LOBLAW COMPANIES LTD. (L:TSX) - Published March 9th, 2020

STOCK BROS

RESEARCH REPORT

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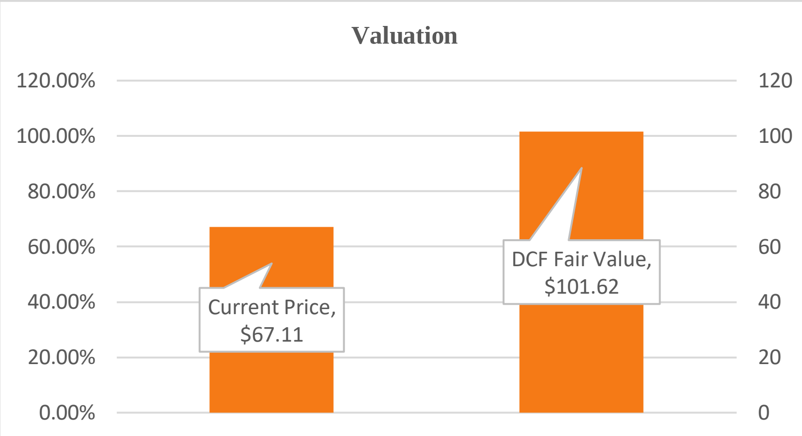


Company Description

Loblaw Companies Ltd is a Canada-based company engaged in food retail and distribution business sector. The Company operates through two segments: Retail and Financial Services. The Company's Retail segment consists of corporate and franchise-owned retail food and Associate-owned drug stores. The Company's Financial Services segment provides credit card services, insurance brokerage services, personal banking

Assumptions Used in Valuation

The historical unlevered free cash flows of Loblaw do not grow in a straight line and therefore difficult to determine a growth rate. We use a single stage discounted cash flow model that assumes no growth in FCFF.

Average FCFF of the past 5 years ($2.372 billion) is used as the input in the calculation

A weighted average cost of capital of 5.27% is used to discount the unlevered free cash flow.

The model produces an enterprise value of $45.009 billion which tranlates to an equity value of $37.399 billion (current market cap is $26.45 billion).

Catalysts & Key Points

The share price of Loblaw has proven to be resilient in light of the coronavirus uncertainty. The company is up 0.5% on the year while the S&P 500 is down 15.6% and the TSX is down 15.41%.

Food prices are expected to increase between 2-4% in Canada in 2020 costing the average Canandian an extra $487 over 2019.

The coronavirus has consumers stocking up on supplies which will give Loblaw a boost in sales.

Strong free cash flow with $937M being returned to shareholders through buybacks in 2019.

Company Health

1. Company Margins are positive and good
2. Current FCF's are positive
3. Company can cover its short term liabilities with current assets
4. Company cannot cover long term liabilities with current assets

Income Statement
Gross Margin 30.72%
EBITDA Margin 9.95%
EBIT Margin 4.7%
Profit Margin 2.35%

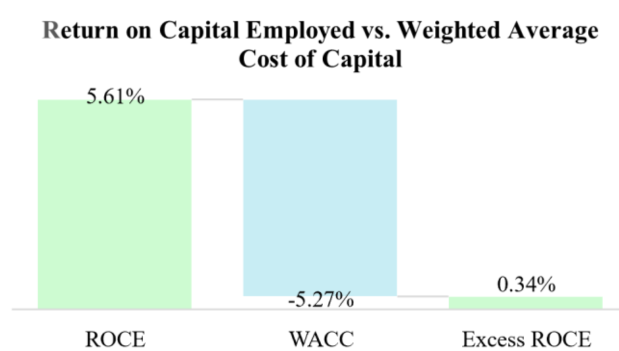
Free Cash Flow
Free Cash Flow $2,770,000,000
Levered FCF $1,970,000,000
Unlevered FCF $3,310,000,000

Balance Sheet
Price to Book 2.36
Total Debt to Equity 149%
Current Ratio 1.23
Cash on Hand $2,400,000,000

Management Efficiency

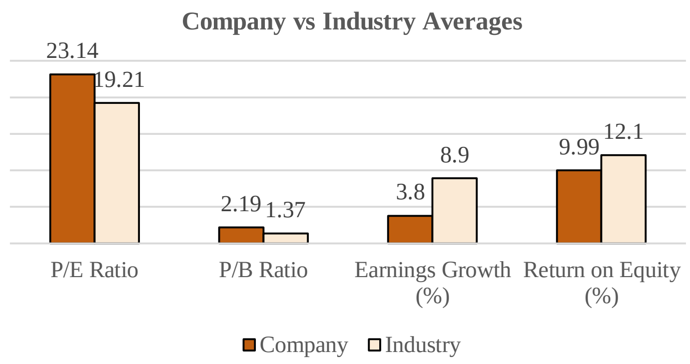
1. Management has been efficient at managing capital as return on capital employed (ROCE) is greater than the weighted average cost of capital (WACC).

2. Economic value added (EVA) is positive.
(EVA is a measure of a company's true economic profit)



True Economic Profit (Economic Value Added)

NOPAT $1.62B − WACC x CE $1.42B = EVA $200M



Company vs Industry Analysis

1. Industry comparison chart score: 0/4
2. Company's price to earnings ratio is greater than it's expected earnings growth which is known as the PEG ratio (price to earnings to growth ratio). A PEG ratio of less than 1 (P/E divided by growth) indicates that the stock is potentially undervalued.
3. Industry PEG ratio is greater than 1.
4. Loblaw is not likely to outperform the industry in terms of earnings growth

Although trading at a premium relative to the industry, we believe Loblaw deserves the premium price because it is an established leader with great value.

Risk Analysis

1. Overall risk profile of the company is good.
2. Company earnings are likely to be correct and trustworthy based on the Beneish M-Score which is used to determine if a company is manipualting it's earnings with fraudulent behaviour. A score that is less than -2.22 means the company is not a manipulator whereas a greater score indicates the possibility for fraudulent activities.
3. Currently, the downside risk of the company is 15% which is less than its potential upside of 40.46% that is based on the intrinsic value.
4. The bankruptcy risk is measured using the average default rate of BBB rated bonds which is the rating given to Loblaw.

Earnings Quality Risk

- Beneish M-Score -2.9
- Not an Earnings Manipulator

Downside Risk

- Standard Deviation 15.08%
- Bankruptcy Risk 0.3%

Payment Schedule

With cash flow from operations of nearly 4 billion dollars and a BBB bond rating, Loblaw should have no issues meeting their obligations or rolling over their debt.

Summary of Contractual Obligations

	Payments due by year						
(millions of Canadian dollars)	2020	2021	2022	2023	2024	Thereafter	Total
Total debt (including interest payments[i])	$ 2,150	$ 817	$ 1,149	$ 1,382	$ 933	$ 4,268	$ 10,699
Foreign Exchange Forward Contracts	466	—	—	—	—	—	466
Lease Payments	1,437	1,272	1,108	1,118	975	4,234	10,144
Contracts for purchases of investment projects[ii]	120	8	—	—	—	—	128
Purchase obligations[iii]	283	270	86	21	—	7	667
Total contractual obligations	$ 4,456	$ 2,367	$ 2,343	$ 2,521	$ 1,908	$ 8,509	$ 22,104

First Price Target
$72.00

Second Price Target
$76.00

Loblaw is currently near a potential support of $66.00 with a resistance level of $73.00. If it can hold support, our first price target is $72.00 which is near resistance. If it can break through $73.00, our next price target is $76.00 which is near all time highs.

However, it is very important to note that Loblaw must hold support at $66.00 and continue to have an almost inverse correlation to the markets should it continue to drop.