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Recommendation: BUY

Allied Domecq is an internationally branded spirits, wine and a quick service restaurant group based in the United Kingdom, with over 500 subsidiaries worldwide.

Quantitative Highlights:

- ◆ AED is undervalued by 23% according to the DCF; currently trading at \$40.58; DCF \$49.99
- ◆ We used modest growth assumptions (5%), low revenue growth compared to expenses
- ◆ Pretax profits grew 6% in 2004 and on track to grow 11% in 2005
- ◆ Substantially higher ROE (109.92%) than peers
- ◆ Trading cheap with P/E at 14.57 compared to the industry

Qualitative Highlights:

- ◆ Turned around business through series of smart, small deals such as Mumm Cuvee Napa and Stolichnaya vodka
- ◆ Improved geographical and category exposure in portfolio enables it to weather through weaknesses in specific individual markets
- ◆ Concerns about divesting QSR business and focus entirely on beverages
- ◆ Consolidation inevitable in Alcoholic Beverages Industry

Financial Highlights

| | AED |
|---------------------------------|-------------------|
| Price as of 3/18/2005 | \$40.58 |
| Symbol | AED |
| Exchange | NYSE |
| 52 - Week Range | \$31.72 - \$41.55 |
| Shares Outstanding | 276.64 M |
| Market Cap (\$B) | 11.35 B |
| Beta (Yahoo) | 0.47 |
| 5 yr Projected EPS Growth | 10.30% |
| 05 P/E | 14.57 |
| 05 P/E to 05-06 EPS Growth Rate | 9.57% |
| ROA | 8.32% |
| ROE | 109.92% |
| Current Ratio | 1.438 |
| Debt/Equity (Book) | 4.059 |
| Fiscal Year Ends | 8/31/2005 |

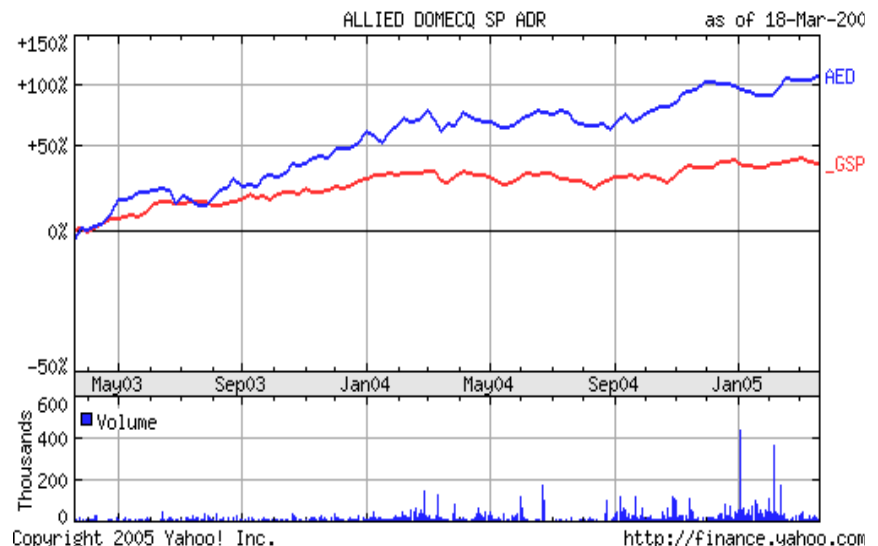


Exhibit: AED vs. 2 yr S&P Return



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INVESTMENT THESIS

At this time, we feel that we should buy Allied Domecq. Once considered a weak player in the industry, Allied has turned around its business through a series of small but smart deals including Mumm Cuvee Napa wine and distribution rights for Stolichnaya vodka. As a result, the firm has become the third largest wine producer by sales behind U.S. based Gallo and France based LVMH. In 2004, a pretax profit grew by 6% and is on track to grow about 11% this year. As a result of its acquisitions, Allied has also improved their portfolio enabling them to better weather weakness in specific individual market. Its QSR business continues to generate much cash for the company, and therefore justifies its existence amidst questions by analyst to divest and focus on the core beverage business. The alcoholic beverages industry is inevitably moving in the direction of consolidation.

In the consumer sector of the portfolio, our exposure includes specialty retail, AutoZone, pharmaceutical retail, Walgreen, Tobacco and Food Products, Altria, and automotive, Harley-Davidson. We have lost exposure in the restaurant sub-sector with the selling of Brinker International and some international exposure with the selling of Catalina Marketing. Allied Domecq will be able to help fill in the exposure gaps in the portfolio. Allied's continued international growth and Quick Service Restaurant business should do well in getting the exposures the portfolio needs. Our valuation exercise suggests that Allied is approximately 20% undervalued. We attribute this to the market not seeing the potential this firm will come into in the near future.

COMPANY PROFILE

Allied Domecq PLC is an international branded drinks and retailing group. It has over 500 subsidiaries. Its business comprises an international spirits and wine group, referred to as the Spirits and Wine business, and an international quick service restaurants group, Dunkin' Brands, Inc., referred to as the QSR business. The Company's Spirits and Wine business manufactures markets and sells a portfolio of premium branded spirits and a portfolio of premium branded wines. Its Spirits and Wine business operates through a global distribution network in over 50 countries. The Company's QSR business operates an international franchise business, which comprises over 12,000 distribution points. The Company also holds a minority-ownership interest in Britannia Soft Drinks Limited, a company engaged in the manufacture and sale of soft drinks, based in the United Kingdom. During the fiscal year ended August 31, 2004 (fiscal 2004), the Company acquired Gary Farrell, a Californian wine brand.

Spirits and Wine

The Company divides its spirits and wine portfolio into core brands, which spirits brands that have strong customer appeal, typically in more than one market, and high margins; local market leaders, which are spirits brands that occupy a strong position in a particular market; premium wines, and other spirits and wine brands. The Company's core brands, Ballantine's Scotch whisky, Kahlua liqueur, Malibu coconut-flavored rum-based spirit, Beefeater gin, Canadian Club whisky, Sauza tequila, Courvoisier cognac, Tia Maria liqueur and Maker's Mark bourbon, collectively accounted for sales of approximately 22.2 million nine liter cases or 32% of the Company's spirits and wine portfolio by volume for fiscal 2004.



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The Company's local market leaders, which include Presidente and Don Pedro brandies, Whisky DYC and Imperial whiskies, and Stolichnaya vodka, accounted for approximately 11.7 million cases or 17% of the Company's spirits and wine portfolio by volume during fiscal 2004. The Company's premium wine portfolio includes still wine, sparkling wine and champagne. During fiscal 2004, the Company sold approximately 15.6 million cases of premium branded wines or 22% of its spirits and wine portfolio by volume. Other spirits and wine brands accounted for sales of approximately 20.6 million cases or 29% of the Company's spirits and wine portfolio by volume for fiscal 2004.

The Company competes with Diageo plc, Pernod Ricard, Brown-Forman Corporation, Bacardi-Martini Inc., Fortune Brands Inc, Gallo, Constellation, Vincor, Southcorp, Orlando Wyndham, Brown Forman, LVMH, Remy Cointreau, Kendall-Jackson and the Fosters Group.

QSR

QSR business comprises the Company's United States and international food franchising business. The core trading market for the business is the United States with over 7,600 distribution points nationwide, while the international business operates more than 4,400 additional distribution points. The system is franchised. QSR is comprised of Dunkin' Donuts, an international coffee and baked goods chains; Baskin-Robbins, an international ice cream franchise, and Togo's, a sandwich chain operating principally on the West Coast of the United States.

During fiscal 2004, Dunkin' Donuts generated 83% of its total retail sales from the United States markets. At August 31, 2004, Dunkin' Donuts had 6,193 distribution points, of which 4,418 were located in the United States. Baskin-Robbins generated slightly

more than half of its total retail sales from the United States markets for fiscal 2004. At August 31, 2004, Baskin-Robbins had 5,410 distribution points, of which approximately half were in the United States. At August 31, 2004, Togo's had 421 distribution points, substantially all of which were in the United States

Accolades

Allied Domecq owns or distributes 14 of the top 100 international premium spirit brands and its brand portfolio commands world No. 1 or No. 2 positions in six leading categories.

Allied Domecq Named 'Best Large Spirits Supplier' for Third Year in a Row.

The following Allied Domecq brands received Double Gold or Gold medals in the 2005 San Francisco World Spirits Competition:

- Stolichnaya® 80 proof brought home the highest honor with "Best Vodka of Show" and a Double Gold medal.
- Ballantine's® 12 Year won Double Gold this year, while Ballantine's® 30 Year Old Blended Scotch and Ballantine's® 17 Year both received a Gold medal in the Blended Scotch category.
- Courvoisier® cognacs received numerous medals; Double Gold winners included L'Esprit de Courvoisier®, Initiale Extra® and XO Imperial®.
- Crown Jewel® by Beefeater® won a Gold medal in its first year of entry in the gin category.
- Laphroaig® 30 year old won Double Gold in the Single Malt Scotch category. Laphroaig® 10 Year Cask Strength and Laphroaig® 10 Year received Gold medals. Tormore® 12 Year and Scapa® 14 Year also received Gold

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medals in the Single Malt Scotch Category.

Glendronach® 33 Year won a Gold medal.

- Tullamore Dew® 12 Year received a Gold medal in the Blended Irish Whisky category.



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SPIRITS

Ballantine's

5.9m cases
 Third largest Scotch
 Whisky worldwide

Key markets:
 Spain, France, Germany,
 Italy, South Korea, Japan,
 Duty free



Beefeater

2.4m cases
 World's leading
 imported gin

Key markets:
 Spain, US, Nordic



Canadian Club

2.6m cases
 No. 3 premium
 Canadian whisky

Key markets:
 US, Canada, duty free



Courvoisier

1.1m cases
 No.1 cognac in UK
 and No. 3 in US

Key markets:
 US, UK, Asia



Kahlúa

3.0m cases
 World's No.1
 coffee liqueur

Key markets
 US, Canada,
 Australia



Maker's Mark

0.5m cases
 Premium handcrafted
 Kentucky bourbon

Key market: US



Malibu

3.0m cases
 No. 2 single
 liqueur worldwide

Key markets:
 US, UK, France, Spain



Sauza

2.9m cases
 Second largest
 tequila worldwide

Key markets:
 US, Mexico



Tia Maria

0.8m cases
 UK's leading
 coffee liqueur

Key markets:
 UK, Spain





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WINES

California – US

A leading producer of premium Californian wine

Key brands:

Clos du Bois, Gary Farrell, Buena Vista, William Hill, Haywood, Atlas Peak, Mumm Cuvée Napa



Bodegas y Bebidas – Spain

Spain's leading wine producer

Key brands:

Campo Viejo, Siglo, Ysios, Aura, Tarsus, Marques de Arienzo



New Zealand

New Zealand's leading wine producer

Key brands:

Montana, Brancott, Lindauer, Church Road, Corbans, Stoneleigh



Argentina

A leading producer of premium Argentine wine

Key brands:

Graffigna, Bodegas Balbi



Champagne – France

Third largest champagne producer

Key brands:

G. H. Mumm & Cie, Perrier Jouët



QUICK SERVICE RESTAURANTS (QSR)

Dunkin' Donuts

The world's largest coffee baked goods chain operates in over 28 countries



and

No.1 in the US for serving coffee, donuts, bagels and muffins



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Baskin-Robbins

The world's largest ice cream franchise operates in over 50 countries



No.1 in the US for serving ice cream

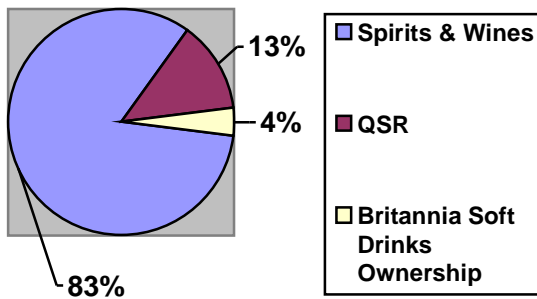
Togo's

The legendary Californian sandwich shop

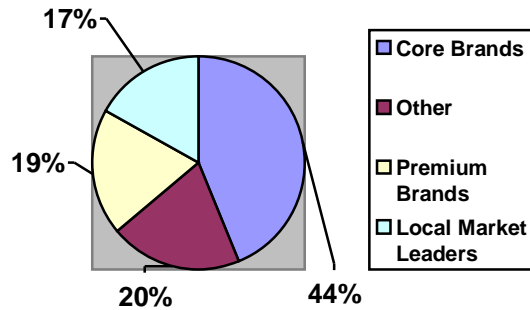


REVENUE BREAKDOWN

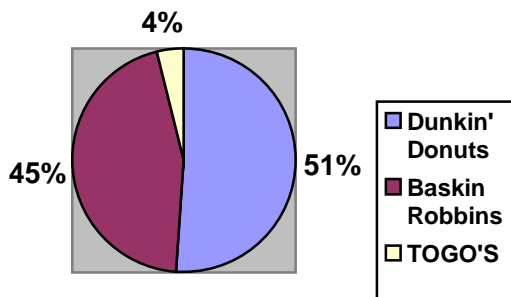
AED Breakdown



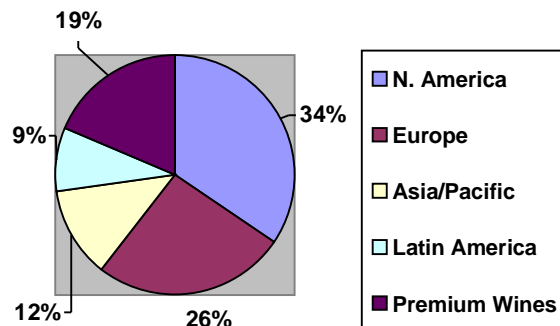
Spirits & Wine Breakdown



Quick Service Restaurant Breakdown



Spirits & Wine Geographical Breakdown





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CORPORATE STRUCTURE

Allied Domecq is based out of the United Kingdom but also has a US headquarters in Connecticut. Allied Domecq PLC is the holding company of Allied Domecq. It has more than 500 subsidiaries incorporated in more than 50 countries. There are only 10 institutional holders making up 1% of the shares outstanding. Insiders and owners hold about 7% of the shares outstanding. This is a very low percentage of insider and institutional holders which could be a good sign for Allied because they are not predominantly controlled by the company itself. Their chairman, CEO and CFO of the company have been a part of the company for at least 10 years now.

COMPARABLE ANALYSIS

| | <u>AED</u> | <u>DEO</u> | <u>BF-B</u> | <u>STZ</u> |
|------------------|------------|-------------|-------------|------------|
| Revenue | \$5800.58 | \$15,863.55 | \$2,577.00 | \$3,552.43 |
| EPS | \$2.82 | \$3.57 | \$2.46 | \$2.66 |
| ROE | 109.92% | 38.10% | 27.70% | 11.80% |
| ROA | 8.32% | 10.03% | 12.63% | 5.12% |
| 04-05 EPS Growth | 9.57% | 8.68% | 10.16% | 18.80% |
| 04 P/E | 13.69 | 17.01 | 21.15 | 20.06 |
| 05 P/E | 14.57 | 16.06 | 21.75 | 19.01 |
| 06 P/E | 13.29 | 14.78 | 19.74 | 16.00 |
| PEG | 0.01 | 0.02 | 0.02 | 0.01 |
| EV/EBITDA | 12.80 | 16.13 | 14.82 | 12.72 |

Allied Domecq has high EPS earnings, second only to Diageo (DEO). Their expected EPS growth is consistent with the others. They have a considerably high ROE with 109.92%, showing great return to its shareholders. Allied has been trading relatively cheap compared to its competitors, making this a good buy at this time.

DCF ANALYSIS

| Valuation model used | \$ Per Share |
|------------------------|--------------|
| Unlevered value | \$42.39 |
| Adjusted Present Value | \$56.11 |
| Flow to Equity | \$47.84 |
| WACC with FCF | \$47.73 |
| AT-WACC with UFCF | \$48.28 |
| Average across models | \$49.99 |

According to Allied Domecq's DCF model their current price is undervalued by 23%. Currently AED is trading at \$40.58 and the DCF is valuing the company at \$49.99. We used a very modest growth rate of 5%. We think that their actual growth rate will be higher than this because of the significant consolidation that they will be a part of in the industry. In the growth assumptions we tied revenue together with SG&A and COGS so that they would all end up with a terminal growth rate of 5%. We also modeled it so that the expenses, SG&A and COGS, grew a little bit faster than revenue to keep with our modest approach. We kept all balance sheet items constant throughout our predictions. Cash remained at 5% of sales and then we kept the rest of the balance sheet items at either the previous year's percentage (2004) or the average of the past five years; whichever was the lowest and least aggressive.

INDUSTRY OVERVIEW

The market for spirits in the US, while dominated by a few major companies is not particularly concentrated. Over half the market is accounted for by the leading five companies. The largest producer is Diageo's Guinness UDV unit, which controls around 15% of the market.



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The alcoholic beverages industry is currently filled with a considerable amount of activity. The industry in itself appears to be consolidating with numerous mergers and acquisitions recently taking place.

- Constellation acquired Mondavi in 2004 and Australia's BRL Hardy Ltd in 2003
- Canada's Molson Inc. merges with Golden based Coors Brewing Co. in February to form Molson Coors Brewing Company
- Chalone Wine Group Merges with Diageo
- Vina Concha y Toro acquires Vina Francisco de Aguirre's Assets
- Fosters currently making bids on Southcorp Ltd.
- South America's second largest brewer, Colombia's Bavaria announces their consideration for a possible merger or strategic partnership with a major world competitor

There seems to be room for growth as many companies are expanding their product lines and raising their expectations for the future.

- Heineken plans new light beer for U.S. Market
- Diageo introduces passion fruit flavored rum
- Central Eu. Distribution Corp and Brown Forman Corp both raise FY 2005 guidance

Evidence shows a trend in a shift away from the French market and towards the American market forcing the United States to become a dominant leader in the industry. Overall, French wine sales in the U.S. are plunging. Since 2001 alone, Jean-Claude and Beatrice Bouche have decreased by 30%. Exports of French wine to the United States (excluding Champagne) decreased by 17% in volume in 2003 and 4.1% in 2004. It is believed that the causation can be linked to the weak dollar, France's stand in the war and just a general shift in the consumers taste towards a fruitier flavor offered by

the wines of California, Australia, New Zealand and Chile. It is predicted that America's consumption of wine is progressing so much that it will be the biggest market by 2008 surpassing that of France and Italy.

One of the major trends driving the growth of the traditionally restrained spirits market was spirit-branded products, especially vodka and tequila. Dubbed alternatives, this new sector grew an impressive 25 percent in the United States in 2001. Globally, ready-to-drinks have grown an average of 33 percent from 2000-2003. Vodka-infused drinks led the category with 24 percent of the market, followed by tequila-infused drinks with 5 percent. Reports have suggested that international expansion may provide opportunities for distillers; top spirit brands have already established themselves worldwide, especially in the whiskey and cognac markets. Export opportunities could be found in the fast-growing markets of the Asia Pacific region, Latin America, and the former Soviet Bloc. Growth among these expanding markets is generally occurring among higher margin, deluxe brands. Trade barriers were also lifted in a number of countries, such as India and Taiwan.

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ALLIED'S OUTLOOK

According to Hoovers, the spirits industry has been consolidating since 1997, and plenty of suitable matches (via joint venture or acquisition) have been suggested for Allied Domecq. The company has been receptive to potential pairings. To make itself more attractive, it sold its UK pubs business. With that business gone, nearly 90% of the company's sales pour in from spirits and wines. Allied is also developing and extending their geographic presence in order to build strong positions in key markets worldwide through consumer-led marketing and focusing spending on markets with strong potential for growth, including the US, Spain and South Korea. Allied also invests in product innovation and brand extension with recent successes including WET by Beefeater, Malibu Pineapple and Malibu Mango. In its QSR business, Allied will be expanding the Dunkin' Donuts brand into US markets and key international territories where it is under-represented.



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COMPARABLE ANALYSIS

| | Allied <u>AED</u> | Diageo <u>DEO</u> | Brown Forman <u>BF-B</u> | Constellation <u>STZ</u> |
|---------------------------------------------------------|----------------------|----------------------|--------------------------------|-----------------------------|
| <i>(LFY Income Statement):</i> | | | | |
| Latest Fiscal Year End Date (as if we are at Dec. 2003) | 31-Aug-04 | 30-Jun-04 | 30-Apr-04 | 29-Feb-04 |
| Revenue | \$5,800.58 | \$15,863.55 | \$2,577.00 | \$3,552.43 |
| Gross Profit | \$2,978.43 | \$3,247.90 | \$1,298.00 | \$975.79 |
| EBITDA | \$1,160.47 | \$3,490.09 | \$463.00 | \$589.40 |
| <i>(Per Share Income Statement Data)</i> | | | | |
| LTM EPS Date | 2004 | | | |
| LTM EPS* | \$3.00 | \$3.37 | \$2.53 | \$2.52 |
| CFY EPS Estimate | 2005 | \$2.82 | \$3.57 | \$2.46 |
| NFY EPS Estimate | 2006 | \$3.09 | \$3.88 | \$2.71 |
| Cash and Cash Equivalents | \$231.74 | \$2,109.24 | \$289.50 | \$12.75 |
| Total Debt (incl. ST Debt and leases) | \$3,720.34 | \$15,268.92 | \$633.30 | \$2,028.58 |
| Total Common Equity (Book Value) | \$3,120.35 | \$18,592.72 | \$1,241.20 | \$2,669.24 |
| <i>(Stock Data):</i> | | | | |
| Stock Price | Mar-05 | Mar-05 | Mar-05 | Apr-05 |
| Common Shares Outstanding | \$41.08 | \$57.33 | \$53.50 | \$50.56 |
| Market Capitalization (MV of Equity) | 276.64 | 752.47 | 121.8 | 108.36 |
| Total Mkt. Capitalization (Tot. Net Debt+MV of Equity) | \$11,364.37 | \$43,139.11 | \$6,516.30 | \$5,478.68 |
| | \$15,084.72 | \$58,408.02 | \$7,149.60 | \$7,507.26 |
| LFY Gross Margin | 51.35% | 20.47% | 50.37% | 27.47% |
| LFY EBITDA Margin | 20.01% | 22.00% | 17.97% | 16.59% |
| ROE | 109.92% | 38.10% | 27.70% | 11.80% |
| ROA | 8.32% | 10.03% | 12.63% | 5.12% |
| Receivable Turnover | 4.96% | 3.97% | 7.47% | 5.16% |
| Inventory Turnover | 1.94% | 0.00% | 2.32% | 2.14% |
| Current Ratio | 1.44% | 1.12% | 2.68% | 1.92% |
| <i>(Growth/Return):</i> | | | | |
| Historical 3 Year Revenue Growth Rate | | | | |
| Historical 5 Year EPS Growth Rate | 3.70 | na | 7.00 | na |



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| | | | | |
|------------------------------------------------|-----------|-----------|----------|----------|
| Projected ROE (CFY) | 25.00% | 14.45% | 24.14% | 10.80% |
| CFY - NFY EPS Growth Rate | 9.57% | 8.68% | 10.16% | 18.80% |
| Proj. Growth in EPS 5 Years | 10.30 | 8.10 | 10.00 | 13.00 |
| Dividend Yield | 2.25 | 2.97 | 1.84 | na |
| VL Timeliness | | | | |
| <i>(Risk):</i> | | | | |
| Beta | 0.47 | -0.04 | 0.37 | 0.27 |
| VL Safety | | | | |
| LT Debt / Market Capitalization (MV of Equity) | 32.74% | 35.39% | 9.72% | 37.03% |
| LT Debt / Common Equity (BV of Equity) | 119.23% | 82.12% | 51.02% | 76.00% |
| <i>(Valuation):</i> | | | | |
| MV of Equity / Book Value | 3.64 | 2.32 | 5.25 | 2.05 |
| 04 Price / EPS Ratio ("P/E") | 13.69 | 17.01 | 21.15 | 20.06 |
| 05 Price / EPS Ratio ("P/E") | 14.57 | 16.06 | 21.75 | 19.01 |
| 06 Price / EPS Ratio ("P/E") | 13.29 | 14.78 | 19.74 | 16.00 |
| Total Market Capitalization / EBITDA | 13.00 | 16.74 | 15.44 | 12.74 |
| Relative P/E (CFY) | | | | |
| CFY P/E to CFY-NFY EPS Growth Rate | 1.52 | 1.85 | 2.14 | 1.01 |
| CFY P/E to Proj. Growth in EPS 5 Years | 0.01 | 0.02 | 0.02 | 0.01 |
| EV | 14,852.98 | 56,298.78 | 6,860.10 | 7,494.51 |
| EBIT | 1,261.07 | 4,113.64 | 171.30 | 489.08 |
| ev/ebit | 11.78 | 13.69 | 40.05 | 15.32 |
| ev/ebitda | 12.80 | 16.13 | 14.82 | 12.72 |
| ev/sales | 2.56 | 3.55 | 2.66 | 2.11 |



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Allied Domecq

Annual Historical and Projected Income Statement
(Dollars in Millions)

| | 0 | 1 | 2 | 3 | 4 | 5 | 6 |
|------------------------------------------------|--------|--------|--------|--------|--------|--------|--------|
| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
| Total Revenue | 5,801 | 6,328 | 6,876 | 7,440 | 8,021 | 8,615 | 9,222 |
| Total Cost of Goods Sold | 2,822 | 3,079 | 3,345 | 3,620 | 3,902 | 4,192 | 4,487 |
| Gross Profit | 2,978 | 3,249 | 3,530 | 3,820 | 4,118 | 4,424 | 4,735 |
| SG&A (SHOULD EXCLUDE DEPR.) | 2,023 | 2,207 | 2,398 | 2,595 | 2,797 | 3,004 | 3,216 |
| Depreciation and Amortization | 212 | 220 | 229 | 238 | 248 | 258 | 269 |
| Total Operating Expenses | 2,235 | 2,426 | 2,626 | 2,833 | 3,045 | 3,263 | 3,485 |
| Operating Income | 744 | 823 | 904 | 988 | 1,073 | 1,161 | 1,250 |
| Other (non-operating) Income / (Expense) | (25) | 116 | 119 | 122 | 125 | 128 | 131 |
| EBIT, Earnings Before Interest and Taxes | 719 | 939 | 1,023 | 1,109 | 1,198 | 1,289 | 1,382 |
| Interest Expense | 257 | 231 | 256 | 282 | 310 | 339 | 364 |
| Other (non-recurring) Charges (pretax) | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| EBT, Earnings Before Taxes | 462 | 708 | 767 | 827 | 889 | 950 | 1,018 |
| Income Taxes (payable) | 221 | 225 | 244 | 263 | 282 | 302 | 323 |
| Tax Rate | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net Income | 241 | 483 | 523 | 565 | 606 | 648 | 694 |
| Growth Assumptions: | | | | | | | |
| Revenue Growth Sequential | 7.8% | 9.1% | 8.6% | 8.2% | 7.8% | 7.4% | 7.0% |
| COGS Growth | 240.7% | 9.1% | 8.6% | 8.2% | 7.8% | 7.4% | 7.0% |
| SGA Growth | -41.3% | 9.1% | 8.6% | 8.2% | 7.8% | 7.4% | 7.0% |
| Derived Income growth | -67.2% | 100.7% | 8.3% | 7.9% | 7.4% | 7.0% | 7.1% |
| As a Percent of Sales: | | | | | | | |
| Total Revenue | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |
| Total Costs of Goods Sold | 48.7% | 48.7% | 48.7% | 48.7% | 48.7% | 48.7% | 48.7% |
| Gross Profit | 51.3% | 51.3% | 51.3% | 51.3% | 51.3% | 51.3% | 51.3% |
| SG&A (SHOULD EXCLUDE DEPR.) | 34.9% | 34.9% | 34.9% | 34.9% | 34.9% | 34.9% | 34.9% |
| Depreciation and Amortization | 3.7% | 3.5% | 3.3% | 3.2% | 3.1% | 3.0% | 2.9% |
| Operating Profit Margin (Excl. Depr. & Amort.) | 16.5% | 16.5% | 16.5% | 16.5% | 16.5% | 16.5% | 16.5% |
| Net Income | 4.1% | 7.6% | 7.6% | 7.6% | 7.6% | 7.5% | 7.5% |

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Annual Historical and Projected Balance Sheet

(Dollars in Millions)

| | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---------------------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Cash and Equivalents | \$ 232 | 316 | 344 | 372 | 401 | 431 | 461 |
| Accounts Receivable | 1,143 | 1,246 | 1,354 | 1,465 | 1,580 | 1,697 | 1,816 |
| Inventories | 2,434 | 2,658 | 2,888 | 3,125 | 3,369 | 3,618 | 3,873 |
| Other Current Assets | - | 127 | 138 | 149 | 160 | 172 | 184 |
| Total Current Assets | 3,808 | 4,347 | 4,723 | 5,111 | 5,510 | 5,918 | 6,335 |
| PPE and Intangibles, Net | 1,654 | 1,732 | 1,810 | 1,892 | 1,978 | 2,067 | 2,159 |
| Investments | 266 | 190 | 206 | 223 | 241 | 258 | 277 |
| Other Long Term Assets | 4,816 | 5,063 | 5,363 | 5,580 | 6,016 | 6,461 | 6,916 |
| Total Long Term Assets | 6,736 | 6,984 | 7,379 | 7,696 | 8,234 | 8,787 | 9,352 |
| Total Assets | \$ 10,545 | \$ 11,332 | \$ 12,103 | \$ 12,807 | \$ 13,744 | \$ 14,705 | \$ 15,687 |
| Accounts Payable and Accrued Liabilities | 1,954 | 2,132 | 2,317 | 2,507 | 2,703 | 2,903 | 3,107 |
| Other Current Liabilities | - | - | - | - | - | - | - |
| Notes and LT Debt due | 679 | - | - | - | - | - | - |
| Total Current Liabilities | 2,634 | 2,132 | 2,317 | 2,507 | 2,703 | 2,903 | 3,107 |
| Other Long Term Liabilities | 1,750 | 1,582 | 1,375 | 1,488 | 1,604 | 1,723 | 1,844 |
| Long Term Debt | 3,041 | 4,059 | 4,410 | 4,772 | 5,144 | 5,526 | 5,915 |
| Total Long Term Liabilities | \$ 4,791 | \$ 5,641 | \$ 5,785 | \$ 6,260 | \$ 6,748 | \$ 7,249 | \$ 7,759 |
| Total Stockholders' Equity | 3,120 | 3,558 | 4,001 | 4,040 | 4,293 | 4,553 | 4,821 |
| Total Liabilities and SE | 10,545 | 11,332 | 12,103 | 12,807 | 13,744 | 14,705 | 15,687 |
| Total Debt for leverage calculations | 3,720 | 4,059 | 4,410 | 4,772 | 5,144 | 5,526 | 5,915 |
| Total Debt and Stock | 6,841 | 7,617 | 8,411 | 8,812 | 9,437 | 10,079 | 10,736 |
| Net Working Capital | 1,854 | 2,215 | 2,407 | 2,604 | 2,807 | 3,015 | 3,228 |
| Change in Net Working Capital + Normal Cash | | 361 | 191 | 198 | 203 | 208 | 212 |



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DCF Inputs

| (Dollars in Millions) | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> | <u>2010</u> |
|----------------------------------------------------------|------------------|-----------------|----------------|----------------|-----------------|-----------------|
| Net Income | \$483 | \$ 523 | \$ 565 | \$ 606 | \$ 648 | \$ 694 |
| Plus Depr. & Amort. | 220 | 229 | 238 | 248 | 258 | 269 |
| Equals Value Line "Cash Flow - Change in NWC | 703 | 752 | 803 | 854 | 907 | 963 |
| Increases/(Decreases) | (361) | (191) | (198) | (203) | (208) | (212) |
| = Cash Flow contributed by operations | 342 | 561 | 605 | 651 | 699 | 751 |
| - Capital Expenditures: all categories | (635) | (831) | (442) | (670) | (692) | (714) |
| Equals OCF to Equity | \$ (293) | \$(270) | \$ 164 | \$ (19) | \$ 7 | \$ 38 |
| Tax Rate for leverage adjustments | 31.8% | 31.8% | 31.8% | 31.8% | 31.8% | 31.8% |
| + Increase (decrease) in debt Equals "EFCF" or "FCFE" | 339 \$ 45 | 351 \$ 81 | 362 \$ 526 | 372 \$ 353 | 381 \$ 388 | 389 \$ 427 |
| + Interest Expense Equals "FCF" | 231 \$ (62) | 256 \$ (14) | 282 \$ 446 | 310 \$ 291 | 339 \$ 345 | 364 \$ 401 |
| - Interest Tax Shields Equals "UFCF" | (73) \$ (136) | (81) \$ (96) | (90) \$ 356 | (98) \$ 192 | (108) \$ 238 | (116) \$ 286 |
| Accounting balance sheet (book value) | | | | | | |
| Net Assets (LT Assets + NWC - Other LT Liab) | \$ 7,617 | \$ 8,411 | \$ 8,812 | \$ 9,437 | \$10,079 | \$ 10,736 |
| Total Debt | \$ 4,059 | \$ 4,410 | \$ 4,772 | \$ 5,144 | \$ 5,526 | \$ 5,915 |
| percentage of capital | 53.3% | 52.4% | 54.2% | 54.5% | 54.8% | 55.1% |
| Total Equity Book Value | \$ 3,558 | \$ 4,001 | \$ 4,040 | \$ 4,293 | \$ 4,553 | \$ 4,821 |
| percentage of capital | 46.7% | 47.6% | 45.8% | 45.5% | 45.2% | 44.9% |
| Economic balance sheet | | | | | | |
| Total Market Value | \$ 18,279 | \$ 19,659 | \$20,685 | \$21,945 | \$23,249 | \$ 24,594 |
| Total Debt | \$ 4,059 | \$ 4,410 | \$ 4,772 | \$ 5,144 | \$ 5,526 | \$ 5,915 |
| percentage of market value | 22.2% | 22.4% | 23.1% | 23.4% | 23.8% | 24.0% |
| Intrinsic Value of Equity | \$ 14,220 | \$ 15,249 | \$15,913 | \$16,801 | \$17,723 | \$ 18,679 |
| percentage of market value | 77.8% | 77.6% | 76.9% | 76.6% | 76.2% | 76.0% |



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Valuation model used

Unlevered value
Adjusted Present Value
Flow to Equity
WACC with FCF
AT-WACC with UFCF
Average across models
Price deviation across models

Summary
Equity \$M \$ Per Share

\$11,728 \$42.39
\$15,521 \$56.11
\$13,233 \$47.84
\$13,204 \$47.73
\$13,356 \$48.28
\$13,829 \$49.99
\$49 17.5%

Debt Cost of Capital Calculations:

| | Principal | MV |
|-----------------------|-----------------|-----------------|
| Long Term Debt | \$ 3,041 | \$3,102 |
| Notes and LT Debt Due | \$ 679 | \$679 |
| Debt Type 3 | 0 | \$0 |
| Total Debt | \$ 3,720 | \$ 3,781 |

wtd. avg. debt rate

Implicit cost of debt according to CAPM:

Equity Cost of Capital Calculations:

| | | |
|------------------------|---|-----------|
| Total Value of Equity | | \$ 11,226 |
| Total Market Capitaliz | 0 | \$ 15,007 |

Key Assumptions for the models:

| | |
|---------------------------------|-----------|
| Date of valuation | 12/3/2004 |
| Risk Free Rate: | 3.60% |
| Equity Market Risk Premium: | 7.00% |
| Long term inflation: | 2.50% |
| Terminal Growth: | 5.00% |
| Adjusted Equity beta | 0.6 |
| No. of shares (diluted): | 277 |
| Current Market Price per share: | \$40.58 |

Without APV: \$47.95
 1.2%

| | Actual | Unlevered |
|-------------------------------|--------|-----------|
| Risk Free Rate | 3.60% | 3.60% |
| Market Premium | 7.00% | 7.00% |
| Beta Debt | | 0.10 |
| Beta Equity | 0.6 | 0.51 |
| Beta - Adjusted Market Premiu | 4.20% | 3.55% |

Various Costs of Capital

R(u) - required return for firm if unlevered **7.15%**
R(e) - required return for equity a **7.80%**