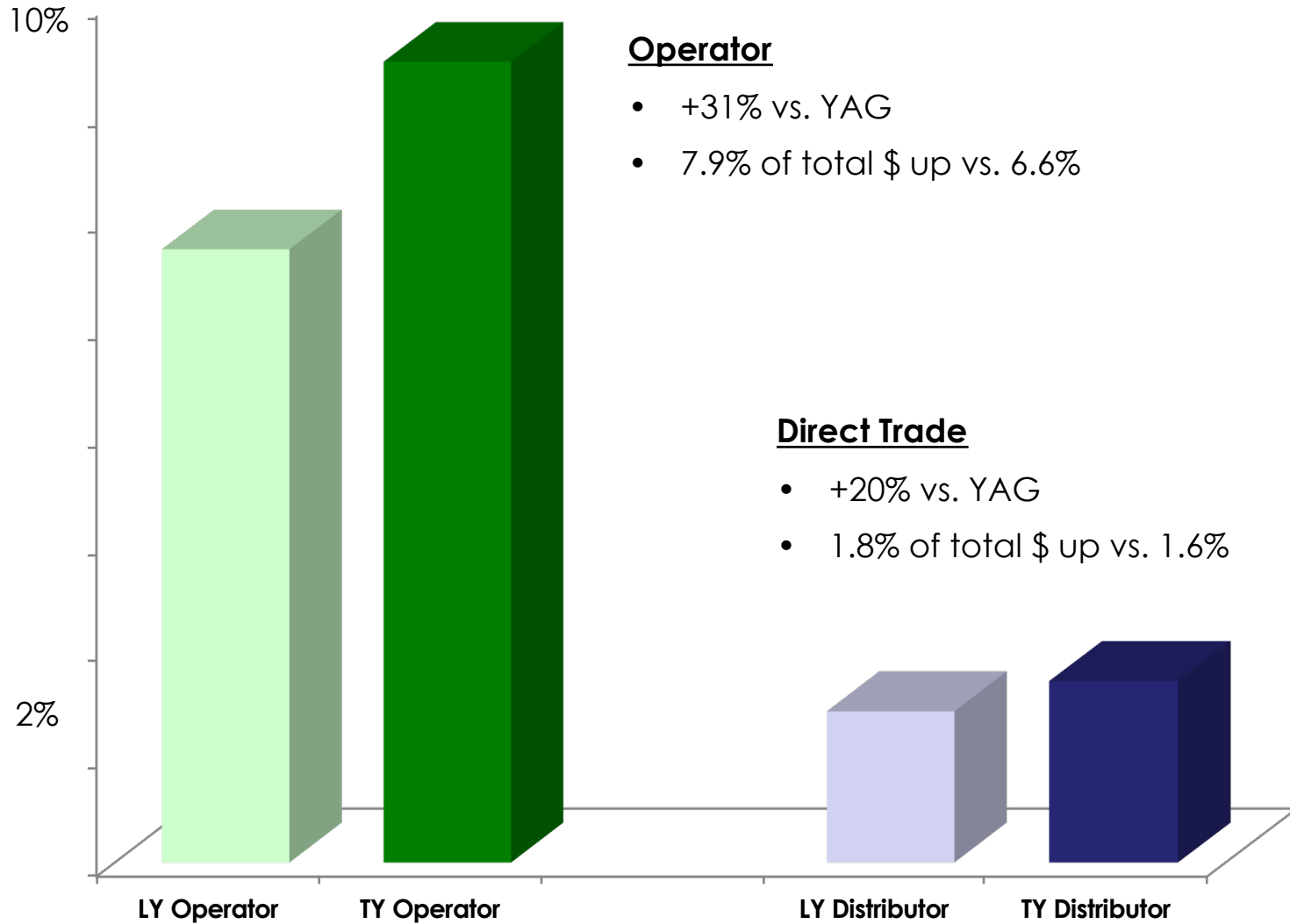
**+ 28%** Total spending change – all in

**+ 27%** Change in operator discounted volume

**+ 1%** Change in street volume



# Spending as a percent of sales \$

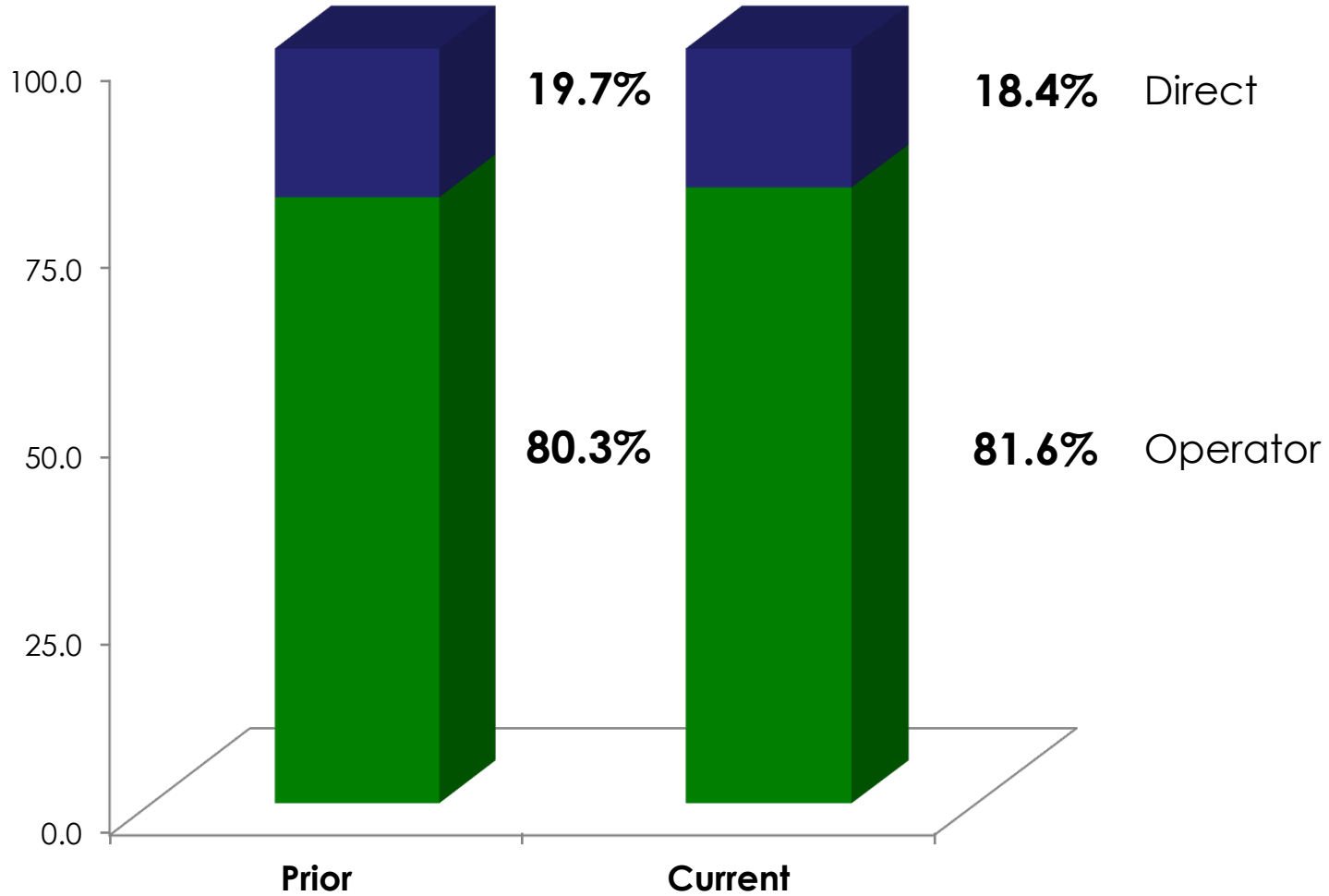




# Spending Mix

There as a slight shift in the spending mix with Operator gaining roughly 1%.

Percent of spend





# Street Base Erosion

## Street Volume

## Operator Volume

Change vs. Prior Year

**+ 1%**

**+ 27%**

Share of total volume

**78%**

**22%**

6% overall volume growth vs. prior period





# Year Over Year Change

## Total Volume

Direct Trade \$

\$'s

Cases

Percent change v. prior year

**20%**

**9%**

**6%**

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Sysco

23%

9%

6%

US Foods

32%

8%

5%

PFS

10%

10%

1%

Gordon

28%

4%

0%

Reinhart

36%

4%

0%

Unipro

23%

4%

10%



## Trade Funded by Discounted Volume

	<u>Direct Trade \$</u>	<u>Volume Change</u>	
		<u>Street</u>	<u>Discounted</u>
Percent change v. prior year	<b>20%</b>	<b>1%</b>	<b>27%</b>
<hr/>			
Sysco	23%	5%	8%
US Foods	32%	(30%)	90%
PFS	10%	0%	3%
Gordon	28%	2%	(5%)
Reinhart	36%	(2%)	5%
Unipro	23%	11%	6%



## Discounted Share of Total Volume

	<u>Discounted Volume</u>	<u>Change</u>
Total	<b>22%</b>	<b>20%</b>
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Sysco	29%	2%
US Foods	51%	90%
PFS	18%	3%
Gordon	28%	(5%)
Reinhart	27%	5%
Unipro	29%	(3%)



# Operator-based



## Non-Commercial Deviated Billing Driving Growth

**+ 31%** Increase in operator spending  
- *84% of operator dollars are settled through the distributor*

**+ 27%** Increase in operator volume growth

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**20%** Share of growth from Big 5

**90%** Big 5 volume change from deviations through distribution



## Big 5 Deviated Billing Growth

**+ 29%** Increase in Big 5 deviated billing dollars

**+ 30%** Increase in Big 5 deviated billing cases

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	<u>Change</u>		
	<u>Volume</u>	<u>Dollars</u>	<u>Size Index</u>
ARAMARK	(5%)	22%	92
Avendra	60%	23%	38
foodbuy	62%	20%	76
Premier	37%	46%	154
Sodexo	39%	22%	139



## Locations and/or Velocity Driving Increases

The data supports the assumption that incremental locations are driving the growth – increases in the depth of the discounts does not bridge the variance.

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**+ 3%** Increase in average stock case price

**+ 13%** Increase in depth of discount for Big 5



# Discrepancies





## Claim Discrepancy Summary

**+ 10%** Total discrepancy dollar growth

**11%** Percent of dollars representing a discrepancy

*\* Down from 13% in the prior period*

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**58%** Rate variance

**39%** Product not eligible on program



## Discrepancy by Major Distribution Group

	<u>% of \$ Claimed</u>	<u>Change</u>	<u>Size Index</u>
<b>Total</b>	<b>11%</b>	<b>(16%)</b>	<b>100</b>
Reinhart	10%	(17%)	76
Sysco	6%	(16%)	105
Unipro	8%	(19%)	156
US Foods	17%	50%	166
Gordon	19%	73%	72
PFS	14%	173%	25



# Is it just me?



## US Foods

	<u>US Foods</u>	<u>Peers</u>
Total trade dollar growth	36%	18%
Shelter dollar growth	32%	22%
Operator dollar growth	37%	17%
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Operator discount volume growth	90%	17%
Street volume change	(30%)	3%
Discounted share	51%	31%
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Shelter case rate index	150	93
Average purchase price index	130	96
Discrepancy rate	17%	10%



## US Foods

**\$716.00** Average billback size

**17%** Discrepancy rate

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**\$121.70** Discrepancy dollars per average claim

**\$140.00** Dispute Resolution Research Fee



# Benchmarks



# Process Benchmarks: Program Approval

**9.3** Days to approve

**(7%)** Change from prior year

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**4** Best In Class

**19** Needs Improvement



## Process Benchmarks: Retroactive Programs

**33%** % Created with Retro Start Date

**14%** Change from prior year

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**11%** Best In Class

**54%** Needs Improvement





## Process Benchmarks: Retroactive Duration

**37** Average days retroactive

**(21%)** Change from prior year

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**19** Best In Class

**137** Needs Improvement



## Process Benchmarks: Billback Approval

**9.0** Average days to approve

**(11%)** Change from prior year

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**3** Best In Class

**21** Needs Improvement



## Process Benchmarks: Deduction Age @ Closing

**23** Average age when closed

**(12%)** Change from prior year

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**13** Best In Class

**46** Needs Improvement



## Process Benchmarks: Deduction as Closing Method

**76%** Percentage of shelter settled via Deduction

**24%** Change from prior year

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**39%** Best In Class

**95%** Needs Improvement



# Storm Clouds



## Storm Clouds: Sysco Scenario

- Investment analysts are predicting a significant increase in the pressure Sysco applies to their vendors [Credit Suisse, Barclays Capital, Morgan Stanley, Cleveland Research].
- Sysco EPS growth is expected to be impacted by several factors –
  - Industry growth
  - Share erosion
  - Customer mix shift to discounted and GPO
- Internally, the implementation of SAP is 2+ years behind schedule with costs projected to now reach \$1.3 billion [50% increase]
- SYSCO has identified need to reduce costs by \$600 million over the next 3 years with 50% of that recovered from Sourcing and Category Management



## Storm Clouds: Sysco Scenario

From their investment filings and notices, Sysco has declared specific goals that will impact suppliers --

- Category Management [1 or 2 vendors per category] will expand to 70% of their purchases, up from 50% today
- They will reduce their overall SKU mix by 10% -- 40,000 items
- They will be placing by an Increased emphasis on SYSCO brand



## Storm Clouds: Sysco Scenario

- Reduced growth realized purely from being “the partner”
- Increased pressure for earned income and price reductions
- Pressure on slow-moving and special order SKUs
- Smaller proportion of the discounts offered will reach the end user





# Storm Clouds Part 2



## Storm Clouds: Litigation and Sheltered Income

There has been a marked increase in Litigation to recover funds that were “sheltered” from Cost Plus bid and contract end users. In just the past 18 months, almost \$70 million has settled with more looming.

\$30 million	US DOJ Settlement with US Foods
\$20 million	NY State Settlement with Sodexo
\$18 million	NY State Settlement with Compass
\$1.6 million	NY State Settlement with Whitson

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\*\* TBD \*\*                      Class Action of Operators against US Foods

*\* Thomas & King [Applebee's], Catholic Healthcare, Waterbury Hospital are the lead plaintiffs*



## Storm Clouds: Litigation and Sheltered Income

“Compass improperly profited by overcharging New York’s taxpayers and shortchanging our schools. There are no excuses for this kind of misconduct. On behalf of students, parents and taxpayers, we are pleased that New York’s schools will get their money back, and that this corporation will be held accountable for siphoning funds meant to benefit students.”

*NY Attorney General Schneiderman, Sept. 19, 2012*



## Storm Clouds: Litigation and Sheltered Income

“Rebating, by any reasonable view, is an intentionally opaque practice. It is a practice intended to obscure the actual costs incurred by food service companies, and also to obscure the relationship between food service companies and food distributors and vendors.

This practice is engaged in by most if not all members of this industry in all of its different segments, including the food service companies, the distributors like SYSCO and US Foods, and food vendors including General Mills, Tyson, and Coca Cola.

*Assistant NY Attorney General John F. Carroll, before the United States Senate, Committee On Homeland Security And Government Affairs, Subcommittee On Contracting Oversight, Oct. 5, 2011*



## Storm Clouds: Litigation and Sheltered Income

“We are continuing to investigate other industry players as well. You may also be interested in learning that officials from numerous other states have been in contact with the Office of the New York Attorney General about this investigation, especially given the extraordinary financial pressure all of the States are under right now, and the increased concerns regarding child nutrition.”

*Assistant NY Attorney General John F. Carroll, before the United States Senate, Committee On Homeland Security And Government Affairs, Subcommittee On Contracting Oversight, Oct. 5, 2011*



## Storm Clouds: Litigation and Sheltered Income

Given the amount of money and the political appeal for driving headlines, there is a high likelihood that Litigation is gaining momentum relative to Cost Plus integrity.

For the manufacturers, there are three implications of note:

1. Government intervention via regulation relative to bid awards could become a reality, similar to GPOs in Healthcare
2. There is some risk relative to public relations when politicians cite major suppliers to increase credibility of the story
3. The settlement dollars are likely to flow downhill.



# Implications



## **So What?**

- 1. Spending is increasing -- for both distributor direct trade and operator-based programs – at a greater rate of change than overall dollar growth.**
- 2. Discounted volume is driving overall volume growth -- the share of volume from “street” business is in decline.**
- 3. In the past 2 years, the growth of operator discounted volume is being driven by deviated billing through the distributor to non-commercial Group Purchasing Organizations [where integrity challenges exist].**
- 4. The rate of discrepancy is increasing dramatically with distributors supporting a high proportion of non-commercial GPO business.**
- 5. Customers are deducting the majority of their trade, eliminating the ability to reconcile discrepancies.**
- 6. Industry trends and external factors indicate that the road ahead will be even more challenging.**





## Implication Focus Areas

1. Increase value for the dollars invested and/or implement more control relative to spending going forward.
2. Gain control over GPO spending growth.
3. Address the issues resulting from the growth in deduction as the settlement mechanism for deductions.
4. Prepare for the potential of a more challenging environment with 'Big Customers' over the next 2-3 years.



## **1. Increase value and/or shore up controls.**

**GOAL: Invest in volume truly incremental to my business.**

**PLAN B: Control how much I have to spend to survive.**

- Low product differentiation has shifted leverage in the channel.
- Direct trade dollars are challenged to drive meaningful positive value.
- With the popularity of deviated billing for GPOs, street conversion is a reality.
- Spending better is difficult if the risk of 'or else' is real – few direct dollars correlate to true volume gains.
- Spending rationally is possible with process and accountability.



## **2. Gain control over GPO spending growth.**

- Define expectations for membership integrity and location validation.
- Clarify process for resolving disputes arising from extendibility.
- Establish rules for reconciling volume from members belonging to multiple groups.
- Clear up contract conflicts where members qualify for their own independent discounts.
- Adopt scorecards to qualify purchasing influence and the overall quality of the proposed relationship.
- Align the size of the discounts with the overall quality of the relationship.
- Improve audit capabilities through standard claim content.



### **3. Address the growth in shelter deductions.**

- Deduction has become the primary vehicle for settling shelter and earned income. Our audit indicates it is now more than 70% of the dollars settled.
- This essentially eliminates the primary lever for reconciling claim discrepancies and ineligible volumes [recapture].
- The cost of validating shelter deductions is high and the process complex. The majority of the industry ‘rubber stamps’ with a low level of validation.
- Litigation that is indirectly related to sheltered income is gaining popularity.

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- A. Move to quarterly adjusted rates – “self-healing” – as a mechanic for reconciliation of discrepancies and recapture.
- B. Adopt policy of Off Invoice [e.g., Sysco] to replace deduction as the vehicle – provides a better rate control, reduces admin burden and lowers legal risks.
- C. Improve rebill process and/or ability to barter and negotiate.



#### **4. Prepare for more challenges with Big Customers.**

- The Sysco 'Perfect Storm' is just an example – a more demanding environment is likely with most large customers.
- In a worse-case, spending will increase dramatically against a smaller volume base that contains an increasing proportion of operator discounted business.
- The price of 'winning' and 'retaining' will increase.
- The effect of distribution losses is relatively immediate – offsetting gains through national accounts is time consuming and equally costly.

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- A. Revisit your customer strategy and segmentation plans. Mitigate risk of having too much dependence upon 1-2 accounts.
- B. Refresh the strategy for operator focus.
- C. Consider locking in your earned income and shelter parameters for a longer time frame – 2014 and 2015 are likely to be “worse” than 2013.



# Hurricane Planning

## 1. Steps and actions to prepare for Category Management, Cluster Bids, Category RFP's, etc.

- Competitive positioning and pricing gaps
- Capture our 'secure' operator business vs. what's at risk
- Contingencies for if we [a] win or [b] lose
- Executive calendars
- Schedule of meetings and events for decisions

### Resources

- Sales | Finance | Supply Chain | Marketing
- Core team in key roles for multiple iterations?
- Skills required for the team
- Time requirements



# Hurricane Planning

2. Assume that the level of aggression is likely to be greater in 2014 and 2015 than it is today. What can we do now to be better positioned for the future?

- Lock in EDA and Shelter Rates
- Operator focus
- Analytics model for visibility
- Skills and training



## General Discussions

- GPO next steps with IFMA
- Other GPO next steps
- Claim standards and minimum requirements [Reinhart, GFS, PFS]
- ONSA
- January meeting – guest speakers